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THE FEDERAL DEATH TAX AND HOW TO LIVE WITH IT

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THIS article is designed to explore the federal estate tax, to explain it, without oversimplifying, and to afford a medium for comment on some of the more important changes made by Congress in its revision of the tax structure of the country by the Internal Revenue Code of 1954. While the authors hope that this article will be of value to the experienced practitioner in the federal estate tax field, it is not primarily aimed at him but rather at the student and the general practitioner who may have been somewhat baffled by the often cumbersome language of the statute. While some of this cumbersomeness has historical justification and is necessary because of troublesome court decisions during the long existence of the federal estate tax, unfortunately it is frequently the source of confusion.

THE NATURE OF THE TAX

The federal estate tax has been construed to be an excise tax.[1] While the term, excise tax, has in popular usage been

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[1] New York Trust Co. v. Eisner, 256 U.S. 345 (1921); Heitsch v. Kavanagh, 200 F.2d 178 (6th Cir. 1952), *cert. denied*, 345 U.S. 939 (1953); *cf.* Bromley v. McCaughn, 280 U.S. 124 (1929) (gift tax).

restricted to the almost infinite variety of taxes on admissions, occupations, and so forth,[2] such a characterization of the estate tax is not only apt but of the utmost significance. For an excise tax is a tax on the doing of something,[3] and the something done which is the subject of the estate tax is the transfer [4] of property at death or under such circumstances that the transfer amounts, in substance, to a disposition at death. An appreciation of this basic concept will strip some of the mystery from the estate tax. For the statute is merely a device to spell out, with certain exceptions dictated by one consideration or another, the types of transfers which are testamentary by nature. The problem of the measure of the tax then becomes merely a question, although often an intricate one, of the value of the property so transferred.

THE STATUTORY SCHEME

The current federal estate tax provisions are set out under Chapter 11 of the 1954 Code (Sections numbered 2001-2056, 2101-2106, and 2201-2207). Although much of the 1939 Code has been left essentially unaltered, some substantive changes in the law have been made. In addition, all the sections have been renumbered and, to some extent, rewritten.[5]

Chapter 11 is divided into three subchapters. The basic provisions of the estate tax grouped under Subchapter A, "Estates of Citizens or Residents," will be discussed in this article. Subchapter B, "Estates of Nonresidents Not Citizens," and Subchapter C, "Miscellaneous," are not discussed since they are of relatively narrow significance.

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[2] INT. REV. CODE OF 1954 (Subtitles D and E).

[3] See note 1 *supra*.

[4] INT. REV. CODE OF 1954, § 2001 (imposes a tax on the "transfer" of the taxable estate).

[5] The most pleasant aspect of the new Code for anyone who has confusedly wandered through the intricacies of Section 811 of the 1939 Code, is the fact that thirteen separately numbered sections have replaced that single section. Three of the new sections deal with the problems contained in Section 811(c) alone.

Except where noted, the provisions of the 1954 Code are applicable to the estates of decedents dying after August 16, 1954.[6]

The basic pattern of the federal estate tax can be illustrated somewhat as follows:

	(a)	What is included and excluded—the gross estate (§§ 2031-2044)
minus	(b)	Exemption ($60,000) (§ 2052)
minus	(c)	Deductions (§§ 2053-2056)
equals	(d)	The taxable estate (§ 2051)
times	(e)	The tax rate (§ 2001)
equals	(f)	The estate tax
minus	(g)	Credits (§§ 2011-2016)
equals	(h)	The amount payable

Thus:

$$a - b - c = d$$
$$d \times e = f$$
$$f - g = h$$

(a) What Goes In—The Gross Estate Sections 2031-2044

While Section 2031 is entitled "Definition of Gross Estate" it really does not define anything. Section 2031 was derived from the first sentence of Section 811 of the 1939 Code and served as a general introductory provision for the specific statutory enumeration of what constituted the gross estate contained in that section. As an introductory provision it served a useful purpose, but standing alone in the new Code under the heading "Definition of Gross Estate" it is not only confusing and misleading but also out of place. Since the only point it adds to the other sections dealing with the gross estate is that the property included in the gross estate will be valued at its date of death value, it really is a valuation provision and will be discussed hereafter when that

[6] Int. Rev. Code of 1954, § 7851(a)(2)(A).

subject is treated. It would seem more logical first to discover what property is includible in the gross estate and only then to determine the value of such includible property.

Thus, there is no comprehensive definition of the term "gross estate" contained in the new Code. In order to discover what property transfers are includible in the gross estate, it is necessary to adopt a section by section approach to the problem and consider Sections 2033 to 2044 inclusive.

Property Owned by the Decedent at the Time of Death—Section 2033

Section 2033 replaces Section 811(a) of the 1939 Code without substantial change. The regulation (Reg. 105, § 81.13) and rulings promulgated under the corresponding section of the 1939 Code are of substantial force and effect in the interpretation of this provision and the court decisions are undoubtedly binding. Hereinafter, a description of a section in the 1954 Code as "substantially unchanged" from its predecessor in the 1939 Code will indicate that the regulations, rulings and court decisions under the old provision retain their vitality. The applicable regulation will be indicated in parentheses.

Section 2033 subjects property owned by the decedent at his death to the estate tax. In the ordinary situation most estates will be taxed almost entirely under this provision. The section extends to all property of every kind and description, except real property located outside the United States,[7] in which the decedent had an interest, to the extent that he owned the interest, at the time of his death.[8] This problem of ownership is governed by state law[9] and is twofold: did

[7] Personal property wherever located is taxable. Guaranty Trust Co. v. Commissioner, 79 F.2d 245 (2d Cir. 1935). The exception for foreign real estate is apparently based on the old common-law principle that the country in which real estate is located has exclusive control over it and, accordingly, the exclusive power to tax its transfer. *Cf.* 31 OPS. ATT'Y GEN. 287 (1918). The newer principle, that this same exclusive dominion extends to tangible personal property permanently located within a state's borders [Frick v. Pennsylvania, 268 U.S. 473 (1925)], is applicable to the states, but has not been extended to the international sphere. Guaranty Trust Co. v. Commissioner, *supra.*

[8] Helvering v. Safe Deposit & Trust Co., 316 U.S. 56 (1942).

[9] Sharp v. Commissioner, 303 U.S. 624 (1938), *reversing per curiam,* 91 F.2d

the decedent have an interest at death [10] and, if so, could he transfer it at death? [11] Vested remainders,[12] possibilities of reverter,[13] accrued income,[14] and claims of the decedent [15] are examples of property interests which must be included in the gross estate. However, interests of the decedent, created by persons other than himself,[16] which terminate upon his death, such as life estates [17] and remainders contingent upon survival,[18] are not includible since such interests are extinguished by the decedent's death and, in any case, are not transferred by the decedent, because they cannot be.

Comment: Many property interests owned by the decedent at the time of his death which could be logically included in the gross estate by virtue of the very general language of Section 2033 are also includible under the more specific provisions of other sections. These other sections, however, generally provide that the entire value of the property subject to certain types of interests is includible, while Section 2033 would only include the value of the interest. It is to be noted that Congress made no attempt to extend the scope of this section to include situations where the only interest of the decedent lies in economic control over, or a "bundle of rights" in the property which would require the inclusion of the in-

804 (3d Cir. 1937); Smith's Estate v. Commissioner, 140 F.2d 759 (3d Cir. 1944).

[10] Of course, interests such as those of a trustee are not sufficient to come within the scope of Section 2033. Reed v. Commissioner, 36 F.2d 867 (5th Cir. 1930). In any event, such an interest would not ordinarily be transferable at death.

[11] See Commissioner v. Rosser, 64 F.2d 631 (3d Cir. 1933).

[12] Frazer's Estate v. Commissioner, 162 F.2d 167 (3d Cir. 1947).

[13] Estate of Sallie Houston Henry, 4 T.C. 423 (1944), *aff'd,* 161 F.2d 574 (3d Cir. 1947). If the possibility of reverter lapses with the transferor-decedent's death, it will not be includible under Section 2033. Rev. Rul. 438, 1955 INT. REV. BULL. No. 27, at 31. In some cases the retention of a possibility of reverter might subject the entire property to the tax under Section 2037 of the 1954 Code.

[14] Estate of G. Percy McGlue, 41 B.T.A. 1199 (1940). As to income accruing after death, *compare* Bull v. United States, 295 U.S. 247 (1935), *with* McClennen v. Commissioner, 131 F.2d 165 (1st Cir. 1942).

[15] Parrott v. Commissioner, 30 F.2d 792 (9th Cir.), *cert. denied,* 279 U.S. 870 (1929).

[16] If such interests were created by the decedent they may be taxable under the provisions of Sections 2036-2042 of the 1954 Code.

[17] Frew v. Bowers, 12 F.2d 625 (2d Cir. 1926).

[18] Commissioner v. Rosser, 64 F.2d 631 (3d Cir. 1933).

come from the property in the decedent's income under the *Clifford* doctrine.[19]

Transactions in Contemplation of Death—Section 2035

Section 2035 replaces Section 811(c)(1)(A) and Section 811(l) of the 1939 Code without substantial change (Reg. 105, § 81.16).

While it is readily apparent that property owned by the decedent at his death is and should be included in his gross estate, it is not so clear that, in addition, property which the decedent had under certain circumstances validly and effectively transferred during life, should also be included in the estate. However, certain inter vivos transfers are by nature so testamentary in character and substance—although not testamentary in the common-law property sense—that there is no sufficient reason for treating the transfers any differently than transfers by will or intestacy for the purposes of the application of an intensely practical federal estate tax, which strives for equality and fairness between taxpayers similarly situated.

The most common illustration of an inter vivos transfer which is the subject of the estate tax is the transfer in contemplation of death. In general, a gift in contemplation of death is a transfer which has as its impelling cause the thought of death rather than motives associated with life.[20] Such transfers should not be confused with the revocable gifts causa mortis of local property law which are sometimes referred to as gifts in contemplation of death. There is an entirely distinct characterization of that term for federal estate tax purposes and, while the definition includes common-law causa mortis gifts, its scope is far more inclusive.[21] The most frequently advanced criteria for determining the motive of the transfer, whether thought of life or thought of death,[22]

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[19] Helvering v. Clifford, 309 U.S. 331 (1940). The Government's attempt to include such property in the gross estate under Section 811(a) of the 1939 Code, the predecessor of Section 2033, was frustrated in Helvering v. Safe Deposit & Trust Co., 316 U.S. 56 (1942). Sections 671-678 of the 1954 Code constitute codification of the *Clifford* doctrine for income tax purposes.

[20] See United States v. Wells, 283 U.S. 102 (1931).

[21] *Ibid.*

[22] *Cf.* City Bank Farmers Trust Co. v. McGowan, 323 U.S. 594 (1945).

are the age of the donor,[23] his physical condition,[24] his plans for the future,[25] and the nature of the property, whether productive or unproductive.[26] By special legislative pronouncement, gifts made more than three years prior to death, even though made in contemplation of death, are excluded from the application of the statute. On the other hand, gifts made within three years of death are rebuttably presumed to have been made in contemplation of death.[27]

Comment: Section 2035 represents a fine illustration of the convenient union of two related provisions which were widely separated in the 1939 Code. It is interesting to note that, for no apparent reason, the title of the section has been changed from "Transfers in Contemplation of Death" to "Transactions in Contemplation of Death."

Transfers With a Retained Life Estate or a Retained Right to Govern Enjoyment—Section 2036

Section 2036 replaces Section 811(c)(1)(B) of the 1939 Code without substantial change (Reg. 105, § 81.16).

This section illustrates the second form of transfer during life which subjects the property previously transferred to the estate tax. If the decedent made an effective inter vivos disposition of property but retained, for a period which is in effect his own life, the possession, enjoyment or income from the property,[28] or the right either alone or with any other person to designate the persons who should possess or enjoy the property or receive the income therefrom,[29] the value of

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[23] See, *e.g.*, Updike v. Commissioner, 88 F.2d 807 (8th Cir.), *cert. denied*, 301 U.S. 708 (1937).

[24] See, *e.g.*, Percy B. Eckhart, 33 B.T.A. 426 (1935).

[25] See, *e.g.*, Wishard v. United States, 143 F.2d 704 (7th Cir. 1944).

[26] See, *e.g.*, Reeves' Estate v. Commissioner, 180 F.2d 829 (2d Cir.), *cert. denied*, 340 U.S. 813 (1950). *But see* Aaron's Estate v. Commissioner, 224 F.2d 314 (3d Cir. 1955).

[27] A conclusive presumption that gifts made within two years of death were made in contemplation of death has been held unconstitutional. See Heiner v. Donnan, 285 U.S. 312 (1932). Since the determination of the Commissioner already enjoys a presumption of correctness, it is not clear what the effect is of this additional specific presumption.

[28] For example, *D* transfers property in trust to *X*, as trustee, to pay the income from the property to *D* for his life and then to distribute the corpus to *Y* or his heirs.

[29] For example, *D* transfers property in trust to *X*, as trustee, to pay the

the property so transferred is included in his gross estate. This type of transfer is regarded for estate tax purposes as transferring nothing during life since the decedent has maintained until death either the financial benefit of the property or the right to control the property. The transferee, in substance, does not receive anything until the intervening life estate or the right of control is extinguished by the death of the decedent. Transfers of this type are includible only if they were made after March 3, 1931, for Section 2036(b) continues in effect the rule of *May v. Heiner*[30] which exempted such transfers under the estate tax law existing at the time.

Comment: There is much overlap between the provisions of this section dealing with the retention of the right during the transferor's life to control the possession or enjoyment of property or to designate the recipients of the income therefrom, and Section 2038 which deals with the taxability of transfers with the power to change enjoyment retained.[31] Transfers prior to May 4, 1931 with a retained life estate may constitutionally be subject to the estate tax because *Commissioner v. Estate of Church*[32] overruled *May v. Heiner.*

Transfers Not Completely Effective Until Death—Section 2037

Section 2037 replaces Section 811(c)(1)(C), Section 811(c)(2) and (3) with two substantial changes. Reg. 105, § 81.17 may be partially effective, particularly subdivision (c) which would appear to be applicable regardless of the date of the transfer.

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income as *D* may direct during his life and at *D*'s death to distribute the corpus to *Y* or his heirs.

[30] 281 U.S. 238 (1930). While the principle that a transfer with a life estate retained does not constitute an essentially testamentary disposition is generally referred to as the doctrine of *May v. Heiner*, it was not until three decisions were rendered by the Supreme Court, per curiam, on March 2, 1931 [Burnet v. Northern Trust Co., 283 U.S. 782 (1931); Morsman v. Burnet, 283 U.S. 783 (1931); McCormick v. Burnet, 283 U.S. 784 (1931)] that this principle became apparent. Within thirty-six hours Congress overruled these decisions. 46 STAT. 1516 (1931) (Joint Resolution of March 3, 1931).

[31] See, *e.g.*, Industrial Trust Co. v. Commissioner, 165 F.2d 142 (1st Cir. 1947).

[32] 335 U.S. 632 (1949). The Technical Changes Act § 7(b), 63 STAT. 895 (1949), overruled the *Church* decision.

Another form of inter vivos transfer which will be considered essentially testamentary in nature for purposes of the estate tax is the transfer under which the transferor retains such an interest, or string, in the property transferred that effective possession or enjoyment of the property, as defined by Section 2037, is not realized until the death of the transferor.[33]

For Section 2037 to be operative two conditions must be met. In the first place, the decedent, *D*, must have transferred an interest in his property to another, *X*, under such circumstances that *X* can possess or enjoy the property under the interest transferred *only* if he survives *D*. For example, this requirement would be met if *D* transferred property to *A* for life and then back to *D*, if living, and, if not, to *X*, since *X* must survive *D* in order to obtain the property. This requirement would not be met, however, if *D* transferred property to *A* for life and then to *X*, if living, and, if not, back to *D*, since *X* is not required to survive *D* in order to take, for both *X* and *D* could be alive at the death of *A* and still *X* would obtain the property.[34] The second condition which must be met before Section 2037 becomes operative is that the decedent must have reserved some interest in the property under which the property itself (not merely the income from the property) or control over its disposition may be returned to him, and this interest must have a value, immediately before the decedent's death, of more than 5% of the property transferred. In other words, the transferor must have better than one chance in twenty of getting the property back.

The following illustration will serve to demonstrate the fulfillment of both conditions contained in Section 2037. A young wife, *W*, transferred property in trust, providing for the payment of income to her elderly husband, *H*, during his life and at his death for the payment of the corpus to her, if living, and, if not, to *X*. Two consequences may flow from

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[33] The statutory predecessors of Section 2037 have had a tumultuous history in the courts. See, *e.g.*, Estate of Spiegel v. Commissioner, 335 U.S. 701 (1949); Helvering v. Hallock, 309 U.S. 106 (1940); Helvering v. St. Louis Trust Co., 296 U.S. 39 (1935) (overruled by the *Hallock* case, *supra*); Klein v. United States, 283 U.S. 231 (1931).

[34] Commissioner v. Marshall's Estate, 203 F.2d 534 (3d Cir. 1953).

this transfer. First, if *W* survives *H*, she gets the property back and the whole transaction has no estate tax effect because the property will be included in her gross estate as property owned by her at her death under the provisions of Section 2033, discussed above. On the other hand, if *W* predeceases *H*, the value of *X*'s remainder interest will be includible in *W*'s gross estate, that is, the entire value of the property transferred, less *H*'s remaining life estate. Since *H*'s life estate was indefeasibly vested by the original transaction, whatever value it still has at the time of *W*'s death should be deducted from the value of the property previously transferred. *W* chose to make a transfer from which one of two possible consequences could flow, depending upon the time of her death. Since the eventuation of the first consequence would subject the entire property to inclusion in her gross estate, it seems logical also to include the property, if, in the alternative, the second consequence results. Because of the age and sex differential between *W* and *H*, it is clear that the value of *W*'s reversionary interest is more than 5% of the value of the property immediately prior to *W*'s death; she had a better than twenty to one chance of getting the property back.

Under Section 811(c)(3) of the 1939 Code, enacted following the decision of the Supreme Court in *Estate of Spiegel v. Commissioner*[35] and applicable to transfers made after October 7, 1949, a condition of survivorship alone, the first condition discussed above, was enough to subject the property to the estate tax even though the transferor retained no reversionary interest.[36] Moreover, this section of the 1939 Code provided for the inclusion of property in the gross estate if it were transferred under such circumstances that possession or enjoyment could be obtained under two or more alterna-

[35] 335 U.S. 701 (1949).

[36] For example, if *D* transferred property in trust, to pay the income to *A* for *D*'s life and at *D*'s death to pay the corpus to *C* or *C*'s heirs, the property was includible in *D*'s estate. The rejection of this as the sole test in the 1954 Code reinstates the rule of Reinecke v. Northern Trust Co., 278 U.S. 339 (1929).

tives, one of which was outliving the transferor, and the transferor died before any other alternative materialized.[37]

The new Code provision does not substantially change the law previously applicable to transfers made on or before October 7, 1949, and, with one exception, makes the law applicable to transfers made after such date the same as that applying to the earlier transfers. For transfers made prior to October 8, 1949, the requisite reversionary interest must arise by the express terms of the instrument in order for the property to be includible, while for transfers made after October 7, 1949, the property will be subject to tax even if the reversionary interest arose merely by operation of law.

Comment: The two changes made in the new Code are highly commendable. If the decedent had previously parted with all his interest in the property, that is, had retained no reversionary interest of any kind in it, there does not seem to be any reason for including the property in his gross estate simply because his death marked the time for the shifting of interests in the property. Moreover, if, in fact, survivorship was not required for possession of the property, there seems to be no reason for taxing the property simply because the transferor dies before the other circumstance eventuates. On the other hand, a literal reading of the present statute, "possession . . . can . . . be obtained *only* by surviving the decedent" (emphasis added), would exclude situations where possession can be obtained under either of two alternatives, one of which is survivorship and the other of which is unreal (for example, on January 1, 2055 or on transferor's death, whichever first occurs). It can be anticipated that the Commissioner and the courts will have no difficulty with such a device.[38]

It is to be noted that if the transferor's reversionary interest is not more than 5% of the value of the property, that is, he has only one chance in twenty or less of getting the property back, the value of the chance would be includible

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[37] For example, if *D* transferred property to *X* until *Y* reached 30 or *D* died, and then to *Y*, the value of the property would have been includible in *D*'s gross estate in the event that *D* died before *Y* reached 30.

[38] *Cf.* U.S. Treas. Reg. 105, § 81.17 (1939), as amended, T.D. 6078, 1954-2 CUM. BULL. 286 (last sentence of first paragraph in subdivision (c)).

under Section 2033. However, if the value of the reversionary interest is more than 5% of the value of the property (for example, he has one chance in nineteen) the entire value of the property is includible under Section 2037.[39] This is an example of line-drawing which leads to more or less arbitrary results.

Transfers With the Power to Change Enjoyment Retained—Section 2038

Section 2038 replaces Section 811(d) of the 1939 Code without any substantial change (Reg. 105, § 81.20).

Still another type of inter vivos transfer which will subject the property so transferred to the estate tax is the transfer wherein the transferor reserved in himself alone, or in himself and any other person, the right to alter, amend, revoke or terminate the enjoyment of the property transferred and this right was retained until the date of decedent's death or was released in contemplation of death.[40] In the case of transfers made on or before June 22, 1936, this power to amend, and so forth, must have been derived from a right reserved at the time of transfer, while in the case of transfers after that date a power in the grantor regardless of its source will result in includibility.[41] The reservation of a power to change the enjoyment of property is the retention of a substantial string. In some cases, the transferor would hold as much power over the donees as one who had made no transfer would hold over the persons who expected or hoped to be remembered in his will. No donee can be certain what he is getting until this power of alteration is extinguished and, if death causes the extinguishment, there is every reason in logic and justice to include the property in the gross estate. The courts have broadly interpreted this provision and included in the gross estate property which was transferred subject

[39] This principle is discussed under the *Comment* regarding Section 2033.

[40] The test as to what constitutes a release in contemplation of death is the same as the one applicable to transfers in contemplation of death generally, and the three-year presumptions are the same. INT. REV. CODE OF 1954, § 2035(b).

[41] White v. Poor, 296 U.S. 98 (1935).

only to a power in the donor to terminate the trust and accelerate the remainders which were already vested.[42]

Comment: Since the only difference between transfers made on or before June 22, 1936 and those made after that date is the source of the power to change enjoyment, there seems to be little justification for two separate complete subparagraphs based on this date and for differences in phraseology between the paragraphs which are of no significance whatever.[43]

Annuities—Section 2039

Section 2039 is completely new. It clarifies existing case law and rulings, for example, Rev. Rul. 158, 1953–2 CUM. BULL. 259 and Rev. Rul. 260, 1953–2 CUM. BULL. 262.

Under the 1939 Code and prior Revenue Acts the value of an annuity, receivable by reason of surviving a decedent who was a joint annuitant or the primary annuitant and who had contributed the purchase price or a portion thereof of the annuity, was includible in the decedent's gross estate either as a transfer with a reserved life estate under the predecessors of Section 2036,[44] or as a transfer not effective until death under the predecessors of Section 2037,[45] or in some cases, as a transfer with the power to change enjoyment retained under the predecessors of Section 2038.[46]

Section 2039 of the 1954 Code for the first time in the federal revenue laws makes explicit provision for the estate taxation of annuities. Probably in recognition of the principle founded on *May v. Heiner,*[47] dealing with transfers with a retained life estate made before March 4, 1931, discussed above under Section 2036, the annuity provision is applicable only to annuity contracts entered into on or after that date. Under this section, the value of a survivor's interest under

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[42] Lober v. United States, 346 U.S. 335 (1953).
[43] See Commissioner v. Estate of Holmes, 326 U.S. 480 (1946); U.S. Treas. Reg. 105, § 81.20(a) (1939), as amended, T.D. 6073, 1954–2 CUM. BULL. 280.
[44] Mearkle's Estate v. Commissioner, 129 F.2d 386 (3d Cir. 1942); *cf.* Commissioner v. Twogood's Estate, 194 F.2d 627 (2d Cir. 1952).
[45] Rev. Rul. 260, 1953–2 CUM. BULL. 262.
[46] *Ibid.*
[47] 281 U.S. 238 (1930).

the decedent's annuity is includible in the decedent's gross estate in proportion to the decedent's contribution to the total purchase price. For example, if a husband were to pay three-quarters of the cost of a joint annuity for himself and his wife, and someone else, not necessarily the wife, were to pay the other one-quarter, three-quarters of the value of the wife's right to receive the annuity [48] would be includible in the husband's gross estate. If the annuity arises from the decedent's employment, the payments made by the employer are regarded as payments by the decedent unless the annuity is receivable under an employees' trust which meets the requirement for qualification under Section 401(a) of the new Code, or under a plan which meets the non-discriminatory provisions of Section 401(a)(3) of the new law. In the case of such trusts or plans only the amounts contributed by the decedent are regarded as made by him and the employer's contributions are treated as contributed by someone other than the decedent. While generally the annuity provisions are applicable only to decedents dying after August 16, 1954, the provision dealing with the non-attribution to the decedent of contributions for annuities by an employer to a qualified trust or a non-discriminatory plan is applicable to decedents dying after December 31, 1953, the effective date of the new income tax provisions dealing with annuities.[49]

Comment: The question arises as to whether annuity contracts executed prior to March 4, 1931, which are explicitly excluded from the operation of Section 2039, will continue to be governed by the other provisions of the estate tax law, specifically, as transfers effective at death or as transfers with a power to revoke, as they were before the enactment of this special annuity section. Similarly, questions are bound to arise as to what constitutes a payment by a decedent, particularly since this new section does not use the phrase "paid directly or indirectly" which was contained in Section 811(g) of the 1939 Code, dealing with the payment

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[48] Under prior law there was considerable confusion concerning the valuation of the surviving annuitant's rights. *Compare* Mearkle's Estate v. Commissioner, *supra* note 44, *with* Estate of William J. Higgs, 12 T.C. 280 (1949), *rev'd on other grounds*, 184 F.2d 427 (3d Cir. 1950).

[49] INT. REV. CODE OF 1954, §§ 2039(c), 7851(a)(1)(A).

of premiums on life insurance.[50] This section offers a further example of the discrimination in favor of employees who are fortunate enough to work for an employer who establishes a qualified employees' trust. In such a case, the employee does not pay income tax on the contributions of the employer and at death the value of the annuity attributable to the contributions of the employer will be excluded from the gross estate. On the other hand, if the employee is not covered by such a trust, he will have to pay income tax on the income he receives and uses to purchase an annuity and his gross estate will be increased by the value of the annuity attributable to these payments.

Insurance—Section 2042

Section 2042 replaces Section 811(g) of the 1939 Code with a substantial change. However, Reg. 105, §§ 81.25, 81.26, 81.28 and parts of 81.27 would appear to be still applicable.

Insurance proceeds that are payable to a decedent's estate are included in the gross estate.[51] However, insurance proceeds payable to other beneficiaries are includible only if the decedent possessed an incident of ownership in the policy at his death. Incidents of ownership include the power to change the beneficiary, to surrender or cancel the policy, to assign it, to pledge it for a loan and so forth.[52] An incident of ownership also includes a reversionary interest arising expressly or by operation of law, which might include a possibility that the proceeds would be payable to decedent's estate,[53] if the value of such interest exceeds 5% of the value

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[50] *Cf.* U.S. Treas. Reg. 105, § 81.27 (1939), as amended, T.D. 6073, 1954-2 CUM. BULL. 280.

[51] Insurance proceeds payable to the estate were held taxable under the predecessor of Section 2033 [Mimnaugh v. United States, 66 Ct. Cl. 411 (1928), *cert. denied,* 280 U.S. 563 (1929)] prior to enactment of the predecessor of Section 2042.

[52] See Commissioner v. Treganowan, 183 F.2d 288 (2d Cir.), *cert. denied,* 340 U.S. 853 (1950); Bailey v. United States, 90 Ct. Cl. 644, 31 F. Supp. 778, *cert. denied,* 311 U.S. 721 (1940); U.S. Treas. Reg. 105, § 81.27(c) (1939), as amended, T.D. 6073, 1954-2 CUM. BULL. 280.

[53] *Cf.* INT. REV. CODE OF 1954, § 2037; Goldstone v. United States, 325 U.S. 687 (1945).

of the policy immediately before the decedent's death.[54] While the statute does not specifically so provide, it is probable that the transfer of an incident of ownership in contemplation of death under Section 2035 would subject the proceeds of life insurance to tax by virtue of this latter section.[55] Under Section 811(g) of the 1939 Code, insurance proceeds were also includible in the gross estate, in an amount proportionate to the percentage of premiums paid directly or indirectly by the decedent after January 10, 1941, even though the decedent retained no incident of ownership. The new Code abolished this premium payment test.[56]

Comment: Insurance proceeds are by nature testamentary.[57] Even though one may own no incident of ownership on a policy on his own life, when he pays premiums he is thinking of providing a fund at his death for the beneficiary of the policy. This fund constitutes the greater economic value of the policy and usually is the predominant reason for making the payments. It would not seem illogical to argue that the payment of premiums constitutes a transfer that is not completely effective until death.[58] On the other hand, as pointed out by the Senate Finance Committee,[59] no other property is subject to the estate tax when the decedent long before death has divested himself of all incidents of ownership in it. The new provision eliminates the troublesome requirement of determining what payments were made indirectly by the decedent. Insofar as any reversionary interest is concerned, the insured can prevent any such interest from arising in his favor by operation of law by assigning all reversionary interests to a tax-exempt organization.

In revising the estate tax law, Congress made no effort to clarify the complex problem of what constitutes insur-

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[54] Bank of New York v. United States, 115 F. Supp. 375 (S.D. N.Y. 1953); Ford v. Kavanaugh, 108 F. Supp. 463 (E.D. Mich. 1952).

[55] *Cf.* May Billings, 35 B.T.A. 1147 (1937); U.S. Treas. Reg. 105, § 81.25 (1939), as amended, T.D. 5239, 1943-1 CUM. BULL. 1081.

[56] This direct or indirect test has been the source of controversy. See, *e.g.*, Estate of Albert Dudley Saunders, 14 T.C. 534 (1950).

[57] Garrett's Estate v. Commissioner, 180 F.2d 955 (2d Cir. 1950).

[58] See H.R. REP. No. 1337, 83d Cong., 2d Sess. B14 (1954) (Minority views of the House Ways and Means Committee).

[59] See S. REP. No. 1622, 83d Cong., 2d Sess. 124 (1954).

ance.[60] The draftsmen might well have placed this section closer to the provision dealing with annuities. With the elimination of the premium payment test, the problem arises as to whether premium payments made within three years of death are transfers in contemplation of death and includible under Section 2035.

Joint Interests—Section 2040

Section 2040 replaces Section 811(e) of the 1939 Code without any substantial change (Reg. 105, § 81.22). This section provides that all property held by the decedent in joint tenancy or in tenancy by the entirety shall be included in his gross estate except to the extent that the survivor can show that the property originally belonged to him or can show consideration in money or money's worth.[61] If the property was originally received as a gift or inheritance from a third party by two tenants as joint tenants, only one-half of the value of the property will be includible in the decedent's gross estate. The same principle applies if there are more than two tenants. It should be noted that this section does not apply to tenancies in common, which interests are taxable under Section 2033.

Comment: The establishment of a joint tenancy by a person is another example of a transfer wherein the transferor retains a substantial string on the property which is not broken until death. It seems clear that property held in such tenancy should be subject to the estate tax in accordance with the provisions of Section 2040 and the survivor should bear the burden of tracing the consideration for the property.[62] Section 2515 provides that the creation of a tenancy by the entirety in real property by one of the spouses will not give rise to the gift tax unless the parties so elect. A hardship, in regard to the basis to the survivor of property orig-

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[60] See Helvering v. Le Gierse, 312 U.S. 531 (1941); Commissioner v. Treganowan, 183 F.2d 288 (2d Cir.), *cert. denied,* 340 U.S. 853 (1950); Estate of John C. Morrow, 19 T.C. 1068 (1953).

[61] See Harvey v. United States, 185 F.2d 463 (7th Cir. 1950).

[62] See Estate of Joseph H. Heidt, 8 T.C. 969 (1947), *aff'd per curiam,* 170 F.2d 1021 (9th Cir. 1948).

inally held in joint tenancy existing under prior law,[63] has been eliminated by Section 1014(b)(9) of the 1954 Code which provides that the property shall have the date of decedent's death value to the extent it was included in his gross estate, rather than the value of the property as of the creation of the tenancy.

Powers of Appointment—Section 2041

Section 2041 replaces Section 811(f) of the 1939 Code without substantial change (Reg. 105, § 81.24). If a decedent dies with power to designate the persons who shall receive property, he has at death substantial power over that property even if he were not the transferor of that property.[64] Congress has, however, refrained from exercising its full estate taxing rights over the possessor of such a power [65] and has restricted the tax on property subject to a power of appointment to relatively narrow grounds. In the first place, the tax is applicable only if the power is one that is termed a "general power," with a single exception in the case of a power creating a new power which postpones vesting. A "general power" is defined as including only a power that is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate. However, a power to invade under a reasonable standard for invasion will not be construed as enabling the possessor of the power to appoint it to himself. In addition, in the case of a power created prior to October 22, 1942, the power will not be considered a general power if it is exercisable only in connection with another person and, in the case of a power created after October 21, 1942, it will not be considered a general power if it is exercisable only in connection with the creator of the power or with someone having a substantially adverse interest in the property.

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[63] See Lang v. Commissioner, 289 U.S. 109 (1933).

[64] Powers of appointment should be distinguished from situations where the transferor of the property in question retained an interest or power therein under Sections 2036-2038.

[65] Section 403 of the Revenue Act of 1942 extensively revised Section 811(f) of the 1939 Code and provided for much broader taxation of powers of appointment. The scope of the section was considerably narrowed by Section 2 of the Powers of Appointment Act of 1951 which is the basis for Section 2041 of the 1954 Code.

Once it is established that the power is a "general power" under these tests, still a further inquiry is necessary to determine whether the property subject to the power is includible in the gross estate. In the case of a power created before October 22, 1942, the general power must be exercised by will or by a disposition [66] (not including a complete release) that is essentially testamentary in nature, such as where the decedent retains a substantial string on the power until death. In the case of a general power created after October 21, 1942, mere possession of such a power at the time of death or the release of it under testamentary circumstances within the meaning of Sections 2035-2038 is enough to require the inclusion of the property subject to the power within the gross estate. The statute also contains further limitations dealing with the partial release of certain general powers [67] and the lapse of others.[68]

Comment: The narrowing of what constitutes a taxable power of appointment has resulted in an unnecessarily complicated statutory provision. This reflects the intention of Congress to permit flexibility in property dispositions where the creator of the power is in no position to estimate the future needs of the beneficiaries. However, it also enables a decedent to transmit property from one generation to another without incurring any estate tax liability.[69]

Dower and Curtesy—Section 2034

Section 2034 replaces Section 811(b) without substantial change (Reg. 105, § 81.14). This section includes within the gross estate the value of the interest of a surviving spouse, such as dower, curtesy or the statutory substitute therefor.[70] This section was originally considered necessary in order to avoid the effect of decisions [71] which held, under state tax

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[66] Estate of Rogers v. Commissioner, 320 U.S. 410 (1943); *cf.* Helvering v. Grinnell, 294 U.S. 153 (1935).

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

[68] *Id.* § 2041(b)(2).

[69] For example, *D* to *A* for life and at *A*'s death as he shall appoint by will under a special power.

[70] *E.g.*, N.Y. DEC. EST. LAW § 18.

[71] See, *e.g.*, Matter of Starbuck, 137 App. Div. 866, 122 N.Y. Supp. 584 (2d Dep't 1910), *aff'd mem.*, 201 N.Y. 531, 94 N.E. 1098 (1911).

laws, that property received by the surviving spouse by dower, curtesy or the like was not includible because such interest does not pass from the decedent but arises by operation of law.

Comment: This section does not provide for the inclusion in the gross estate of property which would not be otherwise includible. Rather it has the negative effect of precluding the exclusion of property because of technical common-law property rules. For this section to be operative, the decedent must have at the time of his death an interest in the property which would be includible in his estate under one of the other sections pertaining to gross estate.[72] The draftsmen of the Code might well have placed this section adjacent to Section 2043 due to the fact that these sections are overlapping to some extent.[73]

Transfers for Insufficient Consideration—Section 2043

Section 2043(a) replaces Section 811(i) of the 1939 Code without substantial change (Reg. 105, § 8115) and Section 2043(b) replaces a small portion of Section 811(b) without substantial change (Reg. 105, § 8129).

If property or an interest in property is transferred as a result of a bona fide sale for an adequate and full consideration in money or money's worth, that property or that interest is not includible in the gross estate even though the circumstances under which the sale took place might, under a literal reading of Sections 2035-2038 or Section 2041, constitute the transfer a testamentary disposition.[74] This provision is absolutely sound, because, under the hypothesis of a bona fide sale, the amount of the decedent's property which will be includible in the gross estate is not decreased, but one form of property merely takes the place of another.

If, however, the property or the interest in property was transferred for some consideration in money or money's worth, but the full value of the property or interest was not

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[72] Estate of Harry E. Byram, 9 T.C. 1 (1947).
[73] See Empire Trust Co. v. Commissioner, 94 F.2d 307 (4th Cir. 1938).
[74] Mary E. McDonald, 2 B.T.A. 1295 (1925).

received, there is no reason for excluding from the gross estate the excess of what was given over what was received. Accordingly, Section 2043(a) provides that, in the latter case, the fair market value at the time of decedent's death of the property transferred under testamentary circumstances is includible in the gross estate, less the value of the consideration received by the decedent. In order to constitute a bona fide sale the transfer must have been made in good faith, and the price received must have been an adequate and full equivalent reducible to a money value for the property transferred.[75]

Property transferred to obtain the relinquishment of dower, curtesy, the statutory estate created in lieu thereof or of other marital rights in the decedent's property furnishes the consideration for common-law contracts. As demonstrated above, however, Section 2034 provides that these marital interests of a surviving spouse shall be includible in the decedent's gross estate. Accordingly, it would be an anomaly to require the inclusion of a dower interest of a surviving spouse, while at the same time exempting property transferred under circumstances essentially testamentary in nature to the spouse under contracts supported by the consideration of the relinquishment of this same right.[76] Thus, Section 2043(b) provides that the relinquishment of such marital rights will not be considered consideration in money or money's worth.

Comment: It has been well established that the relinquishment of support rights by a spouse or child is not one of the other "marital rights" referred to in this section.[77] In addition, a decree of separation or divorce which incorporates an agreement requiring the decedent to transfer property to his spouse in satisfaction of rights of dower, curtesy or the statutory equivalent has been found to furnish full consideration for the transfer, the court refusing to look through the

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[75] U.S. Treas. Reg. 105, § 81.15 (1939), as amended, T.D. 6016, 1953-1 CUM. BULL. 391. See also U.S. Treas. Reg. 108, § 86.8 (1940) (gift tax regulation); Commissioner v. Wemyss, 324 U.S. 303 (1945).

[76] See Empire Trust Co. v. Commissioner, *supra* note 73.

[77] E.T. 19, 1946-2 CUM. BULL. 166.

transaction to its basic source.[78] On the other hand, if the agreement is operative outside of the court decree, the usual rule applies.[79] It must be noted that under Section 2516 of the gift tax law such agreements need no longer be dependent upon a court decree in order to furnish consideration in money's worth for purposes of that tax, provided a decree of divorce is entered within two years of such agreement. There is a question as to whether this provision will be absorbed into Section 2043(b).

Valuation of Property Included in the Gross Estate—Section 2031

Section 2031 replaces the first sentence of Section 811(a) without substantial change (Reg. 105, §§ 81.10, 81.12, 81.28).[80]

The property includible in the gross estate is, with the exception provided in Section 2032, discussed below, valued at the date of decedent's death. This provision is applicable not only to property owned in possession and enjoyment by the decedent at his death which is taxable under Section 2033, but also to all property required to be included under Sections 2035-2043.

The problem arises as to what is the date-of-death value of the property. The value used is the "fair market value" which is defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell." [81] Often, however, property and interests in property have no ready marketability and, therefore, special methods have been set up to approximate this fair market value.[82]

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[78] Commissioner v. Maresi, 156 F.2d 929 (2d Cir. 1946). A similar result has been reached under the gift tax. See Harris v. Commissioner, 340 U.S. 106 (1950).

[79] Bank of New York v. United States, 115 F. Supp. 375 (S.D. N.Y. 1953).

[80] See text *Comment* dealing with the gross estate generally (Sections 2031-2044).

[81] U.S. Treas. Reg. 105, § 81.10(a) (1939), as amended, T.D. 5906, 1952-1 CUM. BULL. 155.

[82] For example, the fair market value of a future interest is calculated under Mortality Tables set out in U.S. Treas. Reg. 105, § 81.10(i) (1939), as amended, T.D. 5906, 1952-1 CUM. BULL. 155. The factors to be considered in valuing shares of stock of closely held corporations have been set out in Rev.

Comment: As noted above, Section 2031 is misplaced and misnamed. In addition, there appears to be no justification for the existence of Section 2031(b) which deals with one aspect of the problem of valuing one type of property, unlisted stocks and securities. Since so many factors are involved in valuing such stocks and securities,[83] it is unfortunate that the statute is cluttered by one, the sales price of comparable securities on exchanges, which is certainly of relatively small applicability.

Alternative Valuation—Section 2032

Section 2032 replaces Section 811(j) of the 1939 Code without substantial change (Reg. 105, § 81.11).

Since the value of property may drop sharply in the process of administration, as happened in many cases as an aftermath of the depression of 1929, the decedent's executor is given the election to value the property as of the date of death or one year later. The executor has up until the time of filing the estate tax return to make the decision most favorable to the estate. If the election is made to use the optional valuation date, it applies to all property includible in the gross estate except property sold or disposed of prior to the optional valuation date, which is valued as of the date of sale or other disposition. However, values of interests which are affected by *mere* lapse of time, such as terms for years,[84] are not reduced simply because of the passage of the year. Of course, if property is valued at a date one year after death, deductions must also be so valued, with safeguards to prevent a double deduction in the case of losses to property between the date of death and the alternate valuation day.

Comment: While there is an improvement in placing this section, Section 811(j) of the 1939 Code, closer to Section 2031, Section 811(a) of the 1939 Code, it would have

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Rul. 77, 1954-1 CUM. BULL. 187. The valuation of life insurance policies payable to third parties presents complex problems treated specially by U.S. Treas. Reg. 105, § 81.28 (1939).

[83] See Rev. Rul. 77, 1954-1 CUM. BULL. 187.

[84] See Estate of John A. Hance, 18 T.C. 499 (1952).

been an even greater improvement if a separate valuation subdivision had been provided.

Prior Interests—Section 2044

Section 2044 replaces Section 811(h) of the 1939 Code without substantial change. No regulations were promulgated under Section 811(h).

This section provides that, except where otherwise specifically provided, the estate tax shall apply to transfers, and so forth, whenever made.

Comment: Since every other section has a specific effective date or is obviously applicable for everyone living as of the effective date of the new Code, the retention of this section appears unjustified. The Internal Revenue Service so lightly regarded its predecessor that no regulations were ever issued under it.

(d) WHAT IS THE TAXABLE ESTATE—(a) (THE GROSS ESTATE) MINUS (b) (EXEMPTION) AND (c) (DEDUCTIONS)—SECTIONS 2051-2056

Taxable Estate—Section 2051

Section 2051 replaces the first sentence of Section 812 of the 1939 Code without substantial change (Reg. 105, § 81.4).

The taxable estate equals the value of the decedent's gross estate, less the total amount of authorized deductions, including a specific exemption. The estate tax return need not be filed unless the value of the gross estate exceeds $60,000.[85] Of course, there will be no taxable estate unless the gross estate exceeds the authorized deductions.

Comment: The term "taxable estate" is used in place of, and as a clarification of, the term "net estate" of the 1939 Code. This is consistent with the use of "taxable income" rather than "net income" in Section 63(a) of the income tax sections.

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[85] INT. REV. CODE OF 1954, § 6018(a)(1); Estate Tax Return, Form 706.

Specific Exemption—Section 2052

Section 2052 replaces Sections 812(a) and 935(c) of the 1939 Code with a substantial change. However, Reg. 105, § 81.48 may be partially effective.

A specific exemption of $60,000 is first deducted from the gross estate when determining the taxable estate.

Comment: There is no longer an exemption in the amount of $100,000 applicable against the basic estate tax, that tax having been eliminated as pointed out under Section 2001 below. But every decedent still obtains a $60,000 deduction just for dying.

Expenses, Debts and Taxes—Section 2053

Section 2053 replaces Section 812(b) of the 1939 Code with substantial changes. However, Reg. 105, §§ 81.29 to 81.40 would appear to be still applicable for the most part.

Amounts actually expended for funeral expenses,[86] reasonable administration expenses,[87] settlement of bona fide claims enforceable against the estate existing at time of decedent's death [88] and in satisfaction of the full unpaid amount of mortgages on property includible in the gross estate [89] may be deducted provided their payment is authorized by the laws of the jurisdiction under which the estate is being administered.[90]

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[86] Commissioner v. Cardeza's Estate, 173 F.2d 19 (3d Cir. 1949).

[87] Reasonable administration expenses include executor's commissions, Fidelity-Philadelphia Trust Co. v. United States, 122 F. Supp. 551 (E.D. Pa. 1954); trustee's commissions, Sharpe's Estate v. Commissioner, 148 F.2d 179 (3d Cir. 1945); attorney's fees, Peoples-Pittsburgh Trust Co. v. United States, 54 F. Supp. 742 (W.D. Pa. 1944); taxes, Thompson v. United States, 8 F.2d 175 (D. Minn. 1925); and miscellaneous costs and fees for maintaining and/or selling decedent's property, Haggart's Estate v. Commissioner, 182 F.2d 514 (3d Cir. 1950).

[88] To be deductible, such claims must be supported by adequate consideration in money or money's worth. Irving Trust Co. v. United States, 221 F.2d 303 (2d Cir. 1955); Commissioner v. Estate of Swink, 155 F.2d 723 (4th Cir. 1946).

[89] Parrott v. Commissioner, 30 F.2d 792 (9th Cir.), *cert. denied,* 279 U.S. 870 (1929).

[90] If the state court has actually passed on the merits of the deduction in a bona fide litigation, its finding is binding on the Commissioner. Goodwin's Estate v. Commissioner, 201 F.2d 576 (6th Cir. 1953).

For the most part, it will no longer be necessary to distinguish between decedent's probate estate, namely his property subject to claims, and decedent's gross estate, namely all his property including that not subject to claims (for example, life insurance payable to beneficiaries other than the estate). Claims against the estate are deductible even though such claims exceed the value of the probate estate if such claims are paid prior to the time for filing of the estate tax return.[91] Moreover, administration expenses incurred in connection with property included in the gross estate, but not included in the probate estate, are deductible if such expenses are paid prior to expiration of the period of limitations for assessment of the estate tax.[92]

Comment: The amendments with respect to deductions for claims and expenses incurred in connection with property not included in the probate estate are fairly designed to extend the scope of deductions to embrace expenses attributable to property included in the gross estate for federal estate tax purposes. These expenses, as well as losses allowed under Section 2054, below, are not deductible if they have been claimed as a deduction in an income tax return. In order to claim them for income tax purposes, a waiver of the right to take them as estate tax deductions must be filed.[93]

Losses—Section 2054

Section 2054 replaces Section 812(b) of the 1939 Code without substantial change (Reg. 105, § 81.39).

A deduction may be taken for uncompensated losses to undistributed assets of the estate, incurred during settlement of the estate, arising from fire, storm, shipwreck, or other casualties as from theft.

Comment: Should the alternative valuation date be elected as provided in Section 2032, such losses are not deductible if they are incurred before such date and the amount of the losses is reflected in a lower valuation of the property.

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[91] INT. REV. CODE OF 1954, § 6075(a).
[92] *Id.* § 6501.
[93] *Id.* § 642(g).

Charitable Deductions—Section 2055

Section 2055 replaces Section 812(d) of the 1939 Code without substantial change (Reg. 105, §§ 81.44-81.47).

Deductions are allowed for all bequests and devises to, or for, public, religious, charitable,[94] scientific, literary and educational uses.[95] The amount of such deductions may not exceed the value of the property transferred as included in the gross estate and is permitted for any portion of the estate which goes to the charity because of an irrevocable disclaimer filed prior to the filing of the estate tax return by another beneficiary who otherwise would receive an interest in the same property.[96] Complete termination of a power to appropriate property for the benefit of an individual beneficiary, such as by the beneficiary's death, prior to the exercise of such power now constitutes such a disclaimer.

Comment: If a life beneficiary who has been given a power to use trust principal dies within a short time of decedent's death, the deduction is now allowable even though the beneficiary signed no written document disclaiming his power, so long as the remainder goes to a charity.

Marital Deduction—Section 2056

Section 2056 replaces Section 812(e) of the 1939 Code without substantial change (Reg. 105, § 81.47(a) to (e)).

A deduction up to 50% of the value of decedent's "adjusted gross estate" [97] is permitted for interests in prop-

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[94] No deduction is permitted for a conditional bequest to a charity where there is no assurance that the charity will receive the bequest. Commissioner v. Sternberger's Estate, 348 U.S. 187 (1955).

[95] Section 2055(a)(4) provides for a deduction for bequests and devises to certain veterans' organizations.

[96] Commissioner v. Macaulay's Estate, 150 F.2d 847 (2d Cir. 1945).

[97] The "adjusted gross estate" is defined in Section 2056(c)(2)(A) as equalling the gross estate minus deductions for expenses, debts and taxes allowed under Section 2053 and the deduction for losses allowed under Section 2054. Thus the maximum marital deduction is computed without regard to the $60,000 specific exemption under Section 2052, or to charitable deductions under Section 2055. For example, a man with a gross estate less expenses and losses equal to $180,000 may leave $30,000 to a charity and $90,000 to his wife without incurring any federal estate tax; the $60,000 exemption remaining to apply to any other devises and bequests he might make.

erty belonging to the decedent "passing" [98] to decedent's surviving spouse provided such interests are not considered "terminable," [99] or, if terminable, the equivalent of a taxable general power over such interest is also passed to the surviving spouse.[100]

Two additional types of terminable interests which, when coupled with a general power of appointment, will qualify for this deduction have been formulated by the 1954 Code:

(a) A transfer to the surviving spouse of a legal life estate, together with a general power of appointment over the property, qualifies for the deduction.[101]

(b) A transfer of an interest in an undivided portion of property to the surviving spouse qualifies for the deduction if the surviving spouse has the right to income from a specific portion of the transferred property and a general power of appointment over that portion.[102]

Comment: In an effort to equalize federal estate taxes between decedents who died as residents of community property states and those who died as residents of non-community

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[98] "Passing" includes property transferred to the surviving spouse as the result of joint tenancy, the exercise of a power of appointment, dower or curtesy, insurance and the like. U.S. Treas. Reg. 105, § 81.47a(b) (1949), as amended, T.D. 6082, 1954-2 CUM. BULL. 295; see Rev. Rul. 83, 1953-1 CUM. BULL. 395.

[99] A surviving spouse receives an interest in property which is "terminable" (a) if such interest will terminate and (b) if another interest in the same property has passed from decedent to a third person (c) who may enjoy the property after termination of the surviving spouse's interest. INT. REV. CODE OF 1954, § 2056(b)(1). For example, *D* transfers a life estate in property to *S*, his surviving spouse, remainder to his children living at *S*'s death.

[100] If property is left in trust for a surviving spouse, the deduction is not lost if the spouse is entitled to the income of the trust annually and has a taxable general power of appointment over the corpus. INT. REV. CODE OF 1954, § 2056(b)(5). If proceeds of life insurance are payable in installments to the surviving spouse, or the interest from the proceeds is so payable annually, the deduction is not lost if the spouse has the right to designate to whom the remaining installments shall be paid. *Id.* § 2056(b)(6).

[101] Since Section 812(e)(1)(F) of the 1939 Code spoke in terms of a "trust," the Commissioner had successfully taken the position that a legal life estate, subject to a general power, did not qualify as an exception to the "terminable" interest rule. Estate of Edward F. Pipe, 23 T.C. 99 (1954); Estate of Michael Melamid, 22 T.C. 966 (1954).

[102] Under Section 812(e)(1)(F) of the 1939 Code, all income of the trust had to be receivable by the surviving spouse and her general power also had to embrace the entire trust. Estate of Harrison P. Shedd, 23 T.C. 41 (1954); Rev. Rul. 20, 1954-1 CUM. BULL. 195.

property states, the marital deduction section was enacted in 1948,[103] bringing into the Code one of its most complicated,[104] yet most useful, provisions. It is designed to extend to non-community property states the tax advantage of treating up to one-half of the deceased spouse's property as already belonging to the surviving spouse, to the extent that a deceased spouse is willing to put his property in the same status as it would be in a community property state.[105] Thus, the deduction, the equivalent to estate splitting, cannot exceed 50% of the decedent's adjusted gross estate, since no more than one-half of the dead spouse's estate belongs to the survivor in a community property state. Inasmuch as the surviving spouse in a community property state owns outright one-half of the community property, the marital deduction may be taken only with respect to fee interests, or their equivalent, passing to the surviving spouse in non-community property states. This requirement has been expressed in the Code by providing that the deductions may not be taken for terminable interests in property passing to the surviving spouse unless such spouse receives a general power over the property—the equivalent of virtual ownership.[106]

If the interest passing to the surviving spouse is encumbered, the encumbrance must be taken into account in determining the value of the interest transferred. Moreover, allowance must be made for the effect of any local inheritance tax upon the interest passing to the surviving spouse.[107] The changes made in the marital deduction provisions by the 1954 Code are perfectly in accord with the basic purpose of the section as outlined above and overrule two highly technical restrictions of the 1939 Code.

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[103] Revenue Act of 1948, § 361, 62 STAT. 117 (1948).

[104] Even the term "spouse" has led to litigation. A wife retains her status as spouse until an interlocutory divorce decree becomes final. Marriner S. Eccles, 19 T.C. 1049, *aff'd mem.*, 208 F.2d 796 (4th Cir. 1953).

[105] See S. REP. No. 1013 (Part 2), 80th Cong., 2d Sess. (1948) (Report of the Senate Finance Committee), 1948-1 CUM. BULL. 331.

[106] See Estate of Frank E. Tingley, 22 T.C. 402 (1954); Rev. Rul. 121, 1954-1 CUM. BULL. 196.

[107] *Cf.* Estate of Rosalie Cahn Morrison, 24 T.C. No. 109 (1955).

(f) WHAT IS THE ESTATE TAX? (f) = (d) (THE TAXABLE ESTATE) TIMES (e) (THE TAX RATE)—SECTIONS 2001-2002

Rate of Tax—Section 2001

Section 2001 replaces Sections 810 and 935 of the 1939 Code with substantial change. However, Reg. 105, § 81.7 may be partially effective.

A single estate tax schedule with rates progressing from 3% to 77% is applied to the taxable estate computed above.

Comment: By combining into a single schedule the two separate tax schedules of the 1939 Code it is no longer necessary to compute a "tentative tax," a "basic tax" and an "additional estate tax." Despite this long overdue simplification, there has been no change in effective tax rates.

Liability for Payment—Section 2002

Section 2002 replaces Section 822(b) of the 1939 Code without substantial change (Reg. 105, §§ 81.76 and 81.99).

The estate tax is payable in full fifteen months after decedent's death and is to be paid by decedent's executor, who is personally liable therefor.[108] Any person in actual or constructive possession of property of the decedent is deemed an executor in the absence of formal administration.[109]

(h) WHAT IS THE AMOUNT PAYABLE? (h) = (f) (THE ESTATE TAX) MINUS (g) (THE CREDITS)—SECTIONS 2011-2016

Credit for State Death Taxes—Section 2011

Section 2011 replaces Section 813(b) of the 1939 Code. However, Reg. 105, § 81.9 may be partially effective.

A credit against the amount of federal estate tax computed above is allowed for death taxes actually paid to a state. No credit is granted unless the taxable estate exceeds $40,000. The amount of such credit is limited by a table set

[108] INT. REV. CODE OF 1954, § 2204 makes provision for discharge of the executor from personal liability upon compliance with the provisions.
[109] *Id.* § 2203.

out in Section 2011(b) to 80% of the former "basic tax." That is, the former 80% limit is applied to a hypothetical tax computed under the former basic rates using the former exemption.

Comment: To preserve the existing credit for state death taxes, the combination of the two former federal estate taxes in a single rate schedule has created the need for a special schedule in this section in order to determine the credit.

Credit for Gift Tax—Section 2012

Section 2012 replaces Sections 813(a)(2) and 936(b) of the 1939 Code without substantial change (Reg. 105, § 81.8).

As pointed out above in the discussion of what constitutes the gross estate, it may happen that property validly transferred inter vivos by the decedent is also included in his gross estate because of the character of the transfer. In order to minimize the hardship resulting from the imposition of two taxes, the estate and the gift, on the same transfer, a credit against the estate tax is allowed for federal gift taxes paid on property includible in the gross estate. The credit will be allowed regardless of when the gift tax was paid. The amount of the credit shall not exceed either the actual gift tax paid on the property,[110] or an amount computed under the following ratio:

$$\frac{\text{X (Credit)}}{\text{D's Estate Tax}} = \frac{\text{Value of Gift}^{111}}{\text{Value of Gross Estate (less charitable and marital deductions)}}$$

Comment: The new Code justifiably extends the availability of the credit to gift taxes paid under the Revenue Act of 1924.

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[110] Adjusted for "gift splitting" provision available to spouses. *Id.* § 2513.

[111] Value at the time of gift or death, whichever is lower, reduced by the amount of gift tax exclusion, estate tax marital deduction and estate tax charitable deduction attributable to the property.

Credit for Tax on Prior Transfers—Section 2013

Section 2013 completely replaces Section 812(c) of the 1939 Code. Reg. 105, § 81.41 will no longer be applicable.

It may happen that the decedent's estate includes property transferred from the estate of another decedent and that an estate tax was imposed on this transfer to him. In order to minimize the hardship resulting from the imposition of multiple estate taxes on closely related transfers of the same property, a credit is allowed based upon the value of property included in another gross estate which incurred federal estate taxes upon the transfer of such property within ten years prior to, or two years following, decedent's death.

The amount of the credit can never exceed the amount of tax attributable to the property in the decedent's estate.[112] Moreover, the amount of credit is limited to the portion of the estate tax on the other decedent's estate borne by the property transferred to the decedent:

$$\frac{\text{X (Credit)}}{\text{Other decedent's estate tax}^{113}} = \frac{\text{Value of such property}^{114}}{\text{Total taxable estate of other decedent — death taxes + \$60,000}}$$

The amount of credit as computed above is taken in full where the decedent dies within two years of the other decedent's death and is decreased in the amount of 20% for every additional two years separating the deaths.

Comment: This section provides for a credit for other estate taxes paid on the transfer of the same property, rather than a deduction for the value of the property itself as under prior law. Since the basic policy behind the former provision was to avoid multiple estate taxation, this change brings the

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[112] In determining this figure, adjustment must be made to reflect the portion of the charitable deduction attributable to the property.

[113] Amount prior to reduction for gift tax credit and credit for tax on prior transfer.

[114] Value in other decedent's estate, less death taxes, encumbrances and any marital deduction attributable to the property.

effectuation of this policy in line with other provisions having a similar policy, such as the credit for state, foreign and gift taxes. It is not applicable with respect to property subjected to federal gift taxes as was its 1939 predecessor.[115] However, it extends the credit to transfers subsequent to decedent's death as long as the other decedent's death takes place within two years. In addition, the credit is allowable even if the other decedent received the benefit of a similar credit under this section. Its complicated provisions clear up the problem of how the value of the property on which the credit is based is to be determined.[116]

Credit for Foreign Tax—Section 2014

Section 2014 replaces Sections 813(c) and 936(c) of the 1939 Code without substantial change.

A credit against the federal estate tax is allowed for death taxes paid to a foreign country on property includible in decedent's gross estate.

Credit for Death Taxes on Remainders—Section 2015

Section 2015 replaces Section 927 of the 1939 Code without substantial change (Reg. 105, § 81.79).

Where a credit under Sections 2011 or 2014 is attributable to a reversionary or remainder interest and an election is made to postpone the tax on such interest under Section 6163(a) until termination of the prior estate, the credit may be claimed at the time of termination of such estate.

Recovery of Taxes Claimed as Credit—Section 2016

Section 2016 replaces Section 874(d)(3) of the 1939 Code without substantial change.

If decedent's estate recovers any of the taxes paid to states or foreign countries for which credits have been taken against the federal estate tax under Sections 2011 and 2014,

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[115] INT. REV. CODE OF 1939, § 812(c).

[116] See Estate of Anna C. Yantes, 21 T.C. 830 (1954), *aff'd per curiam*, 220 F.2d 754 (6th Cir. 1955).

the executor shall pay any additional tax due upon recomputation of the tax. No interest shall be collected on any amount of tax due except to the extent a foreign country paid interest on the refund of tax.

WHEN IS THE AMOUNT PAYABLE DUE?

The estate tax return shall be filed within fifteen months after the date of decedent's death,[117] and the full amount of tax is due at that time.

CONCLUSION

In the main, the provisions of the federal estate tax accomplish their objective of reaching transfers at death and their equivalent. The most glaring exception is contained in the favored treatment afforded life insurance. In areas such as this, changes and modifications are to be anticipated.

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[117] INT. REV. CODE OF 1954, § 6075(a).