University of Minnesota Law School
Scholarship Repository

Minnesota Law Review

1967

A Case for Realizing Gains at Death in Terms of Family Interests

Thomas L. Waterbury

Follow this and additional works at: https://scholarship.law.umn.edu/mlr

Part of the Law Commons

Recommended Citation
Waterbury, Thomas L., "A Case for Realizing Gains at Death in Terms of Family Interests" (1967). *Minnesota Law Review*. 2431.
https://scholarship.law.umn.edu/mlr/2431

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenzx009@umn.edu.

A Case for Realizing Gains at Death in Terms of Family Interests

Thomas L. Waterbury*

The Kennedy Administration's proposal of January 1963 that gains be realized at death was less than robust at birth, and short-lived. By May, Professor Anthoine doubted that ". . . the country [was] yet ready for . . ."[1] it. Indeed, the terms of the proposal suggested that its authors had earlier doubts on this score.

To be sure, the central conception of the proposal, that net unrealized appreciation in a decedent's capital assets, determined as of the applicable estate tax valuation date, should be included in his final federal income tax return,[2] could not be applied in that skeletal form. Hence the proposal dealt with net losses,[3] and realized net gains and losses in the event of an inter vivos gift which the estate tax would not reach.[4] And hence the proposal *should* have provided, though it did not,[5] for periodic realization of gains and losses on assets held in trust for successive beneficiaries. The proposal also had to deal with a number of narrower problems. For example, it was thought appropriate to distinguish assets subject to gains tax realization at death from items of income in respect of a decedent, and to tax such of the latter items that yield ordinary income as at present.[6] And, sensibly enough, ordinary personal belongings and ordinary household goods of the decedent were exempted from the realization at death proposal, both because of the unattractiveness of securing a detailed accounting of such items and

---

* Professor of Law, University of Minnesota.

1. Anthoine, *Tax Reduction and Reform: A Lawyer's View*, 63 COLUM. L. REV. 809, 815 (1963).

2. *Hearings Before the Comm. on Ways and Means of the House on the Tax Recommendations of the President*, 88th Cong., 1st Sess., pt. 1, at 128 (1963) [hereinafter cited as *Hearings*].

3. The proposal contained provision for some allowance of such losses against ordinary income and a carryback of any excess of such losses against the decedent's income of the three preceding years. *Id.*

4. Generally, the proposal would not have levied a gains tax in the event of a transfer which would not remove the transferred property from the donor's gross estate for federal estate tax purposes. However, it was proposed that a gift in contemplation of death be a taxable transfer. *Id.* item 8, at 139.

5. Professor Anthoine has called attention to this omission. Anthoine, *supra* note 1, at 816 n.23. For argument in support of a corrective, see notes 185-87 *infra* and accompanying text.

6. *Hearings*, pt. 1, item 7, at 138.

the likelihood that, if included, they would usually yield nondeductible personal losses.[7]

None of the foregoing, it will be observed, involves a material qualification of the principle that a gratuitous transfer of an asset is a realization of gain for federal income tax purposes.[8] There were, however, such qualifications, culminating in the administration's claim that the applicability of the proposal would be limited "to fewer than 3 percent of those who die each year."[9] Thus fifteen thousand dollars in gains were to be exempt in all cases and a stepped-up basis was to be granted, as at present, to the transferees of the assets involved.[10] Gain on the personal residence of a decedent was also exempted, and a stepped-up basis was granted as before, with the qualification that if the decedent's spouse survived, the spouse must receive the residence in order to secure the exemption.[11] A "marital exclusion," corresponding to the federal estate tax marital deduction was proposed, permitting nonrecognition of gain as to one-half of the total appreciation in the decedent's estate if one-half of his total property "goes" to his surviving spouse.[12] A similar exclusion was proposed for inter vivos gifts to a spouse.[13] The proposal would not have affected the present exclusion from income of life insurance proceeds payable by reason of the death of the

7. *Id.* item 4(a) at 129.

8. The exception for items of ordinary income in respect of a decedent is not such a qualification. Realization at death for these items would create a greater income bunching problem than realization at death for items taxable at capital gains rates. Moreover, as to many of the unrealized receivables of a cash basis taxpayer which fall into this category, the period of delay until actual receipt by the decedent's beneficiary is unlikely to be very long. Congress gave these reasons for abandoning realization at death for such items in the Revenue Act of 1942, which added § 126 (the predecessor of 1954 Code § 691) to the 1939 Code. See the House Report on § 125 of the House Bill (which became § 126 of the 1942 Act) and the Senate Report on § 135 of the Senate Bill (which became the same § 126 of the 1942 Act). H.R. REP. No. 2333, 77th Cong., 1st Sess. 83 (1942); S. REP. No. 1631, 77th Cong., 2d Sess. 100 (1942). It must be admitted that this bunching argument was stronger before enactment of INT. REV. CODE of 1954, §§ 1301-05 in 1964.

The failure to realize gains upon assets held in trust for successive beneficiaries is technically distinguishable in that successive interests in the same asset are created by one transfer in such a case.

9. Statement of Hon. C. Douglas Dillon, Secretary of the Treasury. *Hearings*, pt. 1, at 55.

10. *Hearings*, pt. 1, item 4(d) at 132.

11. *Id.* item 4(e) at 132.

12. *Id.* item 4(c) at 130.

13. *Id.* item 8, at 139.

insured.[14] Finally, gifts and bequests of appreciated assets to charity were to remain exempt in their entirety.[15]

However, even this restrained proposal was short-lived. By the end of August 1963, the Ways and Means Committee had decided to retain the forgiveness-at-death features of the present gains tax,[16] in lieu of struggling toward an acceptable draft of its initially chosen alternative—a carry-over basis rule[17] of the sort suggested by the Treasury Department during World War II, per the late Randolph Paul,[18] and by Dean Griswold.[19]

Since then a stillness has settled once more over this aspect of the income tax-gratuitous transfer tax relationship. And there is little evidence of dissatisfaction with that stillness in the country.[20]

Perhaps, for a further time, the matter should rest there. After all, since the enactment of the federal estate tax in 1916, the federal government has levied progressive taxes upon the transmission of wealth within the family as well as upon individual (and hence family) incomes. So the problem of achieving an appropriate relationship between those progressive taxes

---

14. *Id.* item 7, at 139.

15. *Id.* item 4(b) at 130.

16. The Ways and Means Committee decision was reported in the August 30, 1963, issue of a weekly tax publication, U.S. TAX WEEK.

17. Revenue Release 63-6 (May 28, 1963) provided in pertinent part as follows:

> With respect to the . . . taxation of accrued gains on capital assets at the time of gift or transfer at death, the Committee tentatively approved . . . the "carryover basis rule." Under the Committee decision, an asset transferred at death will have a basis to the heir equal to the basis in the hands of the decedent plus any estate tax attributable to the asset; this basis, however, cannot exceed the fair market value of the asset at the time of death.

18. *Hearings Before the Comm. on Ways and Means of the House of Representatives on Revenue Revision of 1942*, 77th Cong., 2d Sess., pt. 1, at 89 (unrev. ser. 1942).

19. Griswold, *A Plan for the Coordination of the Income, Estate, and Gift Tax Provisions with Respect to Trusts and Other Transfers*, 56 HARV. L. REV. 337, 350 (1942).

20. There is still some interest in the subject. *See, e.g.*, Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925, 970 (1967); Somers, *The Case for a Capital Gains Tax at Death*, 52 A.B.A.J. 346 (1966); Wormser, *The Case Against a Capital Gains Tax at Death*, 51 A.B.A.J. 851 (1965). And there were, of course, contemporaneous comments upon the Kennedy Administration proposals. *See, e.g.*, Anthoine, *Tax Reduction and Reform: A Lawyer's View*, 63 COLUM. L. REV. 808, 815 (1963); Heckerling, *The Death of the "Stepped-Up" Basis at Death*, 37 SO. CAL. L. REV. 247 (1964); Koudelis, *Some Observations on the Proposed Capital Gains Reforms*, 37 TEMP. L.Q. 289 (1964).

has been before the Congress and the Treasury for two generations. And, at least since 1918,[21] a familiar feature of the administrative and congressional solution has been to refrain from collecting the gains tax upon unrealized appreciation in a decedent's probate assets and to grant a new basis therefor to the decedent's successors.[22] Moreover, the Congress has extended this benefit to several classes of nonprobate assets, commonly[23] allowing a new basis only if the asset is included in the decedent's gross estate for federal estate tax purposes.[24]

There is nothing new, either, in academic scrutiny of gains tax forgiveness. For instance, that fervent apostle of enterprise economics and progressive taxation, Henry Simons, regarded realization at death and the abolition of preferential rates for capital gains as cornerstones of pre-[25] and post-[26] World War II federal tax reform.

Simons, who seems to have derived his notions of fairness in taxation from the pro-producer premises of his beloved free market system, favored peculiarly heavy taxation of gratuitous receipts, commencing with the inclusion of such receipts in in-

---

21. Apparently the first explicit statutory provision for a new basis at death was contained in Revenue Act of 1921, § 202(a)(3), 42 Stat. 229 (1921). The corresponding provision of the 1918 Act, Revenue Act of 1918, § 202(a), 40 Stat. 1060 (1918), did not make specific reference to property received by bequest, devise, or descent but was interpreted to provide a basis equal to fair market value on the date of death.

22. To be sure, not all probate assets reach a decedent's successors tax free under the present law. For instance, many items of income in respect of a decedent are probate assets, but are expressly denied a new basis at death. INT. REV. CODE of 1954, §§ 691, 1014(c). See 3A J. MERTENS, FEDERAL INCOME TAXATION § 21.83.

23. One instance of property which is not includible in the decedent's gross estate for federal estate tax purposes, but which is granted a new basis is the surviving spouse's one-half share of community property in the case of decedents dying after 1947 when "at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate . . ." INT. REV. CODE of 1954, § 1014(b)(6).

24. See INT. REV. CODE of 1954, § 1014; Treas. Reg. §§ 1.1014-1 to -8 (1957). INT. REV. CODE of 1954, § 1014(b)(9), which was added in 1954, contains a broadly worded grant of the new basis at death in the case of:

> property acquired from the decedent by reason of death, form of ownership, or other conditions (including property acquired through the exercise or non-exercise of a power of appointment), if by reason thereof the property is required to be included in determining the value of the decedent's gross estate . . . .

See also SENATE REPORT, 1954 Code § 1014.

25. H. SIMONS, PERSONAL INCOME TAXATION 162-68 (1938).

26. H. SIMONS, FEDERAL INCOME TAX REFORM 44-54 (1950).

come.[27] At the close of World War II, he became more concerned with facilitating the accumulation of private capital and proposed elimination of the income tax upon reinvested earnings coupled with the imposition of a tax upon asset appreciation at death, or upon the event of a gift. He believed that, in this way, a progressive tax might be collected agreeably with the needs of the economy.[28]

In a phrase, Simons sought to shift the progressive income tax toward a progressive tax upon consumption expenditures and gratuitous transactions. Gains tax realization at death, if not before, was a central conception in his program. A number of authorities share his dim view of forgiveness.[29] And a number also share his enthusiasm for realization at death.[30]

One might think that these academic objections would have found sympathetic listeners among the legislative representa-

---

27. *See* H. SIMONS, PERSONAL INCOME TAXATION 125-47 (1938). The following passage is illustrative.

> The case for the taxation of gratuitous receipts as income stands, as does the case for regarding the income tax as the basic form of levy upon inheritance; but the case for supplementary levies is also strong. The accumulation of property through receipt of gifts, inheritances, and bequests is a kind of accumulation which can be taxed with least adverse effect upon the morale of an enterprise economy; and opinion generally supports especially heavy taxation of "income" in this form. . . .

Id. at 144-45.

28. H. SIMONS, FEDERAL TAX REFORM 40, 44-54, 125-27 (1950).

29. *E.g., Hearings Before the Committee on Ways and Means of the House of Representatives on Revenue Revision of 1942*, 77th Cong., 2d Sess., pt. 1 at 89 (unrev. ser. 1942) (testimony of Randolph Paul then adviser to the Treasury proposing the adoption of a statutory carryover basis rule to the Congress); Heller, *Investors' Decisions, Equity, and the Capital Gains Tax*, in JOINT COMMITTEE ON THE ECONOMIC REPORT, 84TH CONG., 1ST SESS., FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY 381, 393 (1955); COMMITTEE ON TAXATION, TWENTIETH CENTURY FUND, INC., FACING THE TAX PROBLEM 483 (1937); H. GROVES, POSTWAR TAXATION AND ECONOMIC PROGRESS 60 (1946); L. SELTZER, THE NATURE AND TAX TREATMENT OF CAPITAL GAINS AND LOSSES 299-304 (1951); W. VICKREY, AGENDA FOR PROGRESSIVE TAXATION 139-42 (1947); Clark, *The Paradox of Capital Gains: Taxable Income That Ought Not to be Currently Taxed*, 2 TAX REVISION COMPENDIUM 1243, 1250 (1959); Griswold, *A Plan for the Coordination of the Income, Estate and Gift Tax Provision with Respect to Trusts and Other Transfers*, 56 HARV. L. REV. 337, 350 (1942) (also supporting the substitution of a carry-over basis rule); Holt & Shelton, *The Lock-in Effect of the Capital Gains Tax*, 15 NAT'L TAX J. 337, 352 (1962); Tannenbaum, *Basis of Property Transmitted at Death—Need for Revision*, 3 TAX L. REV. 166, 170 (1947).

30. *E.g.*, R. MUSGRAVE, THE THEORY OF PUBLIC FINANCE 167 (1959); Blum, *A Handy Summary of the Capital Gains Arguments*, 35 TAXES 247, 257 (1957); see also the statements of Groves, Vickrey, Seltzer, Heller, Clark, and Holt & Shelton, cited in the preceding note.

tives of our many personal service income taxpayers. From a distributional point of view, why *should* we forgive the readily deferrable gains tax which is itself imposed at preferential rates? Should we not, at least, limit the preference to the life span of the taxpayer?

Yet the legislative response to all of this is well-known—a substantial broadening of gains tax forgiveness at death under the 1954 Code,[31] and adherence to it in 1963.

Doubts regarding congressional power to legislate in this area do not seem substantial enough to explain the tenacity of gains tax forgiveness at death. The substitution of a carry-over basis rule appears to be within Congress' power to tax income under the sixteenth amendment. At least, the Supreme Court's opinion in *Taft v. Bowers*,[32] upholding the carry-over basis rule which was made applicable to inter vivos gifts in the 1921 Act, is fully consistent with that conclusion.[33]

True, some doubt that the sixteenth amendment authorizes an unapportioned income tax upon capital appreciation which is otherwise unrealized, upon the event of a gratuitous transfer.[34]

---

31. Congress decided, in 1954, that the new basis at death should be made applicable to the generality of cases in which property acquired from a decedent was required to be included in determining the value of the decedent's gross estate for federal estate tax purposes. See INT. REV. CODE of 1954, § 1014(b)(9), discussed in H.R. REP. No. 1337, 83d Cong., 2d Sess. 78 (1954); S. REP. No. 1622, 83d Cong., 2d Sess. 107-08, 423-24 (1954). Of course, this extension did not encroach upon the category of items of income in respect of a decedent, explicitly excepted under INT. REV. CODE of 1954, § 1014(c).

32. 278 U.S. 470 (1929).

33. Mr. Justice McReynolds' opinion broadly affirms the power of the Congress to prevent avoidance of the tax on realized gain by requiring a donee to accept the basis of his donor. *Id.* at 482-84.

34. *Hearings* pt. 4, at 2394, 2396-403 (1963) (American Bankers Association); *id.* pt. 5, at 2836, 2839 (Committee of the Tax Section of the New York State Bar Association). Roehner & Roehner, *Realization: Administrative Convenience or Constitutional Requirement?*, 8 TAX L. REV. 178, 200 (1953).

The fullest discussion of the question is that of Roehner and Roehner. Interestingly, these authors distinguish the case of "a statute taxing to the donor the appreciation in value of a gift," believing that a statute taxing unrealized appreciation in a decedent's final return "unlike the one taxing appreciation in gifts, is not necessary for the protection of the revenue, since men do not die in order to reduce their income taxes." *Id.*

It is not easy to believe that the Supreme Court would accept this distinction in evaluating a general proposal to tax unrealized appreciation in the event of either a noncharitable gift or a noncharitable transfer at death.

The first reason is that, prima facie, the carry-over basis rule of

But it is hard to see why these doubts should immobilize Congress.

First, assuming the doubts to be well founded, it would seem that the distributional and economic effects of realization at death or at the time of an inter vivos gift could be secured by a constitutionally permissible excise tax upon the gratuitous transfer of property, levied at rates similar to gains tax rates, upon that portion of the value of the transferred property equal to its unrealized appreciation.[35]

INT. REV. CODE of 1954, § 1015 leaves less room for gains tax avoidance by gift than does the forgiveness rule of § 1014 in the case of a transfer at death. Hence, prima facie, the remedy of realization is less necessary in the former case than in the latter.

Secondly, the Roehners' notion that tax-motivated suicides are no threat to the revenue may be conceded for, at best, it states an irrelevant truth. Surely it is more to the point that most taxpayers do expect to die, and to leave their worldly goods behind when they do, and that most of them have other beneficiaries whom they would choose to benefit in preference to the Treasury.

The Roehners' distinction is not implausible when applied to the narrow category of cases which they had in primary focus. They were focusing immediately upon the then current effort of the Treasury to realize appreciation in the event of gifts of low basis inventory. *Id.* at 186-200. The tax incentives to such gifts are obviously greater. If the gift of inventory is to charity, the donor will frequently have the reward of a deduction against ordinary income. If the gift is to a private beneficiary, the income-splitting possibilities plainly may be much greater than in the case of a gift of an appreciated capital asset.

35. This sort of suggestion has been made before. *See* L. SELTZER, THE NATURE AND TAX TREATMENT OF CAPITAL GAINS AND LOSSES 302-03 (1951).

A successful attack upon the constitutionality of this excise tax approach certainly does not seem likely. The constitutionality of the federal estate tax was upheld in New York Trust Co. v. Eisner, 256 U.S. 345 (1921), and the federal gift tax was held constitutional in Bromely v. McCaughn, 280 U.S. 124 (1929). Both taxes were sustained as excise taxes authorized by article I, § 8 of the Constitution, rather than direct taxes which, under article I, § 9, must be apportioned. While article I, § 8, requires that excise taxes be uniform, this requirement is only one of geographic uniformity. Flint v. Stone Tracy Co., 220 U.S. 107, 158 (1911); Knowlton v. Moore, 178 U.S. 41, 85-87 (1900).

These points being clear, the remaining area of constitutional doubt seems confined to the chance that the Supreme Court would hold an excise tax thus limited to unrealized appreciation to be so unreasonable and arbitrary in classification as to violate the due process clause of the fifth amendment. This chance seems very small. In Watson v. State Comptroller, 254 U.S. 122 (1920), the Court held that an additional inheritance tax upon certain assets, upon which the decedent had not paid property taxes during a fixed period prior to death, did not violate the equal protection clause of the fourteenth amendment.

Conceding the overstatement of earlier cases stating that the fifth amendment does not limit the taxing power of the Congress, *e.g.*, Brushaber v. Union Pac. R.R., 240 U.S. 1, 24-5 (1916), *discussed in* Dodd,

Second, the sixteenth amendment problem does not seem to be very serious. Because Congress has never attempted to tax such appreciation as income, it seems inevitable that there would be some doubt as to the constitutionality of such an unapportioned income tax. However, some analogous income taxes have been imposed. For example, items of income in respect of a decedent were taxed in the decedent's final return from 1934-1942.[36] More recently, the Treasury thought (mistakenly, it later concluded) that Congress had authorized the realization of gain to a cash basis farmer upon a charitable or intrafamily gift of wheat or livestock inventory.[37] And the income tax law has long provided that gain shall be realized upon the gift of an installment obligation.[38] As a final example, in implementing the recent revision of the stock option rules, Congress and the Treasury have undertaken to tax, as personal service income, gain upon a gift of stock acquired through the exercise of a qualified stock option in order to police compliance with the holding period requirements of part II of subchapter D.[39]

Implied Powers and Implied Limitations in Constitutional Law, 29 YALE L.J. 137 (1919); *cf.* United States v. Manufacturers Nat'l Bank, 363 U.S. 194, 200-01 (1960), it remains evident that the Supreme Court is more reluctant to strike down a congressional classification under the fifth amendment, which contains no "equal protection" clause, than to strike down a state classification under the equal protection clause of the fourteenth, Detroit Bank v. United States, 317 U.S. 329, 337-38 (1943); H. ROTTSCHAEFER, HANDBOOK OF AMERICAN CONSTITUTIONAL LAW 215 (1939). Since the Supreme Court in *Watson* thought it quite reasonable for a state legislature to single out assets which had not been subjected to a property tax for a compensatory additional inheritance tax, it is hard to believe that the Court would deny an analogous privilege to Congress.

36. Revenue Act of 1934, ch. 277, § 42, 48 Stat. 694; Int. Rev. Code of 1939, § 42, 53 Stat. 24, prior to its amendment by Revenue Act of 1942, ch. 619, § 134(a), 56 Stat. 830.

37. I.T. 3910, 1948-1 CUM. BULL. 15, *rev'd*, Rev. Rul. 55-138, 1955-1 CUM. BULL. 223; I.T. 3932, 1948-2 CUM. BULL. 7, *rev'd*, Rev. Rul. 55-531, 1955-2 CUM. BULL. 520. *See* Griswold, *Charitable Gifts of Income and the Internal Revenue Code*, 65 HARV. L. REV. 84 (1951); Bittker, *Charitable Gifts of Income and the Internal Revenue Code: Another View*, *id.* at 1375; Griswold, *In Brief Reply*, *id.* at 1389; Miller, *Gifts of Income and of Property: What the Horst Case Decides*, 5 TAX L. REV. 1 (1949).

38. The current provision to this effect is INT. REV. CODE of 1954, § 453(d)(1). The first such provision appeared as § 44(d) of the Revenue Act of 1928.

39. Under INT. REV. CODE of 1954, § 421(b), a disposition of stock, acquired through the exercise of an option which qualifies under §§ 421(b), 422(a), 423(a), or 424(a) before the expiration of the requisite holding periods causes the difference between the option price and the value of the stock at the time of the exercise of the option to be taxed, at the time of the disposition, as personal service income. Treas. Reg.

Each of these situations can be distinguished from that of appreciation in the value of such hardcore investments as land and listed securities in terms of traditional statutory categories, if not very clearly in terms of a constitutional requirement of realization.[40] Thus one of these situations involves, and another sometimes involves, the taxation of personal service income previously earned, in respect of which the earning is the equivalent of realization.[41] And two of these situations involve, and another sometimes involves, the problem of determining a convenient point at which to tax previously realized gains from property transactions.[42] Finally, all of these situations may be distinguished from classic cases of investment appreciation on the broad categorical basis that they pertain to income rather than capital items.[43]

---

§§ 1.421-6 (1959); 1.421-8(b)(1) (1966). One instance of such a disposition is a disposition by gift. INT. REV. CODE of 1954, § 425(c).

40. Viewed as of constitutional significance, such distinctions suggest that this area of constitutional limitations on the taxing power requires the Congress to turn unusually square corners. Thus neither Miller, Griswold, nor Bittker, in their several articles cited in note 37 *supra*, was willing to discuss such distinctions in terms of constitutional limitations upon congressional power.

41. This may be said of items of personal service income in respect of a decedent, and of the compensatory element in the value of stock acquired under a stock option as in note 39 *supra*. Helvering v. Enright, 312 U.S. 636 (1941), sustained the position of the Commissioner that § 42 of the Revenue Act of 1934 required an accrual at death of personal service income attributable to a deceased law partner's right, under the terms of the partnership agreement, to payments to his estate in respect of his partnership percentage of "the earned proportion of the estimated receipts from unfinished business." *Id.* at 638. In so doing, the Court emphasized the relevance of the fact that the decedent had earned these payments during his lifetime. *Id.* at 644.

42. Griswold thought, for instance, that the Treasury rulings on gifts of wheat and livestock inventory, mentioned in note 37 *supra* could be squared with the realization doctrine on the basis that the wheat had been realized when severed and that the cattle also had been realized (though he did not say when—at birth perhaps if they were the yield of the taxpayer's breeding herd). Griswold, *Charitable Gifts of Income and the Internal Revenue Code*, 65 HARV. L. REV. 84, 86-88 (1951). And Magill though it easy enough to explain the realization of gain upon the gift of an installment obligation on the basis that realization had occurred at the time of sale, so that deferral of tax was discretionary with Congress. R. MAGILL, TAXABLE INCOME 416-17 (1945). Finally, Griswold has tendered a similar rationalization of the rule of INT. REV. CODE of 1954, § 691(a)(2), then Int. Rev. Code of 1939, § 126 (a)(2) that the gratuitous transfer of a right to receive an item of income in respect of a decedent is a taxable event. Griswold, *supra* at 87.

43. Bittker and Griswold, in their articles cited in note 37 *supra*, divided precisely at this point. Bittker thought it inappropriate, as a matter of administrative policy, for the Treasury to heighten the con-

So when the cases are examined to determine whether otherwise unrealized capital appreciation can be taxed when the capital is given away inter vivos or at death, reliance must be placed on judicial language primarily addressed to some other question.

Eisner v. Macomber,[44] dealing with the taxability of a common on common stock dividend as a distribution of earnings and profits, but stating flatly that unsevered asset appreciation is not income within the amendment, is the piece de resistance of those who think that realization at death poses a serious sixteenth amendment problem.[45] Yet *Eisner v. Macomber* is qualified by *Helvering v. Bruun*,[46] which held that value added to a leasehold by the lessee's construction of a building thereon might be taxed to the lessor when the latter regained possession upon the lessee's default.[47]

Helvering v. Horst,[48] can be read to say that the act of transferring soon-to-mature bond coupons by gift was a sufficient realization of the bond interest because the act of transfer procured "a satisfaction" for the donor-bondholder "which can be obtained only by the expenditure of money or property."[49] Thus *Horst* has been cited as indicating the propriety, under the sixteenth amendment, of realization upon a transfer inter vivos or at death.[50]

Helvering v. Stuart[51] in turn qualified *Horst* by distinguishing it as a case in which the taxpayer had not "really disposed of the res which produced the income."[52] The Court added (inaccurately, it would seem)[53] that "the 'non-material satisfactions'

trast between "income" and "capital" items by treating a gift of inventory as an event of realization while retaining the position that a gift of an investment asset was not such an event. Bittker, *supra* note 37, at 1377-78. Griswold was quite willing to accept this heightened contrast, but thought it better to achieve the result by statutory amendment than by administrative action. Griswold, *supra* note 42, at 90-93.

44. 252 U.S. 189 (1920).

45. *See, e.g.*, Roehner & Roehner, *Realization: Administrative Convenience or Constitutional Requirement*, 8 TAX L. REV. 173, 174-75 (1953); *Hearings*, pt. 4, at 2397-403 (Opinion of Special Tax Counsel for the American Bankers Association).

46. 309 U.S. 461 (1940).

47. *Id.* at 468-69.

48. 311 U.S. 112 (1940).

49. *Id.* at 117.

50. See the discussion of *Horst* in the opinion of the General Counsel of the Treasury regarding the constitutionality of the 1963 realization at death proposal, *Hearings*, pt. 1, at 594-98.

51. 317 U.S. 154 (1942).

52. *Id.* at 168.

53. As Rice observed, "The *Horst* case in fact held just the con-

(gifts-contributions) of a donor are not taxable as income."[54] Hence, the Court held that a settlor who created irrevocable trusts for the benefit of his adult children in 1930 was not taxable upon the trust income realized by the trustees in the years 1934 and 1935, though the trustees' dispositions of such income "would satisfy the normal desire of a parent to make gifts to his children."[55]

The scope of the *Stuart* restriction of *Horst* is scarcely transparent.[56] Apparently some would read it broadly, as reducing *Horst* to the proposition that an anticipatory assignment of the immediately prospective yields produced and to be produced by a retained res may be disregarded for income tax purposes.[57] Of course, if the taxing premise of *Horst* is that the assignment of the coupons was a nullity, the case furnishes no support for the thesis that an assignment of an appreciated asset is an income creating realization by the assignor of the appreciation.

This constricted reading, however, clearly conflicts with Mr. Justice Stone's language in *Horst*, which, at the least, treats the assignment of prospective yields by the donor, *coupled with* the donee's later receipt of them, as a realization by the donor. He repeated this formulation for a unanimous Court in *Harrison v. Schaffner*.[58] Mr. Justice Reed, in *Stuart*, cited both cases with approval in equating the donor's *use* of economic gain with *realization* thereof.[59]

Accordingly, *Stuart* may simply be read as limiting *Horst's* "realization by transfer and payment" premise to cases in which the donor assigns the immediately prospective yield of a retained res and the yield is subsequently received by the assignee. This reading may be rationalized as follows: In cases like

---

trary." Rice, *Judicial Trends in Gratuitous Assignments To Avoid Federal Income Taxes*, 64 YALE L.J. 991, 995 (1955).

54. 317 U.S. at 168.

55. *Id.*

56. Rice, *supra* note 53, at 995.

57. Miller, *Gifts of Income and of Property: What the Horst Case Decides*, 5 TAX L. REV. 1, 9 n.20, 10 (1950).

58. 312 U.S. 579, 580 (1941). In *Schaffner*, Mr. Justice Stone cited *Horst* and Helvering v. Eubank, 311 U.S. 122 (1940), in tandem for this proposition. *Eubank* is a case in which the assignor retained no rights whatever in the contracts assigned and yet, on the authority of *Horst*, was held taxable on sums paid to the assignees. As Bittker has pointed out, this use of *Horst* in *Eubank* makes such a restricted reading of *Horst* difficult to maintain. Bittker, *Charitable Gifts of Income and the Internal Revenue Code: Another View*, 65 HARV. L. REV. 1375, 1375-76 (1952).

59. Helvering v. Stuart, 317 U.S. 154, 168 (1942).

Horst, the "use," *i.e.*, "realization," of economic gain to the donor is not one event but two. As to coupon interest accrued to the date of the assignment, the act of realization was the act of assignment to the donee. As to that accruing thereafter, prior to the date of payment, the act of realization was payment to the donee, pursuant to the donor's assignment of the yield of a res retained by the donor. As to both, the imposition of the tax on the donor at any convenient time after realization was proper.[60]

And, of course, the implications of this latter reading for gains tax realization upon a gratuitous transfer are very different from those of the former. By the former, the transfer itself is not a realization. By the latter, it is realization as to gain accrued to the date of transfer. Since realized capital appreciation is as taxable a sort of income as any other,[61] the conclusion that accrued interest may be realized by the gratuitous transfer of an unmatured interest coupon supports the conclusion that asset appreciation may also be realized upon such a transfer of an appreciated asset.

In view of our tradition against the treatment of gratuitous transfers as taxable events, the Treasury's reluctance to advance this argument under section 61(a) and its predecessor is not surprising.[62] But, given explicit statutory language requiring realization upon a gratuitous transfer, the Supreme Court would surely be faced with *Horst*. For the reasons given, it seems that the Court would favor the latter reading of the case, and find *Horst* a persuasive precedent for upholding the legislation.

Another reason for thinking that the sixteenth amendment problem is not a serious one is a cryptic footnote in Mr. Justice Reed's opinion in *Helvering v. Estate of Enright*,[63] which can be read, in context, as assuming that gains tax realization at death is constitutionally permissible.

60. It may be that the act of payment would also suffice as a realization of the interest accrued to the date of transfer. Miller insisted that *Horst* so held. Miller, *supra* note 57, at 7-10. But the *Horst* opinion emphasized both the act of assignment and the act of payment. Helvering v. Horst, 311 U.S. 112, 116-18 (1940).

61. Merchants' Loan & Trust Co. v. Smietanka, 255 U.S. 509 (1921), *discussed in* R. MAGILL, TAXABLE INCOME 109-13 (rev. ed. 1945).

62. The Treasury's effort, via I.T. 3910, see note 37 *supra* and accompanying text, to realize gain to a cash basis farmer upon a charitable gift of wheat or livestock inventory floundered in the courts on just this point. Campbell v. Prothro, 209 F.2d 331 (5th Cir. 1954).

63. 312 U.S. 636, 645 n.23 (1941).

Enright's Estate arose under section 42 of the 1934 Act which provided that:

> In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts *accrued* up to the date of his death if not otherwise properly includible in respect of such period or a prior period.[64]

At his death, Enright was a cash basis partner in a cash basis law firm. The partnership agreement entitled his estate to a percentage of the firm's cash, receivables, and "the earned proportion of the estimated receipts from unfinished business"[65] at his death. The Court held that the last item, like the first two, was an amount "accrued" within section 42.

The Government argued that this construction of section 42 was necessary to achieve the congressional objective of preventing the loss of revenue resulting from decisions[66] holding that such items were not taxable income to a decedent's estate when received.[67]

The taxpayer replied:

> The same argument can be applied to increment in the value of any property owned by a decedent at the time of his death. Such increment could not be taxed as accrued income unless the property had been sold prior to the date of death. The mere desire to obtain revenue cannot justify the inclusion in the income of a decedent of any unrealized increment, under the Sixteenth Amendment. Likewise, the value of services which have not ripened into income at the date of death cannot be classed as income under the said Amendment.[68]

The taxpayer also invoked the fifth amendment, arguing that section 42, construed as the Government contended, discriminated against the deceased partner by bunching his income in respect of firm work in process into one taxable year, while the surviving partners were privileged to report their income as received, and that such discrimination rendered section 42 "arbitrary, harsh, and confiscatory. . . ."[69]

Mr. Justice Reed, speaking for a unanimous Court, adopted the Government's view on the first point.

> Accruals here are to be construed in furtherance of the intent

64. Revenue Act of 1934, ch. 277, § 42, 48 Stat. 694. (Emphasis added).
65. 312 U.S. at 638.
66. *E.g.*, Nichols v. United States, 64 Ct. Cl. 241 (1927), *cert. denied*, 277 U.S. 584 (1928).
67. Brief for Petitioner, pp. 19-25, Helvering v. Estate of Enright, 312 U.S. 636 (1941).
68. Brief for Respondents, pp. 15-16, Helvering v. Estate of Enright, 312 U.S. 636 (1941).
69. *Id.* at 29.

> of Congress to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns. Congress sought a fair reflection of income.[70]

Then he added the following footnote.

> It is immaterial that all possibility of escaping an income tax is not barred, as for instance the increased value of asset items is an estate return. Act, 113(a) (5), . . . "[T]he entire field of proper legislation [need not] be covered by a single enactment." Rosenthal v. New York, 226 U.S. 260, 271 [1921] . . . ; *cf.* Keokee Coke Co. v. Taylor, 234 U.S. 224, 227, . . . [1913].[71]

Both *Rosenthal* and *Keokee* are fourteenth amendment cases; neither is a tax case. In each the appellant argued unsuccessfully that state legislation before the Court, which concededly applied to him, denied him equal protection because it did not impose like burdens upon others similarly situated. In *Keokee,* Mr. Justice Holmes replied:

> [A] statute aimed at what is deemed an evil, and hitting it presumably where experience shows it to be most felt, is not to be upset by thinking up and enumerating other instances to which it might have been applied equally well, so far as the court can see. That is for the legislature to judge unless the case is very clear.[72]

It is easy to connect Mr. Justice Reed's footnote to his text by supposing that he was addressing himself to the parallel drawn by the taxpayer between a lawyer's work in process at his death and an investor's asset appreciation at death. And it is easy to connect the cases he cites to that parallel by supposing that, in Mr. Justice Reed's view, section 42 could constitutionally have been extended to cover asset appreciation insofar as the sixteenth amendment is concerned.

Given these connections, the Court's footnote emerges as a rather contemptuous revision of the taxpayer's constitutional argument, and a response to the argument as revised. In other words, the taxpayer might better argue that section 42 violates the fifth amendment because it does not extend to asset appreciation, to which Congress could properly extend it under the sixteenth amendment. But even this argument cannot prevail because it is within the prerogative of the Congress to close some avenues to tax avoidance while permitting other like avenues to remain open.[73]

---

70. 312 U.S. 636, 644-45.

71. *Id.* at 645 n.23.

72. 234 U.S. 224, 227 (1913).

73. The characterization of gains tax forgiveness at death as an avenue to tax avoidance is, of course, familiar. See the many authorities cited in note 29 *supra.* Many of the authorities therein cited pro-

At least, I am inclined to accept this reading[74] and hence to think that the Court addressed itself to and accepted the constitutionality of gains tax realization at death under the sixteenth amendment in *Enright's Estate.*

Finally, it is hard to see why congressional respect for the Supreme Court's position in *Eisner v. Macomber* should inhibit the enactment of gains tax realization at death because a generation ago, in *Helvering v. Griffiths,*[75] the Court itself *invited* the Congress to explicitly repudiate *Macomber* so as to give the Court an opportunity to reconsider its holding. This being so, why should the Congress hesitate to encroach again upon *Macomber's* premise?[76]

It would appear, therefore, that the future of gains tax forgiveness at death ought to be regarded as a legislative question of politics and policy rather than as a question of constitutional law. Thus, those who find Professor Anthoine's estimate of the temper of "the country" too terse may call upon a rich legacy to explain the doings of the Ways and Means Committee in this instance. For the friends of forgiveness there is, of course, the *finest hour theory.*[77] Its foes, if spitefully inclined, may prefer

---

posed a carry-over basis rule as a remedy, but the remedy which was before the Supreme Court in the *Enright* case was a realization at death remedy.

74. In part, because a careful reading of the opinion and the briefs of counsel in the *Enright* case fails to reveal a plausible alternative explanation of Mr. Justice Reed's footnote.

75. 318 U.S. 371, 400-01 (1943).

76. For example, see the new provisions taxing certain income of controlled foreign corporations to their United States shareholders. INT. REV. CODE of 1954, §§ 951-64; For opinions presented to the Ways and Means Committee as to whether these provisions are reconcilable with *Eisner v. Macomber, see Hearings Before the Comm. on Ways and Means, House of Representatives,* 87th Cong., 1st Sess., v. 1, at 311, 313.

77. This familiar theme is aptly illustrated by editorial views expressed in U.S. TAX WEEK, August 30, 1963, at 1337, in commenting upon the demise of the Kennedy Administration's effort to eliminate gains tax forgiveness at death:

> Highlight
>
> Ways & Means Comm. kills death basis reforms
>
> Because of the difficulty encountered in drafting into legislative language its "final decisions" reached with respect to the tax basis of property acquired from a decedent, the Ways & Means Comm. has killed the proposed revisions to § 1014. . . .
>
> Comment
>
> Good!
>
> The existing § 1014 provides that the basis of property acquired from a decedent shall be its fair market value at the date of the decedent's death (or at an alternate valuation date). Thus, by simply dying, a taxpayer can avoid income taxes on the unrealized appreciation in his properties. The treasury . . . proposes

the *conspiracy theory*,[78] or if not, perhaps the more benevolent *meaning no harm theory*.[79] A cheekier alternative is the *babes-in-taxland theory*,[80] (as adapted, the Committee was deceived by the progressive rate schedules into believing that our income tax structure is more progressive than it is and hence was unduly tolerant of forgiveness). Those addicted to the taxing insights of the Supreme Court, and impressed with the Committee's drafting difficulties, may favor Mr. Justice Cardozo's *eternal tally-ho theory*[81] (the Committee continues to pursue the wily gains tax-

---

> to tax the unrealized appreciation in value as if the taxpayer has sold the property at its fair market value upon his death bed. . . . The Ways & Means Comm. wisely rejected this recommendation . . . .
>
> We believe that most tax practitioners and IRS tax administrators who have to live with death-basis questions will join us in hoping that the report of the death of the proposed changes to § 1014 is not greatly exaggerated.

78.
> Progression has gone to seed rather ludicrously in our federal taxes. . . . The result is a decorative sort of progression, yielding much discussion, much indignation, and very little revenue. . . . Moreover, the whole procedure involves a subtle kind of moral and political dishonesty. One senses here a grand scheme of deception, whereby enormous surtaxes are voted in exchange for promises that they will not be made effective. Thus, politicians may point with pride to the rates, while quietly reminding their wealthy constituents of the loopholes.

H. SIMONS, PERSONAL INCOME TAXATION 218-19 (1938).

79. Surrey, *The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted*, 70 HARV. L. REV. 1145 (1957). Although advanced by Surrey to explain the success of lobbyists for bits of fine print in the Code, the theory is plausibly applicable to Committee members preoccupied with the great economic issues of the recent revenue revision.

> In many cases the congressman considering a special tax provision may not realize that tax fairness is at all involved. He sees only the problem of the particular constituent or group concerned. The case in this focus may be very appealing . . . . The proposal, so viewed, becomes merely a "little old amendment" which helps a constituent and does no harm.

Id. at 1156-57.

Cf. this stanza from a wishful and familiar boot camp ballad of World War II:

> So the pretty maiden, not meaning any harm,
> Jumped in beside him to keep the sailor warm,
> Singing,
> 'Bell bottomed trousers, coats of Navy blue,
> He'll climb the rigging like his Daddy used to do.'

80. Thus, a decade ago, the late Randolph Paul presumed to explain to the Subcommittee on Tax Policy of the Joint Committee on the Economic Report, that our tax system was not as progressive as appeared, upon a first glance at the rate schedules. Paul, *Erosion of the Tax Base and Rate Structure*, JOINT COMM. ON THE ECONOMIC REPORT, PAPERS SUBMITTED BY PANELISTS APPEARING BEFORE THE SUBCOMM. ON TAX POLICY, 84TH CONG. 1ST SESS. 297 (1955).

81.
> One can read in the revisions of the revenue acts the record of the Government's endeavor to keep pace with the fertility of

payer along the tricky trails of forgiveness, but, since 1918, has failed to catch him).

With the constitutional law and political science of realization at death behind us, we face consideration of the matter as one of legislative policy, and again, it is arguable that this aspect has been sufficiently explored at the academic level, so that only more time is needed to produce an enduring consensus—time, that is, for the rationality of our less hidebound scholars to accommodate to the unrationalized instincts of our populace and their representatives, or vice versa. But of course I have not thought so.

There has been, to my knowledge, no extended discussion of gains tax realization at death, or of a carry-over basic rule, or of gains tax forgiveness, in terms of the impact of any of these alternatives upon the parties to transfers of property at death, who are commonly members of the same family group. Yet, for several reasons, such discussion seems relevant to a choice among the three alternatives. First, there is the immediate impact of the question upon what may be termed the family interest[82] in the inheritance[83] of property. Second, there is suf-

---

> invention whereby taxpayers had contrived to keep the larger benefits of ownership and be relieved of the attendant burdens.

Burnet v. Wells, 289 U.S. 670, 675-76 (1933).

82. There is sufficient domestic evidence that inheritance is predominantly a family matter. First, data indicates that "of those who die with *some* accumulated wealth, only about half provide for its disposition by the leaving of a will." R.R. POWELL, CASES ON TRUSTS AND WILLS 11 (1960). This means, of course, that about half die intestate, and, under our intestacy statutes, relatives take to the exclusion of nonrelatives, except in odd cases of escheat. More limited, though more recent, data from probate records for Cook County, Illinois, indicates that "almost 60 per cent of the estates are testate." Dunham, *The Method, Process and Frequency of Wealth Transmission at Death*, 30 U. CHI. L. REV. 241, 248 (1963). Professor Dunham's data also indicated a 90% concentration of wealth in the testate estates, Dunham, *supra* at 240-51. But Professor Powell was not so sure: "This percentage of will-makers is lowest among persons of small wealth and becomes higher (but never really high) as the quantity of wealth increases." R.R. POWELL, *supra* at 11.

Second, it appears that most dispositions of wealth are in favor of relatives, in particular spouses and descendants, in preference to charities or others. *See* Dunham, *supra* at 255-56.

Shoup's recent study, FEDERAL ESTATE AND GIFT TAXES (1966), consisting of statistical evidence gathered from federal estate tax returns, indicates that charitable transfers constituted a relatively small percentage of gross transfers at death. C. SHOUP, *supra* table B-2, at 156. *See also id.* table E-1, at 216. Data drawn from estate tax returns filed in 1957 and 1959 for estates exceeding $1,000,000 shows nonrelatives as life tenants of fewer than 14% of the noncharitable trusts created from

ficiently widespread evidence of regard for family interests in our tax and nontax law to suggest that such interests may be relevant to this legislative choice. Third, a consideration of this family interest for the purpose of deciding how to tax gains unrealized at death may serve to illuminate the much larger legislative problem of achieving an appropriate relationship between our progressive federal taxes upon incomes and gratuitous transfers.

As will be seen, the immediate result of this inquiry into family interests is a persuasive argument for the abolition of gains tax forgiveness in favor of gains tax realization at death.

I. FORGIVENESS AT DEATH AS A CONCESSION TO INHERITANCE

The family interest in inheritance is the interest most immediately served by forgiveness. Is forgiveness an appropriate income tax subsidy to this family interest? It is convenient to subdivide this question. First, can a persuasive case be made for substantial concessions to the family interest in inheritance under a progressive income tax structure?[84] Second, if so, does that case support this particular concession?

A. The Case for Income Tax Subsidies to Inheritance

An evident route to such a case is to establish a parallel between the families within our society and our society itself, viz.: that families are distinct and continuing social units with significant ties to their past and future generations, so that each family's interest in the inheritance of its property parallels that of the society as a whole in benefiting from the material productivity of its past generations and contributing to that of its future ones.

---

those estates. C. Shoup, *supra* table B-8, at 165. While data regarding the transfer of trust remainders is not available, it is clear that transfers to relatives are preponderant. C. Shoup, *supra* table B-9, at 166.

83. The term "inheritance" is hereinafter used to refer to intra-family transfers of property for other purposes than immediate consumption by the transferee, whether the transfers are effected inter vivos or at the death of the transferor.

84. There have, of course, been doubts about this. Simons certainly had some. *See* note 27 *supra*. And other scholars have, in recent years, pondered the propriety of cumulative income tax burdens upon the inheritance of property. *See, e.g.*, W. Blum & H. Kalven, The Uneasy Case for Progressive Taxation 87 n.214 (1953); Klein, *An Enigma in the Federal Income Tax: The Meaning of the Word "Gift"*, 48 Minn. L. Rev. 215, 225-27, 246-59 (1963).

Indeed, it is easy to concede that our families are distinctly subordinate social units without impairing the position that they possess sufficient continuity to justify substantial concession to the family interest in inheritance under our progressive income tax.

An evident objection to this position is that it grossly overemphasizes the extent of the family interest in the inheritance of property in our society. More precisely, most American families are far more dependent upon the personal capacities of their present and succeeding generations to produce income than upon the inheritance of substantial amounts of property from their past generations.[85] So, it may be argued, tax concessions to the inheritance of property are an inappropriate subsidy to the interests of a small, and privileged, minority of our families.

But this broad objection is vulnerable. The inheritance of property is only an instance of inheritance. One is also indebted to his family for heredity and environment, and the fact that this part of one's inheritance is blended indistinguishably into his personal capacities scarcely demonstrates that it is of less importance to his future prospects than an inheritance of property which is not so blended.[86] This personal inheritance is

---

85. This fact is indicated by recent studies of the nationwide distribution of income and wealth. Lampman concludes that "only about 25 per cent of all income may be characterized as property income." R. LAMPMAN, THE SHARE OF TOP WEALTH-HOLDERS IN NATIONAL WEALTH 7 (1962). This study also indicates that a minimum of 2.28% of households and 2.35% of married couples have at least one member owning $60,000 of gross estate. Leaning on prior research by Kuznets, Lampman offers the following:

> The association of high income and larger wealth-holding is also indicated by the concentration of property income in the higher income groups. The relatively great importance of property income for the top percentiles of persons when ranked by per capita income is shown . . . [in] Kuznets' work . . . . [W]hile "property income" (in this case, rent, interest, and dividends) is 15.8 per cent of the income of the total population, it is 48.7 per cent of the income of the top 1 per cent. . . . [T]his top 1 per cent received 40 per cent of the national total of property income.

Id. at 108.

86. *But see* W. BLUM & H. KALVEN, *supra* note 84, who take a more individualistic view of personal achievement and urge that the tax law should respect the interest of the individual in the rewards that he has earned.

> [We assume] that those around us and we ourselves deserve in some way the praise and blame, the rewards and punishments, we all dispense and receive. . . . No matter what our endowments of heredity and environment, something more is required for them to be realized, and this something must be close to the heart of personal responsibility. For fulfillment, even the most lavish talents require perseverance, discipline, integrity, dedi-

transmitted to him without exposure to the burdens of our gift[87] and death taxes. So the fact that the inheritance of substantial amounts of property is a distinctly minority phenomenon does not establish that substantial benefit from the total inheritance derived from one's family is a minority phenomenon. And it is clear that the inheritance of property is already burdened with some taxes which do not apply to an inheritance of personal capacities.

A further objection to the position that income tax concessions to the inheritance of property are justified by the status of the family as a continuing social unit is the direct retort that the "majority" family unit in contemporary American society is a contracting one, centering upon the husband-wife relationship in each generation, rather than upon lineal ties. John Stuart Mill raised this point a century ago,[88] and the theme is a familiar one among modern sociologists.[89]

To be sure, those who make this point seem clearer on the withering of collateral ties within the majority family than in the withering of lineal ones.[90] Nonetheless, a part of this line of thought is that the family unit is primarily a transitory union of spouses rather than a unit with a continuity which is sustained by strong lineal ties.[91]

But, assuming that the family unit has so contracted, the

> cation and other personal qualities. There are at least two reasons, not just one, why most of us do not play the violin as well as Heifetz. It may be that personal responsibility is just one more inherited talent, but even so it is still uniquely appealing to tie our system of rewards and punishments to it.

W. BLUM & H. KALVEN, *supra* note 84, at 82-83. Why is it not even more appealing (insofar as there is appeal in facing facts) to acknowledge that if we tie our system of rewards and punishments (insofar as that is contained in the tax law) to either of the reasons, we necessarily tie it to both?

87. Apparently it has not been the practice of the Treasury to attempt to collect gift taxes upon transfers made to dependents for maintenance, at least where the argument is available that the transfers satisfied a legal obligation of support imposed upon the transferor under local law. Note, *Federal Tax Aspects of the Obligation to Support*, 74 HARV. L. REV. 1191, 1213 (1961); *see also* ALI, FEDERAL ESTATE AND GIFT TAX PROJECT 98 (Study Draft No. 1, 1965).

Of course, many transfers for the maintenance of the transferee would avoid the gift tax in any case. *See* INT. REV. CODE of 1954, § 2503(b).

88. 1 J. MILL, PRINCIPLES OF POLITICAL ECONOMY 282-83 (5th London ed. 1920).

89. *E.g.*, J. SIRJAMAKI, THE AMERICAN FAMILY IN THE TWENTIETH CENTURY 83-85 (1953).

90. *Id.*

91. *Id.* at 100.

relevance of the fact to the present inquiry is not clear. Our subject is the conflict between the desire of contemporary Americans to provide for their families, and the redistributional effect of a progressive tax structure, which tends to require them to provide for strangers instead. The asserted contraction in the family unit is only relevant to that conflict insofar as it indicates that we are significantly more willing to disadvantage our lineals in order to improve the lot of the generality of society than our fathers and grandfathers were. It is not very clear that this is so. At a glance, there is a great preoccupation with children and grandchildren in contemporary American society. Certainly, as a whole, we are providing more adequately for them than was true in generations past. As a matter of longevity, it seems more likely that we and our children will be personally acquainted with our more remote lineals than was true in colonial times. And, insofar as family unity is thought to vary directly with affluence,[92] have we not been called the affluent society?

Moreover, the tradition of mutual assistance within the family is surely the most prominent instance of redistribution of income and wealth within society. Much of this assistance is mutual, in the substantial sense that, with the benefit of hindsight, quid pro quos may be observed. Doubtless much of the assistance afforded by children to lineal, and in some cases collateral, ancestors may appropriately be described in these terms. Doubtless the same point is stronger still in the context of things that spouses and siblings do for one another. And no doubt there is self-realization, if not a calculation of future material benefits, in the case of much assistance given to lineal and even collateral descendants. Nonetheless, even this mutual assistance is redistributional in the sense that assistance is given and received as an incident of the status of the parties in relation to one another, as members of a common social unit, rather than in performance of an arm's length bargain.

Such redistribution of wealth and income within the family unit, it may be argued, is analogous to the redistributive functions sought to be achieved by a progressive income tax structure. The analogy proceeds upon the assumption that the social and moral principles which motivate redistribution within the family unit are similar to the policies underlying the attempt,

92. It is commonplace to contrast the relative stability (in descending order) of "upper," "upper-middle," and "lower-middle" class families with the relative instability (in ascending order) of "working" and "lower" class families. *See, e.g.*, J. SIRJAMAKI, *supra* note 89, at 138-51.

through the progressive income tax, to redistribute wealth and income among the larger unit of society. If this is so, is it feasible, under a democratic system, to assert that individuals should assume the burdens of redistribution among the large unit without recognizing the desire of the individual to perform a similar function within his own family unit. Conversely, the analogy can, in addition to justifying a tax concession to inheritance, serve as support for a redistributional progressive income tax structure. Recognition of the legitimacy of the motives which underlie redistribution within the family unit justifies, to some degree, the application of the same motives to the benefit of the society as a whole.

It may be urged that the analogy of the society to the family for the latter purpose fails because the "voluntary" redistribution which occurs within effective family units is the antithesis of the "coerced" redistribution which is imposed upon those who pay the progressive portion of the income tax.[93] But, since a variety of nonlegal sanctions prompt provision for one's family, this argument seriously overstates the element of unconditional free will involved in family redistribution. And since the prime point of the analogy of the society to the family is to persuade those who pay redistributional taxes of the reasonableness of the progressive principle, so as to minimize the need to coerce them into compliance, the fact that they may have felt unduly coerced in the past scarcely demonstrates the wisdom of maximizing this complaint in the future. The fact that redistribution within the family unit enjoys such wide acceptance tends rather to support the conclusion that redistribution throughout society is more likely to be accepted if it can be reconciled with family redistribution.

It may also be urged that the analogy of the society to the family for this tax purpose fails because the premise that an income tax should be seriously redistributional is in hopeless conflict with the premise that an income tax should make substantial concessions to family interests, and in particular to the family interest in the inheritance of property. But of course this is not so.

It is *quite* true that the harmonizing of these premises leads to a very different progressive income tax structure than that envisioned by Simons and his disciples—one in which gratuitous

93. This problem of coercion evidently contributed to the uneasiness of Blum & Kalven, regarding progression in taxation. *See* W. BLUM & H. KALVEN, *supra* note 84, at 455, 496.

(and hence intrafamily) transfers were singled out for peculiarly heavy redistributional taxation.[94] But there is nothing apparent in either of these premises that would foreclose substantial progression in the taxation of income devoted to the maintenance of an unreasonably high standard of living, or in the taxation of savings and other accumulations of wealth which were unreasonably large in relation to future family needs.

Indeed, the acknowledgment of the redistributional claims of the family as a counterbalance to those of the society seems useful as a partial answer to the familiar objection that progression in taxation, once conceded in principle, is uncontrollable in practice because one degree of progressivity is as defensible as another.[95] At least the response is available that there is one appropriate stopping point—that at which further redistribution of income and wealth would unduly infringe upon the redistributional interests of the families whose income and wealth are being redistributed.

It may also be urged that taxing concessions to the family interest in redistribution will not promote acceptance of redistribution in taxation because family relationships are unique, being founded as they are upon ties of blood, marriage, and personal association. Perhaps, but this is an ultimate prediction. And some evidence to the contrary exists in the traditional efforts of organized religion to extend benevolent family instincts beyond the family.[96]

The objection does suggest, though, that a progressive tax structure which seeks sanction in the family interest in redistribution should also seek sanction in voluntary provision for nonrelatives, because such a structure ultimately asserts a duty to provide for nonrelatives in general. On this tack, differences between the tax treatment of gratuitous transfers to relatives and those to nonrelatives might well be kept to a minimum.[97]

A more telling objection to a progressive tax structure which concedes a substantial family interest in redistribution is that such a structure cannot hope to achieve equality of opportunity for the children of the society. Surely, this is quite true. Some children are much wiser than others in their choice of lineage

94. *See* note 27 *supra* and accompanying text.

95. *See* Blum & Kalven's perceptive discussion of this problem, W. BLUM & H. KALVEN, *supra* note 84, at 461-65.

96. *See* note 106 *infra* and accompanying text.

97. A rather striking instance of offense in this regard is afforded by the rate classifications under state inheritance taxes. *See, e.g.*, MINN. STAT. § 291.03 (1965).

and are handsomely rewarded for that single act of wisdom, while others pay most cruelly for their lack of foresight. But, as Blum and Kalven have pointed out,[98] equality of opportunity is an attainable redistributional goal only if we are willing to abandon our customary practice of bearing, rearing, and educating children within families. It is evident that we are not. And it is not evident that we would improve the society in the future by working toward a change in this customary practice. These things being so, more modest redistributional goals are indicated.

Let us consider, then, whether our redistributional tax structure is likely to achieve more for children who do not have families to underwrite their opportunities in the customary way if the structure is designed to wage militant war against the family interest in redistribution, or to accommodate to it by substantial taxing concessions.

Is not the promise of the first course materially impaired by its invitation to those who pay progressive taxes to regard them as weapons of assault upon their families—a view well calculated, insofar as defense of family remains instinctive, to arouse savage hostility and uninhibited countermeasures? And this first course has other weaknesses which, if less irrational in origin, are no less grave.

Any attempt to enlist ethical support for progression by rationalizing such taxes as a legislative recognition of the brotherhood of men across the society may be met with the question, how plausible is such a claim when it is founded on a denial that the brotherhood of brothers itself has relevance for progressive tax purposes?

Further, any attempt to support progression more analytically as founded on bonds of mutual interest which extend across the society must reckon with the retort that family members are united by these same bonds, plus the more immediate ones of family interest.

Finally there is evidence of the futility of such an assault upon redistribution within the family in the fact that the best progression scholarship, undertaken without explicit attention to this family interest, tends to present a case for progression in taxation which leans upon it. Blum and Kalven, whose admirable treatise supports progression by downgrading the entitlement of anyone to reap where he has not sown while exalting

98. W. Blum & H. Kalven, *supra* note 84, at 504.

the entitlement of superior producers, as individuals, to superior rewards, may be read as resting substantially upon the ethical entitlement of the society's children to redistribution. This thought is most difficult to disassociate from the family interest in children.

Thus, Blum and Kalven found it easier to justify the progressive taxation of inheritance than the progressive taxation of income.

> For our purposes it can be safely concluded that the case for lessening inequalities in . . . inheritance is surely stronger than the case for lessening inequalities of income. The windfall aspect of inheritance clearly distinguishes the two cases. Moreover there is a tradition of favoring a progressive tax on inheritance but a proportionate tax on income.[99]

On the other hand, they were troubled by the argument that income is, to a significant degree, the product of an individual for which he alone is responsible, as distinct from the product of heredity and the environment for which his family and his society are responsible.[100] Blum and Kalven retain their allegiance to these themes by supporting the progressive taxation of income on the ground that it would minimize expenditures by productive parents for the benefit of their nonproductive children.[101]

Later, however, in discussing the affirmative case for progressive taxation as a means of promoting economic equality within the society, something suspiciously like a primary, though implicit, appeal to our family experiences and the familiar ethical appeal to the brotherhood of men appears in their argument.

> The thing that most clearly emerges is that the case for mitigating economic inequalities is a different case when the reference is to adults than when it is to children. . . . There is an enormously stronger *ethical claim to equality for the sake of children.* What may reduce to envy as among adults surely is *justice as among children*; the contribution to the general welfare which comes from equalizing opportunities among the children is *also* compelling; and the majority of the doubts about the fairness of a competitive system of rewards would be put to rest if the start of the race were thus equalized.[102]

At least as a matter of sequence, their primary argument at this point is the "ethical" quality and "justice" of a societal interest in the children of the society. Since these meticulous scholars did not state the sources of this interest in children and

---

99. *Id.* at 502-03.
100. See the passage quoted in note 87 *supra.*
101. W. BLUM & H. KALVEN, *supra* note 84, at 503.
102. *Id.* at 505 (emphasis added).

these notions of ethics and justice, their sources must have been thought familiar. Are not our experiences within our own families the most familiar sources of our general interest in children? And is not the theme of the brotherhood of men the source of the "ethical" quality and "justice" of that interest?

Compare the posture of the matter if, instead, we reason from the premise that the social interest in redistribution through the progressive income tax should be expressed in a tax structure deliberately designed to make substantial concessions to the family interest in redistribution.

Is it not more difficult for a family buff to achieve heat in denying the propriety of progressive taxation, or the degree of it, if those who oppose him concede the competing interest in redistribution within the family and only urge, by analogy, that some, or more, redistribution across the society through taxation is appropriate. Also, advocates of family redistributional interests have difficulty in constructing an appealing and plausible case for it which will not bear extension beyond the family to the society. Thus if one urges that the income tax should respect the family interest in inheritance because the family, like society, is a continuing social unit, it is hard to top the response which concedes the point, but adds that this family interest is, after all, prominently redistributional, and that the society is also a social unit.

The reply cannot be a denial of the redistributional nature of the inheritance of property.[103]

The reply cannot be, either, the individualistic point that the transmission of property by inheritance is a voluntary act in the individualistic tradition, while redistribution under the tax law is sheer collectivism. This point has been anticipated.[104] To argue that a gratuitous transfer within the family is an individualistic act of free will is to deny the force of the very ties which were urged above as strong enough to merit recognition of the family as a social unit for tax purposes.

Nor is there much promise in the reply that family ties are unique, so that we should eschew progression out of reverence for the unique desire of our producers to provide for their families.

First, unless one is prepared to establish the existence of a direct relationship between the strength of these ties and family

---

103. *See* page 21 *supra*.
104. *See* text accompanying note 93 *supra*.

affluence, some strong family units will benefit from progression in the tax structure.[105]

Second, this argument is in the teeth of our ethical tradition, previously adverted to, and expressed with (utilitarian) fervor by Macmurray:

> What is it . . . that enables the natural instincts of family affection to be extended farther and farther beyond the bounds of the natural family until it comes to embrace and hold together in a unity of affection masses of individuals who have never met one another face to face? . . . This is not a theoretical question merely. It is the practical problem that has faced human society from the beginning and which faces it today.
>
> History itself provides the answer. This is precisely the function of religion. . . . If we look to the development of religion in history, we find that the extension of this bond of family affection to larger and larger groups of people through the acceptance of a common faith has been one of the controlling factors in the development of society. We are driven to the conclusion that the function of religion is to increase the scope and the complexity of human cooperation by creating, sustaining, and expressing the union of persons in a spiritual family or a spiritual brotherhood. . . . We might express this shortly by saying that the task of religion is the maintenance and extension of human community.[106]

---

105. The sociologists, while noting relative instability in "working" class families (described as including "half or more of Americans"), certainly do not suggest a general disregard of family obligations. J. SIRJAMAKI, *supra* note 89, at 147.

Income tax data suggests that the families in this large segment of society are not much affected by *rate* progression under the federal income tax (as distinct from the progression introduced by the presence of the basic personal exemptions). Thus Treasury data drawn from individual income tax returns filed in respect of 1963 income shows that over half of the joint returns and returns by surviving spouses, which did report taxable income, paid tax at the then minimum marginal rate of 20%. More specifically, this was true of 17.5 million of a total of 32.4 million such returns. Another 10.3 million of these returns paid at the 22% marginal rate. IRS, STATISTICS OF INCOME, INDIVIDUAL RETURNS FOR 1963, table 32.

And the same income tax data show that these American families are heavily concentrated in adjusted gross income brackets under $8,000, at which modest levels the payment of taxes impinges materially upon expenditures which may be regarded as important to the maintenance of an adequate standard of living, which is certainly a significant family interest. See text accompanying notes 120-21 *infra*.

Nonetheless, it is evident that these families do pay progressive income taxes when account is taken of the progressivity introduced by the basic personal exemptions. So it seems unlikely that many of them are hostile to having those with significantly larger incomes contribute more than proportionately more to the heavy cost of government via rate progression applicable to such larger incomes.

106. J. MACMURRAY, THE STRUCTURE OF RELIGIOUS EXPERIENCE 36-38 (1936).

Third, the assertion of this position is itself so much evidence that, contrary to the teaching of the ethical tradition just referred to, family traditions of mutual assistance do not readily lend themselves to extension beyond the family to the society as a whole. And if so, there is less reason for advocates of progression in taxation to exercise restraint in warring against family interests.

A final reason for urging that we should have a progressive income tax which respects the family interest in redistribution (and hence the family interest in the inheritance of property) is that we have had both a progressive income tax and a society filled with families for half a century without any widespread assumption of incompatibility between the two. Moreover, it is a progressive income tax law which contains a number of provisions that serve family redistributional interests. Perhaps, then, it is somewhat late in the day to stage a war between society and the family within the covers of the Internal Revenue Code.

Anyway, to the extent of the persuasiveness of the foregoing, we have a case for the general propositions that tax concessions to the family interest in family income and wealth may support the legitimacy of the progressive principle and, by way of reciprocity, that tax concessions to the progressive principle may support the legitimacy of this family interest. And, in like degree, we have succeeded in harmonizing the notion of income tax concessions to the institution of inheritance with that of taxing income, and gratuitous transfers, progressively.

As noted at the outset, however, such general propositions cannot make a case for the *particular* income tax concession to inheritance which results from gains tax forgiveness at death. We now have to consider whether *this* concession, or the less indulgent alternative of a carry-over basic rule, is a sensible way to subsidize the family interest in inheritance.

B. Gains Tax Forgiveness (or a Carry-Over Basis) as Specific Income Tax Subsidies to Inheritance

Upon turning to this narrower topic, one quickly discovers that the yield of the prior discussion is not support for retaining gains tax forgiveness, or even for the substitution of a carry-over basis rule, but a solid argument for gains tax realization at death.

1. The Family Interest in Realizing Gains at Death

Our problem under this heading is to consider whether gains tax forgiveness, or a carry-over basis rule, or gains tax realization

at death, is the more appropriate general rule, in view of the family interests involved.

Even if we confine ourselves strictly to the family interest in inheritance, it is easy to justify a preference for a carry-over basis rule, as against gains tax forgiveness. To do this, we need only to compare cases of the inheritance of appreciated assets with cases of the inheritance of assets worth their cost which were purchased with the after-gains-tax proceeds of appreciated assets. It may be argued that the gains tax should differentiate between these groups of cases because in the latter case the gains were realized voluntarily by an inter vivos transaction, a fact which tends to insure that the payment of the gains tax was not judged a serious burden by the seller. However, this reasoning is satisfied by the proposal that gains tax forgiveness be abolished in favor of a carry-over basis rule, which continues postponement of the gains tax pending voluntary realization.

A further comparison will underline the inappropriateness of gains tax forgiveness as a concession to inheritance and, beyond this, cast doubt on the appropriateness of a carry-over basis. On the one hand, assume a case involving the inheritance of appreciated assets purchased with savings out of personal service incomes, and, on the other, assume a case involving the inheritance of assets of like cost, which have not appreciated, but also purchased with savings out of like-sized personal service incomes. Plainly, the inheritances will be larger in the former group of cases. As plainly, because of gains tax forgiveness, their accumulation will have been subjected to income taxation at lower effective rates.

One can, to be sure, use the past to justify the present and assert that this sort of disparity is inherent in "our system."[107] But such an assertion invites the retort that if income tax concessions to the family interest in inheritance are supportable in general because they serve to justify the progressive taxation of income, they should not be tailored in particular to tax inheritances regressively instead.

Nor can the onus of regression be avoided by the assertion that a tax upon saving for initial investment is not comparable to a tax at death upon unrealized appreciation because, within

107. Griswold once insisted, in these terms, though not in defense of gains tax forgiveness, that there was a significant difference between gifts of "appreciated property" and "other sorts of gifts of income." "[T]he mere having of unrealized appreciation is not income. I do not say that it could not be income. I merely say that it is not income under our system" Griswold, *In Brief Reply*, 65 HARV. L. REV. 1389 (1952).

limits, a saver can respond to a tax upon his income by curtailing his consumption rather than his saving, while a gains tax levied at death is a specific burden upon the family interest in inheritance. The same reasoning may be employed to question the burden that is imposed upon inheritance by realization at death. Thereby the owner of appreciated assets could fund the payment of the gains tax at death by increased cash savings at the expense of inter vivos consumption.

Moreover, if we focus upon the income tax deferral aspects of this last comparison, it appears that realization at death can do more to bring the income taxation of these cases into line than a carry-over basis rule.[108] The retention of an asset while it appreciates is a form of accumulation of wealth that is indistinguishable, in terms of family interests in the inheritance of property, from the acquisition of like assets after they have appreciated by investing savings out of personal service income. Therefore, if it is appropriate to collect an income tax upon the savings prior to the inheritance of the asset in the latter case, it is appropriate to collect a gains tax upon the appreciated asset, prior to its inheritance, in the former case.

It is true that there are ways to provide an inheritance out of personal service income that will be taxed to the beneficiary rather than to the employee or self-employed individual. Death benefits under qualified retirement plans are an instance, insofar as they are attributable to employer contributions not taxed to the employee during his lifetime.[109] But such death benefits are

---

108. An exception should be made, of course, in instances in which it would appear more burdensome to require the more successful investors to pay gains taxes at death than for the less successful ones to pay initial income taxes on their savings. Such instances would, however, appear to be uncommon. One might be that of assets of conjectural value. Another might be appreciated assets that are nonetheless unmarketable.

109. The initial deferral of income under qualified plans is facilitated by a current deduction to the employer for contributions to such plans. However, this current deduction is restricted by the general statutory requirement that contributions by the employer are only deductible to the extent that they, together with other deductions allowed for compensation for the employee's services, do not exceed a reasonable allowance for such services. *See* INT. REV. CODE of 1954, § 404(a); Treas. Reg. § 1.404(a)-1(b) (1966). The recipient of benefits under a qualified plan is taxed in the year of distribution. INT. REV. CODE of 1954, §§ 402(a), 403(a), (b).

Such plans are in rather general use. It has been estimated that over 158,000 qualified plans were in operation at the close of 1966, including a little over 26,000 qualified plans covering self-employed individuals. P-H PENSION & PROFIT SHARING SERV. ¶ 15,002 (1966). Havig-

distinguishable upon several grounds. First, such plans are primarily retirement plans. Hence the principal consequence of deferring personal service income under such plans is more likely to be to provide maintenance for the employee in retirement (and for his surviving spouse, if any) than to provide an inheritance for others.[110] In contrast no such restrictions limit the amount of unrealized gains which may be deferred under a carryover basis rule. Second, the income tax that is ultimately collected in respect of such deferred compensation is an ordinary income tax,[111] except in the case of lump-sum distributions under some qualified plans,[112] wherein the recipient of deferred com-

---

hurst cites Department of Health, Education and Welfare correspondence of January and March, 1964, indicating that some 23,100,000 employees were covered by qualified plans at the end of 1962. H. HAVIGHURST, DEFERRED COMPENSATION FOR KEY EMPLOYEES 27 (1964).

110. As to plans covering self-employed individuals, the statute now requires such plans to provide that, not later than at age 70½ or the date of retirement, whichever occurs last, there shall be full distribution or commencement of annuity payments to run for the actual or expected life of the employee or the employee and his spouse. INT. REV. CODE of 1954, § 401(a)(9). Qualified pension, profit-sharing and stock bonus plans are subject to less explicit limitations in this regard, but the Treasury interprets its regulations as imposing a general requirement that benefits under such qualified plans be distributed to the employee, so that payments to others "should be merely incidental." *See* Rev. Rul. 656, 1956-2 CUM. BULL. 280; Treas. Reg. §§ 1.401-1(b)(1)(i), (ii), (iii) (1966). The revenue ruling just referred to also holds that an otherwise qualified pension, profit-sharing or stock bonus plan will be disqualified if the plan

> contains a provision permitting a participant to irrevocably elect, prior to retirement, to have all or a part of his nonforfeitable interest in the plan, which would otherwise become available to him during his lifetime, paid to his designated beneficiary after his death . . . .

Rev. Rul. 656, 1956-2 CUM. BULL. 280, 281. While the propriety of this ruling has been questioned, it appears to represent the current position of the Treasury. *See* 4A J. MERTENS, FEDERAL INCOME TAXATION § 25.05, at 25 (rev. ed. 1966).

111. It is true that employer contributions may be devoted, in part to the purchase of insurance upon an employee's life, payable to the employee's beneficiaries; but if so, the employee may be currently taxable on the cost of such life insurance protection. Treas. Reg. § 1.72-16 (1966).

112. Capital gains treatment is available in respect of lump-sum distributions by qualified pension, profit-sharing, and stock bonus trusts. INT. REV. CODE of 1954, § 402(a)(2). Such treatment is also available in respect of lump-sum distributions under those qualified annuity plans described in INT. REV. CODE of 1954, §§ 403(a)(1), (2). However, such treatment is not available in respect of annuity plans established by § 501(c)(3) organizations or public schools. *See* § 403(b). Nor is such capital gains treatment available in respect of plans covering self-employed individuals; instead, averaging is provided for in the case of lump-sum distributions from such plans. *See* § 72(n).

pensation receives all distributions to which he is entitled under the plan within a single taxable year. But this capital gains exception is unlikely to lead to capital gains treatment for death benefits which have remained unrealized for an extended period following the death of a deceased employee. The reason is that the capital gains exception is only available to a distributee if the lump-sum distribution to him is received in the taxable year of the distributee in which distributions to him commence under the plan.[113] Third, the control which the employee, or his beneficiary, has over such deferred compensation during the period of deferral is much less than the control which an investor, or his beneficiary, has over individually owned appreciated assets.

There are, to be sure, individual deferred compensation arrangements which might be designed to provide death rather than retirement benefits.[114] But the income tax ultimately payable under these plans is an ordinary income tax, for no capital gains exception is available under these individual contracts. And, again, the control which the employee, or his beneficiary,

---

113. As to qualified pension, profit-sharing and stock bonus plans, these restrictions are imposed by INT. REV. CODE of 1954, § 402(a)(2), which provides in pertinent part that capital gains treatment is available

> if the total distributions payable with respect to any employee are paid to the distributes within 1 taxable year of the distributee on account of the employee's death or other separation from the service, or on account of the death of the employee after his separation from the service . . . .

The phrase "total distributions payable" is not all-inclusive. *See* INT. REV. CODE of 1954, § 402(a)(3)(C); Treas. Reg. § 1.402(a)-1(a)(6)(ii) (1966).

The corresponding restrictions as to qualified annuity plans are imposed by INT. REV. CODE of 1954, § 403(a)(2)(A)(iii), which provides in pertinent part that capital gains treatment is available if

> the total amounts payable by reason of an employee's death or other separation from the service, or by reason of the death of an employee after the employee's separation from the service, are paid to the payee within one taxable year of the payee . . . .

The phrase "total amounts" is not all inclusive. *See* INT. REV. CODE of 1954, § 403(a)(2)(B); Treas. Reg. § 1.403(a)-2(b)(1) (1966).

114. Presumably there is nothing to prevent an employee from contracting for the payment of deferred compensation after his death under an individually negotiated deferred compensation contract. From the employer's standpoint, however, long-continued deferral of receipt by the employee or his beneficiaries may mean equally long-continued deferral of the employer's deduction for compensation. *See* H. HAVIGHURST, *supra* note 109, at 274-82 (1964). *Cf.* Bank of Sheridan v. United States, 13 Am. Fed. Tax R.2d 343 (D.Mont. 1963), holding that an employer could deduct a contribution to a non-qualified profit-sharing plan even though individual employees did not appear to have nonforfeitable rights to the contribution, since any forfeitures would accrue to the benefit of the remaining participants in the plan.

has over such deferred compensation during the period of deferral is much less than an investor's control over his individually owned assets. It is difficult to design a nonqualified deferred compensation contract which gives nonforfeitable rights to deferred compensation to the employee, or to his beneficiaries after his death, without requiring the employee and his beneficiaries to rely upon the credit of the employer.[115]

However, the shortcomings of a carry-over basis rule, and of gains tax forgiveness, become most apparent when we turn to an analysis in terms of relative tax burdens upon family interests in current maintenance and in the inheritance of property. Let us ask, simply, whether it makes sense in terms of family redistributional interests to require current payment of the income tax upon modest personal service incomes while indefinitely deferring or forgiving the tax in respect of appreciated assets held until the owner's death?

There are solid arguments for the view that it does not make sense to do this. They pivot on the premise that we ought not to exempt an income sufficient to permit the tax-free maintenance of a reasonably adequate family standard of living, as we did in the earlier years of the income tax.[116] This premise is as supportable as the view that families with income above the bare subsistence level benefit materially from the services provided by government[117] and hence should make some contribution to the cost of government.[118]

115. H. HAVIGHURST, *supra* note 109, at 283-84, 287-89.

116. Until 1931, with a brief exception during the years 1917-20, the exemptions for a married couple with two dependents ranged from $4,000 to $3,300, and, during these same years, the consumer price index (taking the 1947-49 average as 100) ranged from a low of 42.3 in 1913, to a high of 85.7 in 1920, 76.4 in 1921, being the next highest year. WAYS AND MEANS COMM., 85TH CONG., 1ST SESS. 1 TAX REVISION COMPENDIUM 527 (Comm. Print 1959). More recently, the consumer price index for selected cities (taking the 1957-59 average as 100) has ranged from 48.8 in 1940 to 109.9 in 1965. U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 357 (1966). Some tie between the 1947-49 and 1957-59 based indexes is revealed by data for 1957-58 and the first five months of 1959 which show an index of 120.2 to 123.8 on the 1947-49 base. WAYS AND MEANS COMM., *supra*. Currently, of course, the exemptions for a married couple with two dependents are $2,400.

117. *Cf.* W. BLUM & H. KALVEN, THE UNEASY CASE FOR PROGRESSIVE TAXATION 39 (1953). "If . . . resort is had to some general assumption about the distribution of the highly diffuse benefits of government, the most plausible one is that all citizens benefit approximately alike." *Id.*

118. As Madden put this point, in recording the opposition of The Chamber of Commerce of the United States to proposals to increase personal exemptions incident to the 1954 code revision:

The chamber is opposed to the proposal to increase the ex-

Given this premise, one such line of argument runs as follows. The initial reliance of every family has been upon the personal productive capacities of its members, of past generations if not of the current one. Adequate, as distinct from subsistence level, maintenance for the family is important to realizing the personal productive capacities of both adults who are producing currently and children whose productive capacities are at various earlier stages of development.

In view of the foregoing, it is a clear distortion, if not an inversion, of the appropriate tax impact upon family redistributional interests to tax personal service income which is required for adequate current maintenance of the family and hence, at lower income levels, impinge upon an already inadequate family standard of living, while retaining a prolonged postponement or exemption of income from the tax in order to subsidize the transfer of an owner's gains to succeeding generations.

A similar line of argument asserts a somewhat more precise connection between the family redistributional interests in maintenance and the inheritance of property. The personal accumulation of a material amount of wealth for transmission at death requires productive capacities that are well above the average.[119] Productive capacities of this substantial kind can be materially assisted in development by early maintenance and economic opportunity at levels well above subsistence.[120] Hence an indefinite deferral or exemption of gains unrealized at death from the income tax, accompanied by such a tax upon ordinary maintenance level incomes operates simultaneously to permit families which have accumulated wealth to retain it for their succeeding generations, while inhibiting the chances for comparable future accumulations by families which have not as yet done so.

> emptions of individual taxpayers up to $1,000. Surely everyone should do his share, whether large or small, to bear the Nation's responsibilities through direct taxes and, further, it is inequitable, as well as impractical, to transfer the income-tax responsibility of one class to another.

Hearings before the Senate Committee on Finance on H.R. 8300, 83d Cong., 2d Sess. pt. 3, at 1944 (1954).

119. Lampman's recent study indicates that "a minimum of 2.28% of households and 2.35% of married couples have at least one member owning $60,000 of gross estate." R. LAMPMAN, *supra* note 85, at 7. Even if all of this wealth were personally accumulated by its owners—an assumption which is scarcely flattering to the role of the inheritance of property in our society—it is evident that a small percentage of our producers possesses such talent for accumulation.

120. *See, e.g.*, W. BLUM & H. KALVEN, *supra* note 117, at 87.

These arguments for gains tax realization at death, which involve a comparison of the family interest in adequate current maintenance with that in the inheritance of property, require refinement if they are not to appear as general arguments against *any* deferral of the income tax on savings out of current compensation, including, for example, deferral afforded by qualified retirement plans or nonqualified deferred compensation contracts.

One basis for such refinement is that the latter means of deferral serve primarily to fund maintenance in retirement. Thus these deferrals reduce the demands of a family's retired generation upon the productivity of later generations, a contribution to the family's financial future which is logically antecedent to the accumulation of wealth for transfer by inheritance. Another basis for refinement is that deferrals which fund maintenance in retirement typically permit an individual taxpayer to realize his income over his expectancy, as distinct from the usually shorter period of his personal productivity. Hence, such deferrals are primarily an income-averaging rather than a redistributional device.

The yield of this general consideration of gains tax forgiveness at death as a concession to the family interest in redistribution is a clear case for its abandonment. The reason is that this concession is anomalous in the light of our income taxes upon gains realized in switching investments, upon personal service income that is realized, saved, and invested, and upon personal service income used for family maintenance. However, the argument to this point has been aided by two assumptions: first, as is doubtless true in the average case, that one who dies holding appreciated investments does not die prematurely; second, that gains taxes are as readily payable as other income taxes, which is only true in the case of readily marketable appreciated assets. Let us test this case by viewing it in a situation in which neither of these assumptions is correct.

Suppose the case of *H*, deceased, whose estate consists predominantly of shares in a close corporation in which he has been active in an executive capacity. Let us assume that *H*'s shares cost him $10,000 and have a fair market value at his death which is highly speculative, but which ranges between $150,000 and $250,000. Also assume that *H* dies at a relatively young age, leaving the stock to his several surviving dependents. Is gains tax realization at death appropriate in such a case or should an exception be created for cases of this kind? Let us consider,

first, whether the difficulty in liquidating the investment to pay the gains tax justifies such an exception.

The more limited concession of extending the time for payment of gains taxes might be appropriate, in order to prevent forced sale liquidation of such investments. Such a concession can be found at present under the federal estate tax law,[121] and was included in the Kennedy Administration's realization at death proposal.[122] It is even arguable that, as to assets of such highly speculative value, the taxpayer should be given the further option of paying gains and estate taxes at a valuation date subsequent to the decedent's death.[123]

---

121. INT. REV. CODE of 1954, §§ 6161, 6166. The former section authorizes the Treasury to extend the time for payment of the estate tax upon a finding that the payment, on the due date, of any part of the estate tax "would result in undue hardship to the estate," the permissible period of extension being "a reasonable period not in excess of 10 years from the date prescribed . . . for payment of the tax," *i.e.*, the due date of the estate tax return, which is fifteen months after the date of death. The latter section authorizes an executor to elect to pay "part or all of the tax imposed by section 2001 in two or more (but not exceeding 10) equal installments." The election is available only

> if the value of an interest in a closely held business which is included in determining the gross estate of a decedent . . . exceeds either (1) 35 percent of the value of the gross estate of such decedent, or (2) 50 percent of the taxable estate of such decedent.

The election is limited to the tax attributable to the closely held business interest. Interests in two or more closely held businesses may be treated as one for purposes of satisfying the above percentage requirements, "with respect to each of which there is included in determining the value of the decedent's gross estate more than 50 percent of the total value of each such business . . . ."

122. It was proposed that "section 6161 should be liberalized so that circumstances involving a forced sale of a family business to outsiders, or a forced sale on a depressed market, are considered to be an undue hardship." WAYS AND MEANS COMM., 88TH CONG., 1ST SESS., PRESIDENT'S 1963 TAX MESSAGE 131 (Comm. Print 1963). It was also proposed that § 303, which permits redemptions of stock to pay death taxes, be broadened to permit such redemptions to pay gains taxes on gains realized at death. *Id.*

123. The optional valuation date for federal estate tax purposes is familiar. INT. REV. CODE of 1954, § 2032. This provision was inserted in the federal estate tax in 1935 in response to depression-sparked concern over rapid decline in the value of assets immediately following a decedent's death. C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES § 18.3 (2d ed. 1962).

Since gains tax rates have a ceiling of 25% as opposed to 77% for the federal estate tax, the maximum burden of a sharp decline in values would be significantly less under a system of gains tax realization at death. On the other hand, in the case of hard-to-value assets such as the hypothetical close corporation stock under discussion, there is something to be said for an optional valuation period. First, insofar as realization at death involves the analogy of a transfer at death to a sale, it

Perhaps we should go further and forgive the gains tax altogether in order to facilitate retention of such investments. But why so when we do not facilitate the initial acquisition of investments by forgiveness of the income taxes on savings, or gains taxes on gains realized inter vivos?

It may also be argued that the prematurity of death factor justifies forgiveness in such cases. In effect, the suggestion is that, in cases of premature death, unrealized asset appreciation should be regarded as the proceeds of life insurance which are generally not subjected to an income tax.[124] But this suggestion is difficult to defend.

Those who earn personal service incomes, or realize their gains inter vivos, are required to run the risk of subsequent premature death without being forgiven income taxes on their inter vivos gains. This stock appreciation was inter vivos gain to our decedent *H*, however speculative its amount may be. "Pure"[125] life insurance gains are not of that character—at least until a premature death becomes predictable, at which time an insured prospective decedent is not, to put it mildly, in an optimum position to make inter vivos use of the appreciation in the value of his insurance policies.

It would seem, therefore, that even in this appealing case, gains tax forgiveness at death is an inappropriate concession to the family interest in inheritance and should be abandoned.

2. *The Specificity of the Case for Gains Tax Realization at Death*

It remains, however, to place this position in perspective in relation to some other notable concessions to the inheritance of

may be argued that an asset of highly speculative value would not be voluntarily sold if the prospects seemed at all bright that its value would be more readily ascertainable within a reasonable period of time. Secondly, in the specific case of an interest in a business in which the decedent was active at his death, an optional valuation period might help to clarify the effect of the decedent's death upon the future of the enterprise. Third, there is some authority, under the income tax, for a deferral of the determination of the gain or loss upon a deferred payment sale where the value of the consideration promised by the purchaser is unascertainable. Burnet v. Logan, 283 U.S. 404 (1931); Commissioner v. Carter, 170 F.2d 911 (2d Cir. 1948). However, the Treasury regards such cases as "rare and extraordinary." Rev. Rul. 402, 1958-2 CUM. BULL. 15.

124. INT. REV. CODE of 1954, § 101.

125. The portion of a life insurance premium which is paid for current insurance protection is frequently termed the "pure insurance" portion of a premium. *See, e.g.*, Vickrey, *Insurance Under the Federal Income Tax*, 52 YALE L.J. 554, 560, 562 (1943).

property under our progressive income, estate and gift tax structure; for assuming acceptance of the argument thus far, it is well to consider whether the abolition of gains tax forgiveness can readily be urged as an isolated adjustment within our system of progressive taxes upon inheritance. For this purpose, three prominent concessions will be considered, in each case only for the limited purpose of determining whether the case for realization at death is substantially applicable or distinguishable.

(a) Realization at Death in the Case of a Decedent's Life Insurance Proceeds

One such concession is that we do not realize gain to a decedent who, at his death, controls a policy of insurance upon his life payable to beneficiaries of his choosing. It may seem to friends of family interests that our practice in this regard is so instinctively correct that the inquiry is idle. But we have an equally well-settled practice of taxing decedents upon their life insurance under the estate tax, though the reach of the estate tax in this regard was reduced by the Congress in 1954.[126] And since the premise of the estate tax is that the decedent made a taxable transfer of the proceeds of the policy, is it so self-evident that he did not previously acquire them for income tax purposes?

Let us, for this purpose, consider an appealing case for maximum income tax concessions for life insurance proceeds. Suppose an insured decedent dies early in his productive life, having recently purchased a declining term insurance policy upon his life in the face amount of $100,000, payable to his dependents, and having paid a single annual premium of $400. The risk which this decedent insured against was the loss to his dependents of his future personal income by reason of his premature death.

In the preceding discussion, it was argued that gains tax forgiveness was an inappropriate income tax concession to the family interest in the inheritance of property because we do not forgive the income tax upon personal service incomes which are required for adequate family maintenance, or upon other income that is realized in the course of accumulating wealth for transmission at death. Do these arguments apply to our decedent's life insurance gain of $99,600?

126. Under Int. Rev. Code of 1939, ch. 2, § 811(g), 53 Stat. 122, an insured decedent was taxable upon the proceeds of life insurance purchased with premiums, or other consideration, paid directly or indirectly by the decedent as well as under the circumstances specified in INT. REV. CODE of 1954, § 2042.

It seems evident that whether they do or not depends primarily[127] upon whether the difference that pure life insurance gains are created by a premature death, whereas unrealized asset appreciation is not, is a difference in facts which justifies a difference in tax results. That factual difference aside, it is easy to argue that such life insurance proceeds are merely a substitute for future earnings which the decedent would have made but for his premature death, which earnings would have been taxable income. On this tack the decedent's interest in providing for the policy beneficiaries after his death cannot even found a case for a modest exemption of life insurance proceeds equal in amount to the present value of the aggregate of $600 personal exemptions lost by his death, for, had he lived, he would have had to spend more than $600 per year of his income in maintaining himself.

Let us, then, consider the relevance of the prematurity of death factor. Several arguments may be advanced for income tax concessions to such an insured decedent.

First, it may be urged that the personal productive capacities of a relatively young person are unlikely to be fully insured,[128] and hence that the proceeds of pure insurance on his life are unlikely to exceed the provision which he could have made for the policy beneficiaries, after taxes and costs of self-maintenance, had he lived out his productive expectancy. Indeed, this argument may be extended. Arguably, as a matter of social insurance, the surviving contemporaries of such underinsured decedents should make the latters' contributions to the cost of government. At least this line of argument states a reasonable case for taxing such a decedent's life insurance proceeds with greater restraint than the personal income which he would have earned

---

127. The argument that the decedent did not realize the proceeds because his death was the event which created the right to the proceeds seems seriously embarrassed by our practice of regarding the decedent as their transferor for estate tax purposes in the case under discussion. INT. REV. CODE of 1954, § 2042. Moreover, the distinction between the decedent's realization of items of income accrued at death in *Helvering v. Estate of Enright,* see notes 63-65 *supra* and accompanying text, and the decedent's realization of the proceeds of insurance upon his life in the hypothetical under discussion requires heavy emphasis upon the rather formal distinction that personal service income is realized when earned, even though it is not then available to the earner.

128. Institute of Life Insurance statistics for 1965 show disposable income per family in the United States as $7,600 and life insurance per family as $14,700, a ratio which surely suggests inadequate insurance against early loss of future personal service income. INSTITUTE OF LIFE INSURANCE, LIFE INSURANCE FACT BOOK 22 (1966).

had he lived, though the case for a total exemption is embarrassed by the fact that it may extend to a large amount of life insurance proceeds even though very small personal service incomes are subjected, somewhat, to the income tax.

Second, in the average case, our tax rates on personal service income will be applied to earnings over a full life span. Because family obligations frequently survive a prematurely deceased producer, it may be argued that a producer who dies prematurely should be taxed on his actual earnings as though they had been earned over a normal expectancy. Because the present income tax law does not recognize this, it may be argued that such a producer has been overtaxed on the income earned prior to his death. If this much is accepted, then it is appropriate, once such a producer is dead, to undertax the insurance proceeds which he leaves in lieu of the yield of his future productivity. The weakness of this argument, of course, is that large life insurance gains may be realized upon the death of an insured who was too young to have produced much in the way of taxable income prior to his death. But, again, this argument explains why life insurance proceeds might reasonably be taxed with greater restraint than the personal income which the decedent would have earned had he lived.

And both of the preceding lines of argument may gain some support from an analogy between the proceeds of pure life insurance and the traditionally exempt category of damages for personal injury[129] which can also provide a fund for the maintenance of dependents.

Finally, we are considering an instance in which the decedent's life insurance proceeds will be included in his gross estate for federal estate tax purposes. The crux of the case for including such proceeds in income is that they stand in lieu of personal income which the decedent would have earned had he lived. This fact invites the further point that the bulk of such income, had it been earned, would have been expended inter vivos and hence would have escaped the estate tax. Hence the argument is available that the over-estate taxation of such proceeds creates a case for their under-income taxation. If there were no more to the argument than this, it would be wholly vulnerable to the proposal that both the income tax exemption and the gross estate inclusion be eliminated. But there

129. *See* Hawkins v. Commissioner, 6 B.T.A. 1023 (1927) (holding damages for libel and slander nontaxable); INT. REV. CODE of 1954, § 104(a)(2).

is more to it.

One of the embarrassments of the thesis that pure life insurance proceeds ought to be included in the decedent's final return because they stand in lieu of his future earnings is that foreward averaging of income is required to fix the appropriate rate of tax. This means that no rate can be realistically defended as taxing the decedent as he would have been taxed, under future rates and exemptions, with allowance for future deductions, had he earned over his productive expectancy. This being so, crude expedients must be resorted to. If a tax like the estate tax, which has a large initial exemption, errs in undertaxation of life insurance proceeds, it errs most heavily in this direction in the case of smaller estates, and, at present rates, may well err in the opposite direction in the case of large ones.[130] At least, this crude expedient is grossly consistent with simultaneous respect for the family interest in inheritance and progression in taxation.

To sum up, notwithstanding the existence of a solid case for collecting a gains tax upon gains transferred at death, a series of, at least collectively, substantial arguments can be made for income tax concessions to the family interest in inheritance in taxing pure insurance gains in cases of premature death, where the decedent has insured his dependents against the loss, through death, of his personal capacities to produce taxable income in the future.

These arguments do not make a comprehensive case for exempting a decedent from an income tax upon his life insurance proceeds. For example, if pure insurance proceeds are made payable to a decedent's estate to pay consumer debts incurred during his lifetime, the arguments just made are not fully applicable. In such a case, the decedent receives a personal benefit—the payment of a personal debt. And, since there is an estate tax deduction for claims,[131] insurance proceeds so used are not burdened with a federal estate tax. Further, if the insurance proceeds payable to a decedent's beneficiaries are the proceeds of permanent insurance so that the policy beneficiaries receive, in part, a policy reserve including accrued but untaxed interest, the arguments just made are not fully applicable either.[132] First,

130. See ALI FED. ESTATE AND GIFT TAX PROJECT § X2 (Study Draft No. 2, 1966), outlining proposals for rate reductions incident to the revision of the federal estate and gift taxes into a "Unified Transfer Tax."

131. INT. REV. CODE of 1954, § 2053(a) (3).

132. It can, of course, be argued, in derogation of the customary rules of cash receipts accounting for federal income tax purposes, that

the policy reserve was largely available to the decedent for inter vivos purposes. Second, it is less easy to characterize such reserves as insurance against the loss of the decedent's personal capacities to produce future income without extending the characterization to such investments as bonds with accrued interest,[133] or appreciated assets generally, and moving into a wholly distinct area of argument—the advocacy of general income tax forgiveness in cases of premature death.[134]

Nonetheless, enough has been said to indicate that the case previously made against gains tax forgiveness is not necessarily applicable to the taxation of life insurance gains.

(b) The Exclusion of Gifts and Inheritances from Income

It is apparent that the case made above for gains tax realization at death does not support the inclusion of gratuitous receipts in income, notwithstanding the fact that some friends of realization at death also favor such inclusion.[135]

First, the case made above for gains tax realization at death rested materially upon the fact that an income tax is imposed upon ordinary maintenance incomes. The friends of an income tax upon gratuitous transfers do not seem to contemplate the collection of such a tax upon the recipients of ordinary intra-household transfers for maintenance.[136] Hence, this part of the argument for realization at death does not support the inclusion of gratuitous receipts in income.

Second, the case made above for gains tax realization at death is a case against the exemption of gain from the *first* income tax upon it. A case for including gratuitous receipts in the income of the recipient must be a case for imposing a *second* income tax upon such receipts in any case in which such receipts

---

the interest element in these policy reserves should be taxed to the policyholder as they accrue. W. VICKREY, AGENDA FOR PROGRESSIVE TAXATION 65 (1947); Goode, *Policyholders' Interest Income From Life Insurance Under the Income Tax*, 16 VAND. L. REV. 33 (1962).

133. Such interest accruals are currently taxed as items of income in respect of a decedent. INT. REV. CODE of 1954, § 691(a); Treas. Reg. § 1.691(a)-1(b)(1) (1957).

134. *See* text accompanying notes 124-25 *supra*.

135. *E.g.*, R. MUSGRAVE, THE THEORY OF PUBLIC FINANCE 165-67 (1959).

136. Even Simons shrank from such rigorous application of the principle, though he avoided a concession on the merits by pleading that "the appropriate measures are forbidding from the standpoint of administration; and we may be reconciled to the ignoring of gifts in many such cases. . . ." H. SIMONS, PERSONAL INCOME TAXATION 136 (1938).

were previously exposed to an initial income tax in the hands of the transferor.[137] Indeed, the adoption of gains tax realization at death would serve to buttress this argument. The argument is inapplicable to the taxation of the recipient of life insurance proceeds which have not previously been taxed as income. But, in this instance, the substitution of an estate tax thereon may be a defensible alternative.[138]

Third, and more fundamentally, the proposal that gratuitous receipts be included in income requires consideration of the question whether income tax rates and exemptions, primarily designed for application to earned receipts, should be applied to the taxation of largely intrafamily gratuitous transactions. This question was not reached in the consideration of the propriety of gains tax realization at death. There is, moreover, a powerful argument for a negative answer to the question—one which should be persuasive both to persons who are inclined to think that a gratuitous transferee has reaped where he has not sown and hence should be taxed heavily upon his windfalls,[139] and to those who are inclined to think of gratuitous transfers as a vital mechanism for allocating a family's resources among its members, and hence deserving of peculiar subsidy under the tax structure. The point is that there are enough differences between the receipt of a gratuitous transfer and the realization of individually produced income to place the burden of proof upon those who would urge that the same set of tax rates and exemptions should apply indiscriminately to both.

Fourth, there is the more technical difficulty that, in many cases of substantial gratuitous transfers, the beneficial interests of the transferees cannot be identified and valued at the time of the transfer for the purpose of subjecting them to an individualized income tax at progressive rates. Beneficial interests may be given to unascertained persons, or may be subject to the exercise of discretionary powers held by trustees or other beneficiaries. In such cases, if the tax is to be collected when the transfer is made, the rate of tax must be determined in ignorance of the

137. This point assumes, to be sure, that the inclusion of gratuitous receipts in the incomes of donees would not be accompanied by allowing a deduction to donors for gifts. But the premise that gratuitous transfers within the family are redistributional surely supports the conclusion that the making of such a transfer is a personal expense of the donor. And the generality of personal expenses are not deductible.

138. *See* discussion pp. 62-64 *supra*.

139. Blum & Kalven seems to have been so inclined. *See* note 99 *supra* and accompanying text.

identity of the recipients.[140] And if a nonindividualized gratuitous transfer tax must be resorted to in the case of these transfers, it seems arguable that such a tax should be employed in all cases in the interest of uniformity And, if so, why struggle to fit the resulting tax into the category of an income tax rather than that of a gratuitous transfer tax?

(c) The Failure To Collect Gift or Estate Taxes in Each Generation

The problem here is, of course, that successive outright transfers of wealth from generation to generation result in gift or estate tax exposure upon the occasion of each successive transfer, whereas a single transfer creating successive interests in several generations, results, if made with ordinary attention to tax consequences, in only one such exposure.

At a glance, this problem seems no more related to the case made above for gains tax realization at death than the question whether gratuitous receipts should be included in income.

Again, insofar as the case for realization at death rests upon the income tax imposed upon maintenance incomes, gratuitous transfer taxes are not ordinarily imposed upon such incomes.

Further, both the question whether gratuitous receipts should be included in income, and the question of the propriety of collecting a gratuitous transfer tax in each generation, relate to taxes that burden successions to family wealth. Hence both involve judgments regarding the continuity of family claims to family property. One may agree, with Rignano, that there is no legitimate continuity in this regard beyond a couple of generations, so that the tax structure should be designed to exhaust family wealth after it has been transmitted for a couple of generations.[141] Or one may think of families as subordinate social

140. There is recourse to an amusing variety of statutory presumptions as to future events for the purpose of imposing the inheritance tax currently. Under MINN. STAT. § 291.11(5) (1965), in the case of a transfer which leaves the identity of the recipient uncertain, a current tax is imposed at the highest rate which could ultimately be payable, with provision for a refund. Ohio law is similar, OHIO REV. CODE ANN. § 5731.28 (1954) Under Missouri law, a current tax is imposed at the lowest rate which could ultimately be payable, with provision for a deficiency. MO. REV. STAT. § 145.240(2) (1959). Under Illinois law, a current tax is imposed at the rate which would ultimately be payable if the most probable events occurred, with provision for refund. ILL. REV. STAT. ch. 120, § 398 (1965)

141. E. RIGNANO, THE SOCIAL SIGNIFICANCE OF THE INHERITANCE TAX 34 (W. J. Shultz transl. 1924)

units within the society and insist that it is odd to contend that a third generation heir to a nineteenth century fortune has no legitimate claim to it, while assuming that each newborn citizen of the United States has, as of birthright, his aliquot claim to our accumulated national wealth. The point of present importance is that neither of these positions questions the propriety of continuing to levy progressive taxes upon gratuitous transfers, and hence both of them accept the propriety of whittling down accumulations of wealth as they are transmitted from generation to generation. This point is important because the justification of gains tax realization at death requires no such assumption, but depends solely on the assertion that the initial acquirer of family wealth should pay an income tax on it.

Indeed, these distinctions are plain enough so that no one would be likely to contest their conclusiveness if our progressive taxes upon income and gratuitous transfers had been in operation, under rate schedules comparable to those which have prevailed since World War II, long enough to virtually insure that family wealth accumulated by past generations and transferred to present ones had in fact been burdened more heavily by these progressive taxes than such wealth which is currently being accumulated. The difficulty is that such is not the case.

To briefly review some familiar history, progressive taxation in this century began with the enactment of a progressive income tax which, by its basis rules and exemption of gratuitous receipts, treated past accumulations as sacrosanct. Several years later, an estate tax was added which permitted an accumulation of wealth, once exposed to the tax, to escape further death taxes for the period of perpetuities if the transferor chose to take full advantage of his chance to make a multigeneration transfer in trust. Gains tax forgiveness at death accompanied the estate tax, allowing the transferor to defer further gains taxes on appreciation in the transferred property for the full term of the trust and, indeed, beyond it if no realization was required in the course of terminal distributions of principal.

A gift tax was not permanently added for another decade and a half, during which interval, a well-advised inter vivos transferor could achieve all of the multigeneration trust blessings above-mentioned, except gains tax forgiveness at death, without sustaining the initial burden of paying the estate tax.

Hence one who observes that currently it is necessary that a decedent's wealth be exposed to estate tax rates which escalate to a very high level in order to gain the advantage of gains

tax forgiveness may wonder whether it makes much sense to adopt gains tax realization at death without doing something to insure that past multigeneration transfers will be burdened by our income and gratuitous transfer taxes in some substantial way. After all, to adopt gains tax realization at death without doing so would be to insist upon exposing current accumulations for the benefit of immediate beneficiaries (other than a spouse) to both an income and a gratuitous transfer tax, while the more remote kindred of past transferors retain the blessings aforesaid, perhaps still unburdened by exposure to either.

Indeed, in terms of the case made above for gains tax realization at death, it may be asked whether it makes sense to use the current income taxes levied upon maintenance incomes, savings out of personal service income, and realized gains, to justify realization of gain upon a gratuitous transfer, while ignoring these possibilities of more remote tax-free inheritances of property. It is easy to concede, by way of initial response, that some scheme should be devised for realizing gains periodically in the case of assets held in multigeneration trusts—including those established in the past.[142] The consequence of doing this, after all, is only to collect a first tax upon such gains.

It is less evident, however, that the adoption of some scheme for the collection of a new round of gratuitous transfer taxes in each generation is also appropriate. Presumably, if such a remedy were applied to tax each succession to the enjoyment of past, as well as future, multigeneration transfers, the result would be to collect some initial gratuitous transfer taxes upon the hitherto untaxed principal of some old family trusts a half century sooner than would otherwise be the case. But it is as clear that the result would also be to collect further gratuitous transfer taxes upon the property of other decedents whose transfers have been made with assets already exposed to income and estate or gift taxes. As demonstrated above, the case made herein for gains tax realization at death does not support this latter result.

This is not to say, of course, that such support may not be found upon a further analysis of the family interest in inheritance. It is only to say that such support ought not to be assumed. Is it plain, for instance, that we should design a gratuitous transfer tax structure under which a grandparent's efforts to transmit wealth to his grandchildren are burdened more

142. See Anthoine, *Tax Reduction and Reform: A Lawyer's View*, 63 COLUM. L. REV. 809, 816 (1963).

heavily than like efforts to transmit like wealth to children?[143]

So much for the specificity of the case for gains tax realization at death in terms of family interests. It seems appropriate, before concluding the discussion, to relate this case to other factors which must be considered by the Congress in making a wise legislative choice. The most emphasized of these, at the time that the Kennedy Administration's realization at death proposal was before the Congress, was the economic consequences of the change.

II. ECONOMIC ASPECTS OF THE CHOICE BETWEEN GAINS TAX FORGIVENESS AND REALIZATION AT DEATH

Since the discussion under topic I considered gains tax forgiveness in terms of its impact upon the family interest in inheritance, while this one will consider it in terms of the impact of forgiveness upon the economy, it seems appropriate to notice the relationship between the topics. The families within society have a stake in the health of the national economy. Conversely, the national economy has a stake in the success with which these families perform their subordinate roles within the society. So, given a conflict between family and national economic interests, some attempt would have to be made to resolve the conflict with minimum jeopardy to both. Our immediate question under this topic is, however, a prior one. It is whether significant national economic interests do hinge upon the choice between gains tax forgiveness and realization at death.

---

143. This is the result of full fidelity to the premise that a single transfer of property by a grandparent which creates successive estates in his child and grandchild should be taxed as though there had been two successive transfers of that property in fee, the second being from the child to the grandchild.

In terms of family interests, this taxing premise seems to involve the notion that there is a lesser grandparental interest in providing for grandchildren than in providing for children, and, beyond this, that the difference can be quantified in a meaningful way for tax purposes. Does it follow, then, that, all else being equal, a grandparent who is bequeathing his wealth to his grandchildren because his children have predeceased him should pay higher death taxes than a like grandparent who is bequeathing his wealth to his children?

For some current efforts of the American Law Institute to minimize the use of successive estates as a device for gratuitous transfer tax avoidance, see ALI FED. ESTATE AND GIFT TAX PROJECT § X40, App. II (Study Draft No. 1, 1965); ALI FED. ESTATE AND GIFT TAX PROJECT §§ EX 40-43, GX 40-43 (Study Draft No. 2, 1966).

A. THE LOCK-IN ARGUMENT

Stated generally, the argument is that the prospect of deferring and ultimately avoiding the gains tax by holding an appreciated asset until death, distorts the allocation of resources because investments which would otherwise be disposed of inter vivos in favor of others are retained to secure gains tax forgiveness.[144] A key thought within this general point is that, if gains were realized at death, the incentive to defer the gains tax by retaining an appreciated asset would decline, rather than increase, as the prospect of early death became greater.[145]

But the argument is not very persuasive in this general form. It only states an objection to gains tax forgiveness which can be raised against any taxing provision that makes significant tax consequences turn upon an event within the control of the taxpayer. Hence one is quickly led to the further question, how important is this particular departure from economic neutrality under the income tax? Or, more specifically, how significant is the influence of gains tax forgiveness upon the aggregate of investment decisions within our economy?

While it has been estimated that as large a proportion of capital gains are forgiven at death as are realized by taxable sales or exchanges,[146] there seems to be little empirical evidence of the contribution of gains tax forgiveness at death to this state of affairs.[147] And the analysis which demonstrates that a rational investor would be increasingly reluctant to realize his gains as the prospect of his death became more immediate[148] cannot but remind us that a person who expects to die within a few years may well have better reasons than gains tax forgiveness for being inattentive to alternative investments. True, such a person's investments may be in the hands of agents who would give full rational weight to this factor. Still, it is difficult to suppress the thought that if we are really in economic need of increased investment activity by either princi-

144. *See* the statement of Treasury Secretary Dillon in *Hearings*, 88th Cong., 1st Sess., pt. 1, at 29, 54 (1963)

145. Beazer, *Expected Income Changes and the Lock-in Effect of the Capital Gains Tax*, 19 NAT'L TAX J. 303, 317-18 (1966), Holt & Shelton, *The Lock-in Effect of the Capital Gains Tax*, 15 NAT'L TAX J. 337, 352 (1962), Wallich, *Taxation of Capital Gains in the Light of Recent Economic Developments*, 18 NAT'L TAX J. 133, 135 (1965)

146. *Hearings*, pt. 1, at 369 (1963)

147. As Wallich recently put the matter, "The lock-in effect of the capital gains tax has been enveloped in a great deal of controversy, but of evidence there is not much." Wallich, *supra* note 145, at 145.

148. Holt & Shelton, *supra* note 145, at 343-49.

pals or agents who are making investment decisions in contemplation of death, there is something wrong with the economy that gains tax realization at death is unlikely to cure.

To be sure, the widespread interest in estate planning on the part of middle-aged investors of some wealth is wholly sufficient evidence of compatibility between personal attention to the prospect of one's death and investment activity. But such planning is designed to guard against deaths that are statistically premature. For such people, gains tax forgiveness appears as a relatively remote future tax benefit.

In conclusion, it does appear that the lock-in effect of the gains tax upon changes in investments by individuals contemplating death would tend to be reduced by switching from gains tax forgiveness to realization at death. Since the prospect of gains tax forgiveness is only immediate insofar as the prospect of death is immediate, and since there is an obvious inverse relationship between one's personal vigor and one's prospects of dying shortly, it seems far from clear that this tendency is of substantial economic importance. Indeed, logically, it seems probable that the lock-in effect has a greater impact upon investment decisions which are not materially influenced by the prospect of gains tax forgiveness.[149] So much for the lock-in argument. Its counterpart is that to realize the gains tax at death will also produce undesirable economic effects.

B. THE LIQUIDITY PROBLEM

The problem here is that economic decisions may be distorted by the need to raise money for payment of the gains tax on appreciated assets which, as an investment matter, should not be sold.[150] This may be true of both assets, such as many listed securities, which are readily marketable and assets which are hard to sell because their value is conjectural, or because they have a limited market.

At least as to such investment assets as marketable securities, it is hard to be impressed with the point. We seem to think it all right, economically, to compel would be purchasers of such assets to purchase them out of income after taxes and hence dis-

149. If so, the whole problem may not be of substantial economic importance. Heller, *Investors' Decisions, Equity, and the Capital Gains Tax*, in JOINT COMMITTEE ON THE ECONOMIC REPORT, FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY, 84TH CONG., 1ST SESS. 381 (1955).

150. Wormser, *The Case Against a Capital Gains Tax at Death*, 51 A.B.A.J. 851 (1965).

courage purchases. If so, why is it impermissible to impose a gains tax upon newly deceased owners of such assets which have appreciated because the tax might encourage sales—particularly when we wait until the seller has died so that a change in ownership of the asset is necessary anyway? Further, enough has been written about the separation of ownership and management of publicly held corporate enterprises in recent years[151] to suggest that it is unlikely to be vital to the enterprise whether a decedent's beneficiaries or his estate's vendees succeed him as stockholders.

There remain, of course, unmarketable assets that have appreciated, such as an interest in a small business. But the extent of the liquidity problem in respect of such interests can be overstated.

If an arrangement has been made for the sale of such an interest upon the death of its owner, there may be no liquidity problem at all. Business purchase agreements, providing for the sale of an interest in a corporation or partnership or the sale of a proprietorship upon the owner's death are familiar estate planning tools.[152]

If, on the other hand, the decedent wishes his beneficiaries to retain his interest in a business, and if the value of the interest is modest enough so that the payment of taxes in respect of it can be funded with insurance on the decedent's life, the liquidity problem may be dealt with in this way. Under present law, it may even be possible to work this out without exposing the insurance proceeds themselves to the estate tax.[153]

---

151. *E.g.*, A. BERLE, POWER WITHOUT PROPERTY (1959); J. LIVINGSTON, THE AMERICAN STOCKHOLDER (1958). Both of these recent books build, of course, upon A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

152. *See, e.g.*, 2 A. CASNER, ESTATE PLANNING, Ch. XV (3d ed. 1961).

153. Suppose that *H* is the controlling stockholder in *H*, Inc. His wife, *W*, creates a revocable life insurance trust of policies insuring *H*'s life. *W* is the holder of all incidents of ownership in the policies and designates the trustee as beneficiary of the proceeds. *W* pays premiums on the policies. The trust instrument authorizes the trustee to invest the proceeds of the policies collected at *H*'s death and provides that stock in *H*, Inc. is a permissible investment. The beneficiaries of the trust are *W* and the children of *H* and *W*. *H* dies, and the trustee, in his discretion, purchases some or all of the *H*, Inc. stock at market value.

Since *H* had no incidents of ownership in the policies of insurance, and did not pay any premiums within three years prior to his death, and since *H*'s executor had no power to require the trustee to purchase the *H*, Inc. stock, it would appear that the proceeds of the policies would escape inclusion in *H*'s gross estate for federal estate tax purposes under either INT. REV. CODE of 1954, § 2042 (as respects life insurance proceeds)

Or, if the value of the interest is less modest, the need to pay taxes in respect of it can sometimes be minimized by the creation of a charitable foundation to receive a portion of the decedent's interest.[154] Such a charitable gift may be deductible for estate tax purposes[155] and apparently would not have been subject to the Kennedy Administration's realization at death proposal either.[156]

Also, under present law, stock redemptions are permitted in order to meet the need for liquid funds to pay death taxes,[157] and there are provisions for installment payment of the estate tax in respect of a small business interest.[158] The Kennedy Administration's realization at death proposal contemplated the extension of these provisions to cover liability for gains taxes in respect of gains realized at death.[159] Indeed, beyond this, that proposal included averaging provisions to prevent the taxation of gains realized at death at bunched-gain rates.[160]

In view of these possibilities, it is certainly difficult to predict with confidence that the funding of gains tax liability at death would pose a problem for the owners of small business interests that would threaten the economic health of their enterprises. But, if further concessions are appropriate in this area, does it not seem that death tax rate concessions, which would benefit decedents whose business interests had not appreciated since their acquisition as well as those whose interests had done so, would be more appropriate than concessions in the area of gains tax realization at death? After all, the bite of the estate tax in respect of very valuable interests in closely held enterprises is considerably greater than that of the gains tax.

Also, it must be remembered that the present discussion concerns liquidity as a national economic problem. It is evident that the problem can be much more serious for particular families who have not planned adequately to meet the problem than for the economy as a whole.

---

or § 2035 (as respects gifts in contemplation of death). As to the chance that, if *H* paid the premiums during the three years prior to his death, a rateable portion of the insurance proceeds might be includible in his estate under § 2035, see 1 A. CASNER, ESTATE PLANNING 328 (3d ed. 1961).

154. *See, e.g.*, Leake, *Use of Foundations in Estate Planning*, N.Y.U. 16TH INST. ON FED. TAX. 929 (1958).

155. INT. REV. CODE of 1954, § 2055; Leake, *supra* note 154, 933 (1958).

156. *Hearings*, pt. 1, at 24, 54, 130, 139.

157. INT. REV. CODE of 1954, § 303.

158. INT. REV. CODE of 1954, § 6166.

159. *Hearings*, pt. 1, at 55, 137.

160. *Id.* at 137.

As a recent study illustrates, one's own business associates may squeeze him out of a small business,[161] or squeeze his beneficiaries out following his death,[162] to the grave financial disadvantage of the "squeezees"[163] but not necessarily to the disadvantage of the enterprise, which may emerge from the affair with a more competent management.[164] To be sure, this study emphasizes the economic injury to the particular small enterprises which experience such internal power struggles, as well as the potential injury to the capital market for new high-risk enterprises if potential investors become overly wary of exposure to them.[165] But the whole object of the study is to examine means of minimizing squeeze-out problems by advance planning.[166]

Mutatis, it has been indicated above that the liquidity problem raised by gains tax realization at death can also be solved by advance planning. If so, the problem will pose a difficulty only to those who have failed to plan against it. The stake of the economy in enterprises owned by the latter seems far from clear.

This last point does not, of course, make a case for a realization at death proposal that is heedless of the liquidity problems of those who have failed to plan adequately.[167] It does suggest, however, that the strongest reasons for being attentive to such problems may not lie in national economic aspects of the matter.

C. Realization at Death and the Supply of Private Capital

The immediate impact of gains tax realization at death upon the formation of private capital is, of course, that if it is necessary to sell appreciated assets in order to raise funds with which to pay gains taxes, those who purchase the assets must purchase them out of savings which would otherwise be available for investment in other productive assets. Hence, viewed in isolation, realization at death has an unfavorable impact upon the supply of savings for investment.[168]

161. This may occur when the "squeezees" are overly trusting, less able, inactive, superannuated, or in a minority position without safeguards. *See* F. O'Neal & J. Derwin, Expulsion or Oppression of Business Associates §§ 2.01-.03, 2.05, 2.15 (1961).
162. *Id.* § 2.04.
163. *Id.* §§ 1.04, 2.03-.04.
164. *Id.* § 2.06.
165. *Id.* § 1.05.
166. *Id.* § 1.06.
167. *See* text accompanying notes 121-23 *supra*.
168. There seems to be general agreement among economists that

The weakness of the point is that, were the Congress to conclude that the yield of this gains tax was a sufficient encroachment upon savings to merit some counterbalancing adjustment (a question which seems to be debatable at any point in time),[169] it would be easy enough to come up with counterbalancing adjustments which are easier to defend against the charge of perpetuating regression in the income tax than is gains tax forgiveness.[170] To mention three, the Kennedy Administration's realization at death proposal was included in an over-all

---

the gains tax is paid more largely out of funds that would otherwise be reinvested than the income tax upon yields of personal services or invested capital. *See, e.g.*, L. SELTZER, THE NATURE AND TAX TREATMENT OF CAPITAL GAINS AND LOSSES 87 (1951); D. SMITH, FEDERAL TAX REFORM 148-49 (1961); Wallich, *supra* note 145, at 142.

If a gains tax realized at death may be analogized to a death tax rather than to a tax on gains realized inter vivos, the impact upon savings may be essentially the same. J. DUE, GOVERNMENT FINANCE 369 (Rev. ed. 1959); D. SMITH, *supra;* W. SHULTZ & C. HARRISS, AMERICAN PUBLIC FINANCE 627 (6th ed. 1954).

169. This is so because of the intrinsic uncertainty as to whether the long-term tendency of our economy is to produce a relative deficiency of savings or of demand for capital. Kuznets states that our statistics are necessarily confined to ex post facto measures of the supply of savings and the actual level of capital formation achieved which

> cannot enable us to discriminate properly between two alternative hypotheses each of which refers to *ex ante* assumptions: (1) that would-be savings were greater than would-be capital investment opportunities (and that, therefore, the latter served as a brake); or (2) that would-be savings were smaller than would-be capital investment opportunities (and that, therefore, the former served as a brake).

S. KUZNETS, CAPITAL IN THE AMERICAN ECONOMY 399 (1961). Hence Kuznets' historical analysis of long-term trends in total capital formation and factors determining the volume of savings only leads him to a "reasonable impression" that "the limitation on savings available for financing capital formation held down capital formation levels. . ." over the post-World War II period. *Id.*

170. Wallich's recent expression of concern with the impact of the gains tax upon savings, Wallich, *supra* note 145, at 143, has drawn fire on the ground that off-setting adjustments are available. Folsom, *Capital Gains, Consumption, Capital Gains Taxes and the Supply of Saving,* 19 NAT'L TAX J. 434, 436-37 (1966).

To illustrate the feasibility of such off-setting adjustments in the present setting, the Treasury estimated that the revenue increase attributed to its gains tax-realization-at-death proposal would be around $300,000,000 annually, and that an additional increase in revenue of around $690,000,000 annually would result from increased voluntary inter vivos sales of appreciated assets. *Hearings,* pt. 1, table 11, at 71. The sum of these figures, then, $990,000,000 annually, would have been the maximum estimate of the reduction in national savings stemming from the adoption of this realization at death proposal. For an earlier estimate of the yield of realization at death, *see* Steger, *The Taxation of Unrealized Capital Gains and Losses: A Statistical Study,* 10 NAT'L TAX J. 266 (1957).

package which included a proposal to reduce gains tax rates,[171] another to reduce the rates upon ordinary income which included substantial reductions in the higher brackets,[172] and a third to somewhat reduce corporate tax rates.[173] To mention another, the American Law Institute is now discussing proposals for revision of our estate and gift taxes, one of which includes rate changes that apparently would produce substantial short term reductions in yield.[174] All of these are adjustments which tend to facilitate saving and hence private capital formation, and all of them succeed in doing so without exempting gains from the income tax altogether after the fashion of gains tax forgiveness.

D. FORGIVENESS VERSUS REALIZATION AT DEATH AND INCENTIVES TO WORK, SAVE, AND INVEST

What seems of primary importance under this heading is the incentives of the people in society who are capable of accumulating wealth while they are alive. And these are best identified as those who have done so because their capacities are demonstrated and, hence, are known quantities.[175] But the ef-

171. The Treasury estimated, in 1963, that the composite effect of the gains tax rate reduction and other minor adjustments would be a revenue loss of $430,000,000 annually. *Hearings*, pt. 1, table 11, at 71.

172. The Treasury estimated, in 1963, that rate reductions applicable to ordinary income for the 2% of taxpayers with adjusted gross incomes of over $20,000 would, even when counterbalanced by other adjustments, result in a net tax reduction for this class of taxpayers of $1,210,000,000 annually. *Hearings*, pt. 1, table 8, at 68. If we apply to this estimated reduction Kuznets' tentative estimate of a 25% savings ratio for persons whose incomes are in the top 5%, S. KUZNETS, *supra* note 169, at 100, the increase in savings resulting from these reductions alone would be around $300,000,000 annually.

173. The Treasury estimated, in 1963, that the revenue effect of its proposed corporate tax rate reductions would be a reduction in yield of $1,320,000,000 annually. If we apply Goode's estimate that 60-70% of the yield of the corporate income tax reduces corporate income that would otherwise have been saved by corporations or shareholders, R. GOODE, THE CORPORATE INCOME TAX 107-08 (1951), it is easy to conclude that the increase in savings from this corporate rate reduction, together with the gains tax rate reduction referred to in note 171 *supra*, would more than off-set the reduction in savings resulting from adoption of gains tax realization at death.

174. The rate schedule and exemption level proposed, at this stage of the project, for a Unified Transfer Tax would reduce yield by an estimated $855,000,000 annually. ALI FED. ESTATE AND GIFT TAX PROJECT 6-9 (Study Draft No. 2, Nov., 1966). The increment to savings resulting from such a reduction would appear to be comparable, dollar for dollar, to the reduction resulting from adoption of gains tax realization at death. *See* note 168 *supra*.

175. The percentage of American households containing one or more members owning at least $60,000 of gross estate has recently been es-

fect of a shift from gains tax forgiveness to gains tax realization at death upon the incentives of these people to work, save, and invest is a matter upon which both those who think family interests are of major importance, and those who think they are not, ought to agree.

Those of the latter view will quickly note that to realize the gains tax upon the event of a gratuitous transfer, inter vivos or at death, is to levy a tax which will not burden the acquisition of gain for purely personal purposes.[176]

And those who think the former should hesitate to insist that the desire to make gratuitous transfers of appreciated assets during one's life or at death may not be impeded by the collection of a gains tax on the appreciation without economically undesirable effects upon incentives to work, save, and invest, unless they are prepared, simultaneously, to insist that there is an equal need to repeal the taxes upon ordinary income and realized gains which impede not only accumulation of wealth but the maintenance of dependents, inter vivos. This seems quite enough of incentives.

E. Summary

This brief look at the economics of gains tax forgiveness and realization at death suggests that it does not matter much to the national economy which choice is made.

Apparently, the lock-in effect of conditioning the gains tax, inter vivos, upon a voluntary transfer would be somewhat reduced by realizing gains at death, though the national economic significance of the change seems slight.

On the other hand, some troublesome individual liquidity problems might be created by the adoption of realization at death. But the composite possibilities of preplanning to assure adequate liquidity, and of paying the tax in installments over a period of years where preplanning has been inadequate, seem likely to keep these problems within manageable bounds. After all, these solutions to the liquidity problem are tested ones, under the federal estate tax. Moreover, it seems unlikely that these individual problems would translate into appreciable problems for the economy as distinct from the individuals involved.

---

timated at a minimum of 2.28%. *See* note 85 *supra*. Of course, not all of these people will have personally accumulated their wealth.

176. H. Simons, Personal Income Taxation 20 (1938).

Beyond this, the economic consequences of the choice seem even less substantial. Thus, any possible untoward effects upon saving and private capital formation seem readily amenable to preferable counter-measures. And effects upon incentives to work, save, and invest seem downright inconsequential.

III. REALIZATION AT DEATH AS A PROBLEM IN LEGISLATIVE DRAFTING

The truly persuasive way to demonstrate that the drafting of statutes to realize gains at death is a manageable task is to tender a draft of appropriate statutes. But if, as is believed to be the case, the following is a representative sample of the drafting problems to be solved, it is hard to see why there should be enervating doubts on this score.

First, many of the drafting problems which must be solved in order to realize gains at death are not unfamiliar. Thus, the problem of distinguishing assets subject to realization at death from those that are not has its counterpart in the problem, under present law, of identifying those assets which benefit from gains tax forgiveness.

The solution to the corresponding problem in respect of inter vivos gifts is less evident because, under present law, there is a carry-over basis in respect of gifts and hence no change in basis whether or not there is a completed gift for federal gift tax purposes. If, as a general rule, we were to proceed in this area by analogy to realization at death, realization in the event of a gift would be tied to the making of a transfer that is taxable under the federal gift tax. The Kennedy Administration's proposal seems to have proceeded on this premise, since some qualifications of it were proposed by the Treasury.[177] Alternatively, gains could be realized to the donor to the extent that the inter vivos transfer would render subsequent gains and losses taxable to someone other than the donor for federal income tax purposes.[178] The basic case for this alternative would seem to be

177. A gift would not be treated as 'completed', and the gain in the property involved subject to income tax, if the property will be part of the gross estate for estate tax purposes. The rules applicable to death transfers would be applied. (An exception would be made here for gifts in contemplation of death which would be taxable as gift transfers, even though the property is part of the gross estate.)

Hearings, pt. 1, at 139.

178. Such an approach would, for instance, avoid realization of gain upon the transfer of appreciated assets in a short-term trust, providing for reversion of principal to the donor, which is effective to render the

that realization of gain in the event of a gift ought to be governed by the income tax conception of a gift, since the gains tax is an income tax.[179]

The problem of valuing assets which are to be subject to realization at death has its counterpart, too, in valuing them for the purpose of determining their basis under gains tax forgiveness, and for purposes of the federal estate tax. The problem of valuing them for purposes of realization in the event of a gift can be solved in the same way if realization in the event of a gift is implemented by tying the definition of a taxable realization to the federal gift tax definition of a gift.

The problem of determining the decedent's basis for assets which are to be subject to realization at death is largely a problem in securing information which the decedent himself should have recorded and retained for purposes of inter vivos income tax reporting.[180] And realization in the event of a gift eliminates the need to retain basis information secured from donors or to accept administrative fact-finding as at present.[181]

In the case of realization at death, the problem of avoiding bunching of gains in the decedent's final return seems soluble by adaptation of other provisions for the back-averaging of income.[182] And, if the application of realization at death produces a net loss in the decedent's final return, the problem of utilizing the loss can be met by adding an appropriate carryback provision.[183] As prior discussion has indicated,[184] the need

income beneficiary taxable on trust income, but under which the donor remains taxable upon capital gains and losses realized by the trustee during the trust term. *See* INT. REV. CODE of 1954, §§ 673, 677(a); Treas. Reg. § 1.677(a),(f),(g) (1956). It is possible that the Treasury contemplated a fractional realization of gain to the donor in such a case, since it was proposed to realize a fraction of gains upon a transfer to the donor's son for life with remainder to charity. *Hearings*, pt. 1, at 39.

179. Apparently this alternative is not presented in the case of realization at death, since the death of an individual seems to occur at the same time for income and estate tax purposes.

180. There may be cases of individuals who have failed to retain essential basis information with respect to nondepreciable assets because they fully intended to retain them until death to secure a new basis. But it seems reasonable to put the burden of going forward upon those who urge that many persons have been led to dispose of irretrievable evidence by such tax-conscious bookkeeping.

181. Treas. Reg. §§ 1.1015-1(g), 1.1015-1(a)(5) (1963).

182. INT. REV. CODE of 1954, §§ 1301-05. These sections do not now include capital gains in averagable income. Subsection 1302(a)(1), (b). The Treasury proposed this approach in 1963, *Hearings*, pt. 1, at 137.

183. The Treasury proposed this approach in 1963. *Hearings*, 1st Sess., pt. 1, at 128-29.

184. *See* text accompanying notes 121-23 *supra*.

to permit deferred payment of the gains tax realized at death to relieve hardship caused by a shortage of cash or marketable assets can be met by adaptation of provisions in the present law designed to meet this problem under the federal estate tax.

At least one novel and substantial legislative problem is presented—that of devising a compulsory method of realizing gains, periodically and in the absence of any transfer, in the case of appreciated assets held in multigeneration trusts.[185] But even here it may be possible to proceed by analogy to an optional method of inventory valuation under present law.[186] And it seems likely that the problem will provoke more constitutional debate[187] than drafting difficulty.

Second, assuming satisfaction with the case made above for some special treatment of life insurance gains, there is no drafting difficulty in giving effect to an exception in this case. It is only necessary to leave the present provisions governing the income taxation of life insurance proceeds undisturbed.

Third, other possible exceptions, which might be urged if the initial scope of gains tax realization at death were to be as broadly stated as the present rule of gains tax forgiveness, do not present very frightening drafting problems either. In some cases

---

185. *See* text accompanying notes 5 & 142 *supra*.

186. Under Treas. Reg. § 1.471-5 (1958), securities dealers are permitted to value their inventories at market. The proposal would be to periodically require a reporting of gains and losses on a market value basis. Proposals for periodic compulsory realization of gains are, however, familiar in the literature of gains taxation. *See, e.g.*, R. MUSGRAVE, THE THEORY OF PUBLIC FINANCE 167 (1959); H. SIMONS, PERSONAL INCOME TAXATION 167 (1938).

187. This proposal for periodic realization in the case of multigeneration trusts would be a part of a general legislative scheme for gains tax realization at death. As indicated early in this article, it is believed that the general scheme is constitutionally permissible.

In view of the explicit invitation to the Congress in Helvering v. Griffiths, 318 U.S. 371, 400-01 (1942), to enact a statute which would permit the Supreme Court to reconsider the status of realization as a constitutional requirement, Congress should not be reluctant to defend periodic realization in the exceptional case of multigeneration trust as a reasonable departure from the realization requirement to prevent avoidance of realization at death by multigeneration transfers. See the memoranda on the realization doctrine accompanying the Ways and Means Committee's consideration of the 1962 Revenue Code amendments taxing certain income of controlled foreign corporations to their United States shareholders, note 76 *supra*.

But, assuming such congressional reluctance, there would seem to be no constitutional obstacle to a periodic excise tax upon the privilege of employing multigeneration trusts in an estate plan. *See* note 35 *supra* and accompanying text.

this is because familiar analogies are available. In others, the propriety of, and hence need for, any exception is somewhat dubious.

A likely instance of the first sort is that of defining the categories of personal belongings and household goods which were to be left subject to forgiveness under the Kennedy Administration's realization at death proposal.[188] This problem of definition is a familiar one to draftsmen of wills[189] and probate codes.[190]

Another such instance may be that of an exception for appreciation in the value of a personal residence passing to the surviving spouse of a decedent. Since we permit deferral of recognized gains on the sale of a personal residence,[191] the extension of a carry-over basis to a surviving spouse cannot be objected to as inconsistent with the treatment of inter vivos sales. Also, this exception can be supported as a further subsidy to adequate maintenance of people who may no longer be productive. The drafting of such a provision would seem to pose little difficulty since we have already faced the definitional aspects in connection with the nonrecognition provisions just referred to. The Kennedy Administration proposed to forgive the gains tax in this case.[192] It must be admitted, however, that such an exception is hard to square with the income tax on maintenance level incomes.

The Kennedy Administration also proposed a forgiveness exception in the case of gifts to charity.[193] The preceding analysis of gains tax forgiveness in terms of family interests is not dispositive of the question whether such an exception can be adequately supported on the merits.[194] Accordingly, the most that can safely be said of this drafting problem is that if the exception should be made, the drafting problem seems soluble. The

188. *Hearings*, pt. 1, at 129-30.

189. Evidently, it is desirable to keep personal belongings and household goods out of the residuary estate, which requires a bequest of them and thus a workable definition.

190. *E.g.*, MINN. STAT. § 525.15(1)(2) (1965), which provides for an allowance out of the personal property of the decedent to his surviving spouse, or minor children if no spouse survives.

191. INT. REV. CODE of 1954, § 1034.

192. *Hearings*, pt. 1, at 133.

193. *Hearings*, pt. 1, at 130.

194. Perhaps it is unfriendly to the charitable exemption insofar as the analysis invites attention to the question whether our interest in subsidizing charity requires the selective incentive of an income tax deduction for the value of untaxed income contributed to charity. But we have not faced the question whether circumstances peculiar to the social interest in charitable giving justify such a selective incentive.

problem of discriminating between charitable and noncharitable gifts is already a familiar one under the income tax law.[195] And the problem of allocating such an exemption where the charity is bequeathed some interest in a fund of assets, such as a residuary estate, has been solved in other contexts under present law.[196]

Nor is the preceding analysis dispositive of the merits of the Kennedy Administration's proposed "marital exclusion," a carry-over basis for assets transferred to a surviving spouse justified as a means of equating the status of surviving spouses in common law and community property states.[197]

If one takes as given the current statutory premise of the community property states that spouses are cotenants of community assets,[198] the preceding analysis leads, easily enough, to the conclusion that fidelity to gains tax realization at death requires deferral of the gains tax upon the surviving spouse's share of appreciation in such assets until that spouse's death.

On the other hand, it seems difficult, under the preceding analysis, to make a redistributional case for such a marital exclusion in common law states wherein the individually owned assets of one spouse are transferred at death to the surviving spouse. An affirmative redistributional case for the marital exclusion in such cases cannot be found in the reasoning used to support a life insurance exception to realization at death, for that exception ties to cases of premature death. Neither can such a case be found in the reasoning used to support a carry-over basis for a personal residence transferred to the surviving spouse, for that exception ties to the nonrecognition of gain on sales of residences, and to the need to maintain a surviving spouse. And no support for such a case is offered by the fact that we permit qualified retirement plans to be established which contemplate a spreading of retirement benefits over the expectancies of the employee and his spouse,[199] for such plans aim primarily at providing maintenance in retirement.

195. INT. REV. CODE of 1954, § 170(c).

196. For example, § 642(c) permits an income tax deduction to decedent's estates and trusts for gross income destined for a charitable beneficiary. For the corresponding federal estate tax treatment, see § 2055 and the Treasury's regulations thereunder.

197. *Hearings*, pt. 1, at 130.

198. 2 AMERICAN LAW OF PROPERTY pt. 7, § 7.20 at 172 (Moynihan ed. 1952). This premise was originally accepted by the Supreme Court in respect of the Washington statutes in Poe v. Seaborn, 282 U.S. 101 (1930).

199. *See* text accompanying notes 109-10 *supra*.

Thus the preceding analysis might be employed to oppose the marital exclusion as applied to the transfer of individually owned assets. The post-World War II decision to permit income-splitting between spouses could be reconciled with such opposition, for income-splitting is not a tax deferral device. And our tradition of estate and gift tax marital deductions could also be reconciled, for these relate to second (or later) taxes on intrafamily transfers, not to the initial income tax thereon.

Accordingly, we are left with the question whether the greater participation in ownership by a community property spouse justifies a carry-over basis rule for community property spouses that is not available to non-cotenant spouses in common law states, or whether spouses in all jurisdictions should have equal access to a carry-over basis. And, if the latter choice is made, it must be decided whether we should have a "marital exclusion" as proposed by the Kennedy Administration, or realization at death in respect of a surviving spouse's share of community property in community property states.

In view of these uncertainties on the merits of the marital exclusion and on the merits of alternative solutions, it is difficult to know which set of drafting problems would have to be dealt with. But, if the marital exclusion is deemed desirable, we have the composite experience gleaned from the numerous carry-over basis and basis allocation provisions of existing law, and the marital deduction provisions of the estate and gift tax law, to lean on in drafting the provision.

Other possible exceptions to realization at death which seem likely to provoke debate include those regarding items of income in respect of a decedent,[200] and depreciable property subject to depreciation recapture.[201]

As to the former, the Kennedy Administration proposed an exception for those items of income in respect of a decedent which yield ordinary income to the decedent's successor. Gain was to have been determined in respect of such items with reference to the decedent's basis, as is the case under present law. It was proposed that items of inventory belonging to a deceased proprietor be included within the same category.[202] The draft-

200. INT. REV. CODE of 1954, § 691. The Kennedy Administration's proposal in this area is presented in *Hearings*, pt. 1, at 137-38.

201. INT. REV. CODE of 1954, §§ 1245, 1250. The Kennedy Administration's proposals regarding depreciation recapture are presented in *Hearings*, pt. 1, at 138.

202. *Hearings*, pt. 1, at 138.

ing problems here seem manageable, and, because the typical period of deferral of ordinary income taxes in such cases would probably be short, the proposed treatment seems defensible. The omission of a corresponding proposal to grant a carry-over basis in the case of inter vivos gifts of inventory may be supported as necessary to prevent the assignment of inventory gains to lower bracket donees.[203]

It was also proposed, however, that gain be realized at death in the case of items of income in respect of a decedent yielding capital gain,[204] such as gain on a deferred payment sale of land. This proposal would prevent tax-conscious owners of appreciated assets from making deferred payment sales in contemplation of death in order to avoid immediate realization of gain at death. However, it may be argued that, in cases of premature death, such realization conflicts unnecessarily with the objectives of the installment sales provisions.[205] Perhaps gains could be realized at death if the buyer's period of performance substantially exceeds the actuarial expectancy of persons of the decedent's age at his death, the balance of such cases being left within the category of items of income in respect of a decedent.

The Kennedy Administration also proposed realization at death in the case of depreciable property subject to depreciation recapture.[206] In the case of depreciable property which is *not* so subject, realization at death may be less burdensome than in the case of capital assets. The reason is that the decedent's successors may be able to recoup any basis increase resulting from gains tax realization at death in the form of additional depreciation deductions against their ordinary income.

On the other hand, depreciation recapture means realization of ordinary gain. The burden here is clearly greater than in the case of realization of capital gains at death. Moreover, as to relatively short-lived assets, a carry-over basis would only result in a deferral of taxes attributable to excessive depreciation for a correspondingly short period of time, even if the assets were retained by the decedent's successors throughout their useful lives.[207]

---

203. The Treasury sought, unsuccessfully, to prevent such assignments years ago. See note 37 *supra* and accompanying text.

204. *Hearings*, pt. 1, at 138.

205. INT. REV. CODE of 1954, § 453.

206. *Hearings*, pt. 1, at 138.

207. In the case of relatively short-lived assets, excessive depreciation deductions in the earlier years of use will shortly become inadequate depreciation deductions in the later years of use. Hence, if the

Accordingly, one is somewhat tempted toward realization at death for appreciated depreciable property in respect of which the capital gain element in the appreciation is likely to be dominant (*e.g.*, section 1250 assets?), while being tempted toward a carry-over basis for appreciated depreciable property in respect of which the ordinary gain element is likely to be dominant (*e.g.*, section 1245 assets?).

However, whatever the decisions on the merits in this area, the drafting problems seem manageable. To the extent that realization at death is to apply to assets subject to depreciation recapture, this result will follow from failure to create an exception to cover them. Or, if a carry-over basis is to be permitted in some cases, we know how to draft statutes which provide for this basis result.

Finally, something should be said of the Kennedy Administration's proposed blanket forgiveness of $15,000 in gains "to permanently exempt relatively small estates from the impact of the proposal."[208] Why? We do not exempt, as "relatively small," items of income in respect of a decedent of this order of magnitude, such as wages, even though it is arguable that the presence of personal service income in respect of a decedent is indicative of a premature death.[209] If the proposal had been confined to such an amount of appreciation in defined categories of relatively unmarketable assets, it might be defended as a matter of administrative convenience—at least if confined by an appropriate limitation in terms of the size of the decedent's adjusted gross estate for federal estate tax purposes. But what is difficult about determining the first $15,000 of appreciation in a small portfolio of marketable securities? However, if such a blanket exemption is desired, the drafting problem presented does not seem to differ from that of allocating other dollar-value basis adjustments among a variety of assets.[210]

---

decedent's successor has sufficient taxable income, the decedent's practice of excessive depreciation will shortly result in higher income taxes for his successor. There would remain, of course, the possibility of net tax savings to the family if the decedent's personal rates were higher than those of his successors. But the possibility of such tax savings may be greater in the case of a decedent who dies during his productive life than in the case of one who dies at the close of it.

208. *Hearings*, pt. 1, at 129.

209. Prematurity of death, it will be recalled, was the basis upon which a continuation of income tax forgiveness in the case of pure life insurance proceeds was justified. See text accompanying notes 126-34 *supra*.

210. *E.g.*, INT. REV. CODE of 1954, §§ 734, 743, 1017.

This sampling of the drafting problems which must be faced in order to implement gains tax realization at death has largely been focused upon the collection of the gains tax at death rather than upon the event of an inter vivos gift. However, it is believed that this emphasis has not materially impaired the representative character of the sample. To conclude, then, on this final aspect of the matter, it is difficult to regard the drafting problems just surveyed as a serious obstacle to the adoption of gains tax realization at death, given satisfaction with the appropriateness of such realization on the merits.

IV. CONCLUSION

This case for realizing gains at death can be summarized in few words.

First, the question of whether or not gains should be so realized appears to be one of legislative policy, little affected by the compulsions of Constitutional law.

Second, it has been urged that the question of whether or not they should be so realized should be determined primarily on the basis of the impact of such realization upon family interests in the inheritance of property. This focus has been thought specifically appropriate because that family interest is the primary beneficiary of gains tax forgiveness, and hence would bear the primary impact of a switch to gains tax realization at death. And this focus has been thought more generally appropriate, too, because the family interest in the inheritance of property is an interest in redistribution within the family, and, as such, a part of the family tradition of redistribution for the benefit of family members which is, perhaps, our society's most universally persuasive precedent for redistribution across society through progressive taxation.

Third, it appears, upon a comparative examination of gains tax forgiveness and realization at death from this point of view, that the former is indefensible because we do not customarily exempt income from taxation in deference to family redistributional interests, and because the adoption of the latter places only a restrained income tax burden upon the family interest in inheriting appreciated assets. Indeed, it was found to be quite enough of a task to distinguish the forgiveness of the income tax in the case of the proceeds of pure life insurance, by heavy emphasis upon the relevance of the prematurity of death which characterizes such life insurance gains, without attempting to sup-

port a final forgiveness of a gains tax already deferred. By contrast, it was found relatively easy to distinguish the exclusion of gratuitous receipts from income, and even relatively easy to distinguish the collection of gift or death taxes only once in several generations, since these involve second, or later, taxes upon the accumulation and transmission of family wealth, rather than the initial income tax thereon.

Fourth, it appears that the consequences to the nation's economy of retaining gains tax forgiveness, or switching to realization at death, are of insufficient importance to require a substantial modification of the preceding analysis in terms of family interests.

Fifth, it does not appear that the drafting difficulties which must be faced in implementing a switch to gains tax realization at death are of sufficient importance to require such modification.

Renewed attention to the Kennedy Administration's proposals of 1963 in light of the foregoing is, therefore, respectfully urged upon the Treasury and the Congress.