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An Introduction to the Federal Estate and Gift Taxes

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This paper will attempt to introduce the reader to the federal estate and gift taxes by analyzing briefly the principal provisions of the taxes and the relation of those provisions to each other. Its

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purpose is twofold. It is designed to offer the student who is commencing his study of the estate and gift taxes a chance to contemplate the forest before he plunges into the trees, in the hope of making his trip among the trees less confusing. It is also intended to serve as a survey of the estate and gift taxes for the student who does not elect to study those taxes and the practitioner who is not familiar with them, in an effort to supply the minimum knowledge which a lawyer needs, not to solve, but to recognize, an estate or gift tax problem when he encounters one.

Since the federal gift tax is simply a supplement to the federal estate tax, the logical order in which to take up the two taxes is to commence with the estate tax. Before turning to the estate tax, however, it may be helpful to talk briefly about the nature of death taxes in general.

A death tax is the price the sovereign exacts for the privilege of transferring property at death. Although the tax is measured by the property which is transferred, the subject of the tax is the transfer of property. If an economist has difficulty discovering a real distinction between a tax upon property and a tax upon the transfer of property which is a prescribed percentage of the property transferred, it is because he lacks the trained perception of a lawyer. The distinction between the subject and measure of a death tax is a real legal distinction because it is a distinction that results in practical differences. Thus, for example, the Supreme Court upheld the constitutionality of a federal inheritance tax[1] and of a federal estate tax[2] against the challenge that the taxes were direct taxes upon property, which were invalid for lack of apportionment, by pointing out that they were indirect taxes or excises on the transfer of property, which did not require apportionment. The doctrine of intergovernmental immunities does not apply to death taxes because such taxes are imposed upon the transfer of property rather than the property transferred.[3] It should be obvious to anyone that the federal estate tax applies to the transmission of state bonds because a tax upon the transfer of the bonds, unlike a direct tax upon the bonds themselves, is not a burden upon state borrowing power. The distinction between a tax upon the transfer of property and a tax upon the property transferred also plays an

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[1] Knowlton v. Moore, 178 U.S. 41 (1900).
[2] New York Trust Co. v. Eisner, 256 U.S. 345 (1921).
[3] Greiner v. Lewellyn, 258 U.S. 384 (1922); Plummer v. Coler, 178 U.S. 115 (1900).

important role in interpreting tax exemptions, which are construed as limited to taxes upon the exempt property, as distinguished from taxes upon the transfer of the property. Thus, for example, the federal estate tax applied to government life insurance under a statute exempting such insurance from all taxes because the statutory exemption was limited to taxes upon the insurance itself and did not extend to a tax upon the transfer of the insurance.[4]

The federal estate tax is an estate tax. Death taxes are of two types: estate or transfer taxes and inheritance or succession taxes. The theoretical distinction between the two is that an estate or transfer tax is imposed upon the privilege of passing on property at death, while an inheritance or succession tax is imposed on the privilege of acquiring property from a decedent. Upon a practical plane, the distinction between an estate tax and an inheritance tax is that the estate tax is measured by the taxable estate which passed from a decedent at his death, and, except in the case of charitable gifts[5] and gifts to a surviving spouse,[6] is not affected by the character of the beneficiaries of the estate. An inheritance tax, on the other hand, is graduated according to the size of the individual beneficiary's share of the estate and the relation between the beneficiary and the decedent.

THE FEDERAL ESTATE TAX

I. THE GROSS ESTATE

Probably the easiest way to grasp the basic pattern of the federal estate tax is to consider the various steps in the computation of the tax. The first step is to list all the property which the decedent transferred by means of a transfer taxed under the tax. The sum total of this property is called the gross estate and corresponds to gross income under the income tax and gross gifts under the gift tax.

The key to the gross estate lies in the fact that although the primary purpose of the estate tax is to tax the transmission of property at death, it is not limited to such transfers. It would be a simple matter to avoid a death tax which was confined to transfers by will and intestacy—strictly testamentary transfers. Consequently,

[4] United States Trust Co. v. Helvering, 302 U.S. 57 (1939).

[5] The federal estate tax allows a deduction for charitable transfers. INT. REV. CODE OF 1954, § 2055.

[6] The federal estate tax allows a deduction for certain transfers to a surviving spouse. INT. REV. CODE OF 1954, § 2056.

Congress has surrounded the primary tax upon the transfer of property owned by a decedent at his death by a periphery of protective taxes upon other types of transfers that have some of the aspects of a testamentary transfer and would otherwise be resorted to in order to escape a tax limited to strictly testamentary transfers. To be specific, the federal estate tax taxes:

(1) The transfer of property by will and intestacy;[7]
(2) Dower and curtesy and their statutory substitutes;[8]
(3) Transfers in contemplation of death;[9]
(4) Transfers with retained life estates;[10]
(5) Transfers taking effect at death;[11]
(6) Revocable transfers;[12]
(7) Certain survivor annuities;[13]
(8) Survivorship in connection with joint tenancies and tenancies by the entirety;[14]
(9) General powers of appointment;[15] and
(10) Life insurance.[16]

A careful examination of the transfers taxed under the federal estate tax will reveal that they fall into two general categories. First, the statute taxes the transfer of property at death. These taxes include not only the tax upon transfers by will and intestacy imposed by section 2033, but also various taxes imposed upon transfers which are in substance transfers at death, although they may not be classified as such under the technical rules of the property law. Thus, section 2034 expressly taxes dower and curtesy and their statutory substitutes to eliminate any question about whether these interests arise due to the death of a spouse or originate during his life in the marital relation. Section 2040 taxes survivorship in joint tenancies and tenancies by the entirety because the property law denies that there is a transfer here. Since a power of appointment is not regarded as an estate in property, section 2041 expressly taxes property subject to a general power of appointment to the estate of the donee of the power by equating the power with ownership of the property subject to the power. Finally, section 2042

[7] INT. REV. CODE OF 1954, § 2033.
[8] INT. REV. CODE OF 1954, § 2034.
[9] INT. REV. CODE OF 1954, § 2035.
[10] INT. REV. CODE OF 1954, § 2036.
[11] INT. REV. CODE OF 1954, § 2037.
[12] INT. REV. CODE OF 1954, § 2038.
[13] INT. REV. CODE OF 1954, § 2039.
[14] INT. REV. CODE OF 1954, § 2040.
[15] INT. REV. CODE OF 1954, § 2041.
[16] INT. REV. CODE OF 1954, § 2042.

treats life insurance as property passing from the insured at his death.

In addition to taxing the transfer of property at death, the statute taxes certain inter vivos transfers because they have some of the substantial advantages of a will and might otherwise be resorted to in order to avoid the estate tax. The taxes on inter vivos transfers fall into two categories. Transfers in contemplation of death[17] are taxed, even though they take the form of absolute transfers under which the transferor parts irrevocably with the transferred property during his life, because the transferor intended the transfer to serve as a substitute for a will or testamentary disposition. The other inter vivos transfers that are taxed under the statute are taxed, not because of the subjective state of mind of the transferor, but because of the objective operation of the transfers, which are not completed until the transferor's death. Thus, for example, section 2036 taxes transfers under which the transferor retained the possession or enjoyment of the transferred property until his death; section 2037 taxes transfers taking effect at death; and section 2038 taxes transfers where the transferor possessed power to change the enjoyment of the transferred property at his death.

A. Transfers at Death

1. Transfers by Will and Intestacy.—Section 2033 provides: "The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death." Only interests of the decedent that survive his death are taxable under this section. Thus, for example, a life estate which the decedent owned at his death, unless it was an estate pur autre vie that survived his death, is not taxable under section 2033.[18] If the decedent originally owned the fee in the property and transferred it during his life retaining a life estate, the property will be taxed to his estate. However, the tax will be imposed under section 2036 upon the original inter vivos transfer, rather than under section 2033 upon the interest the decedent owned in the transferred property at his death.

There are several possible reasons why section 2033 is limited to inheritable interests, or interests in property which survive the de-

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[17] INT. REV. CODE OF 1954, § 2035.

[18] Helvering v. Rhodes, 117 F.2d 509 (8th Cir. 1941); Gertrude L. Royce, 46 B.T.A. 1090 (1942).

cedent's death. It would be possible to interpret section 2033 literally to require inclusion of any property interests the decedent owned at his death in his gross estate and then to value those interests which ceased at his death at zero. It seems fairly clear, however, that what Congress intended to tax under section 2033 was the transfer of property by will or intestacy; it did not intend to impose any tax under that section where the decedent lacked an inheritable interest which he could transmit at his death.[19] As a practical matter, moreover, in making out the estate tax return, interests which do not survive the decedent's death are not listed as part of his gross estate under section 2033.

Since section 2033 is limited to interests that the decedent owned and transmitted at his death, property which someone acquires because of the decedent's death and in which the decedent owned no interest will not be taxed to his estate under section 2033. Thus, it has been ruled that rights of action for the wrongful death of a decedent[20] and death benefits paid under the social security laws, where the decedent lacked power to designate the beneficiaries of the payments,[21] are not taxable to his estate under section 2033. Various death benefits paid to dependents of a deceased employee by his employer have also escaped a tax on this theory,[22] although some of these would be taxed today under section 2039.

It is not clear whether property might be taxed to a decedent's estate under section 2033 upon the theory that in substance he owned an inheritable interest in the property. In *Helvering v. Safe Deposit & Trust Co.*[23] the decedent was entitled to the income from several trusts during his life and also possessed a general power to appoint the remainders in the trusts after his death. Upon the assumption that he had not exercised his powers of appointment, the government

[19] *Cf.* Reinecke v. Northern Trust Co., 278 U.S. 339 (1929).

[20] Rev. Rul. 54-19, 1954-1 CUM. BULL. 179. *Cf.* Rev. Rul. 55-581, 1955-2 CUM. BULL. 381 (death allowance of U.S. Armed Forces); Rev. Rul. 56-637, 1956-2 CUM. BULL. 600 (death benefits under workmen's compensation acts).

[21] E.T. 18, 1940-2 CUM. BULL. 285; Rev. Rul. 55-87, 1955-1 CUM. BULL. 112. Benefits payable to the estate of the decedent under Social Security are included in his gross estate. E.T. 10, 1937-2 CUM. BULL. 469. Death benefits payable under the Railroad Retirement Act of 1937 are also exempt from the estate tax when the decedent cannot designate the recipients of the payments. Rev. Rul. 60-70, 1960-1 CUM. BULL. 372.

[22] Dimock v. Corwin, 19 F. Supp. 56 (E.D.N.Y. 1937), *aff'd on another issue*, 99 F.2d 799 (2d Cir. 1938); Estate of Albert L. Salt, 17 T.C. 92 (1951); William L. Miller, 14 T.C. 657 (1950).

[23] 316 U.S. 56 (1942).

contended that the trust properties were taxable to his estate under section 2033, since in substance he owned the properties in fee. At that time the statute taxed the exercise but not the nonexercise of a general power of appointment. The Supreme Court held that the property could not be taxed to the decedent's estate under section 2033. It did not repudiate the possibility of a tax under that section upon the basis of substantial ownership, but said that since Congress had explicitly limited the tax on powers of appointment to the exercise of the power, it did not intend to tax the nonexercise under some other section of the statute. There are two difficulties with invoking substantial ownership under section 2033. One is that most of the situations in which a tax could be imposed on this basis under section 2033 are already expressly covered by other sections of the statute, and it is simpler to impose the tax under those other sections. The other obstacle is the problem the government encountered in the *Safe Deposit & Trust Co.* case of showing that by providing expressly for a tax in the situation in question under some other section Congress did not intend to eliminate the possibility of a tax under section 2033. For example, in one case the Tax Court held that jointly held property could not be taxed to the estate of a deceased joint tenant under section 2033 because Congress intended to tax such property under the section dealing specifically with jointly held property exclusively.[24]

All kinds of property are taxable under the estate tax. The doctrine of intergovernmental immunities does not apply to death taxes;[25] moreover, statutory exemptions are generally construed as limited to taxes upon the exempt property itself, as distinguished from taxes upon the transfer of the property.[26] Consequently, the fact that property is exempt from taxes under a statutory or implied constitutional exemption will not prevent the property from being taxed under the estate tax.[27] Property exempt from creditors is also subject to the estate tax.

The fact that property is located outside the United States is no barrier to the estate tax as long as the property belongs to the estate of a deceased citizen or resident of the United States. Jurisdiction to tax in the case of estates of citizens and residents is based on the personal relation between the decedent and the United States

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[24] Nathalie Koussevitsky, 5 T.C. 650 (1945).
[25] Cases cited note 3 *supra*.
[26] United States Trust Co. v. Helvering, 302 U.S. 57 (1939).
[27] Treas. Reg. § 20.2033-1(b) (1958).

and the fact that property is located outside the United States does not preclude imposition of the tax. At one time foreign real estate was not subject to the federal estate tax, but this rule was changed in 1962. In the case of nonresident alien decedents where there is no personal relation between the decedent and the United States, the estate tax is limited to property situated in the United States.[28] United States citizens whose citizenship is derived from birth or residence in a United States possession are treated as non-resident aliens.[29] For the most part, whether property is situated in the United States is determined by the rules of common-law situs. Thus, real estate located in the United States is situated in the United States. So is tangible personal property, at least if it is kept in the United States and is not just passing through this country,[30] unless the property is an art object being exhibited in the United States or on its way to or from such an exhibition, for which the statute makes a special exception.[31] Intangible personal property is property located in the United States if it is embodied in a specialty which is kept in the United States[32] or, in the case of a nonspecialty chose in action, is enforceable against a person in the United States.[33] The statute expressly provides, however, that corporate stock is located where the corporation is incorporated.[34] Moreover, life insurance on the life of a nonresident alien is not property in the United States;[35] nor are deposits with a person in the United States carrying on a banking business, as long as the depositor was a nonresident alien who was not engaged in trade or business in the United States at the time of his death.[36] United States Treasury bonds issued before March 1, 1941, are also excluded from the estate of a nonresident alien, if he was not engaged in trade or business in the United States at the time of his death.[37]

For the purpose of the taxes upon inter vivos transfers, property belonging to a nonresident alien is treated as situated in the United States if it was located in the country either at the time of the

[28] INT. REV. CODE OF 1954, § 2103.
[29] INT. REV. CODE OF 1954, § 2209.
[30] *Cf.* Murchie v. Delaney, 177 F.2d 444 (1st Cir. 1949).
[31] INT. REV. CODE OF 1954, § 2105(c).
[32] Treas. Reg. § 20.2104-1(a)(3) (1958).
[33] Treas. Reg. § 20.2104-1(a)(4) (1958).
[34] INT. REV. CODE OF 1954, § 2104(a).
[35] INT. REV. CODE OF 1954, § 2105(a).
[36] INT. REV. CODE OF 1954, § 2105(b).
[37] INT. REV. CODE OF 1954, § 2106(c).

transfer or at the time of the transferor's death.[38] This means that if a man gave his wife a diamond necklace in contemplation of death when both he and his wife were citizens and residents of a foreign country, and his wife later left him and brought the necklace to this country, where it was located at the time of his death, the necklace would be subject to the federal estate tax, although the United States apparently had nothing to do with the transfer of the property.

Rights to income are taxable under the estate tax as well as the ownership of principal. Thus, any income accrued at the date of the decedent's death must be included in his gross estate.[39] Income accruing after his death is not, however, included in his gross estate, even though the income accrued during the year after his death and the estate is valued according to the alternate valuation date.[40] It is not always easy to distinguish income accruing after the date of a decedent's death from part of the property transferred at his death. Thus, for example, there is considerable confusion whether stock dividends distributed after a taxable transfer should be excluded from the transferor's estate as income accruing after the transfer or should be included in his estate as part of the transferred stock.[41] There is also some confusion as to how the right of a deceased partner's estate to participate in partnership profits for a specified period after the partner's death should be treated. Despite a Supreme Court decision which excluded the profits from the deceased partner's taxable estate, apparently upon the theory that they represented income accruing after his death,[42] the prevailing tendency is to require the right to profits to be included in the decedent's estate as a valuable property right he owned at his death.[43]

2. *Dower or Curtesy Interests.*—Dower and curtesy and their statutory substitutes are explicitly taxed by section 2034 for fear that they might escape a tax under the general language of section

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[38] INT. REV. CODE OF 1954, § 2104(b).

[39] Merritt J. Corbett, 12 T.C. 163 (1949). *Cf.* Treas. Reg. § 20.2033-1(b) (1958).

[40] Maass v. Higgins, 312 U.S. 443 (1941).

[41] Tuck v. United States, 282 F.2d 405 (9th Cir. 1960); Estate of Schlosser v. Commissioner, 277 F.2d 268 (3d Cir.), *cert. denied,* 364 U.S. 819 (1960); English v. United States, 270 F.2d 876 (7th Cir. 1959); McGehee v. Commissioner, 260 F.2d 818 (5th Cir. 1958).

[42] Bull. v. United States, 295 U.S. 247 (1935).

[43] Reigelman v. Commissioner, 253 F.2d 315 (2d Cir. 1958); McClennan v. Commissioner, 131 F.2d 165 (1st Cir. 1942).

2033 because of the argument that they originate in the marital relation rather than in any testamentary transfer. Actually, the tax on dower and curtesy operates in a negative fashion to require inclusion of the full value of the property owned by the deceased spouse in his gross estate without any reduction for the interest of the surviving spouse.

3. Joint Interests.—According to property law, when a joint tenant or tenant by the entirety dies, his interest does not pass to the surviving tenant or tenants, but continues in them since all of the tenants possess a single undivided title that survives the death of any tenant. Conceivably, this archaic feudal conception might prevent a tax upon a joint tenancy or tenancy by the entirety under the general language of section 2033. Therefore, section 2040 expressly taxes joint estates by ignoring property conceptions and treating the joint owners as owning the property according to their respective contributions to the property. The same rule is applied to joint bank deposits and purchases of United States savings bonds payable to the purchaser or another. Thus, for example, if *H* bought Blackacre and took title in his name and that of *W* as tenants by the entirety, the full value of Blackacre would be taxed to *H*'s estate if he predeceased *W*, while nothing would be taxed to *W*'s estate if she predeceased *H*.

In determining the contributions of joint tenants to a joint tenancy, anything originating with one joint owner is attributed to him except to the extent that it was acquired from him for adequate and full consideration in money or money's worth. If, for example, in the hypothetical situation in the preceding paragraph, *W* had paid for Blackacre with 10,000 dollars *H* gave her as an anniversary gift to use in any way she saw fit, the entire consideration for the property would be attributed to *H* under section 2040.

Property acquired by joint tenants or tenants by the entirety by gift or inheritance is treated as contributed by all of the tenants equally. If, for example, *H* and *W* acquired Blackacre as tenants by the entirety by virtue of a gift of the property by *W*'s father, half of the property would be attributed to *H* and taxed to his estate if he predeceased *W*, while half of the property would be attributed to *W* and taxed to her estate if she predeceased *H*.

Section 2040 is limited to joint tenancies and tenancies by the entirety, that is, to tenancies where there is survivorship; it does not apply to tenancies in common, which are taxed under section

2033 according to the interest a deceased tenant in common owned in the property at his death, irrespective of his contribution to the property. Thus, if when *H* purchased Blackacre he had taken title in his name and that of *W* as tenants in common, half of Blackacre would have been taxed to his estate when he died and half of Blackacre would have been taxed to *W*'s estate when she died.

4. Powers of Appointment.—A power of appointment is not an interest or estate in property but merely an authorization to transfer title to property which the donee of the power does not own. Consequently, the Supreme Court in *United States v. Field*[44] held that property subject to a power of appointment was not taxable to the estate of the donee of the power under section 2033, even though the power was a general power which the donee had exercised by will, because the donee did not own the property. Section 2041 explicitly taxes powers of appointment to the estate of the donee of the power.

Under section 2041, powers of appointment are divided into powers created on or before October 21, 1942, which will be called preexisting powers, and powers created after October 21, 1942, which will be referred to as post-1942 powers. With one exception[45] only general powers are taxed. Post-1942 general powers are equated with the ownership of the property subject to the power, and the property is taxed to the donee's estate if the power was in existence at his death or if he exercised or released the power by means of an inter vivos transfer taxed under the estate tax during his life.[46] The only way the donee of a post-1942 power can escape either a gift tax or an estate tax upon the power is to disclaim or renounce the power.[47] The statute also provides, however, that the inter vivos lapse of a post-1942 power will not be treated as a taxable transfer to the extent that the property subject to the lapsed power does not exceed the greater of 5,000 dollars or five per cent of the fund from which the power could have been satisfied.[48]

Only the exercise of a general preexisting power by will or an

[44] 255 U.S. 257 (1921).

[45] A tax is imposed on the testamentary exercise of a post-1942 power to create a second power "which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power." INT. REV. CODE OF 1954, § 2041(a)(3).

[46] INT. REV. CODE OF 1954, § 2041(a)(2).

[47] *Ibid.*

[48] INT. REV. CODE OF 1954, § 2041(b)(2).

inter vivos transfer taxable under the estate tax is taxed.[49] The release or the nonexercise of the power is not taxed. The reason why a preexisting power is only equated with ownership of the property subject to the power when the power is exercised is historical. Under the 1918 act, prior to the 1942 act, only the exercise of a power of appointment was taxed. With one exception[50] the present statute perpetuates the pre-1942 treatment of powers of appointment.

A general power of appointment is a power exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.[51] Ability to appoint to any one of these objects makes the power general. The donee need not be empowered to appoint to all of them. A power will not be treated as a general power, however, if it is "a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support or maintenance of the decedent."[52] Preexisting powers that can only be exercised by the donee of the power with the consent of another person are not taxed as general powers, even though the person whose consent is required to exercise the power is a nonadverse person.[53] A joint post-1942 power is a taxable general power, however, unless the person whose consent the donee must have to exercise the power is the donor of the power or a person possessing a substantial adverse interest in the property subject to the power.[54] In the case of joint post-1942 powers which can be exercised by the donee without the consent of the donor or an adverse party, only a fraction of the property subject to the power equal to the value of the property divided by the donee and the persons who must join in the exercise of the power and are possible appointees is taxed to the donee's estate.[55]

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[49] INT. REV. CODE OF 1954, § 2041(a)(1).

[50] Under the 1918 act no tax was imposed unless the property subject to the power "passed" under the exercise of the power. Thus, there was no tax when the donee of the power appointed to the taker in default of appointment provided the exercise of the power exactly "echoed" the default clause. Helvering v. Grinnell, 294 U.S. 153 (1935). Under the current law a tax is imposed when a preexisting power is exercised in a testamentary fashion regardless of whether the property subject to the power passes under the exercise of the power. Gartland v. Commissioner, 293 F.2d 575 (7th Cir. 1961), *cert. denied*, 368 U.S. 954 (1962).

[51] INT. REV. CODE OF 1954, § 2041(b)(1).

[52] INT. REV. CODE OF 1954, § 2041(b)(1)(A).

[53] INT. REV. CODE OF 1954, § 2041(b)(1)(B).

[54] INT. REV. CODE OF 1954, § 2041(b)(1)(C)(i)-(ii).

[55] INT. REV. CODE OF 1954, § 2041(b)(1)(C)(iii).

5. *Life Insurance.*—Section 2042 taxes life insurance to the estate of the insured where the insurance was payable to his estate, or where the insurance was payable to other beneficiaries but the insured possessed incidents of ownership in the insurance at his death. The tax upon insurance payable to the insured's estate is predicated upon his ownership of the insurance at his death and resembles the tax imposed by section 2033 upon property owned by a decedent at his death. The tax upon life insurance payable to beneficiaries other than the insured's estate is analogous to the taxes imposed by the estate tax on other incomplete inter vivos transfers. By limiting the tax upon insurance payable to other beneficiaries, however, to situations where the decedent possessed incidents of ownership in the insurance, Congress made it possible for a man to pass along unlimited amounts free of the estate tax by investing in life insurance and giving up all rights to the insurance before his death. The committee report accompanying this "loophole" justified it on the ground that it simply treated life insurance in the same way as other property, which, except in the case of transfers in contemplation of death, is not attributed to the estate of a decedent who divested himself of all interest in the property during his life.[56] Actually, life insurance is taxed a little more severely under section 2042 than incomplete transfers are taxed under sections 2036, 2037, and 2038, since taxes are imposed under those sections only where the decedent during his life transferred the property in which he possessed an interest at his death, while insurance may be taxed to the estate of the insured under section 2042 even though he did not transfer the insurance. In this respect the tax on life insurance payable to other beneficiaries under section 2042 bears a closer resemblance to the taxation of powers of appointment under section 2041, since the donee of a power of appointment need not be, and indeed according to the Regulations cannot be,[57] the transferor of the property subject to the power of appointment that is taxed under section 2041. "Incidents of ownership" which are the basis of the tax under section 2042 are much more inclusive, however, than the general powers of appointment which are taxed under section 2041; in this respect the tax under section

[56] H.R. Rep. No. 1337, 83d Cong., 2d Sess. A316, A317 (1954). A minority of the Committee argued that life insurance is not like other property, but is "inherently testamentary" and should be taxed differently than other property. *Id.* at B14, B15.

[57] Treas. Reg. § 20.2041(b)(2) (1958).

2042 bears a closer resemblance to the taxes imposed on reserved powers under sections 2036, 2037, and 2038.

Life insurance is taxable only to the estate of the insured under section 2042. Section 2042 is not, however, exclusive. Life insurance may be taxed to the estate of one other than the insured, and even to the estate of the insured, under some other section of the statute. Thus, for example, if a man assigned his life insurance within three years of his death, irrevocably divesting himself of all incidents of ownership in the insurance in order to get it out of his taxable estate, the proceeds of the insurance would still be taxed to his estate under section 2035 as a transfer in contemplation of death.

B. *Lifetime Transfers*

1. Transfers in Contemplation of Death.—Various inter vivos transfers are taxed under the estate tax because of some similarity to a transfer by will. In most cases the similarity springs from the fact that the transfer is not complete until the transferor's death. Transfers in contemplation of death are taxed, however, not because the transfer is incomplete during the transferor's life, but because they proceed from a testamentary motive—the state of mind which a man has when he makes a will.[58]

It is obvious that the tax on transfers in contemplation of death is necessary to prevent avoidance of the estate tax. If the tax were confined to incomplete inter vivos transfers, it would be a simple matter for one to escape the tax by waiting until he felt that death was near and giving away property by an outright inter vivos transfer. However, the government's inability to tax transfers even by ancient transferors tottering on the brink of eternity is eloquent testimony to the difficulty of administering a tax based on the subjective state of mind of a dead man. Congress recognized this difficulty as early as the first federal estate tax by providing a rebuttable presumption that transfers within two years of the transferor's death were in contemplation of death. Although the presumption proved constitutional,[59] it also proved quite ineffective. In 1926 Congress enacted a conclusive presumption that transfers within two years of the transferor's death were in contemplation

[58] See United States v. Wells, 283 U.S. 102 (1931); Treas. Reg. § 20. 2035-1(c) (1958).
[59] *Cf.* Heiner v. Donnan, 285 U.S. 312 (1932).

of death. The Supreme Court held that this presumption was unconstitutional in *Heiner v. Donnan.*[60] Although it is unlikely that *Heiner v. Donnan* would be followed today, Congress has not undertaken to enact another conclusive presumption that transfers are in contemplation of death. Instead, in 1950, it enacted the conclusive presumption in the current Code[61] that transfers more than three years before the transferor's death are not in contemplation of death. At the same time the two-year rebuttable presumption that transfers are in contemplation of death was extended to three years.[62]

Since the general purpose of taxing transfers in contemplation of death is to prevent a man's escaping the estate tax by means of such a transfer, it seems on principle that it should not be possible to escape the tax by releasing a retained interest, which makes an inter vivos transfer taxable under some other section of the statute, in contemplation of death. For example, in *United States v. Allen,*[63] a decedent during her life transferred property in trust retaining a life estate in the trust property. Shortly before her death, she released her life estate in exchange for the value of the life estate. The Tenth Circuit held that the full value of the trust property less the consideration received for the relinquishment of the life estate was taxable to the decedent's estate. The court regarded the decedent as having transferred in contemplation of death the interest attributed to her for tax purposes before the transfer, rather than merely her life estate. Although the *Allen* case is an admirable decision as far as the underlying policy of the estate tax is concerned, it conflicts with some decisions involving jointly held property that have treated the transfer by a joint owner in contemplation of death as limited to his interest in the jointly held property.[64] Moreover, the fact that section 2038, taxing revocable trusts, expressly provides that the release of a taxable power in contemplation of death shall be ignored for tax purposes, raises some doubt whether this provision can properly be implied in connection with the other

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[60] *Ibid.*

[61] INT. REV. CODE OF 1954, § 2035(b).

[62] *Ibid.*

[63] 293 F.2d 916 (10th Cir.), *cert denied,* 368 U.S. 944 (1961). *Cf.* Estate of Vardell v. Commissioner, 307 F.2d 688 (5th Cir. 1962).

[64] Sullivan's Estate v. Commissioner, 175 F.2d 657 (9th Cir. 1949); D. M. Brockway, 18 T.C. 488 (1952), *aff'd,* 219 F.2d 400 (9th Cir. 1954). *Cf.* Baltimore Nat'l Bank v. United States, 136 F. Supp. 642 (D. Md. 1955); Edward Carnall, 25 T.C. 654 (1955); A. Carl Borner, 25 T.C. 584 (1955). *Contra,* Harris v. United States, 193 F. Supp. 736 (D. Neb. 1961).

sections taxing inter vivos transfers in the absence of express language to that effect.

2. *Transfers with Retained Life Estates.*—An obvious way to avoid a death tax limited to strictly testamentary transfers would be to transfer property during one's life and retain the use of, or income from, the property until death. Consequently, section 2036 (a)(1) taxes a transfer under which the transferor retained the possession or enjoyment of, or the right to the income from, the transferred property "for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death." Section 2036 (a)(2) imposes a tax where the transferor instead of retaining the possession or enjoyment of the transferred property directly kept "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom" for the same periods. The 1916 act did not explicitly tax transfers with a reservation of a life interest because of the belief that such transfers were taxed under the general language taxing transfers intended to take effect in possession or enjoyment at or after the transferor's death. After the Supreme Court had held that a transfer with a life interest was not taxed under this language,[65] Congress amended the statute to tax expressly such transfers, and the Supreme Court held that this amendment was constitutional,[66] although it was not retroactive and did not apply to transfers made before the statute was amended.[67] Later the Supreme Court repented its earlier decision and held that transfers with a reservation of a life interest were taxable after all as transfers intended to take effect in possession or enjoyment at or after death.[68] To overcome the retroactive effect of this decision section 2036(b) of the 1954 Code provides that a transfer with a reservation of a life interest shall not be taxed if the transfer was made before March 4, 1931 (since the joint resolution taxing such transfers expressly was enacted on March 3, 1931), nor even if the transfer was made after March 3, 1931, but before June 7, 1932, if it was not taxable under the express language of the statute before it was amended by the 1932 act.

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[65] May v. Heiner, 281 U.S. 238 (1930).
[66] Helvering v. Bullard, 303 U.S. 297 (1938).
[67] Hassett v. Welch, 303 U.S. 303 (1938).
[68] Commissioner v. Estate of Church, 335 U.S. 632 (1949).

Although literally section 2036 taxes a transfer with a reservation of a life interest without providing expressly that the reserved interest must continue until the transferor's death, it seems fairly well settled that a tax will not be imposed under section 2036 unless the transferor's interest in the transferred property persists until his death, at least, if his interest was not released in contemplation of death.[69]

There is some uncertainty as to what kind of interest the transferor must retain in order to incur a tax under section 2036. It is enough if he retains either the income from, or the possession of, the transferred property. He need not retain both. Moreover, a transfer under which the transferee is obligated to use the income from the transferred property to discharge the legal obligations of the transferor is regarded as a transfer with a reservation of the right to the income from the property.[70] It seems to be settled that the reservation of a contingent life estate to the transferor will be taxable under section 2036,[71] although there is a dispute as to precisely what language imposes the tax. For example, suppose that *A* on June 1, 1931, transferred property to *T* in trust to pay the income from the property to *B* for life, then to *A* for life, and then to distribute the trust property to *C* in fee, and *A* died yesterday survived by *B*. Several cases have held that the trust property could not be taxed to *A*'s estate, since if the transfer were taxable it would be taxable because *A* retained an interest in the property for a period not ascertainable without reference to his death.[72] This was one of the additions of the 1932 act to section 2036, and consequently, under section 2036(b), if the transfer can only be taxed under this language, it is not taxable because it was made before June 7, 1932. There is at least one case, however, that

[69] Rev. Rul. 56-324, 1952-2 CUM. BULL. 999; Robert J. Cuddihy, 32 T.C. 1171 (1959). See *In re* Estate of Thurston, 36 Cal. 2d 207, 223 P.2d 12 (1950). However, in United States v. Allen, 293 F.2d 916 (10th Cir. 1961), Judge Breitenstein, concurring, pointed out that the literal language of section 2036 taxes a transfer with a reservation of a life interest regardless of what happens after the transfer: "As I read the statute, the tax liability arises at the time of the intervivos transfer under which there was a retention of the right to income for life. The disposition thereafter of that retained right does not eliminate the tax liability." *Id.* at 918.

[70] Treas. Reg. § 20.2036-1(b)(2) (1958).

[71] Marks v. Higgins, 213 F.2d 884 (2d Cir. 1954); Commissioner v. Nathan, 159 F.2d 546 (7th Cir. 1947), *cert. denied,* 334 U.S. 843 (1948).

[72] Hubbard v. Commissioner, 250 F.2d 492 (5th Cir. 1957). See Treas. Reg. § 20.2036-1(b)(ii) (1958).

holds that the transfer is taxable under the other language of the statute and may be taxed since it occurred after March 3, 1931.[73]

There is also some uncertainty under section 2036 about the meaning of a transfer under which the transferor retained the possession or enjoyment of, or the income from, the transferred property for a period which did not in fact end before his death. Although this would appear to cover any situation where the transferor continued to possess or receive the income from the transferred property until he died, there are several recent cases which limit the tax to a transfer where the transferor made an agreement with the transferee, albeit an unenforceable agreement, for retention of the possession of, or income from, the property until his death.[74]

Although the cases have construed the language relating to the periods for which a taxable interest must be retained under section 2036 somewhat strictly, they have gone to the opposite extreme in defining the right to designate income or possession that is taxable. Thus, a power to distribute or accumulate income has been held to be a taxable power even where the income beneficiary and the remainderman happened to be the same person.[75] The power which will attract a tax under section 2036(a)(2) may be a fiduciary power, as long as it is a discretionary power.[76] It may also be a power exercisable by the decedent alone or by the decedent in conjunction with some other person, including apparently a person possessing a substantial adverse interest in the transferred property.[77] Although it may not be a power vested in one other than the transferor, the Regulations intimate that a contingent power will be taxable under section 2036, even though the contingency upon which the exercise of the power depends has not occurred at the time of the decedent's death.[78]

3. Transfers Taking Effect at Death.—Section 2037 taxes a transfer as a transfer taking effect at death where the transferee's

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[73] Commissioner v. Estate of Arents, 297 F.2d 894 (2d Cir.), *cert. denied*, 369 U.S. 848 (1962).

[74] Stephenson v. United States, 238 F. Supp. 660 (W.D. Va. 1965); Union Planters Nat'l Bank v. United States, 238 F. Supp. 883 (W.D. Tenn. 1964). *Cf.* Estate of McNichol v. Commissioner, 265 F.2d 667 (3d Cir.), *cert. denied*, 361 U.S. 829 (1959).

[75] Struthers v. Kelm, 218 F.2d 810 (8th Cir. 1955). *Cf.* Industrial Trust Co. v. Commissioner, 165 F.2d 142 (1st Cir. 1947).

[76] Industrial Trust Co. v. Commissioner, 165 F.2d 142 (1st Cir. 1947).

[77] Treas. Reg. § 20.2036-1(b)(3) (1958).

[78] Treas. Reg. § 20.2038-1(b) (1958).

possession or enjoyment was dependent upon surviving the transferor, and, in addition, the transferor retained a reversionary interest worth more than five per cent of the value of the transferred property immediately before his death. It is immaterial whether the transferror's reversionary interest arose by operation of law or by the express terms of the instrument of transfer unless the transfer occurred before October 8, 1949. A transfer before October 8, 1949, is taxable only if the reversionary interest arose by the express terms of the instrument of transfer.

The statute defines a reversionary interest as a "possibility that property transferred by the decedent (1) may return to his estate, or (2) may be subject to a power of disposition by him, but such term does not include a possibility that the income alone from such property may return to him or become subject to a power of disposition by him."[79] Presumably, the reason that the chance of income alone reverting to the transferor is excluded from the definition of a reversionary interest is to prevent a transfer under which the transferor reserved a contingent life estate from being taxed under section 2037, if the transfer took place before March 4, 1931, since transfers before that date are treated as nontaxable by section 2036(b). The "cutoff" date after which a transfer must have been made to be taxable under section 2037 is September 7, 1916.[80] Therefore, if a contingent life estate were regarded as a reversionary interest, it would be possible to tax a transfer under section 2037 that section 2036(b) declares not to be taxable.

Only an interest which meets both the survivorship and the reversionary interest requirements under section 2037 will be taxed under that section. For example, if *A* transferred property to *T* in trust for *B* for life, remainder to *B*'s surviving children and remainder in default of surviving children to *A* or *A*'s estate, the trust property could not be taxed to *A*'s estate under section 2037 because the possession and enjoyment of both *B*'s life estate and the children's remainder was in no way dependent upon outliving *A*. *A*'s reversionary interest, since it was not dependent upon his survival, might be taxed to his estate under section 2033, but nothing could be taxed under section 2037. If *A* had transferred the property in question to *T* in trust for *B* for life, with a remainder to *A*

[79] INT. REV. CODE OF 1954, § 2037(b).
[80] INT. REV. CODE OF 1954, § 2037(a).

if he outlived *B* and a remainder to *B*'s children if *B* outlived *A*, the children's remainder would have been taxable to *A*'s estate under section 2037, since the possession and enjoyment of the children was dependent upon outliving *A*. However, *B*'s life estate would be excluded from *A*'s gross estate because *B*'s enjoyment of the trust property is not dependent upon outliving *A*.

In *Goldstone v. United States*,[81] a man purchased contracts from an insurance company which he made payable to his wife and daughters with the proviso that, if he survived his wife and daughters, the contracts should revert to his estate. Despite the fact that the wife had the power to cash in the contracts during the decedent's life and defeat his reversionary interest, the Supreme Court held that the transfer of the contracts was taxable as a transfer intended to take effect in possession or enjoyment at the decedent's death. Section 2037 repudiates the *Goldstone* case by providing that a transfer shall not be taxed under that section if there was a general power of appointment, as defined in section 2041, exercisable at the decedent's death, by which possession or enjoyment of the transferred property could be vested in a beneficiary during the decedent's life. Although the statute does not say so expressly, obviously the power must be vested in one other than the decedent. Although the exception to section 2037 was designed as a relief provision, it could be a tax trap, since the general power necessary to avoid a tax under the exception to section 2037 would make the property subject to the power taxable to the donee of the power under both the estate and gift taxes. For example, if *H* transferred property to *W* in trust to accumulate the income from the trust during *H*'s life and to distribute the trust property along with the accumulated income to the surviving children of *H* and *W* at *H*'s death, the trust would not be taxable to *H*'s estate if he gave *W* power to alter or amend the trust in any way that she saw fit, provided this power was outstanding at *H*'s death. If, however, *W* exercised the power to vest the trust property in the children during her life, she would incur a gift tax.[82] If she failed to exercise the power and died with the power outstanding, the trust property would be taxable to her estate.[83] Moreover, in this instance, if *H* subsequently died, the

[81] 325 U.S. 687 (1945).
[82] INT. REV. CODE OF 1954, § 2514.
[83] INT. REV. CODE OF 1954, § 2041.

trust property would also be taxable to his estate under section 2037, since the power was not exercisable at his death. It would seem that the danger of additional taxes could be avoided if, instead of giving *W* a general power to alter or amend the trust as she saw fit, *H* gave her power to terminate the trust in favor of the children. This would be a special power which would not be taxable under 2041 and would not, therefore, be within the exception to section 2037. However, it would prevent the transfer from meeting the affirmative requirements for a tax under section 2037 because, due to the power, the children's possession or enjoyment would no longer be dependent on surviving *H*, and since *H*'s reversionary interest could be destroyed by *W* at will, it would not be worth more than five per cent of the value of the transferred property.[84]

4. *Revocable Transfers.*—A revocable transfer bears a sufficient resemblance to the ambulatory aspect of a will to justify its taxation under an estate tax. It is important to notice, however, that although section 2038 is headed "revocable transfers," it actually extends to any transfer where the transferor at his death possessed power, exercisable alone or in conjunction with any other person, to alter, amend, revoke, or terminate the enjoyment of the transferred property. Consequently, the Supreme Court held in *Porter v. Commissioner*[85] that a trust under which the decedent retained power to change the beneficiaries of the trust but could not make himself a beneficiary was taxable to his estate. A power to terminate a trust in favor of the beneficiaries of the trust is a taxable power under section 2038.[86]

Although section 2038 apparently does not reach a power to alter or revoke a transfer that is vested in one other than the transferor,[87] it taxes powers exercisable by a decedent alone or in conjunction with any other person, including a person having a substantial adverse interest in the transferred property.[88] Originally, only reserved powers were taxed under section 2038,[89] but this was changed to provide in the case of transfers after June 22, 1936, for a tax where the decedent at his death possessed a power to alter or

[84] *Cf.* Treas. Reg. § 20.2042-1(c)(3) (1958).
[85] 288 U.S. 436 (1933).
[86] Lober v. United States, 346 U.S. 335 (1953).
[87] Commissioner v. Irving Trust Co., 147 F.2d 946 (2d Cir. 1945).
[88] Helvering v. City Bank Farmers Trust Co., 296 U.S. 85 (1935).
[89] White v. Poor, 296 U.S. 98 (1935).

revoke the transfer "without regard to when or from what source" the decedent acquired the power.[90] Although a power the decedent could only exercise in conjunction with an adverse party is regarded as a taxable power under section 2038, a trust which could be revoked by the decedent only in conjunction with all of the beneficiaries interested in the trust is treated as an irrevocable transfer not taxable under section 2038.[91] Moreover, according to several Supreme Court cases, a trust that can only be altered or revoked by the settlor of the trust in conjunction with a beneficiary of the trust will be treated as an irrevocable transfer, which cannot be taxed constitutionally if the trust was created before the 1924 act which first taxed revocable transfers.[92] Since there is no cutoff date under section 2038, a transfer which can be revoked by the transferor without the concurrence of an adverse party will be taxable regardless of when the transfer took place. However, a transfer which can be revoked only in conjunction with a person possessing a substantial adverse interest in the transferred property will not be taxable unless the transfer was made after the 1924 act. The Regulations provide, however, that in the case of such transfers before the 1924 act only the interest of the beneficiary whose concurrence is required to exercise the power is excluded from the decedent's gross estate, upon the theory that the remainder of the transfer is revocable, since the consent of a person possessing a substantial adverse interest is not required to revoke that part of the transfer.[93]

Section 2038 applies to powers arising by operation of law as well as those created by the express terms of the instrument of transfer.[94] It includes fiduciary powers as long as they are discretionary powers.[95] In order to be taxable under section 2038 a power must be in existence at the decedent's death. Section 2038(b) provides that the fact that the exercise of a power requires a precedent notice, which has not been given at the decedent's death, or can take effect only upon the expiration of a stated period after the exercise of the power and the power was not exercised before the decedent's death,

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[90] INT. REV. CODE OF 1954, § 2038(a)(1).
[91] Helvering v. Helmholz, 296 U.S. 93 (1935).
[92] *Ibid.* White v. Poor, 296 U.S. 98 (1935).
[93] Treas. Reg. § 20.2038-1(d) (1958).
[94] Vaccaro v. United States, 149 F.2d 1014 (5th Cir. 1945); Howard v. United States, 125 F.2d 986 (5th Cir. 1942).
[95] Lober v. United States, 346 U.S. 335 (1935).

will not prevent a transfer from being taxed under section 2038.[96] According to the Regulations if a power is subject to some other contingency, such as the decedent's surviving another person, that has not occurred at the decedent's death, the power will not be taxable under section 2038, although it may be taxable under section 2036 (a)(2).[97] Apparently the Service assumes that by explicitly providing that certain contingencies will not prevent a power from being in existence at the decedent's death section 2038 implies that other contingencies will prevent a tax under that section.

The relation between sections 2038 and 2036(a)(2) raises some interesting questions. Since a power to designate the possession or enjoyment of, or the income from, property is also a power to alter the enjoyment of the property, ordinarily a transfer taxable under section 2036(a)(2) will also be taxable under section 2038. But the coverage of the two sections is not precisely coextensive; nor will the same amount necessarily be taxed under both sections. Since section 2036(a)(2) is limited to transfers occurring after March 3, 1931, while there is no cutoff date under section 2038, a transfer before March 4, 1931, that is not taxable under section 2036 may be taxable under section 2038. Section 2036(a)(2) is limited to transfers where the taxable power was reserved by the decedent in connection with the transfer, while section 2038 imposes a tax where the decedent possessed a taxable power at his death regardless of the source of the power. According to the Regulations, contingent powers, except powers subject to the permissible contingencies specified in section 2038(b), are not taxable under section 2038, while the fact that a power taxable under section 2036(a)(2) is subject to a contingency that has not occurred at the decedent's death will not prevent a tax under that section.[98] Section 2036(a)(2) taxes the full value of the property transferred by the decedent possession or enjoyment of which he retained power to designate; the tax under section 2038 is limited to the value of the interest subject to the taxable power. For example, suppose that *A* during his life transferred property to *T* in trust to pay the income to *C* during *C*'s life and at *C*'s death to distribute the trust property to *D* and reserved

[96] The part of the property which the decedent could not have recovered if the notice had been given, or the power exercised, on the date of his death is excluded from his gross estate. INT. REV. CODE OF 1954, § 2038(b).
[97] Treas. Reg. § 20.2038-1(b) (1958).
[98] *Ibid.*

power to designate a new beneficiary to receive the income from the trust during *C*'s life. If *A* dies survived by *C*, the full value of the trust property will be taxed to his estate under section 2036 (a)(2). However, only the value of *C*'s life estate (as of *A*'s death) will be included in *A*'s gross estate under section 2038.

5. Survivor Annuities.—Section 2039(a) imposes a tax upon any annuity or other payment receivable by a beneficiary by reason of surviving a decedent under a contract or agreement entered into after March 3, 1931 (other than life insurance), if under such contract or agreement an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another, for his life or for any period not ascertainable without reference to his death or for any period that does not in fact end before his death.

Section 2039(b) limits the amount taxable under section 2039(a) to a part of the survivor's payments proportionate to the "part of the purchase price therefor contributed by the decedent." In this connection any contributions made by the decedent's employer if made by reason of the decedent's employment are attributed to the decedent.

Section 2039(c) exempts payments to beneficiaries pursuant to a qualified pension, profit-sharing, or stock bonus plan, along with certain annuities purchased for their employees by specified charitable organizations. The payments in order to qualify for the exemption under section 2039(c) must be receivable by a beneficiary other than the decedent's executor or estate. Moreover, the exemption is limited to a part of the payments proportionate to the contributions of one other than the decedent. In this connection contributions by the decedent's employer are not attributed to the decedent. Thus, payments under a qualified plan financed wholly by the decedent's employer are exempt from the estate tax.

Although section 2039 was passed primarily to tax death benefits payable to the beneficiaries of a deceased employee, it also extends to joint and survivor annuities purchased by a decedent. On the other hand, although the section is labelled "annuities," it applies to annuities and "other payments," including lump-sum payments.

Section 2039 is not a satisfactory section. Although it was

apparently designed to tax death benefits payable to the survivors of a deceased employee, it fails to achieve this objective. The fact that payments under qualified pension and profit-sharing plans are exempted from the estate tax creates a totally unjustifiable discrimination in favor of the estates of those who are fortunate enough to qualify for such benefits. Moreover, the tax imposed by section 2039(a) on unqualified plans is subject to various arbitrary limitations which seem to have no better justification than the fact that section 2039 was for some mysterious reason modelled after section 2036. One of the examples of how section 2039 operates set forth in the Regulations is an excellent illustration of how inept that section is. The example in question involves an unqualified retirement plan financed entirely by an employer under which an employee is to receive half of the amount credited to his account when he retires at age sixty and his designated beneficiary is to receive the other half of the account at the employee's death, with the further proviso that if the employee dies before reaching sixty, the full amount in his account is to be paid to the designated beneficiary. According to the Regulations, if the decedent dies before age sixty, the amount credited to his account must be included in his gross estate, since he had a right to a payment at his death. If, however, he lives until he is sixty, collects half of the account and dies later, nothing can be taxed to his estate at his death, because he was not entitled to payments nor receiving payments at his death.[99] It is difficult to see, if the purpose of the statute is to tax the death benefits payable at a decedent's death, any reason for conditioning the tax upon the decedent's right to payments during his life. The insistence of section 2039 upon an interest in the decedent at his death is obviously due to the fact that section 2039 was modelled after section 2036. This resemblance finds expression in the fact that section 2039 only applies to contracts entered into after March 3, 1931, which is also the magic date under section 2036, and in the further fact that the specified periods for which the decedent's interest must persist under section 2039 are the same periods prescribed by section 2036. It is obvious where the restrictions on the tax imposed by section 2039 came from. It is not obvious why the restrictions imposed by section 2036 should be imported into section 2039.

[99] Treas. Reg. § 20.2039-1(b)(2), example (5) (1958).

6. Consideration.—The taxes on inter vivos transfers under the estate tax are limited to gratuitous transfers. Sections 2035 through 2038 explicitly exclude "a bona fide sale for an adequate and full consideration in money or money's worth." In this context "sale" includes an exchange. Section 2043(a) provides that a transfer taxable under sections 2035 through 2038 for an insufficient consideration shall be taxable only to the extent that the value of the property transferred exceeds the value of the consideration. Section 2043(a) also applies to the exercise or release of a taxable power of appointment under section 2041, which will be taxed only to the extent the property subject to the power exceeds the consideration received in connection with the exercise or release of the power.

It is important to remember that the consideration necessary to prevent a taxable transfer under the estate tax must be more than a good contractual consideration; it must be "adequate and full consideration in money or money's worth."

The requirement of "money or money's worth" means that the consideration that will prevent a taxable transfer must be capable of expression in monetary terms. Thus, marriage or a promise to marry is not consideration for purposes of the estate tax.[100]

"Adequate and full consideration" means that the consideration that will prevent a taxable transfer must be the economic equivalent of the transferred property. According to section 2043(a) a transfer for an insufficient consideration will only be taxed to the extent that the value of the transferred property exceeds the value of the consideration. According to the Regulations, this difference is computed by taking the difference between the value of the transferred property on the date at which the estate is valued and the value of the consideration at the time of the transfer.[101] This means that if *A* transferred Blackacre to *B* in contemplation of death when Blackacre was worth 100,000 dollars for stock then worth 50,000 dollars and later died when Blackacre was worth

[100] *Cf.* Commissioner v. Wemyss, 324 U.S. 303 (1945).

[101] Treas. Reg. § 20.2043-1(a) (1958). See Estate of Vardell v. Commissioner, 307 F.2d 688 (5th Cir. 1962). Perhaps the fairest way to treat a transfer for an insufficient consideration would be to regard a part of the property proportionate to the value of the consideration as transferred for an adequate consideration and limit the tax on the transfer of the property to the other part of the property. This approach was suggested in Helvering v. United States Trust Co., 111 F.2d 576 (2d Cir.), *cert. denied* 311 U.S. 678 (1940).

150,000 dollars and the stock had increased in value to 200,000 dollars, 100,000 dollars would be included in *A*'s gross estate because of the transfer in contemplation of death, assuming that the estate was valued according to the date of *A*'s death. Since if *A* still retained the stock, it would be included in his gross estate at 200,000 dollars, the value of the stock at the date of his death; this seems unfair. If the decedent owns the consideration received for the taxable transfer at the date of his death, it would seem that the consideration for the transfer should be valued according to its fair market value at the date when the rest of the estate is valued. If the reason a transfer for a consideration is not taxed under the estate tax is that the consideration will be taxed and will prevent the taxable estate from being depleted, it would seem proper to take the consideration into account to the extent it does prevent the taxable estate from being depleted.

Whether or not a transfer is for an adequate consideration obviously depends on what is transferred. In *United States v. Allen,*[102] for example, where a woman who had transferred property to a trust and retained a life interest in the trust released this interest in contemplation of death for a consideration equal to the value of the life estate, the Court held that the relinquishment was not a tax-free transfer for an adequate consideration because what the decedent transferred in contemplation of death was the full value of the property attributed to her under the estate tax before the release in contemplation of death, rather than the life estate. This same reasoning was employed in a somewhat similar situation in *Estate of Vardell v. Commissioner.*[103]

Section 2043(b) provides that "a relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate shall not be considered to any extent a consideration 'in money or money's worth'." The relinquishment of marital property rights is not treated as consideration under the estate tax in order to protect the integrity of the tax on dower and curtesy and their statutory substitutes imposed under section 2034.[104] It is not clear whether

[102] 293 F.2d 916 (10th Cir.), *cert. denied,* 368 U.S. 944 (1961).

[103] 307 F.2d 688 (5th Cir. 1962).

[104] Even before § 2043(b) was enacted, it was held that the relinquishment of dower was not an adequate consideration under the estate tax. Empire Trust Co. v. Commissioner, 94 F.2d 307 (4th Cir. 1938).

section 2043(b) applies to the relinquishment of marital support rights. After several cases had held that the relinquishment of marital support rights was not consideration,[105] the Treasury issued a ruling[106] declaring that it would not follow these cases and the relinquishment of such rights would be regarded as adequate consideration for estate tax purposes up to the value of the relinquished rights. This ruling has been ignored, however, by some of the subsequent cases.[107]

In *Commissioner v. Wemyss*[108] a man transferred property to a widow in consideration of her marrying him and forfeiting an interest she had in a trust created by her first husband. The Supreme Court held that he had made a taxable gift under the gift tax, even though the value of the interest the widow lost under the trust of her first husband equalled the value of the interest transferred to her by the second. The Court said that the consideration that will prevent a taxable transfer under the gift tax must take the form of a benefit to the donor rather than a detriment to the donee, since it must be something which will prevent the donor's taxable estate from being depleted. Although the *Wemyss* case involved the gift tax, presumably it is also applicable to the estate tax, and the consideration that will prevent a transfer from being taxed under the estate tax must take the form of a benefit to the transferor rather than a detriment to the transferee.

7. *Constitutional Considerations.*—When the Supreme Court held that a conclusive presumption that a transfer within two years of the transferor's death was unconstitutional in *Heiner v. Donnan,*[109] the majority of the court intimated that only testamentary transfers could be taxed constitutionally under the estate tax. The court then proceeded to uphold the constitutionality of most of the taxes upon inter vivos transactions under the estate tax by finding some sort of testamentary transfer. Thus, for example, the tax upon transfers in contemplation of death was held to be constitutional upon the theory that the testamentary motive of the trans-

[105] Meyer v. Commissioner, 110 F.2d 367 (2d Cir.), *cert. denied,* 310 U.S. 651 (1940); Helvering v. United States Trust Co., 111 F.2d 576 (2d Cir.), *cert. denied,* 311 U.S. 678 (1940).

[106] E.T. 19, 1946-2 Cum. Bull. 166.

[107] *Cf.* McDonald v. Commissioner, 225 F.2d 621 (8th Cir. 1955), *cert. denied,* 350 U.S. 965 (1956); Robert M. McKeon, 25 T.C. 697 (1956).

[108] 324 U.S. 303 (1945).

[109] 285 U.S. 312 (1932).

feror made the transfer testamentary.[110] In *Helvering v. City Bank Farmers Trust Co.*,[111] the Supreme Court held that a trust that could be revoked only with the consent of a person possessing a substantial adverse interest in the trust could be taxed constitutionally. In view of the Court's earlier decisions[112] it would have been difficult to find a testamentary transfer here. Consequently, the Court abandoned the testamentary transfer theory and held that Congress has power to tax any kind of transfers under the estate tax as long as this is a reasonable method of preventing avoidance of the tax. In *Helvering v. Bullard*,[113] the Court followed the same "penumbra" theory[144] in upholding the constitutionality of the tax upon transfers with a retained life interest, although in a more recent decision upholding the constitutionality of taxing life insurance to the estate of the insured who had paid premiums for the insurance, even though he possessed no incidents of ownership in the insurance, the court seemed again to fall back on the testamentary transfer theory.[115]

Many of the provisions taxing inter vivos transfers under the estate tax have been retroactive in the sense that they taxed transfers made before the enactment of the tax where the transferor died after the tax was passed. In an early case, the Supreme Court held than an irrevocable transfer made before the enactment of any statute taxing such transfers could not be taxed constitutionally under a statute enacted after the transfer was made.[116] However, the Court also held that a revocable transfer could be taxed, even

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[110] Milliken v. United States, 283 U.S. 15 (1931). The Court found some sort of testamentary transfer to uphold the taxes upon life insurance in Chase Nat'l Bank v. United States, 278 U.S. 327 (1929); revocable trusts in Reinecke v. Northern Trust Co., 278 U.S. 339 (1929); joint tenancies in United States v. Jacobs, 306 U.S. 363 (1939); tenancies by the entirety in Tyler v. United States, 281 U.S. 497 (1930); and community property in Fernandez v. Wiener, 326 U.S. 340 (1945).

[111] Helvering v. City Bank Farmers Trust Co., 296 U.S. 85 (1935).

[112] See, *e.g.*, Heiner v. Donnan, 285 U.S. 319 (1932); May v. Heiner, 281 U.S. 238 (1930); Reinecke v. Northern Trust Co., 278 U.S. 339 (1929).

[113] Helvering v. Bullard, 303 U.S. 297 (1938).

[114] The expression "penumbra theory" comes from a phrase in Justice Holmes' dissenting opinion in Schlesinger v. Wisconsin, 270 U.S. 230 at 241 (1926), where, in arguing for the constitutionality of a state statute creating a conclusive presumption that a gift within a prescribed period of the decedent's death was in contemplation of death, he said: "But the law allows a penumbra to be embraced that goes beyond the outline of the object in order that the object may be secured."

[115] See United States v. Manufacturers Nat'l Bank, 363 U.S. 194 (1960).

[116] Nichols v. Coolidge, 274 U.S. 531 (1927).

though the transfer was made before there was a statute taxing the transfer, on the theory that the lapse of the power when the transferor died after the passage of the taxing act was the taxable transfer, and the tax was not really retroactive.[117] It was also held that an irrevocable transfer taxable at the time it was made might be taxed under the higher rates of a later statute in effect at the transferor's death, on the theory that the transferor was warned of the possibility of a tax by the existence of the statute at the time the transfer was made, and he should have anticipated a change in rates.[118] There are, moreover, several cases that appear to permit a tax upon irrevocable transfers made before the taxing act was passed by finding some sort of taxable transfer at the transferor's death after the enactment of the statute to avoid the taint of retroactivity.[119] The truth of the matter seems to be that it is about as unfair not to tax inter vivos transfers retroactively as it is to tax them retroactively, since the choice lies between taxing a transfer that was not taxable at the time the transfer was made or treating decedents who died at the same time and made the same transfers, although they made them at different times, differently.

II. The Taxable Estate; Deductions

The estate tax is computed by multiplying not the gross estate but the taxable estate by the applicable rates of the tax. The taxable estate is the difference between the gross estate and the exemption and the four deductions allowed under the statute for (1) expenses, indebtedness and taxes; (2) losses; (3) charitable transfers; and (4) transfers to a surviving spouse.

A. The Exemption

In computing the taxable estate an exemption of 60,000 dollars is allowed.[120] This means that unless the estate exceeds 60,000 dollars, no estate tax will be due, and if it exceeds that amount, the first 60,000 dollars will not be taxed. For some obscure reason, the exemption under the estate tax is not classified as a deduction, as

[117] Reinecke v. Northern Trust Co., 278 U.S. 339 (1929). *Cf.* United States v. Jacobs, 306 U.S. 363 (1939).

[118] Phillips v. Dime Trust & Safe Deposit Co., 284 U.S. 160 (1931); Milliken v. United States, 283 U.S. 15 (1931).

[119] See United States v. Manufacturers Nat'l Bank, 363 U.S. 194 (1960); United States v. Jacobs, 306 U.S. 363 (1939).

[120] INT. REV. CODE OF 1954, § 2052.

it is under the gift tax. However, it has precisely the same effect as a deduction.

B. Expenses, Indebtedness and Taxes

Section 2053 lumps a number of deductible items together under the heading of "expenses, indebtedness and taxes." The items specifically mentioned as deductible under section 2053 include (1) funeral expenses, (2) administration expenses, (3) claims against the estate, (4) unpaid mortgages on property included in the gross estate, and (5) other administration expenses. "Other administration expenses" mean the expenses of administering property included in the taxable but not the probate estate. If, for example, a decedent during his life transferred property in trust and retained the right to income for life, the expenses of distributing the trust property at his death, such as the trustee's commission on principal, the cost of the final accounting, and counsel fees connected with determining the federal estate tax upon the trust, would be deductible as "other administration expenses."

Before the 1954 Code, debts and expenses of the estate were deductible only to the extent there was property in the estate subject to such claims. This rule has been relaxed by the 1954 Code to permit such items to be deducted even though they exceed the property in the estate subject to claims provided that they are paid before the estate tax return is due. Thus, for example, if a decedent died and left only life insurance which was not subject to creditors, debts of the decedent and administration expenses actually paid by the beneficiary of the insurance before the estate tax return was due would be deductible.

In order to be deductible debts and expenses must be allowable out of the estate under the laws of the jurisdiction where the estate is administered. Thus, for example, a debt disallowed by the local probate court cannot be deducted as a claim against the estate. There is a conflict of authority as to whether a claim which is a valid claim at the decedent's death may be deducted if it subsequently becomes unenforceable, as for example, where the creditor fails to present his claim within the time for presenting claims to the executor.[121] There is a somewhat similar uncertainty as to whether a

[121] *Compare* Winer v. United States, 153 F. Supp. 941 (S.D.N.Y. 1957) *and* Estate of Feder, 22 T.C. 30 (1954) *with* Rev. Rul. 60-247, 1960-2 CUM. BULL. 272.

deductible claim should be valued according to its actuarial value at the date of the decedent's death, or according to the amount actually paid to discharge the claim after the decedent's death.[122]

Claims founded upon a promise or agreement (including unpaid mortgages), are deductible only to the extent they were incurred bona fide for an adequate and full consideration in money or money's worth, although a claim incurred for insufficient consideration will be deductible up to the amount of the consideration.[123] Consideration here means about the same thing as the consideration that will prevent a transfer from being taxable under the estate tax. Thus, the relinquishment of marital property rights, and perhaps even marital support rights, is not a consideration which will support the deduction of a claim. The statute expressly provides, however, that charitable pledges are deductible, as long as the charity is one to which a deductible bequest might be made, regardless of whether the pledge is supported by adequate consideration.[124] Apparently, moreover, the consideration that will support the deduction of a claim need not take the form of a benefit to the debtor, but may be a detriment to the creditor. At least the liability of a guarantor or indorser may be deductible in an appropriate case, although it is difficult to see any benefit moving to the indorser.[125]

Only claims founded on a promise or agreement require consideration to be deductible. Thus, a tort or a tax claim may be deducted irrespective of consideration. An obligation founded upon an agreement to settle up marital property rights that is incorporated in a divorce decree is deductible, if the divorce court had jurisdiction to decree a different settlement.[126] The obligation in this case does not need consideration since it is based upon the divorce decree rather than the agreement of the spouses.

Although section 2053 is headed "expenses, indebtedness and taxes," there is no general provision for the deduction of taxes,

[122] See Ithaca Trust Co., v. United States, 279 U.S. 151 (1929); Commissioner v. Estate of Shively, 276 F.2d 372 (2d Cir. 1960).

[123] INT. REV. CODE OF 1954, § 2053(c)(1)(A).

[124] *Ibid.*

[125] Carney v. Benz, 90 F.2d 747 (1st Cir. 1937). If the decedent's liability as an indorser is deducted from the gross estate, any rights of reimbursement or contribution to which he is entitled must be included in his gross estate. DuVal's Estate v. Commissioner, 152 F.2d 103 (9th Cir. 1945), *cert. denied*, 328 U.S. 838 (1946).

[126] Commissioner v. Watson, 216 F.2d 941 (2d Cir. 1954). *Cf.* Harris v. Commissioner, 340 U.S. 106 (1950).

which must be deducted ordinarily as claims against the estate. Like other claims, taxes are deductible only when they represent obligations of the decedent, as distinguished from liabilities of his estate arising after his death.[127] This is explicitly recognized by the statutory provision denying any deduction for income taxes on income received after the death of the decedent or property taxes not accrued before his death.[128] This means that any federal income taxes paid by the executor upon the decedent's returns, on the income realized by the decedent during his life, are deductible. However, income taxes paid by his estate are not deductible. In much the same way, any property taxes that became a lien or accrued before the decedent's death are deductible, while property taxes accruing after his death are not deductible. The statute explicitly provides that "any estate, succession, legacy, or inheritance taxes, shall not be deductible."[129] However, section 2053(d) subsequently makes an exception to this rule in the case of state and foreign death taxes imposed upon a transfer to charity, which are deductible provided that the benefit of the deduction inures exclusively to a charity, although not necessarily the charity receiving the bequest.[130]

Administration expenses deductible for purposes of the estate tax may also be deductible from the estate's income tax as business expenses or section 212 expenses. Section 642(g) provides, however, that such expenses cannot be deducted from both taxes, although the expenses may be divided and deducted partly from one tax and partly from the other. The prohibition of section 642(g) against double deductions does not apply to expenses accrued at the decedent's death, the so-called "deductions in respect of a decedent" under section 691(b), which may be deducted from both taxes. It has also been held that an "other administration expense" connected with a trust included in the taxable but not the probate estate may be deducted both from the estate tax and the trust's income tax, on the ground that the prohibition of section 642(g) against a double deduction is limited to deducting the same item on the income tax

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[127] But excise taxes incurred in selling or distributing assets of the estate may be deducted as administration expenses. Treas. Reg. § 20.2053-6(e) (1958).

[128] INT. REV. CODE OF 1954, § 2053(c)(1)(B).

[129] *Ibid.*

[130] INT. REV. CODE OF 1954, § 2053(d).

return of the estate, not the income tax return of a trust, and the estate tax.[131]

C. Losses

Casualty and theft losses incurred during the settlement of an estate are deductible from the estate tax.[132] Since these items may also be deducted from the estate's income tax, section 642(g) prohibits deducting them from both taxes.

D. Charitable Transfers

Section 2055 provides that "bequests, legacies, devises, or transfers" to the governmental and charitable organizations specified in that section shall be deductible. The only limitation on the deduction of charitable transfers under the estate tax is that the property transferred to the charity must be included in the gross estate of the decedent. The charitable transfers that are deductible under the estate tax include inter vivos transfers, although, of course, in order to qualify for the deduction, the transferred property must be included in the transferor's gross estate.[133] Thus, for example, a transfer to charity in contemplation of death or a revocable transfer to charity would be deductible under the estate tax.

Ordinarily, only transfers to charity by the decedent will be deductible in computing his taxable estate. The statute provides, however, that any interest passing to charity by virtue of a disclaimer qualifies for the charitable deduction.[134] Moreover, when an unexercised power to consume or invade property terminates because of the death of the donee of the power before the estate tax return is due, this will be treated as an irrevocable disclaimer of the power.[135] For example, suppose that *A* died and left his estate in trust for his wife for life, remainder to charity, and also empowered his wife to withdraw any amounts of principal she desired for her happiness or comfort. The charitable remainder would not be deductible because of the widow's power to divert the property from the charity. If, however, the widow disclaimed her power, or if she died within fifteen months of the decedent's death without exercising the power, the remainder would qualify for the charitable deduction.

[131] Commissioner v. Burrow Trust, 333 F.2d 66 (10th Cir. 1964).
[132] INT. REV. CODE OF 1954, § 2054.
[133] INT. REV. CODE OF 1954, § 2055(d).
[134] INT. REV. CODE OF 1954, § 2055(a).
[135] *Ibid.*

If she disclaimed her life estate also, with the result that the entire property passed to the charity, the life estate as well as the remainder would qualify for the charitable deduction. The death of the widow within fifteen months of the decedent's death would not operate as a disclaimer of the life estate, however, since death is only treated as a disclaimer of a power to invade or consume property.

Any property passing to charity that is included in the estate of a donee of a taxable power of appointment over the property is treated by the statute as passing from the donee to the charity and is deductible from the donee's gross estate.[136] Ordinarily in this case the property would not be treated as passing from the donor of the power to the charity so as to entitle his estate to a charitable deduction. There is, however, a weird provision under the statute designed to take care of a special case, under which property left to a surviving spouse over eighty years of age at the decedent's death may, if the surviving spouse is entitled to the income from the property during her life and has power to appoint the property to charity, be treated as passing from the decedent to charity, if certain statutory conditions are met.[137]

Contingent gifts to charity do not qualify for the charitable deduction[138] unless the condition is negligible, so that there is no chance that the charity will not take the property.[139] Moreover, a charitable gift will not be deductible if someone possesses power to divert the property from the charity unless it can be determined, because the power is subject to objective limitations, that there will be no such diversion or that any possible diversion will be in an ascertainable amount under the facts of the particular case.[140]

The deduction for a charitable transfer must be reduced by any death taxes payable out of the property passing to the charity.[141] The competent draftsman will make sure that no taxes are payable

[136] INT. REV. CODE OF 1954, § 2055(b)(1).

[137] INT. REV. CODE OF 1954, § 2055(b)(2).

[138] Sternberger v. Commissioner, 348 U.S. 187 (1955); Humes v. United States, 276 U.S. 487 (1928).

[139] United States v. Provident Trust Co., 291 U.S. 272 (1934). See Empire Trust Co. v. United States, 64-1 USTC ¶ 12,219 (S.D.N.Y. 1963); Bankers Trust Co. v. United States, 190 F. Supp. 671 (S.D.N.Y. 1960), *aff'd mem.*, 299 F.2d 936 (2d Cir. 1962).

[140] *Compare* Ithaca Trust Co. v. United States, 279 U.S. 151 (1929) *with* Merchants Nat'l Bank v. Commissioner, 320 U.S. 256 (1943) *and* Henslee v. Union Planters Nat'l Bank & Trust Co., 335 U.S. 595 (1949).

[141] INT. REV. CODE OF 1954, § 2055(c); Harrison v. Northern Trust Co., 317 U.S. 476 (1943).

out of a charity's share in order to prevent diminution of the charitable deduction and to escape the mathematical dilemma which may arise where death taxes are payable out of a gift to charity and the amount of the federal estate tax depends upon the amount of the charitable deduction, while the amount of the charitable deduction depends on the amount of the tax.

E. Transfers to a Surviving Spouse; the Marital Deduction

1. Amount of the Deduction.—In an effort to equalize the impact of the estate tax upon married couples in community property and common-law states, section 2056 of the Code provides that any property passing from a deceased to a surviving spouse outright, or by an equivalent form of disposition, is deductible from the decedent's gross estate up to one-half of his adjusted gross estate. One-half of the adjusted gross estate is, of course, a ceiling on the marital deduction, not a floor. If a man leaves less than half of his adjusted gross estate to his surviving spouse, the marital deduction will be limited to the amount she actually receives.

The adjusted gross estate, which furnishes the ceiling for the marital deduction, is the gross estate less the deductions allowed for expenses, indebtedness and taxes by section 2053 and losses by section 2054. If community property is involved, the value of the decedent's interest in community property must also be subtracted from his gross estate to ascertain his adjusted gross estate. In this case since the community property is not included in the adjusted gross estate, part of the section 2053 and 2054 deductions equal to the ratio between the community property and the gross estate is not subtracted from the gross estate to get the adjusted gross estate.

Because only section 2053 and 2054 deductions are subtracted from the gross estate to get the adjusted gross estate, it is possible to avoid the estate tax entirely by combining the marital deduction with some other deduction. Thus, for example, a man with an estate of 120,000 dollars may avoid the estate tax by leaving half of his estate to his wife and passing the other half tax-free under the 60,000-dollar exemption. The estate tax on an estate of any size may be avoided by leaving half of the estate to a surviving spouse and the other half to charity.

Only the expenses and losses which are deducted for purposes

of the estate tax, as distinguished from the income tax of the estate, are subtracted from the gross estate to get the adjusted gross estate. This means that if there is a formula gift to a surviving spouse in terms of the maximum marital deduction to which the decedent's estate is entitled, or fifty per cent of his adjusted gross estate, the amount passing to the surviving spouse and qualifying for the marital deduction may be increased by deducting expenses from the estate's income tax instead of the estate tax. Since the adjusted gross estate is increased by taking these deductions against the estate income tax and one-half of this increase is reflected in the marital deduction, the taxable estate will only be increased to the extent of half of the expenses and losses taken against the income tax.

Any obligations imposed on the surviving spouse and any death taxes payable out of the property passing to her reduce the amount of the marital deduction.[142] Consequently the careful draftsman will provide for the payment of taxes out of some other part of the estate in order to prevent reduction of the marital deduction and possibly encountering the mathematical dilemma in computing the tax where the amount of the tax depends upon the amount of the deduction and the amount of the deduction depends on the amount of the tax.

2. *Requirements for the Deduction.*—The two principal requirements for the marital deduction are that an interest in property must pass from the decedent to the surviving spouse and this interest must not be a nondeductible terminable interest.

An interest in property passes to a surviving spouse whenever the decedent transferred property to the surviving spouse, or she acquired the property in any way which is treated as a taxable transfer under the estate tax.[143] Thus property acquired by a surviving spouse by survivorship, or as the beneficiary of an insurance policy, or by virtue of the exercise or nonexercise of a power of appointment passes to the surviving spouse. An interest in property must not only pass to a surviving spouse, but it must also be included in the gross estate of the deceased spouse.[144] Consequently, even though an interest passes to a surviving spouse, it

[142] INT. REV. CODE OF 1954, § 2056 (b)(4).
[143] INT. REV. CODE OF 1954, § 2056(e).
[144] INT. REV. CODE OF 1954, § 2056(a).

will not qualify for the marital deduction unless it was included in the deceased spouse's estate.

Property acquired by a surviving spouse by virtue of a disclaimer does not pass to the surviving spouse. Nor does an interest that the surviving spouse disclaims.[145] Any interest which a surviving spouse takes in her husband's estate as her distributive share of the estate when she elects to take against his will passes to the surviving spouse and qualifies for the marital deduction, provided it is not a nondeductible terminable interest.[146] This is also true of any interest in the deceased spouse's estate that the surviving spouse takes as the result of a bona fide will contest.[147]

One may get a marital deduction by inserting a provision in his will providing that if it is impossible to determine whether he or his spouse survived, it shall be presumed that the spouse survived. If property passes to a spouse under such a clause under the local property law, it qualifies for the marital deduction.[148]

Nondeductible terminable interests do not qualify for the marital deduction.[149] The reason for the rule is that a surviving spouse in a community property state takes her share of the community property outright, and it is usually exposed to an estate tax at her death. Consequently, the draftsmen of the marital deduction limited the interests qualifying for the marital deduction to interests passing to a surviving spouse outright, or by an equivalent form of disposition, that are exposed to a tax in the estate of the surviving spouse.

A terminable interest is an interest that may terminate or fail other than a bond, note or similar contractual obligation the discharge of which will not have the effect of an annuity for life or for a term.[150] Thus, a patent or copyright, or an estate for life or for a term of years is a terminable interest. A determinable fee simple is also a terminable interest, since an interest will be ter-

[145] INT. REV. CODE OF 1954, § 2056(d).

[146] Treas. Reg. § 20.2056(e)-2(c) (1958). A cash allowance in lieu of common law dower qualifies for the marital deduction according to First Nat'l Exch. Bank v. United States, 335 F.2d 91 (4th Cir. 1964); Dougherty v. United States, 292 F.2d 331 (6th Cir. 1961); United States v. Crosby, 257 F.2d 515 (5th Cir. 1958); United States v. Traders Nat'l Bank, 248 F.2d 667 (8th Cir. 1957). *Contra*, Rev. Rul. 279, 1953-2 CUM. BULL. 275.

[147] Treas. Reg. § 20.2056(e)-2(d) (1958).

[148] Treas. Reg. § 20.2056(e)-2(e) (1958).

[149] INT. REV. CODE OF 1954, § 2056(b)(1).

[150] *Ibid.*

minable if it may terminate or fail; it need not necessarily terminate or fail.

Terminable interests qualify for the marital deduction unless they meet one of several statutory conditions. Thus, for example, if a man left his wife a patent or copyright, the bequest would qualify for the marital deduction. The conditions that a terminable interest must meet to be nondeductible are (1) someone else must have acquired an interest in the property in which the surviving spouse took a terminable interest from the decedent for less than adequate consideration, and by virtue of this interest it must be possible for this person (or his heirs or assigns) to possess or enjoy the property when the surviving spouse's interest terminates or fails; or (2) the terminable interest is to be acquired for the surviving spouse pursuant to the directions of the decedent by his executor or the trustee of a trust.[151]

The typical example of a nondeductible terminable interest is the devise of a life estate to a surviving spouse with a remainder over to children. On the other hand, if life estates were left to the children with the remainder in fee to the widow, her interest would not be a terminable interest and consequently not a nondeductible terminable interest. A bequest of a patent to a surviving spouse qualifies for the marital deduction. It is a bequest of a terminable interest but not a nondeductible terminable interest, since no one other than the surviving spouse takes an interest in the patent. If a man left a patent to his wife and son as tenants in common, the gift to the wife would still qualify for the marital deduction. In this case the son would also take an interest in the patent, but his interest would cease along with his mother's, so that he could not enjoy the patent when her interest terminated. If a man died and left money to his executor with directions to invest this sum in an annuity for his widow, the widow's interest would be a nondeductible terminable interest, not because anyone else took an interest in the annuity, but because it was to be acquired for her. If the decedent had purchased a joint and survivor annuity for himself and his wife, however, the value of the survivor annuity of the widow would qualify for the marital deduction. Although the widow's interest in the annuity is a terminable interest, it is not nondeductible because no one else takes any interest in it, and it

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[151] *Ibid.*

is not to be acquired for her. If a man left 10,000 dollars to his executor with directions to buy first mortgages for his wife, the gift to the wife would not be a terminable interest and would qualify for the marital deduction, unless the executor was to invest in a mortgage which paid off in equal annual installments. The discharge of the mortgage would take the form of an annuity for years; it would, therefore, be a terminable interest under the statute, and a nondeductible interest since it was to be acquired for the widow by the executor.[152]

The statute carries the nondeductible terminable interest rule to the extent of requiring any interest passing to a surviving spouse that may be satisfied out of a group of assets that includes a nondeductible terminable interest to be reduced by the value of the nondeductible interest in determining the value of the property passing to the surviving spouse that qualifies for the marital deduction.[153]

3. Exceptions to the Nondeductible Terminable Interest Rule.—There are three exceptions to the nondeductible terminable interest rule, that is, three interests that would be nondeductible terminable interests under the general definition, but are explicitly made deductible by the statute.

The fact than an interest passing to a surviving spouse is contingent upon her not dying as a result of a common disaster from which the decedent died, or upon her surviving the decedent for not more than six months, will not prevent property from qualifying for the marital deduction, if the property actually passes to the surviving spouse.[154] If, however, a surviving spouse must survive an event which may or may not happen in six months, the interest passing to the surviving spouse will not qualify for the marital deduction, even though the event actually happens within six months of the decedent's death.[155]

The most important exception to the nondeductible terminable interest rule is the life-estate power-of-appointment exception under which property passing to a surviving spouse qualifies for the

[152] *Ibid.*
[153] INT. REV. CODE OF 1954, § 2056(b)(2).
[154] INT. REV. CODE OF 1954, § 2056(b)(3).
[155] Kaspar v. Kellar, 217 F.2d 744 (8th Cir. 1954). *Cf.* Kellar v. Kaspar, 138 F. Supp. 738 (D. S.D. 1956).

marital deduction if she is entitled to the income from the property at annual or more frequent intervals for her life and has an unqualified power to appoint the property to herself or her estate that she can exercise without the concurrence of any other person, and no one possesses power to appoint the property away from the surviving spouse.[156] Originally this execption was limited to gifts in trust for a surviving spouse and only operated when the surviving spouse was entitled to all of the income from the trust property and had power to appoint the entire property. The statute was subsequently amended, however, to extend the exception to legal gifts as well as gifts in trust. Moreover, a pro tanto deduction was allowed where the surviving spouse was entitled to the income from only a specific portion of the property left by the decedent and had power to appoint this specific portion.

The most common instance of the life-estate power-of-appointment exception to the terminable interest rule occurs in connection with a marital deduction trust where a surviving spouse is given the income from the trust for life and a power to appoint the remainder to herself or her estate. It is also possible to qualify property for the marital deduction by means of an "estate trust" under which the trust property is left to the surviving spouse's estate.[157] Since in the case of the estate trust no one other than the surviving spouse or her estate takes any interest in the trust property, the estate trust qualifies for the marital deduction since the surviving spouse's interest is not a nondeductible terminable interest. It is not necessary to meet the technical requirements of the life-estate power-of-appointment exception to the nondeductible terminable interest rule to qualify an estate trust for the deduction.

The final exception to the nondeductible terminable interest rule relates to insurance settlements, under which insurance on the life of a deceased spouse is left with the insurer under an agreement to pay the surviving spouse interest on the proceeds of the insurance or to pay her the proceeds in installments. Such settlements qualify for the marital deduction if all payments made during the surviving spouse's life must be made to the surviving spouse annually or at more frequent intervals, and she has an unqualified power, exercisable alone, to appoint to herself or her estate any balance re-

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[156] INT. REV. CODE OF 1954, § 2056(b)(5).
[157] Treas. Reg. § 20.2056(e)-2(b)(1)(ii) (1958).

maining due at her death.[158] The conditions that the insurance settlement exception must meet are substantially the same as those of the life-estate power-of-appointment exception with the additional requirement that payments under the insurance settlement must start within thirteen months of the decedent's death.

III. VALUATION

Although the federal estate tax is imposed upon the transfer of property, it is measured by the value of the property transferred. Consequently, a necessary step in the computation of the tax involves the valuation of the property included in the gross estate along with any property qualifying for the charitable and marital deductions.

The value of property changes from time to time. Therefore, the first step in valuation is to fix the date as of which property is to be valued. Generally property is valued for purposes of the federal estate tax according to its fair market value at the date of the decedent's death. Under section 2032, however, the executor may elect to value the estate according to an alternate valuation date, provided he makes the election upon the estate tax return filed by the due date for the return.

If the alternate valuation date is elected, the property in the estate will be valued according to its fair market value one year after the date of the decedent's death,[159] with the exception of property distributed or disposed of before that time. Property distributed or disposed of during the year after the decedent's death is valued according to its fair market value at the date of such distribution or disposition.[160]

Changes in value due to lapse of time are ignored in valuing property according to the alternate valuation date;[161] and, in the case of property passing under the marital and charitable deductions, any differences in value due to the occurrence or nonoccurrence of a contingency after the decedent's death are also ignored.[162] Any deductions, such as casualty losses during the settlement of the estate, that are reflected in the alternate date valuation are disallowed when this valuation date is elected.[163]

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[158] INT. REV. CODE OF 1954, § 2056(b)(6).
[159] INT. REV. CODE OF 1954, § 2032(a)(2).
[160] INT. REV. CODE OF 1954, § 2032(a)(1).
[161] INT. REV. CODE OF 1954, § 2032(a)(3).
[162] INT. REV. CODE OF 1954, § 2032(b).
[163] *Ibid.*

The statute is silent about the standard employed in valuing property for purposes of the estate tax except for a provision that in valuing unlisted securities quotations for similar listed securities must be taken into account.[164] According to the Regulations, property must be valued according to its fair market value, which is defined as the price that a willing buyer, under no pressure to buy, would pay a willing seller, under no pressure to sell.[165] The Regulations amplify this definition with examples of specific valuation problems.[166] They also contain tables for valuing limited interests, such as annuities, life estates, terms for years, and remainders and reversions.[167] Ordinarily taxpayers will be bound by these tables, although exceptions may be made where valuation is dependent upon the life expectancy of a person having an abnormal life expectancy[168] or the income yield of property which differs radically from the interest rate assumed by the tables.[169] Theoretically valuation involves foresight rather than hindsight. There are several cases, however, that have permitted interests to be valued by taking into consideration events occurring after the valuation date.[170]

IV. Computation of the Tax

The gross estate tax is computed by multiplying the taxable estate by the rates of the tax. The net tax actually due the government is the gross tax less any applicable credits against the tax. Four credits are allowed against the estate tax.

Section 2011(b) allows state death taxes to be credited against the federal estate tax within the limits prescribed by that section. Before the 1954 Code, the credit for state death taxes was limited to eighty per cent of the "basic" federal estate tax. When the 1954 Code combined the basic and additional estate taxes into a single schedule of rates, the credit for state death taxes was still limited to an amount equal to eighty per cent of the old basic tax by section

[164] Int. Rev. Code of 1954, § 2031(b).
[165] Treas. Reg. § 20.2031-1(b) (1958).
[166] Treas. Reg. §§ 20.2031-2 to -6, -8 (1958).
[167] Treas. Reg. § 20.2031-7 (1958).
[168] Estate of Nellie H. Jennings, 10 T.C. 323 (1948); Estate of John Halliday Denbigh, 7 T.C. 387 (1946).
[169] Hanley v. United States, 63 F. Supp. 73 (Ct. Cl. 1945). An interest rate different than that assumed by the Treasury Tables cannot be employed if it is possible to reinvest the property being valued in securities returning a different rate of interest. Estate of Irma E. Green, 22 T.C. 728 (1954).
[170] See Estate of Vardell v. Commissioner, 307 F.2d 688 (5th Cir. 1962); Commissioner v. Estate of Shively, 276 F.2d 372 (2d Cir. 1960).

2011(b). The reason no credit is allowed under section 2011(b) until the taxable estate exceeds 40,000 dollars is that the exemption under the basic tax was 100,000 dollars or 40,000 dollars higher than the current exemption of 60,000 dollars.

The same transfer may be taxed under both the estate and gift taxes. Consequently, section 2012 allows any federal gift tax imposed upon transfers included in the transferor's gross estate to be credited against the transferor's estate tax, within the limits prescribed by that section.

Section 2014 allows foreign death taxes to be credited against the federal estate tax subject to the limitations set forth in that section.

The credits allowed under sections 2011, 2012, and 2014 are designed to prevent double taxes upon the same transfers. Section 2013, which allows a credit for prior federal estate taxes, affords relief from too many estate taxes in too short a time, rather than from multiple taxes on the same transfer. According to section 2013, the estate of a decedent who acquired property from another decedent who died within ten years before or two years after the decedent's death[171] is allowed a credit for the estate tax paid upon the property by the estate of the prior decedent. The credit for prior estate taxes is based upon a sliding scale by which the amount of the credit diminishes as the interval between the deaths of the two decedents increases. For example, if the deaths occurred within two years of each other, one hundred per cent of the tax paid upon the property acquired from the prior decedent by the prior decedent's estate may be credited against the decedent's estate tax. If the deaths are more than eight years but less than ten years apart, the credit is limited to twenty per cent of the tax paid by the prior decedent's estate. If more than ten years elapses between the two deaths, no credit at all is allowed.

V. Payment and Collection of the Tax

When a citizen or a resident of the United States dies leaving a gross estate worth more than 60,000 dollars at the date of his death, a preliminary notice (Form 704) must be filed within two

[171] Credit for a tax paid by the estate of a decedent dying *after* the decedent's death would be allowed where the property was included in the transferor decedent's estate because he made a taxable transfer, such as a transfer in contemplation of death.

months of his death with the District Director of Internal Revenue in whose district the decedent was domiciled. If an executor or administrator is appointed within two months of the decedent's death, the time for filing the preliminary notice is extended for two months after his appointment. If, however, no executor or administrator is appointed within two months of the decedent's death, the preliminary notice must be filed by any person in actual or constructive possession of property included in the decedent's gross estate. A similar notice (Form 705) is required in the case of nonresident aliens who die leaving a gross estate situated in the United States worth more than 2,000 dollars at the date of death. The preliminary notice when a nonresident alien dies is filed with the Director of International Operations, Internal Revenue Service, Washington 25, D. C.

In addition to the preliminary notice, a federal estate tax return (Form 706) must be filed within fifteen months of the death of a citizen or resident of the United States whose gross estate exceeded 60,000 dollars at the date of his death. The final return is filed by the same persons and with the same persons as the preliminary notice. An estate tax return (Forms 706NA and 706) must also be filed within fifteen months of the death of a nonresident alien who left a gross estate in the United States worth more than 2,000 dollars at the time of his death.

The tax is due and payable at the due date of the return. In appropriate cases extensions of time for filing returns may be granted, but an extension of time for filing a return does not extend the time for paying the tax. If, however, payment of the tax would involve undue hardship, and in certain situations where remainders and reversions and business interests are involved, extensions of time for paying the tax may be granted.[172]

Except in the case of proceeds of insurance and property subject to a taxable power of appointment, the federal estate tax does not specify who shall bear the ultimate burden of the tax, but leaves this to the local state law. Sections 2206 and 2207 provide that the beneficiary of life insurance and the recipient of property subject to a taxable power of appointment shall bear the proportionate share of the estate tax imposed upon these interests in the absence of a

[172] See LOWNDES & KRAMER, FEDERAL ESTATE AND GIFT TAXES, 555-57 (2d ed. 1962).

contrary provision in the decedent's will. Insurance and property subject to a power of appointment passing under the marital deduction are exempt from this obligation. Apart from sections 2206 and 2207, the federal statute leaves the determination of who is ultimately to bear the burden of the federal estate tax to any provisions in the decedent's will and, in the absence of such provisions, to the local law. In some states, in the absence of a contrary direction in the decedent's will, the federal estate tax is charged against the residue of his estate, with proportionate abatement in the shares of the other beneficiaries of the estate if the residue is insufficient to meet the estate tax. Other states have apportionment statutes under which the burden of the federal estate tax is apportioned among the benficiaries of the estate according to the value of their respective interests in the estate.

THE FEDERAL GIFT TAX

The federal gift tax, like the federal estate tax, is a tax upon the privilege of transferring property, rather than a tax upon the property transferred. It differs from the estate tax in that it is confined to inter vivos transfers. Since the gift tax is an indirect tax upon the privilege of transferring property rather than a direct tax upon the property transferred, Congress has constitutional authority to impose an unapportioned gift tax.[173] The doctrine of intergovernmental immunities does not apply to the gift tax.[174] Nor do statutory tax exemptions extend to gift taxes upon the transfer of exempt property.[175]

The current gift tax was enacted in 1932. Congress passed a gift tax in 1924, which was repealed in 1926 after it proved quite ineffective because the tax was computed upon an annual rather than a cumulative basis and allowed an annual exemption of 50,000 dollars. The Supreme Court held that the 1924 tax was constitutional,[176] although the Court also held that it could not be applied consti-

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[173] Bromley v. McCaughn, 280 U.S. 124 (1929).

[174] Blodgett v. Holden, 11 F.2d 180 (W.D. Mich. 1926), *rev'd on other grounds*, 275 U.S. 142 (1927); Treas. Reg. § 25.2511-1(a) (1958).

[175] Phipps v. Commissioner, 91 F.2d 627 (10th Cir. 1937), *cert. denied*, 302 U.S. 742 (1937); Hamersley v. United States, 16 F. Supp. 768 (Ct. Cl. 1936), *cert. denied*, 300 U.S. 659 (1937); Treas. Reg. § 25.2511-1(a) (1958).

[176] Bromley v. McCaughn, 280 U.S. 124 (1929).

tutionally to a gift made before the tax was enacted.[177] Out of deference to the decision in *Untermyer v. Anderson*[178] against a retroactive gift tax, Congress was careful to confine the 1932 tax to gifts made after the tax was passed. Moreover, the various amendments to the 1932 tax have provided expressly that they were applicable only to gifts made after the amendments were enacted. The 1932 tax avoided the structural defects of the 1924 tax by limiting the exemption under the tax to a single lifetime exemption and requiring the tax to be computed upon a cumulative basis. Although the tax is confined to the gifts made during the taxable year, the rate of tax is determined by the taxpayer's total gifts since the enactment of the tax in 1932.

The stated purposes of the 1924 and 1932 gift taxes were to prevent avoidance of the estate and income taxes.[179] The gift tax fails to achieve either of these objectives. Due to the rate differential between the two taxes, the gift tax is not an effective deterrent to inter vivos gifts to get property out of the donor's taxable estate. Although nominally the rates of the gift tax are three-fourths of those of the estate tax, actually the effective rates of the gift tax are usually very much lower. Ordinarily, inter vivos gifts come off the top of the donor's taxable estate and fall into a much lower bracket under the gift tax. They also enable the donor to take advantage of the exemption and any exclusions under the gift tax. Finally, the estate tax is computed on a tax base which includes the amount of the tax itself, while the gift tax is calculated upon the amount actually passing to the donee.[180] The gift tax seldom discourages transfers of income-producing property in order to split up a large income taxable in a high bracket into smaller incomes taxable in lower brackets because income tax savings are recurrent annual savings, while the gift tax penalty is incurred only once.

I. Gross Gifts

The easiest approach to the gift tax is to consider the various steps in the computation of the tax. The tax is imposed upon gifts

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[177] Untermyer v. Anderson, 276 U.S. 440 (1928). *Cf.* Blodgett v. Holden, 275 U.S. 142 (1927).

[178] *Supra* note 177.

[179] See Lowndes & Kramer, *op. cit. supra* note 172, at 564.

[180] For example, an unmarried man who had a taxable estate of $1,000,000 and who had made no previous gifts could escape an estate tax of $35,000 at the cost of a gift tax of $8,595 if he gave $100,000 to a single donee during his life.

made during the calendar year. The first step in computing the tax is to list the taxpayer's gifts during the year in excess of any exclusions allowed against the gifts, to determine his gross gifts.

A. The Annual Exclusion

The taxpayer's gross gifts may differ from his total gifts because of the annual exclusion. In the case of gifts of present interests, the first 3,000 dollars of the gifts to each donee during the taxable year is excluded from the gross gifts.[181] Thus, if a man gave 10,000 dollars to each of his three sons in a single year, he would get an exclusion of 3,000 dollars for the gift to each son. His total exclusions would be 9,000 dollars and his gross gifts 21,000 dollars. From 1932 through 1938 the exclusion was 5,000 dollars. In 1939 it was reduced to 4,000 dollars, and since 1943 it has been 3,000 dollars.

The principal problem in connection with the exclusion is what is a future interest, since no exclusion is allowed for a gift of a future interest.[182] For gift tax purposes future interests include not only remainders and reversions, but any interest possession or enjoyment of which is deferred or subject to the will of some person other than the owner of the interest.[183] Although the stated reason for denying any exclusion to gifts of future interests was the anticipated difficulty in determining the donee of the gift and the value of his interest,[184] the fact that a donee is easily identifiable and the value of his interest precisely ascertainable will not make a gift a gift of a present interest, if the donee's possession or enjoyment is deferred. For example, if *A* transferred property to *T* in trust to accumulate the income from the property for ten years and then to distribute the trust property along with any accumulated income to *B* or *B*'s estate, the gift to *B* would be a gift of a future interest.

A gift will be a gift of a future interest even though it is possible for the donee to obtain the present enjoyment of the interest, if his possession or enjoyment is dependent upon the will of some other person. In *Heringer v. Commissioner*,[185] for example, the

[181] INT. REV. CODE OF 1954, § 2503(b).
[182] *Ibid.*
[183] See Commissioner v. Disston, 325 U.S. 442 (1945); Treas. Reg. § 25.2503-3 (1958).
[184] H.R. REP. No. 708, 72d Cong., 1st Sess. p. 39 (1932); S. REP. No. 665, 72d Cong., 1st Sess., p. 41 (1932).
[185] 235 F.2d 149 (9th Cir.), *cert. denied*, 352 U.S. 927 (1956).

court said that if a gift to a corporation were viewed as a group of gifts to the individual stockholders of the corporation, the gifts to the stockholders would be gifts of future interests, since no individual stockholder could liquidate the corporation and obtain possession of the donated property without the consent of the other stockholders, so that his enjoyment depended upon the will of the other stockholders.

According to the Regulations, the term "future interest"

> has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payments in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer used in effecting a gift.[186]

If a man completely assigns his life insurance, this will be treated as a gift of a present interest, even though the insurance has not yet acquired a cash surrender value.[187] Of course, if he limits the assignment in a fashion inconsistent with the assignee's present enjoyment, the assignment will be a gift of a future interest. Thus, where a man transferred his insurance to his two sons jointly, the court held that the sons took future interests in the insurance, since neither son could cash in the policy without the consent of the other.[188] If, after assigning life insurance, a man continues to pay the premiums on the insurance, whether the premium payments constitute gifts of future or present interests depends upon whether the assignment of the policy itself gave the assignee a future or present interest.[189]

According to section 2503(c), a gift to an infant will qualify for the exclusion, if the donated property and the income therefrom may be expended for the infant before he attains age twenty-one, and any unexpended balance will pass to the infant when he reaches twenty-one, or to his estate or as he may appoint under a general power of appointment, if he dies under that age. For example, if *A* transferred property to *T* in trust for the benefit of *B*, who was

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[186] Treas. Reg. § 25.2503-3(a) (1958).

[187] Rev. Rul. 55-408, 1955-1 CUM. BULL. 113.

[188] Skouras v. Commissioner, 188 F.2d 831 (2d Cir. 1951).

[189] If the gift of the insurance policy gave the donee a present interest in the policy, payment of a premium will also be a gift of a present interest. See LOWNDES & KRAMER, *op. cit. supra* note 172, at 730-31.

ten years old and empowered *T* to accumulate the income from the trust or expend income and principal for *B*'s benefit until *B* reached twenty-one, at which time *T* was directed to pay over an unexpended balance to *B*, with a further direction to pay the balance to *B*'s estate if *B* died before reaching twenty-one, this would be a gift of a present interest which would qualify for the annual exclusion.

Section 2503(c) is not exclusive. Apart from this section, a gift to an infant will be a gift of a present interest if it is a present interest under the general definition of a present interest. Thus, an outright gift to an infant or to a guardian for an infant is a gift of a present interest.[190] So, according to some cases, is a gift to an infant in trust where the trustee is required to hold the property as a guardian.[191] An interest in the income from a trust that must be distributed to or expended for an infant will be a gift of a present interest to the extent of the value of the income interest.[192] There is a split of authority whether a gift to a trust under which the trustee is to accumulate income for an infant until his majority will be converted into a gift of a present interest by a provision in the trust authorizing the infant or his guardian to terminate the trust at any time he sees fit.[193]

An exclusion will not be allowed for a gift of a present interest unless the value of the interest can be ascertained with sufficient certainty to determine the amount of the exclusion allowable. If a minimum value for the interest can be ascertained, the Service has ruled that an exclusion will be allowed to the extent of the minimum value.[194] Several cases held that a gift of a present interest in income would not qualify for the annual exclusion where someone possessed power to invade principal in behalf of the income beneficiary, upon the curious reasoning that this would make the value of the income interest uncertain,[195] although obviously the exercise of the power could only increase the present enjoyment of the

[190] Rev. Rul. 54-400, 1954-2 CUM. BULL. 319.

[191] United States v. Baker, 236 F.2d 317 (4th Cir. 1956); Cannon v. Robertson, 98 F. Supp. 331 (W.D.N.C. 1951); Strekalovsky v. Delaney, 78 F. Supp 556 (D. Mass. 1948).

[192] See LOWNDES & KRAMER, *op. cit. supra* note 172, at 726.

[193] *Compare* Kieckhefer v. Commissioner, 189 F.2d 118 (7th Cir. 1951) *with* Stifel v. Commissioner, 197 F.2d 107 (2d Cir. 1952).

[194] Rev. Rul. 55-678, 1955-2 CUM. BULL. 389.

[195] La Fortune v. Commissioner, 263 F.2d 186 (10th Cir. 1958); Estate of Herrmann v. Commissioner, 235 F.2d 440 (5th Cir. 1956); Evans v. Commissioner, 198 F.2d 435 (3d Cir. 1952).

holder of the present interest. Section 2503(b) of the 1954 Code repudiated these decisions by providing that the existence of a power to invade principal in favor of the holder of a present interest shall be disregarded in determining the eligibility of the present interest for the exclusion, where the power cannot be exercised in favor of anyone else. Of course, a power to destroy a present interest by diverting property to one other than the possessor of the present interest would make the value of the present interest uncertain and prevent it from qualifying for the exclusion.[196]

B. Elements of a Taxable Gift

The Code does not undertake to define the gifts which are taxable under the gift tax. Section 2501 imposes the tax "on the transfer of property by gift . . . by any individual." Section 2512(b), which deals with valuation, says: "Where property is transferred for less than adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeds the value of the consideration shall be deemed a gift . . . ." The following definition of a taxable gift may be inferred from statutory fragments like these, Treasury rulings, and court decisions: *A taxable gift is a voluntary and complete transfer of property by an individual for less than an adequate and full consideration in money or money's worth, which is not a bona fide business transfer.* The two principal elements of a gift are (1) a transfer of property, (2) for less than adequate consideration. It will be convenient to consider the nature of a taxable gift under these headings.

1. Transfer.—A taxable gift involves a *transfer* of property. Thus, a true disclaimer of a bequest under a will is not a gift,[197] since it is simply a refusal to accept the property bequeathed by the decedent and not a transfer of property. On the other hand, renunciation of an interest in an intestate estate by an heir was held to be a gift where title to the interest vested automatically in the heir under the local law at the decedent's death, and the renuncia-

[196] See Funkhouser's Trusts v. Commissioner, 275 F.2d 245 (4th Cir.), *cert. denied,* 363 U.S. 804 (1960).

[197] *Cf.* Brown v. Routzahn, 63 F.2d 914 (6th Cir.), *cert. denied,* 290 U.S. 641 (1933).

tion was, therefore, a transfer of this interest, rather than simply a refusal to accept an interest in the estate.[198]

A gift may be made in any way in which property can be transferred. Delivery is not necessary for a gift, unless in the particular situation transfer of title depends on delivery.[199] Thus, a taxable gift may be made by a declaration of trust, release of a power to revoke a trust, irrevocably naming a beneficiary of an insurance policy, or gratuitously cancelling a debt.[200]

A taxable gift involves a transfer of *property* as distinguished from a gift of services. If an executor waives his commissions before he begins to serve, this is not a taxable gift.[201] He has rendered services to the beneficiaries of the estate gratuitously rather than made a gift of his commissions. Some interesting questions have arisen under the income tax with regard to the distinction between a gift of services and a gift of property, which might well arise under the gift tax. If an artist paints a picture and gives it to a friend, has he made a gift of property or services?[202] Would it make a difference if the friend furnished the canvas and paints for the picture?

The gift tax is limited to gifts "by any *individual*." This excludes gifts by corporations. The Regulations provide, however, that gifts by corporations will be taxed as gifts by the individual stockholders of the corporation.[203] The statute says nothing about gifts to corporations. There is some uncertainty about whether a gift to a corporation is a single gift to the corporate entity or a group of gifts to the individual stockholders.[204] The way in which the gift is viewed should not make any difference as far as the amount of the gift is concerned. If the donor is one of the stockholders and the gift is treated as gifts to the stockholders, there will be no gift of the donor's proportionate share of the donated property, since a

[198] Hardenbergh v. Commissioner, 198 F.2d 63 (8th Cir.), *cert. denied,* 344 U.S. 836 (1952); William L. Maxwell, 17 T.C. 1589 (1952).

[199] See Richardson v. Commissioner, 126 F.2d 562 (2d Cir. 1942).

[200] Treas. Reg. § 25.2511-1 (1958).

[201] Rev. Rul. 56-472, 1956-2 CUM. BULL. 21. There may be a taxable gift, however, if he waives the commissions after they have been earned. Rev. Rul. 64-225, 1964-2 CUM. BULL. 15.

[202] The gift to charity of a picture painted by the taxpayer has been held to be a gift of property qualifying for the charitable deduction under the income tax. Hilla Rebay, 22 CCH Tax Ct. Mem. 181 (1963).

[203] Treas. Reg. § 25.2511-1(h)(1) (1958).

[204] *Ibid.* See Heringer v. Commissioner, 235 F.2d 145 (9th Cir.), *cert. denied,* 352 U.S. 927 (1956).

man cannot make a gift to himself. Even if the gift is regarded as a gift to the corporate entity, the amount of the gift should exclude the donor-stockholder's proportionate share of the donated property on the theory that to this extent he received consideration for the transfer in the form of the increase in value of his stock. There is, however, some difference of judicial opinion on this point.[205] If the gift to the corporation is treated as a single gift to the corporate entity, the donor can claim only a single exclusion against the gift. It is not clear whether he will be entitled to any exclusions if the gift is treated as a group of gifts to the individual stockholders. In *Heringer v. Commissioner*,[206] the court said that there would be no exclusions in this case because the stockholders took future interests in the donated property.

The element of a taxable gift that has provoked most litigation is the requirement that the transfer must be a *complete* transfer. An incomplete transfer is not treated as a taxable gift. Originally, the Supreme Court seemed to take the view that the test of a complete transfer under the gift tax was the way in which the transfer was treated under the estate tax, since the gift tax was designed to supplement the estate tax. Thus, when a man transferred property to a trust and retained power to revoke the trust,[207] or to change the beneficiaries under the trust, although he could not make himself a beneficiary,[208] the Court held that he had not made a taxable gift. Since the purpose of the gift tax was to catch transfers that escaped the estate tax, as long as the transfer remained incomplete and taxable under the estate tax, it would be treated as incomplete and nontaxable under the gift tax.

In *Smith v. Shaughnessy*,[209] however, the Supreme Court repudiated the estate tax test of a complete transfer under the gift tax. The Court said that the estate and gift taxes are not mutually exclusive and a transfer will be taxed under the gift tax as a complete transfer whenever the transferred property has passed out

[205] See LOWNDES & KRAMER, *op. cit. supra* note 172, at 581-82.
[206] *Supra* note 185.
[207] Burnet v. Guggenheim, 288 U.S. 280 (1933). There will be a gift when the power to revoke the trust is released. Moreover, as long as the trust remains revocable there will be gifts whenever income is distributed to a beneficiary. Treas. Reg. § 25.2511-2(f) (1958); Commissioner v. Warner, 127 F.2d 913 (9th Cir. 1942).
[208] Estate of Sanford v. Commissioner, 308 U.S. 39 (1939).
[209] 318 U.S. 176 (1943).

of the control of the transferor, regardless of how the transfer is treated under the estate tax.

Whether or not a transfer is complete for purposes of the gift tax depends upon whether the transferor has parted with control over the transferred property. A transfer that the transferor can revoke, either alone or with the concurrence of a person lacking a substantial adverse interest in the transferred property, is an incomplete transfer, which is not taxable under the gift tax.[210] The same thing is true with respect to a transfer beneficial enjoyment of which can be altered by the transferor, although he cannot make himself a beneficiary.[211] On the other hand, a transfer that can be altered or revoked by the transferor only with the consent of a person possessing a substantial adverse interest in the transferred property is a complete transfer and a taxable gift, at least to the extent of the adverse person's interest in the property, even though the transfer is treated as an incomplete transfer which is taxable under the estate tax.[212] For example, if *A* transfers property to *T* in trust for *C* for life, remainder to *D* in fee, and retains power to revoke the trust with *C*'s consent, he has made a taxable gift of *C*'s life estate. If, however, the trust is revocable in whole or in part, he has not made a gift of *D*'s remainder, since the remainder could be revoked without the concurrence of anyone having a beneficial interest in the remainder.[213]

There is considerable confusion as to the gift tax consequences of a transfer which can be altered or amended by one other than the donor. If there is no power to revest the transferred property in the donor, it would appear that the transfer would be a complete transfer and a taxable gift. If, however, the power may be exercised to revest the transferred property in the transferor but there is no way of valuing the transferor's potential interest in the property, it would seem that there would be a complete transfer and a taxable gift of the entire property,[214] although there is authority for the proposition that there will not be a gift in this situation where the power to revest the property in the transferor is subject to external

[210] Burnet v. Guggenheim, 288 U.S. 280 (1933).
[211] Estate of Sanford v. Commissioner, 308 U.S. 39 (1939).
[212] Camp v. Commissioner, 195 F.2d 999 (1st Cir. 1952).
[213] If the trust can only be revoked in its entirety, there will apparently be a gift of the whole property. See Camp v. Commissioner, *supra* note 212.
[214] See Robinette v. Helvering, 318 U.S. 184 (1943).

standards and does not rest solely in the discretion of the powerholder.[215]

Although one of the stated purposes of the gift tax is to prevent avoidance of the income tax, no attempt has been made to correlate the gift tax with the income tax. The fact that income from transferred property remains taxable to the transferor will not prevent the transfer from being treated as a complete transfer and a taxable gift if the transferred property has passed beyond the control of the transferor.[216]

2. *Consideration.*—With the exception of business transfers, the test of a taxable gift is not donative intent but the absence of adequate and full consideration in money or money's worth. A transfer for inadequate consideration is treated as a taxable gift even though it takes the form of a sale or exchange.[217] For many years the Regulations have provided, however, that a "transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth."[218] Although the Regulations say that the transfer must be made "in the ordinary course of business" for adequate consideration to be presumed, the courts have felt that this requirement is met when there is a genuine arm's length business transaction.[219]

Consideration that will prevent a taxable gift is not merely good contractual consideration but the same adequate and full consideration in money or money's worth that is necessary to prevent a taxable transfer under the estate tax. It must be a consideration capable of evaluation in monetary terms. It must also be the economic equivalent of the property transferred, although a transfer for an insufficient consideration will escape the gift tax up to the value of the consideration. Unlike the estate tax, the gift tax does not expressly provide that the relinquishment of marital property rights

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[215] Estate of Leon Holtz, 38 T.C. 37 (1962). See Sarah Gilkey Vander Weele, 27 T.C. 340 (1956), *aff'd,* 254 F.2d 895 (6th Cir. 1958); Estate of Christianna K. Gramm, 17 T.C. 1063 (1951).

[216] Lockard v. Commissioner, 166 F.2d 409 (1st Cir. 1948); Commissioner v. Hogle, 165 F.2d 352 (10th Cir. 1947); Commissioner v. Beck's Estate, 129 F.2d 243 (2d Cir. 1942).

[217] Treas. Reg. § 25.2512-8 (1958).

[218] *Ibid.*

[219] See Shelton v. Lockhart, 154 F. Supp. 244 (W.D. Mo. 1957); Estate of Monroe D. Anderson, 8 T.C. 706 (1947).

will not be treated as consideration, but the Supreme Court has read this requirement into the gift tax.[220] The same uncertainty whether the release of marital support rights constitutes consideration that prevails under the estate tax exists in the case of the gift tax. The consideration that will prevent a taxable transfer under the gift tax must also take the form of a benefit to the transferor rather than a detriment to the transferee.[221]

Only voluntary transfers are taxed under the gift tax. Consequently consideration is only necessary to prevent a transfer resting upon a promise or agreement from being taxed as a gift. Transfers to settle marital property rights pursuant to an agreement incorporated into a divorce decree will not be treated as taxable gifts if the transfers are regarded as made pursuant to the decree rather than to the agreement.[222] Apparently this will occur where the divorce court had jurisdiction to decree a different settlement from that prescribed by the agreement incorporated into the divorce decree.

Section 2516 provides a sure method of making transfers in connection with a divorce that will not be taxed as gifts for lack of adequate consideration. Under this section, any transfer pursuant to a written agreement between husband and wife to settle up their marital or property rights, or to provide a reasonable allowance for the support of issue of the marriage during minority, will be deemed made for adequate consideration provided the parties are divorced within two years of making the agreement. It is important to notice that section 2516 requires the spouses to be divorced within two years of the execution of the agreement; it does not set any limit within which the transfers must be made. Section 2516 is not exclusive. Thus, a transfer pursuant to a postnuptial agreement might escape a gift tax even though the parties were not divorced within two years of making the agreement, if the agreement was incorporated in the divorce decree and the divorce court had jurisdiction to decree a different settlement.

3. *Powers of Appointment.*—Unlike the estate tax, the gift tax does not contain detailed descriptions of the transfers taxed under the tax except for section 2514, which prescribes rules for taxing powers of appointment, and section 2515, which sets forth

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[220] Merrill v. Fahs, 324 U.S. 308 (1945).
[221] Commissioner v. Wemyss, 324 U.S. 303 (1945).
[222] Harris v. Commissioner, 340 U.S. 106 (1950).

an exception to the "common-law" rule for taxing joint tenancies and tenancies by the entirety.

The gift tax, like the estate tax, equates general powers of appointment with ownership of the property subject to the power and follows the provisions for taxing powers of appointment under the estate tax as closely as the differences between the two taxes will permit.

Under the gift tax, powers of appointment are divided into preexisting powers created on or before October 21, 1942, and post-1942 powers created after that date. With one exception, where a post-1942 power is exercised to create a second power that is not subject to the Rule Against Perpetuities,[223] only general powers are taxed. Post-1942 general powers are fully equated with the ownership of the property subject to the power by taxing both the inter vivos exercise and release of the power as a gift.[224] An exception to the tax, which parallels the similar exception under the estate tax, provides that the lapse of a post-1942 general power will not be treated as a taxable gift to the extent that the property subject to the lapsed power does not exceed the greater of 5,000 dollars or five per cent of the fund from which the lapsed power could have been satisfied.[225]

Only the inter vivos exercise of a preexisting general power is taxed as a gift.[226] This follows the estate tax treatment of preexisting powers.

A general or taxable power is defined in the same way under the gift tax as it is under the estate tax to include a power under which the donee may appoint to himself, his estate, his creditors, or the creditors of his estate.[227] A power to invade or consume property that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the donee is not a taxable power.[228] Nor is a joint preexisting power.[229] A joint post-1942 power is a taxable power, unless the person whose concurrence the donee must have to exercise the power is the donor of the power or a person possessing a substantial adverse interest in the property

[223] INT. REV. CODE OF 1954, § 2514(d).
[224] INT. REV. CODE OF 1954, § 2514(b).
[225] INT. REV. CODE OF 1954, § 2514(e).
[226] INT. REV. CODE OF 1954, § 2514(a).
[227] INT. REV. CODE OF 1954, § 2514(c).
[228] INT. REV. CODE OF 1954, § 2514(c)(1).
[229] INT. REV. CODE OF 1954, § 2514(c)(2).

subject to the power.[230] Where, however, a donee exercises or releases a taxable post-1942 joint power, he is regarded as having made a gift only of that part of the property equal to the value of the property divided by a number made up of the donee and the persons required to concur in the exercise of the power who are possible appointees.[231]

4. Joint Estates.—The gift tax, unlike the estate tax, does not prescribe any general statutory rule for taxing joint estates, although section 2515 lays down an exception to a general "common-law" rule. Under the general rule, the gift tax consequences of the creation of a joint tenancy or tenancy by the entirety depend upon the property interests the parties acquire in the common property, as well as their contributions to the consideration for the property, which are the sole determinant under the estate tax. Thus, if *H* purchases stock and takes title in his name and that of *W* as joint tenants with right of survivorship, he will make a taxable gift of one-half of the value of the stock to *W*. In a joint tenancy, since there is a right of severance, each tenant acquires a pro rata interest in the common property regardless of their life expectancies. If, instead of taking the stock in his name and that of *W* as joint tenants, *H* had taken title with *W* as tenants by the entirety, the measure of the gift to *W* would have been the actuarial value of the interest she acquired in the property on the basis of her life expectancy and that of *H*. If both tenants contribute to a joint tenancy or tenancy by the entirety, the taxable gift will be the difference between the amount contributed to the tenancy by the donor and the value of the interest he received in the common property.

When a joint estate creation of which was treated as a taxable gift is terminated, there will be a taxable gift if one tenant receives part of the property, or the proceeds of the property, that exceeds his proportionate interest in the property before the termination. Thus, if in the hypothetical case in the preceding paragraph, where *H* purchased stock and took title in his name and that of his wife as joint tenants, the spouses later sold the stock and divided the proceeds equally, there would be no taxable gift. If, however, *H* kept the entire proceeds, there would be a gift of half of the proceeds by *W* to *H*.

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[230] INT. REV. CODE OF 1954, § 2514(c)(3)(A) & (B).
[231] INT. REV. CODE OF 1954, § 2514(c)(3)(C).

Section 2515 provides that there will not be a gift when a joint tenancy or tenancy by the entirety in real property is created between spouses, unless the donor spouse elects by filing a gift tax return to treat the creation of the tenancy as a gift. If this election is not made, the spouses are regarded as owning the real estate according to their respective contributions to the joint tenancy. Consequently, when a tenancy, creation of which was not treated as a gift, terminates for any reason other than the death of a spouse, there will be a gift to the extent that one tenant receives part of the property, or part of the proceeds of the property, in excess of his proportionate contribution. For example, suppose that *H* and *W* purchased Blackacre for 40,000 dollars and took title to the property as tenants by the entirety. *H* paid 30,000 dollars of the consideration for Blackacre and *W* paid 10,000 dollars. Later they sold the property for 60,000 dollars, which they divided equally between them. Since *W* contributed one-fourth of the consideration for Blackacre, she was entitled to one-fourth of the proceeds or 15,000 dollars. When she received 30,000 dollars, *H* made a gift to her of the 15,000 dollars over and above her proportionate share of the proceeds.

II. Taxable Gifts; Deductions

The gift tax is computed by multiplying the taxable rather than the gross gifts by the rates prescribed by the statute. The taxable gifts of a citizen or resident of the United States are his gross gifts less the three deductions allowed by the statute for (1) the exemption; (2) charitable gifts; and (3) marital gifts. Although nonresident alien donors are allowed the gift tax exclusion, they are limited to the deduction for charitable transfers and do not get an exemption or marital deduction.

A. The Exemption

Section 2521 provides that a specific exemption of 30,000 dollars may be deducted in computing the donor's taxable gifts. This is a lifetime exemption which may be taken only once, although the donor may take it, or any part of it, whenever he chooses. From 1932 to 1935 inclusive the exemption was 50,000 dollars; from 1936 to 1942 inclusive it was 40,000 dollars; since 1943 it has been 30,000 dollars.

B. Charitable Transfers

Section 2522 provides that transfers to the governmental units and the charitable organizations set forth in that section are deductible. The deduction is limited to the amount included in the donor's gross gifts. Therefore, if a man gave 10,000 dollars to a charity, his deduction would be limited to 7,000 dollars, since 3,000 dollars of the gift would be excluded from his gross gifts.

Presumably contingent gifts to charity will be handled under the gift tax in the same way that they are treated under the estate tax and will not be deductible unless the chance of the charity not taking is negligible. A power to divert property away from a charity will also disqualify a transfer to charity for the charitable deduction under the gift tax in the same way it does under the estate tax. Unlike the estate tax, however, the gift tax makes no express provision for disclaiming the power in order to qualify the transfer for the deduction.

It would appear that the donee of a taxable power of appointment who appoints property to charity would be entitled to deduct the property included in his gross gifts because of the power under the charitable deduction. There is, however, no express provision for a deduction in this situation under the gift tax as there is under the estate tax.

C. Marital Deduction

A marital deduction is allowed under the gift tax as well as the estate tax.[232] In general the marital deduction under the gift tax follows the estate tax, but there are differences because of the differences in the two taxes.

Under the gift tax, the amount of the marital deduction is limited to one-half of the property transferred by one spouse to another, with the qualification that the deduction cannot exceed the amount included because of the transfer in the transferor's gross gifts. Thus, if *H* gave 10,000 dollars to *W*, he would be entitled to a marital deduction of 5,000 dollars. If, however, *H* gave only 5,000 dollars to *W*, the marital deduction would be limited to 2,000 dollars, since only this amount, after excluding 3,000 dollars from the gift, would be included in *H*'s gross gifts.

[232] INT. REV. CODE OF 1954, § 2523.

Unlike the estate tax where community property may qualify for the marital deduction if the decedent has separate property so that he has an adjusted gross estate, community property does not qualify for the marital deduction under the gift tax.

The nondeductible terminable interest rule applies to the gift tax as well as the estate tax. However, nondeductible terminable interests under the gift tax are limited to a terminable interest in property given to a spouse, where the donor retained or gave someone else an interest in the same property, by virtue of which the donor or the other person (or their heirs or assigns) might enjoy the property after the donee spouse's interest terminated. Thus, if *H* gave *W* a life estate in Blackacre and retained the reversion in the property after *W*'s life estate, or gave the remainder after the life estate to *X*, *W*'s life estate would be a nondeductible terminable interest. There is, however, no terminable interest which is nondeductible because the interest is to be acquired for the donee spouse under the gift tax.

The only exception to the nondeductible terminable interest rule common to both the estate and gift taxes is the life-estate power-of-appointment exception. The survivorship and insurance exceptions recognized under the estate tax do not apply to the gift tax. However, the gift tax makes an exception to the nondeductible terminable interest rule where a spouse transfers title to property to himself and his spouse as sole joint tenants or tenants by the entirety.

III. Valuation

In general, the same principles of valuation apply to the estate and gift taxes. There is, however, no alternate valuation date under the gift tax; donated property is valued according to its fair market value at the date of the gift.

The same standard of value, fair market value, applies under both taxes, and the Regulations repeat the same tables for valuing limited interests, such as annuities, life estates, terms for years, reversions, and remainders.[233] Life insurance that an insured gives away during his life is valued differently for purposes of the gift tax than the proceeds of insurance included in the decedent's estate,

[233] Treas. Reg. §§ 25.2512-1 to -7 (1958).

for purposes of the estate tax at his death, because of obvious differences in the properties transferred in the two situations.[234]

IV. Computation of the Tax; Split Gifts

The gift tax is computed on a cumulative basis, which means that although only the gifts made in the taxable year are taxed, the rate of tax is determined by the taxpayer's total taxable gifts since 1932. The computation is made by first determining the tax on the taxpayer's total gifts, including his gifts during the taxable year, using current rates and the current exemption, but the exclusions actually in effect at the time the gifts were made. Then a similar tax is computed upon the taxpayer's total taxable gifts in years prior to the taxable year. Since there are no credits against the gift tax, the tax due the government is the difference between the two taxes.

Section 2513 permits a married couple to split their gifts to those outside the marital community. Although splitting gifts will not always save gift taxes, it will ordinarily do so, since it may have the effect of doubling the exclusions and exemptions allowed against the gifts and taxing them in lower brackets. For example, if *H* and *W* have made no previous gifts and *H* gives 100,000 dollars to his son *S*, he will incur a tax of 8,595 dollars on a taxable gift of 67,000 dollars. If he splits his gift with *W*, then each spouse's taxable gift will be 17,000 dollars; his or her gift tax will be 952.50 dollars; and the total tax for both spouses 1,905 dollars.

The gift tax is imposed upon the gifts made during the calendar year. If a taxpayer makes a gift of a present interest to a single donee of more than 3,000 dollars, or a gift of a future interest of any amount, he must file a return (Form 709) by April 15 of the year following the year in which the gift is made.

[234] Upon the insured's death the proceeds of insurance on his life are included in his gross estate for purposes of the estate tax. When life insurance is given away during the insured's life, however, only the then "replacement" value of the life insurance is included in the donor's gross gifts. Guggenheim v. Rasquin, 312 U.S. 254 (1941); United States v. Ryerson, 312 U.S. 260 (1941). When life insurance is taxed to one other than the estate of the insured during the insured's life under the estate tax, it is valued according to its "replacement" value just as it is under the gift tax. Treas. Reg. § 20.2031-8 (1958).