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CADILLACS, GOLD WATCHES, AND THE TAX REFORM ACT OF 1986: THE CONTINUING EVOLUTION OF THE TAX TREATMENT OF GIFTS TO EMPLOYEES

by

MARK W. COCHRAN*

I. INTRODUCTION

The Tax Reform Act of 1986¹ added three new Internal Revenue Code provisions applicable to "gifts" from employers to employees. New I.R.C. Section 102(c)² sets forth a general rule that property transferred by an employer to an employee shall not be excluded from the employee's gross income as a gift.³ A new exclusion for certain employee awards appears in Section 74(c).⁴ The exclusion is keyed to Section 274(j), a new provision limiting an employer's deductions for such awards.⁵ These three provisions should mark the end, or at least the beginning of the end, of many years of uncertainty for taxpayers and inconsistency on the part of the courts, the Congress, and the Commissioner. At the same time, the new provisions, like any new legislation, give rise to new uncertainties.⁶

The purpose of this article is to explore the historical background underlying the 1986 changes,⁷ to explain the changes,⁸ and to assess their meaning and significance.⁹

II. THE *DUBERSTEIN* OPINION

Commissioner v. Duberstein,¹⁰ decided in 1960, is generally regarded as the watershed case on the question of when, if ever, a gratuitous transfer in a business context is a gift and thus excludable from gross income under Section 102. In *Duberstein*, the Supreme Court stated that the word "gift," as it is used in Section 102, means a transfer that "proceeds from a 'detached and disinterested generosity' . . . 'out of affection, respect, admiration, charity or

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¹ Pub. L. No. 99-514, hereinafter referred to as "the Act."

² Act section 122.

³ See *infra* notes 385-96 and accompanying text.

⁴ See *infra* notes 373-80 and accompanying text.

⁵ *Id.*

⁶ See *infra* text accompanying notes 385-406.

⁷ See *infra* text accompanying notes 10-352.

⁸ See *infra* text accompanying notes 353-84.

⁹ See *infra* text accompanying notes 385-418.

¹⁰ 363 U.S. 278 (1960).

like impulses.’” (Citations Omitted).¹¹ Whether a particular transfer is a gift, the Court held, is a question of fact to be decided on a case by case basis.¹²

In *Duberstein*, the taxpayer had received a Cadillac from a business associate as a token of the associate’s appreciation for profitable business referrals Mr. Duberstein had provided.¹³ The associate was under no obligation to compensate Mr. Duberstein for the referrals, but apparently he thought the gift was prudent from a business standpoint.¹⁴ The Tax Court determined, as a factual matter, that the transfer was intended as compensation and, therefore, was not a gift for purposes of section 102.¹⁵ The Court of Appeals reversed.¹⁶ The Supreme Court concluded that the Court of Appeals should not have reversed the Tax Court’s factual conclusion because that conclusion was not “clearly erroneous.”¹⁷ Therefore, the Supreme Court reversed the Court of Appeals’ decision and allowed the Tax Court’s decision to stand.¹⁸

Stanton v. United States, a companion case to *Duberstein*, involved payments by an employer to a departing employee. The taxpayer had resigned his job under circumstances that appeared to be acrimonious.¹⁹ The employer’s board of directors voted to pay Mr. Stanton a “gratuity” of \$20,000, on the condition that Mr. Stanton release any claim against the employer for pension or retirement benefits.²⁰ In fact, Mr. Stanton was not entitled to any such benefits.²¹ Without elaboration, the trial court held that the payment was a gift and as such was excluded from Mr. Stanton’s gross income by section 102.²² The Court of Appeals reversed, holding that Mr. Stanton had failed to demonstrate that the payment was anything other than compensation for services.²³ The Supreme Court vacated the Court of Appeals’ decision, stating that the conclusory nature of the trial court’s opinion made it impossible to determine whether its findings of fact were clearly erroneous.²⁴ The Court remanded the case to the District Court for more detailed findings.²⁵

¹¹ *Id.* at 285.

¹² *Id.* at 290.

¹³ *Id.* at 280.

¹⁴ *Id.* at 281. The donor deducted the value of the Cadillac as a business expense.

¹⁵ *Duberstein v. Commissioner*, 27 T.C.M. (P-H) 58-13 (1958).

¹⁶ *Duberstein v. Commissioner*, 265 F.2d 28 (6th Cir. 1959).

¹⁷ *Commissioner v. Duberstein*, 363 U.S. at 291.

¹⁸ *Id.* at 293.

¹⁹ The taxpayer apparently had objected to the firing of a colleague. 363 U.S. at 282-83.

²⁰ *Id.*

²¹ *Id.*

²² See 363 U.S. at 292, n.14, citing the oral findings of the district court.

²³ 268 F.2d 727 (2d Cir. 1959).

²⁴ 363 U.S. at 292.

²⁵ *Id.* On remand, the district court recited the same facts and held that the payment was a non-taxable gift. 186 F. Supp. 393 (E.D.N.Y. 1960). The district court concluded that the payment was motivated by “good will, esteem, and kindness . . . and . . . a deep sense of appreciation for (the taxpayer’s ser-

Rather than setting forth specific criteria for determining whether a transfer is a gift, the Supreme Court in *Duberstein* stated that “(d)ecision of the issue . . . must be based ultimately on the application of the fact-finding tribunal’s experience with the mainsprings of human conduct to the totality of the facts of each case.”²⁶ The Court did, however, articulate a definition of what is and is not a gift, drawing from language in earlier cases. The Court pointed out that a mere absence of a legal or moral obligation does not make a transfer a gift for purposes of Section 102.²⁷ Thus, a transfer can be a gift in the common law sense but still not qualify for exclusion from the recipient’s gross income.²⁸ In order to be a gift for purposes of Section 102, the donor must make the gift out of “detached and disinterested generosity.”²⁹ Conversely, a transfer is not a gift if the donor is motivated by “‘the constraining force of any moral or legal duty’ or from ‘the incentive of anticipated benefit of an economic nature.’”³⁰ The Court specifically stated that “[w]here the payment is in return for services rendered, it is irrelevant that the donor derives no economic benefit from it.”³¹

The Court declined to adopt a “test” proposed by the Commissioner — that “(g)ifts should be defined as transfers of property made for personal as distinguished from business reasons”³² — stating that to adopt such a test “would be painting on a large canvas with indeed a broad brush.”³³ In support of the proposed test, the Commissioner advanced various propositions, including the propositions that “payments by an employer to an employee, even though voluntary, ought, by and large, to be taxable,” and “that the concept of a gift is inconsistent with a payment’s being . . . a deductible business expense.”³⁴ In rejecting the proposed test, the Court observed, perhaps significantly,³⁵ that “it doubtless is, statistically speaking, the exceptional payment by an employer to an employee that amounts to a gift,”³⁶ and that “it is doubtless relevant to the over-all inference [of whether a transfer is a gift] that the transferor treats a payment as a business deduction.”³⁷

vices).” 186 F. Supp. at 397. It would seem that the latter motivation militates against gift treatment under the standard enunciated by the Supreme Court. See *infra* notes 27-31 and accompanying text.

²⁶ *Duberstein*, 363 U.S. at 289.

²⁷ *Id.* at 285, quoting *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716, 730 (1929).

²⁸ 363 U.S. at 285.

²⁹ *Id.*, quoting *Commissioner v. Lo Bue*, 351 U.S. 243, 46 (1956).

³⁰ 363 U.S. at 285, quoting *Bogardus v. Commissioner*, 302 U.S. 34, 41 (1937).

³¹ 363 U.S. at 285, quoting *Robertson v. United States*, 343 U.S. 711, 714 (1951).

³² 363 U.S. at 284, n.6.

³³ *Id.* at 287.

³⁴ *Id.*

³⁵ See *infra* text accompanying notes 418-19.

³⁶ 363 U.S. at 387.

³⁷ *Id.*

III. *DUBERSTEIN* IN THE EMPLOYER-EMPLOYEE CONTEXT

It is not surprising that controversies have arisen over whether transfers from employers to employees constitute gifts for purposes of Section 102. As the Supreme Court stated in *Duberstein*³⁸ and earlier cases,³⁹ a gift is a transfer out of "detached and disinterested generosity."⁴⁰ Conversely, if the donor is motivated by something other than generosity, the transfer is not a gift.⁴¹ In the employer-employee context, motives other than generosity are almost always present. When an employer makes a purported gift to an employee, the most obvious inference is that the employee is being compensated for services rendered. Clearly, such compensation is not a gift.⁴² There are, however, other possible motives besides a desire to compensate the employee. Often, the transfer might be made for the purpose of establishing or enhancing good will on the part of an individual employee,⁴³ employees as a group,⁴⁴ or the general public.⁴⁵ While the employer's desire to enhance good will can be distinguished from the more basic intention to compensate an employee, it cannot accurately be labeled "detached and disinterested generosity."⁴⁶

Presumably, it was the almost universal presence of motives other than generosity that prompted the government to assert in *Duberstein* that payments by an employer to an employee "ought, by and large, to be taxable."⁴⁷ While the Supreme Court declined to accept the proposition as a basis for deciding the status of a payment, the opinion does concede that a true gift from an employer to an employee is a rare occurrence.⁴⁸

When a donor is motivated in part by generosity and in part by a wish to compensate the recipient for services or a desire to promote business good will, does the existence of *any* motivation besides generosity taint the gift? The *Duberstein* opinion appears to say not. The Court states that in order to determine whether a transfer is a gift, one must look to "the basic reason for [the donor's] conduct . . . the *dominant* reason that explains his action in making the transfer." (Emphasis added).⁴⁹ The clear implication is that motives other than generosity do not preclude gift treatment, so long as generosity is the "dominant" motive.⁵⁰

³⁸363 U.S. 278, (1960).

³⁹See *supra* notes 27-31.

⁴⁰*Duberstein*, 363 U.S. at 285.

⁴¹*Id.* See *supra* text accompanying note 30.

⁴²*Id.* See *supra* text accompanying note 31.

⁴³See, e.g., Rev. Rul. 59-58, 1959-1 C.B. 17, *infra* note 62.

⁴⁴See, e.g., Rev. Rul. 53-131, 1953-2 C.B. 112, *infra* note 67.

⁴⁵*Id.*

⁴⁶*Duberstein*, 363 U.S. at 285. See also *infra* notes 72-76.

⁴⁷*Id.* See also text accompanying note 34.

⁴⁸*Id.* at 287. See also *supra* text accompanying note 36.

⁴⁹*Id.* at 286.

⁵⁰See Willis and Hawley, *I.R.C. Section 274(b) and Duberstein Resurface: The Emperor Still Has No Clothes*,

Employers normally deduct payments to employees as ordinary and necessary business expenses.⁵¹ "Gifts" made for the purpose of compensating employees clearly are deductible by the employer.⁵² Gifts made for the more generalized purpose of establishing or enhancing good will are also deductible, as they are directly related to the employer's business.⁵³ Payments arising purely out of generosity, on the other hand, presumably would be nondeductible personal expenses.⁵⁴ Based on these factors, the government suggested in *Duberstein* that, by definition, an item that is deductible by the donor as a business expense cannot be a gift in the hands of the recipient.⁵⁵ This assertion seems particularly persuasive in view of the Court's approach to mixed motive gifts — i.e. that the dominant motive controls.⁵⁶ When a business expense is incurred partly for personal reasons, the usual approach in determining deductibility is to look to the primary purpose for incurring the expense.⁵⁷ In fact, this approach has been applied in determining whether an employer can deduct the cost of gifts to employees.⁵⁸ Thus, the employer's tax treatment would appear to be a convenient and logical means for determining the employer's dominant motivation. Nevertheless, the Supreme Court, while recognizing that the donor's deduction of the cost of a gift is relevant in determining his motivation, declined to treat it as controlling.⁵⁹

The constant presence of motives other than pure generosity, along with the apparent logical inconsistency between deduction by the donor and exclusion by the donee, has given rise to numerous cases and rulings involving "gifts" to employees. A sampling of these cases and rulings appears below, grouped into five categories: holiday gifts, employer charity, payments to surviving spouses of deceased employees, retirement payments, and bonuses.

25 ARIZ. L. REV. 907 (1983). The authors criticize the "dominant motive" test of *Duberstein* as a misreading of *Bogardus* and suggest an alternative approach of apportioning a transfer to an employee between compensatory and non-compensatory elements.

⁵¹I.R.C. § 162(a) allows a deduction for ordinary and necessary business expenses, including "a reasonable allowance for salaries or other compensation for services actually rendered."

⁵²*Id.*

⁵³See Rev. Rul. 59-58, 1959-1 C.B. 17, *infra* notes 62-63 and accompanying text.

⁵⁴I.R.C. § 262 prohibits the deduction of "personal . . . expenses."

⁵⁵*Duberstein*, 363 U.S. at 287. See *supra* text accompanying note 34. See also Shaviro, *A Case Study for Tax Reformers: The Taxation of Employee Awards and Other Business Gifts*, 4 VA. TAX. REV. 241 (1985), in which the author suggests that it is unacceptable from a policy standpoint to allow the employer to deduct the value of a gift while allowing the employee to exclude the value of the gift from gross income.

⁵⁶See *supra* text accompanying notes 49-50.

⁵⁷See, e.g., Treas. Reg. § 1.162-2(b)(1), authorizing a deduction for the expenses of business related travel only if the trip is primarily for business as opposed to personal purposes.

⁵⁸See, e.g., *Bank of Palm Beach v. United States*, 476 F.2d 1343 (Ct. Cl. 1973), *infra* notes 155-62 and accompanying text.

⁵⁹*Duberstein*, 363 U.S. at 387. See also *supra* text accompanying note 37.

A. *Holiday Gifts*

To the average person, a birthday or holiday present is the quintessential gift. If social pressure is disregarded, most such presents are manifestations of generosity and as such fall squarely within the income tax concept of gifts.⁶⁰ In the employer-employee context, however, generosity and social pressure are not necessarily the donor's only motivations. The employer might also use the occasion of a holiday or an employee's birthday to provide additional compensation, and virtually every birthday or holiday gift to an employee is made, at least in part, for the purpose of creating or enhancing good will.⁶¹ Under a strict application of the traditional test, many of these transfers would be taxable to the recipients. The Internal Revenue Service has, however, taken a more liberal approach. In Revenue Ruling 59-58,⁶² the Service stated that the value of a "turkey, ham, or other item of merchandise" given by an employer to each of his employees as a holiday gift is excludable from the employees' gross income. The same Ruling held that the employer can deduct the cost of the items as a business expense since such gifts are made "primarily for the business purpose of promoting good relations with . . . employees."⁶³ Cash gifts, and presumably gifts of more than nominal value,⁶⁴ would fall outside the scope of the Ruling and would be includable in the employee's gross income.

B. *Employer Charity*

According to the *Duberstein* opinion, a transfer is an excludable gift if the giver is motivated by "charity."⁶⁵ Thus, if an employer makes a gift to an employee out of primarily charitable instincts, the gift is excludable under the *Duberstein* criteria. Typically, however, the employer's motives are not purely charitable. In addition to the psychic satisfaction of helping someone in need, the employer expects to derive enhanced good will from such transfers. Presumably, under *Duberstein* the excludability of the transfer as a gift would depend upon which motivation predominates — charitable generosity or public relations.⁶⁶

The Service addressed the tax treatment of employer charity in Revenue Ruling 53-131,⁶⁷ which involved a corporation⁶⁸ that was one of the largest

⁶⁰ See *supra* text accompanying notes 27-31.

⁶¹ See generally *supra* notes 41-46.

⁶² Rev. Rul. 59-58, 1959-1 C.B. 17.

⁶³ *Id.*

⁶⁴ Treas. Reg. § 1.61-2(a)(1) specifically requires that cash bonuses must be included in the recipients' gross income. Revenue Ruling 59-58 cites "the small amount involved" as justification for excluding the value of the merchandise from the employees' gross income. 1959-1 C.B. at 18.

⁶⁵ *Duberstein*, 363 U.S. at 285. See also *supra* text accompanying note 11.

⁶⁶ See *supra* notes 49-50 and accompanying text.

⁶⁷ 1953-2 C.B. 112.

⁶⁸ The fact that the donor was a corporation is significant in view of the government's position in *Duberstein* that "a business corporation cannot properly make a gift of its assets." 363 U.S. at 287.

employers in an area that was struck by a tornado. The corporation established a relief fund to provide assistance to employees who had suffered injuries or whose homes had been damaged or destroyed. The Ruling first addressed the question of whether the employer may deduct its contributions to the fund as a business expense.⁶⁹ The Ruling holds that the contributions are ordinary and necessary expenses, and therefore are deductible, because they promote goodwill among the employees as well as in the community at large, which is "essential to the successful conduct of the business."⁷⁰ The Ruling then addresses the tax treatment of the recipients and concludes that payments received from the fund are not includable in gross income. While the Ruling points out that the payments are "gratuitous and spontaneous,"⁷¹ the word "gift" does not appear in the Ruling and no reference is made to the statutory exclusion for gifts. Apparently, the Service concluded that such items simply do not constitute gross income.⁷² In view of the position taken by the Commission six years later in *Duberstein*,⁷³ this is the only plausible explanation for the non-taxability of the payments to the employees. The payments would not be gifts under the standards proposed by the government in *Duberstein* — i.e. that payments by an employer to an employee, especially if they are deductible by the employer, are not gifts.⁷⁴ Moreover, the government argued in *Duberstein* that a corporation, as a matter of state law, is incapable of making a gift.⁷⁵ Even under the Supreme Court's *Duberstein* criteria, payments made primarily for public relations purposes do not reflect "detached and disinterested generosity."⁷⁶

Unlike Revenue Ruling 53-131, Revenue Ruling 59-58⁷⁷ specifically states that the holiday turkey or ham is an "excludable gift."⁷⁸ For reasons similar to those outlined above, this conclusion is totally at odds with the government's position in *Duberstein*.⁷⁹ The Ruling can be explained only on practical grounds. Presumably, the Service decided that if only nominal amounts are involved,⁸⁰ the revenue to be generated by taxing the value of the holiday turkey is outweighed by the negative sentiment that would be generated by requiring employers to

⁶⁹ 1953-2 C.B. at 113.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² Similar results have been reached in the context of government and institutional charity. See, e.g., Rev. Rul. 76-144, 1976-1 C.B. 17, ruling that federal payments to needy victims of major disasters do not constitute gross income to the recipients.

⁷³ *Duberstein*, 363 U.S. at 278.

⁷⁴ See *supra* notes 32-37 and accompanying text.

⁷⁵ See *supra* note 68.

⁷⁶ See *supra* text at note 29. See also Willis and Hawley, *supra* note 50, suggesting that under *Bogardus*, the presence of any motive other than generosity should preclude gift treatment.

⁷⁷ Rev. Rul. 59-58, 1959-1 C.B. 17.

⁷⁸ *Id.* at 18.

⁷⁹ See *supra* text accompanying notes 73-76.

⁸⁰ 1959-1 C.B. at 18.

treat such items as compensation and withhold the resulting tax liability from the employees' pay.⁸¹

C. *Payments to Spouses of Deceased Employees*

Gratuitous⁸² payments to the surviving spouse or other dependent of a deceased employee represent a type of employer charity, but they are by nature different from charity of the type described in Revenue Ruling 53-131.⁸³ Unlike the disaster aid described in Revenue Ruling 53-131, payments made by reason of an employee's death normally reflect gratitude, and arguably compensation, for the deceased employee's services. By statute, recipients of such payments may exclude up to \$5,000 from gross income, regardless of whether the payment is the result of spontaneous generosity or a contract between the employer and the employee.⁸⁴ If the employer gives the employee's survivor more than \$5,000, the excess is includable in the recipient's gross income unless it constitutes an excludable gift under the *Duberstein* criteria.⁸⁵ As evidenced by the cases and rulings discussed below, the question of when payments to the survivors of deceased employees are gifts has been, and continues to be, difficult.

The Service's earliest pronouncement on the question of gratuitous payments by an employer to a deceased employee's survivors was issued in 1921.⁸⁶ In declaring that a corporation's payment of the equivalent of two months' salary to the widow of a deceased officer was an excludable gift, the Service appeared to be applying the common law definition of "gift" later rejected in *Duberstein*.⁸⁷ Without elaboration, the Decision simply states that as a gratuitous transfer not supported by consideration, the payment constitutes a gift.⁸⁸ The Service applied similar reasoning in I.T. 3329⁸⁹ to conclude that monthly payments made to an officer's widow for one year after the officer's death were gifts. The Ruling states that "(w)hen an allowance is paid by an organization to which the recipient has rendered no service, the amount is deemed to be a gift or gratuity and is not subject to Federal income tax in the hands of the recipient."⁹⁰ Citing regulations then in effect, the Service also ruled that the employer could

⁸¹ Cf. Shaviro, *supra* note 55, at 245-46, suggesting that the value of such items to the recipient is more psychic than economic.

⁸² If the employer is contractually obligated to make such payments, they are not gifts even under the traditional property law definition.

⁸³ See *supra* text accompanying notes 67-76.

⁸⁴ I.R.C. § 101(b). The exclusion is not available, however, if the employee had a "nonforfeitable right" to receive the payment while alive. I.R.C. § 101(b)(2)(B).

⁸⁵ See text at notes 26-31 *supra*.

⁸⁶ O.D. 1017, 5 C.B. 101 (1921).

⁸⁷ See *supra* notes 27-28 and accompanying text.

⁸⁸ 5 C.B. at 101.

⁸⁹ 1939-2 C.B. 153.

⁹⁰ *Id.* at 154.

deduct the payments as a business expense.⁹¹ The Service changed its position on the gift status of payments to survivors of deceased employees in I.T. 4027.⁹² Revoking O.D. 1017⁹³ and modifying I.T. 3329, the Service stated that payments made by an employer to the widow of a deceased employee in consideration of services rendered constitute gross income, even in the absence of a contractual obligation or established plan.⁹⁴ Citing a Fifth Circuit case,⁹⁵ the Service stated that I.T. 3329 was incorrect in focusing on the fact that the recipient of the death benefit had not performed services.⁹⁶ The correct inquiry, according to I.T. 4027, is whether services have been performed for the payor, either by the recipient or the deceased employee.⁹⁷

Prior to *Duberstein*, and to a large extent since *Duberstein*, courts have been reluctant to accept the Service's position that payments to the survivors of deceased employees are not gifts. Generally, the courts have applied a checklist of factors enunciated by the Tax Court in 1955,⁹⁸ often concluding that the payments are excludable gifts.⁹⁹

In *Estate of Hellstrom v. Commissioner*,¹⁰⁰ a pre-*Duberstein* case, the Tax Court addressed the question of gratuitous payments to the widow of a deceased employee. The Court held that the payments were excludable gifts even though they were made "in recognition of"¹⁰¹ the deceased employee's services.¹⁰² The "controlling facts," according to the Court, were that the payments were made to (the widow), and not to (the employee's) estate; that there was no obligation on the part of the corporation to pay any additional compensation to (the employee); (the corporation) derived no benefit from the payment; (the widow) performed no services for the corporation; and . . . (the services of the deceased employee) had been fully compensated for.¹⁰³

⁹¹ The applicable regulation provided that when the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, such payments may be deducted. *Id.*

⁹² 1950-2 C.B. 9.

⁹³ O.D. 1017, 5 C.B. 101.

⁹⁴ 1950-2 C.B. at 10-11.

⁹⁵ *Varnedoe v. Allen*, 158 F.2d 467 (5th Cir. 1946).

⁹⁶ See text at note 90, *supra*.

⁹⁷ 1950-2 C.B. at 10.

⁹⁸ *Estate of Hellstrom v. Commissioner*, 24 T.C. 916 (1955). The criteria are outlined *infra* text accompanying note 103.

⁹⁹ See *infra* text accompanying notes 122-34.

¹⁰⁰ *Hellstrom*, 24 T.C. 916 (1955).

¹⁰¹ The corporate minutes indicated that the payments were "in recognition of" the deceased employee's services. *Id.* at 918.

¹⁰² The Court quoted language from *Bogardus v. Commissioner*, 302 U.S. 34 (1937), stating that "a gift is none the less a gift because inspired by gratitude for past faithful services." *Hellstrom*, 24 T.C. at 919.

¹⁰³ *Hellstrom*, 24 T.C. at 920.

Based upon these factors, the Court concluded that the principal motive of the corporation in making the payment was to do an act of kindness for the employee's widow, and that the payment therefore was a gift.¹⁰⁴ The Court found no significance in the fact that the corporation had deducted the payment as a business expense.¹⁰⁵

While the Tax Court's ultimate conclusion in *Hellstrom* — that the corporation's primary motivation was to do an act of kindness — is stated in terms that are consistent with the standards later articulated in *Duberstein*,¹⁰⁶ most of the factors cited by the Court indicate that the case may well have been decided on the basis of the common law definition of gift (*i.e.*, a transfer of property without consideration). This would explain the Tax Court's "abrupt swerve"¹⁰⁷ after the Supreme Court emphasized in *Duberstein* that the absence of consideration does not make a transfer an excludable gift.¹⁰⁸ The Tax Court made its abrupt swerve in *Estate of Pierpont v. Commissioner*,¹⁰⁹ its first post-*Duberstein* case addressing the death benefit question.¹¹⁰ In *Pierpont*, the Court concluded that payments essentially indistinguishable from those in *Hellstrom* were not excludable as gifts but rather represented additional compensation for the deceased employee's services.¹¹¹ The Court based its conclusion on a finding that payments "in recognition of services rendered" by the deceased employee reflect not "detached and disinterested generosity" but a dominant motivation to pay additional compensation.¹¹² The Court also cited the lack of any evidence that the payments were motivated by the needs of the employee's survivors.¹¹³

In two memorandum decisions issued shortly after *Pierpont*, the Tax Court cited *Pierpont* and applied similar reasoning in concluding that awards to widows of deceased employees were not excludable gifts. In *Estate of Kuntz*,¹¹⁴ the directors of the deceased employee's corporate employer authorized payments to his widow "as additional compensation and in consideration of services heretofore

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 919.

¹⁰⁶ See *supra* text accompanying notes 26-31.

¹⁰⁷ The Second Circuit Court of Appeals, in *Carter v. Commissioner*, 453 F.2d 61 (1971), accused the Tax Court of making an "abrupt swerve" from its earlier position on the issue of payments to survivors of deceased employees.

¹⁰⁸ *Duberstein*, 363 U.S. at 285.

¹⁰⁹ 35 T.C. 65 (1960).

¹¹⁰ The decision of *Pierpont* had been delayed pending the issuance of the Supreme Court's opinion in *Duberstein*. *Pierpont*, 35 T.C. at 67.

¹¹¹ The taxpayer's late husband was president and majority shareholder of a wholesale drug company. The corporation paid the taxpayer approximately \$10,000 following the death of her husband. The payments were designated "salary continuation," and were roughly equivalent to six months' salary. *Id.* at 66. Perhaps coincidentally, in view of *Duberstein*, the corporation also gave the taxpayer a Cadillac. *Id.*

¹¹² *Id.* at 68.

¹¹³ *Id.*

¹¹⁴ 29 T.C.M. (P-H) 60-1531 (1960).

rendered to this corporation by the (deceased employee)."¹¹⁵ The Court had little trouble concluding, as a factual matter, that the directors did not intend the payment as a gift.¹¹⁶ Likewise, in *Estate of Olsen*,¹¹⁷ a corporate resolution citing "the valuable services which (the deceased employee) has rendered to (the corporate employer) during the last several years" resulted in a finding of taxable compensation rather than non-taxable gift.¹¹⁸

In *Pierpont*, *Kuntz*, and *Olsen*, the Tax Court clearly implied that it was abandoning the criteria articulated in *Hellstrom*¹¹⁹ in light of the Supreme Court's opinion in *Duberstein*. In *Pierpont*, the Court stated that, in view of *Duberstein*'s "clarification" of the subject, "we have not found it profitable to discuss the numerous earlier decisions in the lower courts dealing with payments by an employer to the widow of a deceased employee."¹²⁰ *Kuntz* and *Olsen* contain similar statements discounting the value of pre-*Duberstein* precedent.¹²¹

The appellate courts have not been willing to view pre-*Duberstein* precedent as obsolete. *Pierpont*, *Kuntz*, and *Olsen* were all reversed on appeal, and the appellate court opinions in all three cases rely to some extent on pre-*Duberstein* precedent. The Fourth Circuit Court of Appeals vacated the Tax Court's *Pierpont* decision in a appeal styled *Poyner v. Commissioner*.¹²² Stating that *Duberstein* "did not destroy the authority of the earlier Tax Court cases and the guides enunciated in them,"¹²³ the Court recited the *Hellstrom*¹²⁴ criteria and observed that "(t)he stipulated facts directly respond to every one of the five factors, and in each instance the response is favorable to the widow."¹²⁵ The Court conceded, however, that in light of *Duberstein*, the fact finder could consider "whatever other factors (it) might think helpful,"¹²⁶ and remanded the case for "proceedings not inconsistent with this opinion."¹²⁷

¹¹⁵ 29 T.C.M. (P-H) 61-882 (1961).

¹¹⁶ *Id.*

¹¹⁷ 30 T.C.M. (P-H) 61-882 (1961).

¹¹⁸ 30 T.C.M. at 61-883.

¹¹⁹ See *supra* text at note 103, *supra*.

¹²⁰ 35 T.C. at 69.

¹²¹ In *Olsen*, the Court said

[W]e think it unnecessary, in view of the clarification of this general subject by the opinion in the *Duberstein* case, to discuss the numerous decisions heretofore entered (either prior to said opinion or without consideration of the principles therein set forth) which have dealt with payments by employers to widows of deceased employees. 30 T.C.M. at 61-885.

In *Kuntz*, the Court distinguished a Sixth Circuit case cited by the taxpayer, but "note(d) for completeness" the fact that the case was decided before *Duberstein*. 29 T.C.M. at 60-1532.

¹²² 301 F.2d 287 (4th Cir. 1962). *Poyner* was the co-executor of Mr. *Pierpont*'s estate.

¹²³ 301 F.2d at 292.

¹²⁴ See text at note 103, *supra*.

¹²⁵ 301 F.2d at 291.

¹²⁶ 301 F.2d at 292.

¹²⁷ *Id.* Apparently, the decision on remand was not reported.

In reversing the Tax Court in *Kuntz*,¹²⁸ the Sixth Circuit Court of Appeals relied on *Reed v. United States*,¹²⁹ a *per curiam* opinion it had issued prior to the Supreme Court's decision of *Duberstein*, and a Tenth Circuit case decided after *Duberstein*.¹³⁰ Distinguishing *Duberstein* on the facts,¹³¹ the Court held that the "only reasonable inference" from the facts was that the payment was a gift, and reversed the Tax Court.¹³² In *Olsen*,¹³³ the Eighth Circuit cited *Poyner* and *Kuntz* and reversed the Tax Court's decision, stating that "[i]f the payment made to Mrs. Kuntz upon the death of her husband was a gift, so was the payment to Mrs. Olsen."¹³⁴

The Third Circuit Court of Appeals affirmed the Tax Court's finding of "no gift" in *Smith v. Commissioner*,¹³⁵ declining to follow *Olsen*, *Poyner*, and *Kuntz* because "the question . . . remains basically one of fact, for determination on a case-by-case basis."¹³⁶ Applying the *Duberstein* rationale, the Court concluded that the Tax Court's factual determination was not "clearly erroneous" and therefore should not be disturbed.¹³⁷

Possibly smarting from the *Poyner*, *Kuntz*, and *Olsen* reversals, the Tax Court resurrected the *Hellstrom* criteria¹³⁸ in *Estate of Carter*,¹³⁹ a 1970 memorandum decision. The opinion begins with a citation to *Duberstein* for the proposition that the question of whether a transfer is a gift is one of fact and that the primary consideration is the intention of the transferor.¹⁴⁰ Then the Court outlined various factors that militate for or against a conclusion that a payment is a gift, citing the *Hellstrom* criteria as well as numerous other factors.¹⁴¹ The Court proceeded to apply those factors to the facts at hand: a payment of approximately one year's salary and commissions to the widow of a deceased brokerage firm employee.¹⁴² In concluding that the payment was not a gift, the

¹²⁸ *Kuntz v. Commissioner*, 300 F.2d 849 (6th Cir. 1962).

¹²⁹ 277 F.2d 456 (6th Cir. 1960), *aff'g* 177 F. Supp. 205 (W.D. Ky. 1959).

¹³⁰ *Kasynski v. Commissioner*, 284 F.2d 143 (10th Cir. 1960).

¹³¹ 300 F.2d at 852.

¹³² *Id.* The "only reasonable inference" language was taken from the *Kasynski* opinion, where the Court of Appeals held that the District Court's finding of "gift" was "a reasonable inference." 284 F.2d at 146.

¹³³ *Olsen v. Commissioner*, 302 F.2d 671 (8th Cir. 1962).

¹³⁴ 302 F.2d at 673. The Court also cited several pre-*Duberstein* cases. 302 F.2d at 674.

¹³⁵ 305 F.2d 778 (1962), *aff'g* 30 T.C.M. (P-H) 61-848 (1961).

¹³⁶ 305 F.2d at 782, quoting *Duberstein*.

¹³⁷ 305 F.2d at 780. The taxpayer's late husband was an employee and shareholder of a family owned business. After her husband's death, the corporation paid the taxpayer approximately \$72,000 over a two year period. The Tax Court found that the motive behind the payments was to provide additional compensation for the decedent's services. 305 F.2d at 779.

¹³⁸ See text at note 103, *supra*.

¹³⁹ 39 T.C.M. (P-H) 70-1538 (1970).

¹⁴⁰ 39 T.C.M. at 70-1541.

¹⁴¹ *Id.*

¹⁴² The decedent worked for the brokerage firm for 38 years, but had no ownership interest in the firm. 39 T.C.M. at 70-1538.

Court relied primarily on two factors. First, the Court pointed out that the employer had deducted the payment as a business expense.¹⁴³ The Court said that deduction by the payor, "while not conclusive negates donative intent."¹⁴⁴ The Court also emphasized the lack of any evidence that the payments were based on the surviving spouse's financial need.¹⁴⁵

Accusing the Tax Court of making an "abrupt swerve" from its pre-*Duberstein* position,¹⁴⁶ the Second Circuit Court of Appeals reversed the Tax Court's decision in *Carter*.¹⁴⁷ The Court concluded that the facts in *Carter* were indistinguishable from those in *Olsen* and more favorable to the taxpayer than those in *Kuntz*,¹⁴⁸ and implied that the Tax Court should return to the pre-*Duberstein* approach taken in *Hellstrom*.¹⁴⁹ The Court buttressed its reasoning with the observation that the Tax Court's tendency to find "no gift" in post-*Duberstein* cases, compared with the district courts' almost uniform finding of "gift," imposed an unfair burden on taxpayers who could not afford to pay the disputed liability and sue for a refund.¹⁵⁰ In a dissenting opinion, one judge pointed out that the majority's *de novo* examination of the facts went far beyond the appropriate standard of review.¹⁵¹ The dissenting opinion stresses *Duberstein's* message that the question is one of fact to be decided by the trial court.¹⁵² In response to the majority's comments on the divergence between the Tax Court and the District Courts, the dissenting opinion states that "*Duberstein* contemplated lack of 'symmetry' between 'the variety of forums in which federal income tax cases can be tried.'"¹⁵³

As indicated above, the employer deducted its payment to Mr. Carter's widow.¹⁵⁴ The Commissioner challenged that deduction, and the issue was litigated in *Bank of Palm Beach v. United States*.¹⁵⁵ In holding for the taxpayer, the Court of Claims cited the same factors the government had cited in *Carter* to argue that the payment was not intended as a gift — *i.e.*, that the payment represented additional compensation for Mr. Carter's services and that the

¹⁴³39 T.C.M. at 70-1542. The employer's deduction was later upheld by the Court of Claims in *Bank of Palm Beach v. United States*, *infra* note 155.

¹⁴⁴39 T.C.M. at 70-1542.

¹⁴⁵*Id.*

¹⁴⁶*Estate of Carter v. Commissioner*, 453 F.2d 61, 65.

¹⁴⁷*Id.*

¹⁴⁸453 F.2d at 70. Presumably, the Court found the *Carter* facts more appealing because the deceased employee had been in poor health for some time and owned no interest in the employer corporation.

¹⁴⁹*Id.* at 64-69.

¹⁵⁰453 F.2d at 67-69.

¹⁵¹453 F.2d at 70 (Davis, J., dissenting).

¹⁵²*Id.*

¹⁵³453 F.2d at 72, citing 363 U.S. at 290.

¹⁵⁴*See supra* text accompanying note 143.

¹⁵⁵476 F.2d 1343 (1973).

amount of the payment was determined by reference to his salary rather than the needs of his widow.¹⁵⁶ The Court went on to point out that the payment was also prompted by "the desire by (the employer) to secure a legitimate business benefit, an increase in employee morale."¹⁵⁷ Implicitly, the Court concluded that the payment was not intended as a gift, notwithstanding the Second Circuit's holding in *Carter*.¹⁵⁸ The Court distinguished several earlier cases which had denied deductions for payments to survivors of deceased employee-shareholders, since Mr. Carter had not owned an interest in his employer's business.¹⁵⁹ Thus, the payment to Mr. Carter's widow could not be called a disguised dividend.¹⁶⁰ The Court concluded that the facts were more closely analogous to those in *Fifth Avenue Coach Lines v. Commissioner*,¹⁶¹ a case in which the Tax Court had held deductible an employer's payments to the widow of a deceased non-owner employee.¹⁶²

D. Retirement Payments

Section 61(a)(11) provides that pensions are includable in gross income. Section 102 would, of course, exclude from gross income any payment to a retiring employee resulting from "detached and disinterested generosity"¹⁶³ rather than a desire to compensate the employee for past services. The Tax Court addressed the question of gratuitous pensions in *Walker v. Commissioner*.¹⁶⁴ *Walker*, a pre-*Duberstein* case, involved a corporate employer's gratuitous payment of six months' salary to an employee forced to retire for health reasons.¹⁶⁵ In holding that the payment represented taxable compensation and not an excludable gift, the Tax Court stated that if the recipient of a payment has performed services for the payor, "the presumption is that the amount received is for the service and is not a gift."¹⁶⁶ In concluding that the taxpayer had failed to rebut this presumption, the Court cited the payor's deduction of the payment,¹⁶⁷ a statement in the minutes of the committee meeting authorizing the

¹⁵⁶ *Id.* at 1348.

¹⁵⁷ *Id.* at 1349.

¹⁵⁸ The opinion states that a payment to the surviving spouse of a deceased employee represents deductible compensation "(i)f the amount paid to the widow is not, in reality, a disguised gift. . . ." *Id.* at 1347. The opinion is self-contradictory in that it also states that "a payment might be excludable by the recipient and nevertheless deductible by the employer." *Id.* at 1345.

¹⁵⁹ 476 F.2d at 1347-48, n.7.

¹⁶⁰ *Id.*

¹⁶¹ 31 T.C. 1080 (1959), *rev'd on other issues* 281 F.2d 556 (2d Cir. 1960).

¹⁶² The Tax Court concluded that the payments were additional compensation for the deceased employee's services. *Fifth Avenue Coach*, 31 T.C. at 1086. While the employee's widow had not included the payments in gross income in the years in questions, 1944 through 1948, she had reported as gross income payments received in years subsequent to the issuance of I.T. 4027. *Id.* See *supra* notes C-55 through C-60 and accompanying text.

¹⁶³ *Duberstein*, 363 U.S. at 285.

¹⁶⁴ 25 T.C. 832 (1956).

¹⁶⁵ *Id.* at 834. The employee had suffered a nervous breakdown.

¹⁶⁶ *Id.* at 836. The Court cited *Noel v. Parrot*, 15 F.2d 669 (4th Cir. 1926).

¹⁶⁷ *Walker*, 25 T.C. at 835.

payment that the taxpayer "merited some gift from the Company in recognition of his loyalty,"¹⁶⁸ and the fact that the shareholders of the corporation had not approved the transfer.¹⁶⁹ Implicit in the Court's reliance on the lack of shareholder authorization is acceptance of the principle that a corporation normally cannot make a gift, a position later asserted by the government in *Duberstein*.¹⁷⁰

In a series of pre-*Duberstein* cases involving payments by church congregations to retiring ministers, the Courts of Appeals reversed the Tax Court's findings of "no gift" with striking similarity to the post-*Duberstein* cases involving payments to spouses of deceased employees.¹⁷¹ The first case, *Schall v. Commissioner*,¹⁷² involved a congregation's payment of \$2,000 per year to its minister, who had retired because of poor health. The resolution authorizing the payment characterized it as "salary or honorarium" and named the taxpayer "Pastor Emeritus," a position "with no pastoral authority or duty."¹⁷³ The Court concluded that the payments, although gratuitous, represented compensation for past services and thus were not excludable as a gift.¹⁷⁴ The Fifth Circuit Court of Appeals found that the Tax Court "clearly erred in holding that the payments . . . were taxable income."¹⁷⁵ The Court stated that "all the facts and circumstances . . . clearly prove an intent to make a gift,"¹⁷⁶ and that "a gift is none the less a gift because inspired by gratitude for past faithful service of the recipient."¹⁷⁷

*Abernethy v. Commissioner*¹⁷⁸ involved facts similar to those in *Schall*, and the taxpayer cited the Fifth Circuit's decision as authority for his argument that his pension payments should be excluded from gross income as gifts.¹⁷⁹ The Tax Court stated that there was "a distinguishing difference between the facts of (*Schall*) and those in the instant case"¹⁸⁰ but failed to explain what that difference was.¹⁸¹ Perhaps more to the point, the Tax Court said "we are not convinced that our holding in the *Schall* case was wrong notwithstanding the reversal

¹⁶⁸ *Id.* at 838.

¹⁶⁹ *Id.* at 837 (citing *Noel* 15 F.2d 669).

¹⁷⁰ *Duberstein*, 363 U.S. 287.

¹⁷¹ See *supra* text at notes 122-134.

¹⁷² 11 T.C. 111 (1948).

¹⁷³ *Id.* at 113.

¹⁷⁴ *Id.* at 114-15. The Court pointed out that the taxpayer had not received a raise in 18 years and suggested that the congregation suddenly realized that he had been undercompensated when he was forced to retire early because of his health. *Id.*

¹⁷⁵ *Schall v. Commissioner*, 174 F.2d 893, 894 (5th Cir. 1949).

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* (citing *Bogardus* 302 U.S. 34).

¹⁷⁸ 20 T.C. 593 (1953).

¹⁷⁹ *Id.* at 594.

¹⁸⁰ *Id.* at 596.

¹⁸¹ Presumably, the Court was referring to the fact that the taxpayer in *Schall* retired unexpectedly after suffering a heart attack.

thereof by the Circuit Court.”¹⁸² The Tax Court reached a similar conclusion in *Mutch v. Commissioner*,¹⁸³ a memorandum decision issued eight days after *Abernethy* and involving virtually identical facts.

Citing the Fifth Circuit’s holding in *Schall*, the Third Circuit Court of Appeals reversed the Tax Court’s decision in *Mutch*.¹⁸⁴ The Third Circuit’s opinion relies heavily on the fact that the taxpayer was not required to render any additional services in order to receive his retirement payments.¹⁸⁵ Three months after the Third Circuit issued its opinion in *Mutch*, the Court of Appeals for the District of Columbia Circuit, in a *per curiam* decision, reversed the Tax Court’s decision in *Abernethy*.¹⁸⁶

In the wake of the reversals in *Schall*, *Mutch*, and *Abernethy*, the Service decided to give up the fight, announcing in Revenue Ruling 55-422¹⁸⁷ that it would not continue to litigate cases involving payments by church congregations to retired preachers if certain criteria are present. Those criteria include a close personal relationship between the preacher and the congregation, the lack of any established plan or practice of making such payments, the absence of any duty on the part of the recipient to render further services, and evidence that the amount paid was determined in light of the recipient’s needs and the congregation’s ability to pay.¹⁸⁸ The lack of post-*Duberstein* cases involving such payments tends to indicate that the Service continues to follow Rev. Rul. 55-422.¹⁸⁹

The Service did litigate a case involving a preacher’s retirement payments in 1960, and the Tax Court agreed that the payments involved in that case fell outside the scope of Rev. Rul. 55-422 and the *Schall*, *Mutch*, and *Abernethy* decisions. The case, *Perkins v. Commissioner*,¹⁹⁰ involved payments to a retired Methodist minister. The payments were funded in part by contributions made by the minister’s congregation to a central pension fund for Methodist ministers, but the amount of taxpayer’s pension was determined under a formula established by the regional Conference and the disbursements were actually made by the Conference’s Board of Pensions.¹⁹¹ In holding that the payments were not gifts, the Tax Court cited the existence of an established plan for making such payments, the lack of a personal relationship between the payor (the Board of

¹⁸² *Schall*, 20 T.C. at 596.

¹⁸³ 12 T.C.M. (CCH) 705 (1953).

¹⁸⁴ *Mutch v. Commissioner*, 209 F.2d 390 (3rd Cir. 1954).

¹⁸⁵ 209 F.2d at 392.

¹⁸⁶ *Abernethy v. Commissioner*, 211 F.2d 651 (D.C. Cir. 1954).

¹⁸⁷ 1955-1 C.B. 14.

¹⁸⁸ *Id.*

¹⁸⁹ *Cf. Brimm v. Commissioner*, 37 T.C.M. (P-H) 68-1261 (1968), and *Estate of Sweeney v. Commissioner*, 48 T.C.M. (P-H) 79-1503 (1979).

¹⁹⁰ 34 T.C. 117 (1960).

¹⁹¹ *Id.* at 118.

Pensions) and the recipient, and the fact that the amount of the payments was not determined with reference to the taxpayer's needs.¹⁹²

In one of the few post-*Duberstein* cases dealing with payments to retiring employees, the Tax Court, in a memorandum opinion, held for the taxpayer. The case, *Brimm v. Commissioner*,¹⁹³ involved an individual who had taught at a church-supported graduate school for 11 years. The taxpayer was one of several employees who received a payment equal to one year's salary when the school closed as a result of increasing costs and declining enrollment.¹⁹⁴ Recognizing that the payment was an expression of gratitude for services rendered, the Court nevertheless held that the payment was a gift under the *Duberstein* criteria.¹⁹⁵ The employer admittedly was not obligated to make the payment, and the Court pointed out that no further benefit such as good will could be derived, since the employer was closing its doors.¹⁹⁶ The Court cited the Court of Appeals opinions in *Schall*, *Mutch*, and *Abernethy* as authority for the proposition that "long and faithful service may create the atmosphere of goodwill and kindness toward the recipient which tends to support a finding that a gift rather than additional compensation was intended."¹⁹⁷

The taxpayer in *Estate of Sweeney v. Commissioner*,¹⁹⁸ a 1979 Tax Court memorandum decision, did not fare as well. The taxpayer, a medical doctor, was the founder of a charitable foundation, which operated a summer camp for diabetic children. The taxpayer was employed by the foundation from 1950 until 1975 and worked without pay until he began receiving a \$500 per month "honorarium" in 1964.¹⁹⁹ The foundation continued to pay the taxpayer \$500 per month after his retirement in 1975, and the payments continued until his death in 1976.²⁰⁰ The taxpayer had not reported any of the payments as gross income, contending that they were excludable gifts.²⁰¹ Citing *Duberstein*, the Court held that the payments represented compensation for services and thus were not gifts, notwithstanding the lack of a contractual obligation or the fact that the directors of the foundation called the payments "gifts."²⁰²

¹⁹² *Id.* at 120.

¹⁹³ 37 T.C.M. (P.H) 68-1261.

¹⁹⁴ *Id.*

¹⁹⁵ Ironically, the Court quoted the same passage from *Bogardus* that the Fifth Circuit had quoted in reversing the Tax Court's decision in *Schall*. 37 T.C.M at 68-1264. See *supra* text accompanying note 177.

¹⁹⁶ T.C. Memo (P-H) at 68-1264.

¹⁹⁷ *Id.*

¹⁹⁸ 48 T.C.M. (P-H) 79-1503.

¹⁹⁹ *Id.* at 79-1505.

²⁰⁰ *Id.*

²⁰¹ *Id.*

²⁰² *Id.* at 79-1506.

E. Bonuses

It would seem that a bonus paid to an employee as a reward for services performed is inherently compensatory and therefore not a gift, even if the employer is under no contractual obligation to make the payment.²⁰³ Nevertheless, courts have grappled with the tax character of such payments for over sixty years²⁰⁴ and have continued to do so even after the *Duberstein* decision.²⁰⁵

The Board of Tax Appeals first addressed the question in *John H. Parrott*.²⁰⁶ In *Parrott*, a corporation's board of directors voted to set aside a "gratuitous appropriation"²⁰⁷ of roughly \$150,000²⁰⁸ for distribution to certain officers and employees in such proportions as the members of the corporation's executive committee "deem wise and proper."²⁰⁹ The taxpayer, an employee and director of the corporation, received a \$35,000 share of the appropriation, which was paid to him in cash.²¹⁰ After the payments were authorized, but before they were made, most of the corporation's stock was sold.²¹¹ The purchaser approved the payments, and the recipients of the payments resigned their positions upon receipt of the payments.²¹² The corporation deducted the payments as salaries.²¹³

The Board of Tax Appeals rejected the taxpayer's contention that the payment was a gift, noting that the evidence supported a conclusion that the payment "was intended for the purpose of rewarding officers and employees for long and faithful service and of encouraging them and their successors to fidelity and zeal in the future."²¹⁴ The Board added that it would be "irregular" for a corporation's directors to make a "gift" of corporate assets.²¹⁵

The taxpayer paid the deficiency under protest and sued for a refund in United States District Court,²¹⁶ which awarded a judgment to the taxpayer.²¹⁷

²⁰³ *Duberstein*, 363 U.S. at 285.

²⁰⁴ See *infra* text and accompanying notes 206-299.

²⁰⁵ See *Abdella v. Commissioner*, T.C.M. (P.H.) 83-2498 (1983).

²⁰⁶ 1 B.T.A. 1 (1924).

²⁰⁷ 1 B.T.A. at 1.

²⁰⁸ The amount was based on \$3 per share of the corporation's outstanding stock. *Id.*

²⁰⁹ *Id.*

²¹⁰ *Id.* at 2.

²¹¹ *Id.*

²¹² *Id.*

²¹³ *Id.*

²¹⁴ *Id.* at 4.

²¹⁵ *Id.*

²¹⁶ *Parrott v. Noel*, 8 F.2d 368 (1925). Prior to 1926, decisions of the Board of Tax Appeals were appealable *de novo* in federal district court. C. HAMEL, PRACTICE AND EVIDENCE BEFORE THE U.S. BOARD OF TAX APPEALS 168 (1938).

²¹⁷ *Parrott*, 8 F.2d at 370.

Applying the traditional property law definition of “gift” — a transfer of property without consideration — the Court found that the payment was indeed a gift.²¹⁸ The Court conceded that a gift of corporate assets by the corporation’s directors would be unlawful without consent by the shareholders, but concluded that the shareholders had implicitly approved of the distribution since they were aware of it and did not object.²¹⁹

The Court of Appeals reversed the District Court’s decision,²²⁰ stating that to call the distribution a gift “would do violence to the well understood meaning of that word. . . .”²²¹ The Court concluded that the payment was not without consideration. Rather, the payment was made as compensation for the past services performed by the taxpayer and his agreement to resign his position.²²² The Court found significance in the fact that the corporation had deducted the payment as well as the fact that a gift of corporate assets by the directors would be illegal.²²³

The Second Circuit Court of Appeals cited *Parrott* in *Fisher v. Commissioner*,²²⁴ affirming the Board’s determination that a bonus paid to a resigning employee was not an excludable gift, even though the employer was under no contractual obligation to make the payment.²²⁵

The Board of Tax Appeals distinguished *Parrott* and held for the taxpayer in *David R. Daly*.²²⁶ *Daly* involved payments by a corporation to its president. The president’s annual salary was \$20,000, and over a thirteen month period corporation’s directors authorized three “gifts” to the president, totalling \$72,000.²²⁷ The president had become seriously ill shortly before the first payment was authorized and died approximately six months after the third payment was authorized.²²⁸ He also continued to receive his salary until one month before his death.²²⁹ The Board concluded that the payments were not supported by consideration and thus were excludable gifts.²³⁰ The Board distinguished *Parrott* on the ground that the employer in *Daly*, unlike the employer in *Par-*

²¹⁸ *Id.* at 370.

²¹⁹ *Id.* at 371.

²²⁰ *Noel v. Parrott*, 15 F.2d 669.

²²¹ *Id.* at 672.

²²² *Id.* at 671.

²²³ *Id.* The Court dismissed the District Court’s ratification theory, stating that “we are dealing with the interpretation of resolutions, not the validity of the action taken under them.” *Id.*

²²⁴ 59 F.2d 192 (2d Cir. 1932).

²²⁵ *Id.* at 193. The Court accorded significance to the fact that the employer had deducted the payment as a business expense. *Id.*

²²⁶ 3 B.T.A. 1042 (1926).

²²⁷ *Id.* at 1043.

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ *Id.* at 1044.

rott, had not deducted the payment as compensation for services.²³¹

The Board of Tax Appeals again distinguished *Parrott* in *John H. Rosseter*.²³² In *Rosseter*, the taxpayer was president of a corporation, and the shareholders of the corporation approved a resolution to make a \$50,000 "gift" to the taxpayer "as evidence of the appreciation of the stockholders for the very efficient and valuable services rendered to the company."²³³ The Board found that the intention to make a gift was "clear and conclusive," presumably because of the language in the shareholders' resolution.²³⁴ The Board stressed the fact that the corporation had not deducted the payment and distinguished *Parrott*, presumably on that basis.²³⁵ One judge dissented in a two sentence opinion, concluding that "(t)he so-called "gift" received by Rosseter was, in the final analysis, compensation received for services."²³⁶ The Court of Appeals affirmed the Board's decision in favor of the taxpayer.²³⁷

In *C.D. Jones*,²³⁸ a case decided four months before *Rosseter*, the Board of Tax Appeals upheld the Service's determination that payments to corporate employees upon a sale of the corporation's stock were not excludable gifts. The *Jones* case involved payments made by a trustee for the selling shareholders out of the proceeds from a sale of all of the corporation's stock.²³⁹ The gift was divided among the corporation's employees in proportions set out in a letter from the corporation's president to the trustee.²⁴⁰ The Board was "unable to distinguish this proceeding in principle from the case of *Noel v. Parrott*."²⁴¹ The Board was not persuaded by the opinion of a dissenting judge, who argued that the facts were distinguishable from those in *Parrott* because the "gifts" were paid out of the proceeds to be received by the shareholders rather than out of corporate assets.²⁴² The Court of Appeals, however, found this distinction significant and reversed the Board's decision.²⁴³

²³¹ *Id.* at 1045.

²³² 12 B.T.A. 254 (1928).

²³³ *Id.*

²³⁴ *Id.* at 256.

²³⁵ *Id.* *Parrot* might also be distinguished on the ground that it involved an action by the corporation's directors rather than its shareholders, but the Board's opinion does not point out this distinction.

²³⁶ 12 B.T.A. at 256.

²³⁷ *Blair v. Rosseter*, 33 F.2d 286 (9th Cir. 1929).

²³⁸ 10 B.T.A. 202 (1928).

²³⁹ *Id.* at 206. The contract between the purchaser and the selling shareholders had originally called for the company to make the payments, but at the purchaser's request the provision obligating the company to make the gifts was removed and the purchase price was increased by the amount of the proposed gifts. *Id.* at 205.

²⁴⁰ *Id.* at 206.

²⁴¹ *Id.* at 208.

²⁴² *Id.* at 210 (Green, dissenting).

²⁴³ *Jones v. Commissioner*, 31 F.2d 755 (3d Cir. 1929).

The Board of Tax Appeals appeared to change course in *William C. Barnes*,²⁴⁴ holding that a payment similar to the one in *Jones*²⁴⁵ was an excludable gift.²⁴⁶ The Board cited the Third Circuit's *Jones* opinion as authority and made no attempt to distinguish its own *Jones* opinion.²⁴⁷ Ironically, both the Court of Claims²⁴⁸ and the Court of Appeals for the Fifth Circuit²⁴⁹ held for the Commissioner in cases arising out of the same transaction as *Barnes*.

In *Lunsford v. Commissioner*,²⁵⁰ the directors of an *acquired* corporation voted to make a "gift" from corporate assets to an employee of the *acquiring* corporation. The employee had represented the acquiring corporation in the purchase transaction, and the directors of the acquired company stated that they wished to "remember (the employee) with a memento. . . ." ²⁵¹ The gift was contingent on approval of the owner of the *acquiring* corporation, which, of course, indirectly owned the *acquired* corporation following the purchase.²⁵² The Board of Tax Appeals found that the payment was not a gift but instead represented compensation for the employee's services in connection with the acquisition.²⁵³ The Court of Appeals reversed, relying primarily on the lack of an employment relationship between the payor and the payee.²⁵⁴

The taxpayer in *Cunningham v. Commissioner*²⁵⁵ received a bonus equal to one year's salary when he resigned his position as president of an acquired corporation to allow the new directors to name a new president. The Board of Tax Appeals, without an opinion, affirmed the Service's determination that the payment was not a gift.²⁵⁶ In a one page opinion that cites no authority, the Court of Appeals reversed, finding that the payment was "voluntary" and therefore a gift.²⁵⁷

²⁴⁴ 17 B.T.A. 1002 (1929).

²⁴⁵ 10 B.T.A. 202 (1928).

²⁴⁶ The taxpayers were employees of El Paso & Southwestern Railroad Co., a wholly owned subsidiary of a corporation called El Paso & Southwestern Co. (the "holding company"). The holding company sold the subsidiary to another corporation and the shareholders of the holding company approved payment of bonuses aggregating approximately \$1,000,000 to the employees of the subsidiary. The bonuses were allocated among the employees by three of the subsidiary's officers. 17 B.T.A. at 1002-7.

²⁴⁷ *Id.* at 1010-11.

²⁴⁸ *Schumacher v. United States*, 55 F.2d 1007 (1932).

²⁴⁹ *Bass v. Hawley*, 62 F.2d 721 (5th Cir. 1933).

²⁵⁰ 22 B.T.A. 881 (1931).

²⁵¹ *Id.* at 882.

²⁵² *Id.*

²⁵³ *Id.* at 887.

²⁵⁴ *Lunsford v. Commissioner*, 62 F.2d 740 (6th Cir. 1933).

²⁵⁵ 67 F.2d 205 (3d Cir. 1933).

²⁵⁶ *Wilfred H. Cunningham*, 26 B.T.A. 1491 (1932) (memorandum decision).

²⁵⁷ *Supra* note 255. As evidence that the payment was without consideration, the Court pointed out that the directors sought shareholder ratification. *Id.*

A transaction that was factually similar to *Parrott*,²⁵⁸ *Jones*,²⁵⁹ and *Barnes*,²⁶⁰ gave rise to three Court of Appeals decisions and, ultimately, a Supreme Court case. The transaction involved employees of the Universal Oil Products Company.²⁶¹ The shareholders of Universal sold their stock for a total consideration of \$25,000,000 after taking \$4,100,000 from the assets of Universal and forming a new corporation called Unopco.²⁶² The stock of Unopco was held by the original Universal shareholders in proportion to the Universal stock they owned.²⁶³ At the suggestion of the Unopco board of directors, the shareholders voted to distribute \$607,500 of the \$4,100,000 "as a bonus to sixty-four (64) former and present employees, attorneys and experts of Universal Oil Products Company . . . in recognition of the valuable and loyal services of said employees, attorneys and experts. . . ." ²⁶⁴ The shareholders authorized the board of directors to determine how the bonus would be apportioned.²⁶⁵

Several of the recipients maintained that their bonuses were excludable from gross income as gifts. The Board of Tax Appeals upheld the Commissioner's determination that the bonuses were taxable compensation.²⁶⁶ In separate proceedings, three of the recipients took their cases to the Court of Appeals. The first of the three cases was decided by the First Circuit in February of 1937. In that case, styled *Walker v. Commissioner*,²⁶⁷ the Court affirmed the Board's decision. Stating that whether a payment constitutes a gift depends upon the intention of the payor, as determined from the facts and circumstances surrounding the payment,²⁶⁸ the Court declined to question the Board's finding of fact.²⁶⁹ The Court cited, but did not rely upon, an earlier statement by the Supreme Court that "payment for services, even though *entirely voluntary*, [is] nevertheless compensation within the statute."²⁷⁰ A dissenting judge argued that since the recipient had not been an employee of Unopco, there was not "the slightest evidence of compensation."²⁷¹

²⁵⁸ *Parrott*, 1 B.T.A. 1.

²⁵⁹ *Jones*, 10 B.T.A. 202.

²⁶⁰ *Barnes*, 17 B.T.A. 1002.

²⁶¹ *Walker v. Commissioner*, 88 F.2d 61, 62 (1st Cir. 1937).

²⁶² *Id.*

²⁶³ *Id.*

²⁶⁴ *Id.*

²⁶⁵ *Id.*

²⁶⁶ All of the decisions were unreported memorandum decisions. E.g. Arthur G. Bogardus, 34 B.T.A. 1310 (1936).

²⁶⁷ 88 F.2d 61 (1st Cir. 1937).

²⁶⁸ *Id.* at 62.

²⁶⁹ *Id.* at 63. The Court stated that while the evidence was "conflicting," the Board's determination was final. *Id.*

²⁷⁰ *Id.* at 62, citing *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929).

²⁷¹ 88 F.2d at 63 (Morton, Circuit Judge, dissenting).

The Second Circuit decided the second case, *Bogardus v. Helvering*,²⁷² in March of 1937. Writing for the Court, Judge Hand stated that when the donor is under no legal obligation to make a payment, the status of the payment as a gift depends upon the donor's motivation.²⁷³ If that motivation is a desire to compensate the recipient for services, the payment is not an excludable gift.²⁷⁴ While recognizing that an employer might make a gift to an employee, Judge Hand observed that "such cases will be uncommon, especially if (the employer) declares that the payment is 'in recognition of' past services."²⁷⁵ Judge Hand concluded that the same analysis should apply to the transfer authorized by the Unopco shareholders, who had benefited from the employees' services, even though they had not been their employers in the strict legal sense.²⁷⁶ Ultimately, however, the Court based its conclusion on deference to the Board's initial finding of fact.²⁷⁷ One judge dissented, stating that "the facts indicate that the shareholders of Unopco, by reason of selling their Universal shares, for such fabulous sums, were moved to an act of 'spontaneous generosity,' rather than actuated by a sense of moral obligation to pay for services. . . ."²⁷⁸

The Fourth Circuit viewed the size of the shareholders' windfall as evidence of a *lack* of donative intent in *Hall v. Commissioner*,²⁷⁹ the third Court of Appeals case dealing with the Unopco payments. In an opinion issued in April of 1937, the Court observed that "the stockholders were cutting a larger melon than they had anticipated and felt that certain faithful employees who had contributed greatly to its growth should be given a larger share than had theretofore been allotted them."²⁸⁰ Noting that the case fell "squarely within the principle laid down by us in *Noel v. Parrott*,"²⁸¹ the Court affirmed the Board's finding that the payment was not a gift.

The Supreme Court granted certiorari in the *Bogardus* case and reversed the Second Circuit in a five-to-four decision.²⁸² Writing for the majority, Justice Sutherland found that the payments were motivated by "spontaneous generosity" and therefore were excludable gifts.²⁸³ The opinion states that the Court

²⁷² 88 F.2d 646 (2d Cir. 1937).

²⁷³ *Id.* at 648.

²⁷⁴ *Id.*

²⁷⁵ *Id.*

²⁷⁶ *Id.*

²⁷⁷ *Id.* at 649. Judge Hand stated that "the decision is not primarily for us at all; the Commissioner had first to make his, and then the Board its own; more exactly, the taxpayer had to show the Board that the Commissioner had been wrong, and he must show us not only that the Board was wrong, but that its conclusion was beyond any reasonable inference from the evidence." *Id.*

²⁷⁸ 88 F.2d at 649 (Swan, Circuit Judge, dissenting).

²⁷⁹ 89 F.2d 441 (4th Cir. 1937). The decision was reversed on rehearing subsequent to the Supreme Court's decision in *Bogardus*. 93 F.2d 1005 (4th Cir. 1938).

²⁸⁰ 89 F.2d at 443.

²⁸¹ *Id.*

²⁸² *Bogardus v. Commissioner*, 302 U.S. 34.

²⁸³ *Id.* at 42.

is free to review the lower court's determination because the question of whether a transfer is a gift is "a conclusion of law or at least a determination of a mixed question of law and fact."²⁸⁴ The Court also observed that since the concepts of "gift" and "compensation" are mutually exclusive, "a bestowal of money cannot, under the statute, be both a gift and a payment of compensation."²⁸⁵ In finding that the payments in question were gifts, the Court relied heavily on the lack of an employment relationship between the shareholders and the employees.²⁸⁶ The Court discounted the fact that the shareholders had derived a benefit from the employees' services, stating that "(a) gift is none the less a gift because inspired by gratitude for the past faithful service of the recipient."²⁸⁷

Writing for himself as well as Justices Stone, Cardozo, and Black, Justice Brandeis observed in dissent that "(t)o hold, as the prevailing opinion seems to do, that every payment which in any aspect is a gift is perforce not compensation and hence relieved of any tax, is to work havoc with the law."²⁸⁸ The dissenting opinion is short and remarkably similar in principle to *Duberstein* (a case that would not be decided until twenty-three years later). Justice Brandeis stated that the critical question of whether the payment had been motivated by pure generosity, as opposed to a desire to compensate the recipient, was a question of fact.²⁸⁹ Concluding that the facts at hand would support either interpretation, the dissenters would have let the Board's determination stand.²⁹⁰

The *Duberstein* opinion cites *Bogardus* at several points but neither endorses nor overrules it.²⁹¹ In a footnote, the *Duberstein* opinion intimates that *Bogardus* was incorrect to the extent it treated the "gift" question as a question of law.²⁹² A rejection of that aspect of *Bogardus* is implicit in the *Duberstein* court's ultimate holding that the "gift" question is one of fact.²⁹³

Twenty-three years after the *Duberstein* decision, the Tax Court addressed a situation similar to that in *Bogardus*. In *Jamie L. Abdella*,²⁹⁴ a memorandum decision, Judge Parker found that a payment to a corporate employee by shareholders who had sold their stock "at an enormous profit" and "chose to share some of those profits with certain employees and former employees of

²⁸⁴*Id.* at 38-9. This appears to be contrary to the position later taken by the Court in *Duberstein*, 363 U.S. 290.

²⁸⁵302 U.S. at 39.

²⁸⁶*Id.* at 41-2.

²⁸⁷*Id.* at 44.

²⁸⁸*Id.* at 44.

²⁸⁹*Id.* at 45.

²⁹⁰*Id.* at 45-6.

²⁹¹*Duberstein*, 363 U.S. 285, quoting *Bogardus v. Commissioner*, 302 U.S. 34, 41 (1937).

²⁹²363 U.S. at 289 (footnote 11). In a rather indirect fashion, the footnote describes as "sound" an earlier opinion's criticism of the *Bogardus* court's characterization of the question as one of law. *Id.*

²⁹³See *supra* note 12.

²⁹⁴T.C.M. (P-H) 83-2498 (1983).

the corporation" was a gift.²⁹⁵ Stating that "the fact that the recipient . . . previously performed services for a corporation . . . owned and controlled by the payors . . . does not necessarily make the payments compensation for past services," the opinion cites *Bogardus* and points out in a footnote that "(t)he world of nontaxable gifts did not, as (the Commissioner) suggests, begin anew with (*Duberstein*)."²⁹⁶ The opinion quotes extensively from *Duberstein*, however, and concedes that the Supreme Court "stated the governing principles" regarding excludable gifts in *Duberstein*.²⁹⁷ Curiously, Judge Parker concluded that the payment was a gift even though the payors testified that the recipient had been underpaid²⁹⁸ and that they felt a moral obligation to share their profits with him.²⁹⁹

IV. LEGISLATIVE CHANGES OCCURRING AFTER *DUBERSTEIN* AND BEFORE THE TAX REFORM ACT OF 1986

Two years after the Supreme Court decided *Duberstein*,³⁰⁰ Congress enacted section 274(b) of the Internal Revenue Code.³⁰¹ Section 274(b) represents Congress's first attempt to deal with the question of whether a payment can be both an excludable gift and a deductible business expense — a possibility the Supreme Court had refused to foreclose in *Duberstein*,³⁰² and one that ultimately became an officially reported reality with *Carter*³⁰³ and *Bank of Palm Beach*,³⁰⁴ cases dealing with different sides of the same transaction.³⁰⁵

²⁹⁵ *Id.* at 83-2502.

²⁹⁶ *Id.*

²⁹⁷ *Id.* at 83-2500.

²⁹⁸ *Id.* at 83-2502.

²⁹⁹ *Id.* at 83-2501.

³⁰⁰ *Duberstein*, 363 U.S. 278.

³⁰¹ As originally enacted, section 274(b) provided as follows:

(b) Gifts. —

- (1) Limitation. — No deduction shall be allowed under section 162 or section 212 for any expense for gifts made directly or indirectly to any individual to the extent that such expense, when added to prior expenses of the taxpayer for gifts made to such individual during the same taxable year, exceeds \$25. For purposes of this section, the term "gift" means any item excludable from gross income of the recipient under section 102 which is not excludable from his gross income under any other provision of this chapter, but such term does not include —
 - (A) an item having a cost to the taxpayer not in excess of \$4.00 on which the name of the taxpayer is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the taxpayer.
 - (B) a sign, display rack, or other promotional material to be used on the business premises of the recipient, or
 - (C) an item of tangible personal property having a cost to the taxpayer not in excess of \$100 which is awarded to an employee by reason of length of service or for safety achievement.
- (2) Special rules. —
 - (A) In the case of a gift by partnership, the limitation contained in paragraph (1) shall apply to the partnership as well as to each member thereof.
 - (B) For purposes of paragraph (1), a husband and wife shall be treated as one taxpayer.

³⁰² See *supra* text accompanying notes 32-37.

³⁰³ *Carter*, 453 F.2d 65.

³⁰⁴ *Palm Beach*, 476 F.2d 1343.

³⁰⁵ Section 274(b) did not preclude the employer's deduction in *Bank of Palm Beach* because the payment

The argument that a payment should not be simultaneously excluded by the payee and deducted by the payor has been made on two levels. First, a payment made primarily for business purposes, and therefore deductible by the donor,³⁰⁶ by definition is not made out of "detached and disinterested generosity" as required by *Duberstein* for excludability by the recipient.³⁰⁷ Second, on a policy level, if the donor is allowed a deduction for a payment that the donee is not required to include in gross income, the result is an unacceptable "double benefit."³⁰⁸ While the enactment of section 274(b) addressed the policy concerns, it exacerbated the uncertainty over the meaning of the *Duberstein* standard.

The general rule of section 274(b) is that a taxpayer making "business gifts" may claim a deduction for such gifts *only* to the extent of \$25 per donee per year, assuming the "gifts" otherwise meet the requirements for deductibility set forth in section 162.³⁰⁹ A higher limit, \$100, was enacted for gifts "of tangible personal property . . . awarded to an employee by reason of length of service or safety achievement."³¹⁰ The limitations of section 274(b) apply to "any item excludable from gross income of the recipient under section 102. . . ."³¹¹

By imposing a limit on the donor's ability to deduct gifts that are excludable from the recipient's gross income, Congress resolved, to an extent, the "double benefit" policy dilemma.³¹² At the same time, however, Congress implicitly recognized the possibility that a payment can be both deductible as a business expense and excludable as a gift.³¹³ Absent such a possibility, the limitations of section 274(b) would never be triggered. In fact, commentators have asserted that section 274(b) is superfluous because it is logically impossible for a payment to meet both the *Duberstein* standard for excludability and the requirements

was made before 1962. 476 F.2d at 1345. Cf. Jamie L. Abdella, *supra* note 294, a case arising out of a 1976 payment. The Tax Court held that the payment was excludable from the employee's gross income as a gift even though the employer had deducted it as compensation, stating that "(t)he fact that the payors improperly claimed deductions should not preclude exclusion of the payment from the recipient's income as a gift. . . ." T.C. Memo (P-H) at 83-2502.

³⁰⁶ See *supra* text accompanying notes 51-54.

³⁰⁷ See *supra* text accompanying note 11.

³⁰⁸ See *supra* Shaviro accompanying note 55.

³⁰⁹ See *supra* text accompanying notes 51-54.

³¹⁰ Section 274(b)(1)(C), Internal Revenue Code of 1954. The Conference Committee Report states that (i)t is a common practice of many employers to give such items as pins or watches to employees upon their completion of a specified number of years of satisfactory employment or in recognition of some safety achievement. Your committee felt that gifts for these purposes which serve to strengthen the relationship between business and its employees should not be discouraged by the tax law. Conf. Rept. No. 2508, 87th Cong. 2d Sess., 108 Cong. Rec. 21, 742 (1962).

³¹¹ Section 274(b)(1), *supra* note 301.

³¹² See *supra* text accompanying note 308.

³¹³ According to the Ways and Means Committee Report, the enactment of section 274(b) was not intended to change existing law on whether particular transfers were excludable from the recipient's gross income as gifts. H.R. Rep. No. 1447, 87th Cong., 2d Sess., reprinted in 1962-3 C.B. 405, at 423-24. The Finance Committee Report contains similar language, but one author has observed that the exceptions for display racks, advertising item, and employee achievement awards added by the Committee betray a fundamental misunderstanding of the scope of section 102. Shaviro, *supra* note 55 at 266.

for deductibility as a business expense.³¹⁴ Assuming that Congress would not enact a superfluous statute, the \$25 (or \$100) per donee deduction allowed by section 274(b) can be rationalized as a legislative condonation of taxpayer practice, even though that practice departs from correct theory.³¹⁵ Only three years prior to the enactment of section 274(b), the Service had ruled that the value of "merchandise of . . . nominal value, distributed by an employer to an employee at Christmas, or a comparable holiday" could be deducted by the employer as a business expense and excluded from gross income by the employee as a gift.³¹⁶ While section 274(b) is somewhat broader in scope than the "Christmas turkey" ruling, it certainly is not inconsistent in principle.

The Economic Recovery Tax Act of 1981 dramatically liberalized the limitations of section 274(b) applicable to gifts of tangible personal property to employees. The maximum allowable deduction was increased from \$100 to \$400,³¹⁷ and the language of the statute was changed to allow a \$400 deduction even if the total cost of the "gift" exceeds \$400.³¹⁸ More significantly, the statute was amended to allow a deduction of up to \$400 for tangible personal property awarded to an employee by reason of "productivity."³¹⁹ The 1981 amendments also added a higher \$1,600 per donee deduction limit for property awarded under a "permanent, written plan or program of the (employer) which does not discriminate in favor of officers, shareholders, or highly compensated employees as to eligibility or benefits," provided that the average award under such plan does not exceed \$400.³²⁰

While the increase in the deduction limit from \$100 to \$400 can be attributed to inflation,³²¹ the other changes caused considerable consternation.³²² Since the limitations of 274(b) never come into play unless the transfer is a gift under section 102,³²³ the inescapable implication was that transfers of the type described in section 274(b)(3) could, at least in some circumstances, be excludable gifts.³²⁴ The possibility that an employee could exclude, under section 102, \$1,600 worth of property received from her employer under a written plan for rewarding productivity stretches the *Duberstein* standard beyond the breaking point. It is not surprising that the 1981 amendments to section 274(b)

³¹⁴ Willis and Hawley, *supra* note 50, at 924.

³¹⁵ For a discussion of taxpayer practice in reporting such items, see Shaviro, *supra* note 55, at 243-246.

³¹⁶ Rev. Rul. 59-58, 1959-1 C.B. 17.

³¹⁷ Economic Recovery Tax Act of 1981, Pub. L. No., 97-34, 95 Stat. 172, 265 (1981).

³¹⁸ *Id.*

³¹⁹ *Id.*

³²⁰ *Id.*

³²¹ See Staff of Jt. Comm. on Taxation, 97th Cong., 1st Sess., General Explanation of the Economic Recovery Tax Act of 1981 179-180, cited in S. Rep. No. 169, Vol. 1, 98th Cong., 2d Sess., 771 n.4 (1984).

³²² See Shaviro, *supra* note 55, at 271-73, and Willis and Hawley, *supra* note 50, at 926-31.

³²³ See *supra* text accompanying note 311.

³²⁴ See *supra* notes 313-315 and accompanying text.

engendered a flurry of debate over the applicability of section 102 to recipients of "qualified plan awards."³²⁵ Various "experts,"³²⁶ as well as two senators who were the initial proponents of more liberal deduction limits for qualified plan awards,³²⁷ maintained that "congressional intent . . . was that the awards be tax free to employees."³²⁸ This position is questionable at best in light of a statement in the General Explanation that "(t)he (1981) Act does not change prior law as to whether amounts received by an employee constitute taxable compensation or a gift."³²⁹

Since the original enactment of section 274(b) in 1962, the Service and the Treasury have steadfastly maintained that it has no effect on the question of whether a particular transfer is a gift for purposes of section 102.³³⁰ The Service reiterated this position in a News Release issued after the enactment of the 1981 changes, stating that the value of a qualified plan award must be included in the employee's income "(u)nless it can be shown that the award was given because of the employer's detached generosity and in no way represented compensation for services. . . ." ³³¹ The Release observes that "(a) number of newspaper stories" commenting on the 1981 legislation "have erroneously concluded that all such awards are tax free to employees."³³²

In 1984, as a result of "disagreements . . . between some taxpayers and the IRS over whether . . . employee awards for length of service, safety, or productivity qualify for exclusion from gross income under section 102 as gifts,"³³³ the Senate Finance Committee proposed, and the full Senate approved, a new statutory exclusion from gross income for "employee achievement awards."³³⁴

The proposed exclusion would have applied to "watch(es), clock(s), or other timepiece(s), . . . emblematic jewelry or ring(s) . . . custom designed and manufactured to identify or symbolize the awarding employer or the achievement being recognized," and, "to the extent provided in regulations," items

³²⁵ Under the 1981 amendments, the higher \$1600 limit applied to "qualified plan awards." Economic Recovery Tax Act of 1981, § 265(b), adding Code § 274(b)(3).

³²⁶ The opinions of these "experts" appeared in the *New York Times* and the *Wall Street Journal*. Willis and Hawley, *supra* note 50, at 929.

³²⁷ "Senators Garn and Chaffee publicly maintained that Congress intended the awards to be tax-free to employees." *Id.*

³²⁸ *Id.* at page 927, n.112.

³²⁹ Staff of the Joint Comm. on Taxation General Explanation of the Economic Recovery Tax Act of 1981 at 179, n.1. Similar observations appear in various proposals leading up to the Tax Reform Act of 1986. See *infra* notes 356-57, note 364 and accompanying text.

³³⁰ See, e.g., Treas. Reg. Sec. 1.274-3(b)(2) (1963), which states, in part, that "(t)he fact that . . . items are expected from the applicability of this section has no effect in determining whether the value of such items is includible in the gross income of the recipient."

³³¹ Internal Revenue News Release IR 81-138, STAND. FED. TAX. REP. (CCH) ¶ 6258 (Dec. 21, 1981).

³³² *Id.*

³³³ S. Rep. No. 169, Vol. 1, 98th Cong., 2d Sess. 771 (1984).

³³⁴ *Id.* at 772-74.

“of a type traditionally used” to make retirement or employee achievement awards.³³⁵ Proposed section 74(c) would have excluded the value of such items from the recipient’s gross income, up to certain dollar limitations, provided the items were awarded in recognition of “length of service (including retirement), productivity, and safety achievement.”³³⁶ The proposed statute would have specifically *included* the value of such items in gross income to the extent such value exceeded the dollar limitations.³³⁷ While the proposed rules of exclusion and inclusion would have applied only to “qualified employee achievement award(s),”³³⁸ the accompanying Committee Report states that “(e)xcept to the extent that the new exclusion specifically applies, any amount of an employee award (whether or not satisfying the definition of an employee achievement award) is includible in the employee’s gross income under section 61, and is not excludible under . . . section 102 (gifts).”³³⁹

The proposed dollar limitations were based on the deduction limits of section 274, which would have been revised under the Senate’s proposal. Generally, the existing \$400 and \$1,600 limits would have been liberalized to allow a deduction for awards to a single employee aggregating \$4,800 in a single year (\$1,600 for length of service, \$1,600 for productivity, and \$1,600 for safety achievement).³⁴⁰ More significantly, the Senate’s proposal would have moved the limits on the deductibility of employee achievement awards from section 274(b) to new subsection 274(k).³⁴¹ By virtue of this change, the applicability of the limits would not have depended upon excludability by the recipient under section 102, thus removing any implication that such awards could be excludable gifts.³⁴²

The Senate’s proposal was dropped in conference.³⁴³ Nevertheless, the tax legislation passed by Congress in 1984 did address gifts to employees, albeit indirectly. Section 61 of the Code, which defines gross income, was amended to include a specific reference to “fringe benefits” as taxable compensation.³⁴⁴ The Ways and Means Committee Report, quoting a Supreme Court opinion, states that gross income includes “any economic or financial benefit conferred on the employee as compensation.”³⁴⁵ As part of the same act, Congress add-

³³⁵ *Id.*

³³⁶ *Id.*

³³⁷ *Id.*

³³⁸ *Id.*

³³⁹ *Id.* at 773.

³⁴⁰ *Id.*

³⁴¹ H.R. 4170, 98th Cong., 2d Sess., Sec. 828(b) (as passed by the Senate, 130 Cong. Rec. S5973 (daily ed. May 17, 1984).

³⁴² See *supra* notes 322-32 and accompanying text.

³⁴³ H.R. Rep. 98-861, 1984-3 C.B. Vol. 1 at 433-34.

³⁴⁴ Tax Reform Act of 1984, Pub. L. No. 98-369, Sec. 531(c).

³⁴⁵ H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1166, *reprinted in* 1984-3 CB Vol. 2 (quoting *Commissioner v. Smith*, 324 U.S. at 181).

ed new code section 132, which specifically *excludes* certain fringe benefits from gross income. The Committee Reports point out that any fringe benefit not *excluded* under either section 132 or "another statutory fringe benefit provision" is includable in the employee's gross income.³⁴⁶ One author has observed that the 1984 changes "leave little room for disputing that employee awards should be included in the recipient's taxable income . . . , unless provided out of detached and disinterested generosity."³⁴⁷ This reasoning appears persuasive, assuming the term "fringe benefit" is read to include employee awards.³⁴⁸ Moreover, the language in the Committee Reports seems to imply that any item that is a "fringe benefit" is not excludable as a gift under section 102.³⁴⁹

As enacted in 1984, section 132 excludes from gross income four main categories of benefits.³⁵⁰ The category potentially applicable to "gifts" to employees is the "de minimis fringe," which is defined by section 132(e) as "any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable."³⁵¹ According to the Committee Reports, "traditional holiday gifts (to employees) of property with a low fair market value" are excludable from the recipients' gross income as de minimis fringes.³⁵²

V. THE TAX REFORM ACT OF 1986

On November 27, 1984, the Treasury Department submitted its report to the president, titled *Tax Reform for Fairness, Simplicity, and Economic Growth*.³⁵³ That report proposed a denial of gift treatment for "all employee awards of tangible personal property."³⁵⁴ The report explained that "(t)he on-going business relationship between an employer and an employee is generally inconsistent with the disinterest necessary to establish a gift for tax purposes," adding an

³⁴⁶*Id.* at 1169.

³⁴⁷Shapiro, *supra* note 55, at 274-5.

³⁴⁸*See id.*

³⁴⁹*See supra* text accompanying note 346.

³⁵⁰I.R.C. § 132 provides an exclusion for no-additional-cost services, qualified employee discounts, working condition fringes, and de minimis fringes. I.R.C. § 132(b) defines no additional cost service as a service the employer sells to customers and allows employees to use for free, provided no additional cost is incurred by the employer. The most familiar example of a no-additional-cost service is free travel on a space-available basis for airline employees. A qualified employee discount, as defined in § 132(c), is a discount on goods or services purchased by employees from an employer who offers such goods or services to the general public. A working condition fringe, according to § 132(d), is a benefit provided by the employer, the cost of which the employee could deduct as a business expense if she paid for it herself. Under section 132(e), a de minimis fringe is a benefit of such small value that accounting for it would be unreasonable or impracticable.

³⁵¹I.R.C. § 132(e)(1).

³⁵²H.R. Conf. Rep. No. 861, *supra* note 345, at 1168.

³⁵³United States Dep't of Treas., *Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President* (Nov. 1984). The Report is popularly referred to as "Treasury I."

³⁵⁴*Id.* at Vol. 2, pages 45-6.

observation that "in the unusual circumstances where an employee award truly has no business motivation [and thus would be an excludable gift], it cannot consistently be deducted as an ordinary and necessary expense of the employer's business."³⁵⁵ In describing the existing law, the report stated that, notwithstanding misperceptions to the contrary,³⁵⁶ "(t)he fact that an award does not exceed the dollar limitations on deductions [imposed by section 274(b)] has no bearing on whether the award constitutes taxable compensation to the employee."³⁵⁷

A similar proposal, along with a virtually identical supporting explanation, appeared in the *President's Tax Proposals to the Congress for Fairness, Growth and Simplicity*, issued on May 29, 1985.³⁵⁸ The president's proposal, however, extended to "all employee awards" rather than just "awards of tangible personal property."³⁵⁹

The Tax Reform Bill of 1985,³⁶⁰ as passed by the House in December of 1985, followed the President's proposal by providing that section 102(a) "shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee."³⁶¹ Recognizing that the deduction limitations of section 274(b)(3) "have no application" if no transfer to an employee can be excluded as a gift,³⁶² the House Bill proposed their repeal.³⁶³

While the House Bill appeared to lay to rest any "uncertainty . . . concerning the proper tax treatment of an employee award,"³⁶⁴ a footnote in the Ways and Means Committee report leaves open the possibility of gift treatment for transfers from an (individual) employer to an employee "made exclusively for personal reasons (such as birthday presents) that are wholly unrelated to an employment relationship."³⁶⁵ The footnote adds, however, that such a transfer "cannot give rise to a deduction under section 162 or section 212."³⁶⁶ The report does point out that an award *can* be deductible by the employer under section 162 and excludable by the employee as a de minimis fringe benefit under section 132(e), and suggests that de minimis fringe benefit treatment will apply, "under appropriate circumstances, to items presented to

³⁵⁵ *Id.*

³⁵⁶ See *supra* notes 322-332 and accompanying text.

³⁵⁷ Treasury Dept. Rept., *supra* note 353, at Vol. 2 page 45.

³⁵⁸ The Proposal is popularly referred to as "Treasury II."

³⁵⁹ President's Proposals, *supra* note 358, at 48. Perhaps the difference can be explained by reading the Treasury I proposal as an attempt to clarify the general non-excludability of employee achievement awards. Treasury II, it would seem, addresses the issue more broadly.

³⁶⁰ H.R. 3838, 99th Cong., 1st Sess. (1985).

³⁶¹ H.R. 3838, *supra* note 360, Sec. 123(c)(1).

³⁶² H. Rep. 426, 99th Cong., 1st Sess. 106 (1985).

³⁶³ H.R. 3838, *supra* note 360, Sec. 123(c)(2).

³⁶⁴ H. Rep. 426, *supra* note 362, at 105.

³⁶⁵ *Id.* at 106, n.5.

³⁶⁶ *Id.*

employees upon retirement.”³⁶⁷ As an example of “appropriate circumstances,” the report states that “in the case of an employee who has worked for the employer for 25 years, a retirement gift of a gold watch may qualify as a de minimis fringe benefit even though gold watches given throughout the period of employment could not so qualify for exclusion.”³⁶⁸

The Senate Bill contained similar provisions amending section 102 and repealing the limitations of section 274(b).³⁶⁹ The Senate Bill differed from the House Bill, however, in that it added a new statutory exclusion, and corresponding deduction limitations, for employee achievement awards.³⁷⁰ The Senate provisions were adopted by the Conference Committee and ultimately become sections 102(c), 74(c), and 274(j) of the Internal Revenue Code.³⁷¹

New Code section 102(c) provides that section 102(a), which excludes gifts from gross income, “shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee.”³⁷² Section 74(c) provides a new exclusion for employee achievement awards.³⁷³ The definition of employee achievement award, as well as dollar limitations on the exclusion, are keyed to new Code section 274(j), which places limits on the employer’s deduction for such awards.³⁷⁴ The General Explanation of the Tax Reform Act states that “(e)xcept to the extent that the new section 74(c) exclusion or section 132(e)(1) applies, the fair market value of an employee award (whether or not satisfying the definition of an employee achievement award) is includible in the employee’s gross income under section 61.”³⁷⁵

Section 274(j)(3)(A) defines “employee achievement award” as “an item of tangible personal property which is — (i) transferred by an employer to an employee for length of service achievement or safety achievement, (ii) awarded as part of a meaningful presentation, and (iii) awarded under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation.”³⁷⁶ Significantly, an award recognizing only productivi-

³⁶⁷ H. Rep. 426, *supra* note 362, at 106.

³⁶⁸ *Id.*

³⁶⁹ H.R. 3838, as passed by the Senate, 99th Cong., 2d Sess., sec. 122.

³⁷⁰ *Id.*

³⁷¹ Tax Reform Act of 1986, *supra* note 1, sec. 122.

³⁷² I.R.C. of 1986, sec. 102(c).

³⁷³ I.R.C. of 1986, sec. 74(c).

³⁷⁴ I.R.C. of 1986, sec. 74(c)(1).

³⁷⁵ Staff of the Joint Comm. on Taxation General Explanation of the Tax Reform Act of 1986 at 37.

³⁷⁶ According to the General Explanation,

(t)he types of conditions and circumstances that are to be deemed to create a significant likelihood of payment of disguised compensation include, for example, the making of employee awards at the time of annual salary adjustments or as a substitute for a prior program of awarding cash bonuses, or the providing of employee awards in a way that discriminates in favor of highly paid employees. General Explanation, *supra* note 375 at 35, n.15.

ty cannot be an employee achievement award.³⁷⁷ An award is treated as having been given in recognition of length of service only if the recipient has been an employee for more than five years, and an employee can receive only one excludable length of service achievement award every five years.³⁷⁸ Safety achievement awards do not include items "awarded to a manager, administrator, clerical employee, or other professional employee," and only 10 percent of all other employees can receive safety achievement awards during any taxable year.³⁷⁹ For purposes of applying the limitations on length of service and safety achievement awards, awards excludable under section 132(e) as de minimis fringe benefits are disregarded.³⁸⁰

Section 274(j)(2) limits an employer's deduction for achievement awards given to any single employee to \$400 per year, but a higher limit (\$1600) applies to awards given pursuant to a nondiscriminatory written plan if the average award under such plan does not exceed \$400.³⁸¹ For purposes of determining the average award under a plan, and presumably for purposes of determining whether the dollar limitations have been exceeded, awards "of nominal value" are disregarded.³⁸²

Section 74(c) excludes from an employee's gross income the value of any employee achievement award to the extent that the cost of the award to the employer does not exceed the deduction limits of section 274(j).³⁸³ If the cost to the employer exceeds the limitations of section 274(j), the employee must include in gross income the excess of the cost of the award over the deduction limitation, or, if greater, the excess of the value of the award over the deduction limitation.³⁸⁴ Section 74(c)(3) provides that the same exclusion limits apply to employees of tax exempt organizations, even though the deduction limitations of section 274(j) would not apply to the employer.

VI. ANALYSIS OF THE 1986 CHANGES

The addition of section 102(c) and the creation of a separate, non-gift exclusion for employee awards eliminates any argument that such awards are excludable as gifts.³⁸⁵ Moreover, as a general proposition, section 102(c) represents

³⁷⁷ *Id.* at 35, n.14.

³⁷⁸ I.R.C. of 1986, Sec. 274(j)(4)(B).

³⁷⁹ I.R.C. of 1986, Sec. 274(j)(4)(C).

³⁸⁰ I.R.C. of 1986, Sec. 274(j)(4)(B), (C)(i).

³⁸¹ I.R.C. of 1986, Sec. 274(j)(2)(B).

³⁸² I.R.C. section 274(j)(3)(B)(ii) provides that the average cost of awards under a plan "shall be determined by including the entire cost of qualified plan awards, without taking into account awards of nominal value." The purpose of excluding awards of nominal value apparently is to prevent the employer from artificially lowering the average by giving away a large number of low cost items.

³⁸³ I.R.C. § 74(c)(1).

³⁸⁴ I.R.C. § 74(c)(2).

³⁸⁵ See *supra* notes 322-332 and accompanying text.

congressional approval of the argument made by the Commissioner in *Duberstein* — *i.e.*, that “payments by an employer to an employee, even though voluntary, ought, by and large, to be taxable.”³⁸⁶ The Ways and Means Committee report recognizes in a footnote the possibility of an employer making an excludable gift to an employee if the transfer is made “exclusively for personal reasons.”³⁸⁷ Such an exception would seem to be implicit. For example, it could not be realistically argued that section 102(c) would render a mother’s holiday gift to her son taxable simply because the son happens to be a part-time employee of his mother’s business. A logical approach would seem to be that section 102(c) does not apply because the gift arises out of the parent-child relationship rather than the employer-employee relationship. A more vexing question is whether section 102(c) denies gift treatment to a birthday present by an employer to an employee if their relationship is purely professional. While the Ways and Means Committee footnote specifically refers to birthday presents as an example of “exclusively . . . personal” gifts,³⁸⁸ the more appropriate answer would seem to be that, absent some significant relationship other than that of employer-employee, such “gifts” should be treated as taxable compensation to the extent they are not excludable as de minimis fringe benefits under section 132(e).³⁸⁹ In any event, the Ways and Means Committee Report clarifies that an employer cannot claim a deduction for any transfer to an employee that is sufficiently “personal” to qualify for exclusion under section 102.³⁹⁰

While section 102(c), together with the Committee Reports, goes a long way toward resolving some uncertainties, it also creates new uncertainties. In applying a limitation that applies to transfers by an “employer” to an “employee,” the meaning of the words employer and employee will be critical. Section 102 does not define the words, and the only general definition applies, by its terms, only for purposes of the employment tax.³⁹¹ For purposes of other income tax provisions using the words employer or employee, courts typically apply the traditional common law tests for determining the existence of an employment relationship.³⁹² Presumably, similar principles will be applied in construing section 102(c).

A more troubling question is whether section 102(c) will preclude gift treatment in situations similar to that in the *Bogardus* case.³⁹³ A gift by shareholders

³⁸⁶ *Duberstein*, 363 U.S. 287.

³⁸⁷ H. Rep. 426, *supra* note 362, at 106, n.5.

³⁸⁸ *Id.*

³⁸⁹ See *supra* text at note 352.

³⁹⁰ H. Rep. 426, *supra* note 362, at 106, n.5.

³⁹¹ See I.R.C. section 3121(d).

³⁹² See, e.g., Rev. Rul. 55-547, 1954-2 CB 57, which states that the traditional common law test will be applied to determine employment status for purposes of the exclusion provided for employee death benefits.

³⁹³ *Supra* note 282. See also Rhodes, *Are Employer Bequests Income?*, 36 Tax Notes 1305 (1987). Professor Rhodes suggests that the applicability of § 102(c) to bequests by employers to employees might be uncertain because in such a situation there is no transfer “by an employer,” as the employer is dead

to an individual employed by a corporation appears, at first blush, to fall outside the scope of section 102(c) because there is no transfer by an employer to an employee. (Quaere whether the transfer is a transfer *for* an employer to an employee.) It is a relatively easy step, however, to re-cast the transaction as a contribution to the corporation's capital by the shareholders followed by a payment by the corporation to the employee, which clearly would be governed by section 102(c).³⁹⁴ It should be remembered, however, that the Supreme Court relied heavily on the form of the transaction in *Bogardus*³⁹⁵ and did not overrule *Bogardus* in *Duberstein*.³⁹⁶ Similar distinctions based on form might be applied to restrict the scope of section 102(c).

Other uncertainties are sure to arise under section 102(c). For example, will section 102(c) prevent gift treatment for a present from a manager to a staff member if both are employees of a large corporation? The applicability of section 102(c) to payments to survivors of deceased employees — *i.e.*, whether such payments are “transfers . . . for the benefit of” the deceased employee — will also have to be addressed.

From a policy standpoint, the exclusion for employee achievement awards provided under section 74(c), under the limits of section 274(j), presents the same “double benefit” problem that was inherent in previous section 274(b)(1)(C).³⁹⁷ According to the Joint Committee's General Explanation, “Congress believed that the double income tax benefit of excludability and deductibility is acceptable for such types of employee achievement awards under rules intended to prevent abuse and limit the scope of the double benefit.”³⁹⁸

New sections 74(c) and 274(j) create the potential for a double detriment as well as double benefit. Employee Achievement Awards in excess of the limitations of section 274(j)(2) result in gross income to the employee as well as a denial of the employer's deduction.³⁹⁹ It would seem that policy (as well as symmetry) might better be served by allowing an exclusion for the employee, but

and the relationship is terminated before the transfer takes place. *Id.* at 1306. Professor Rhodes does, however, concede that such an analysis elevates form over substance. *Id.* Professor Rhodes also suggests that the corporate veil might be pierced and § 102(c) invoked, in the case of a bequest by a shareholder to a corporate employee. *Id.*

³⁹⁴ Cf. *Gregory v. Helvering*, 293 U.S. 465 (1935), which has been labeled the “fountainhead of learning” on the business purpose and substance-over-form doctrines. BITTKER & EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* 14-169 (5th Ed. 1987).

³⁹⁵ See *supra* note 286 and accompanying text.

³⁹⁶ *Supra* note 291.

³⁹⁷ See *supra* note 308 and accompanying text.

³⁹⁸ General Explanation, *supra* note 375, at 33. The enactment of § 74(c) might be viewed as exacerbating the double benefit problem, since it will “increase taxpayer exploitation of the double benefit, both by eliminating the uncertainty and consequent risk and by stimulating publicity about the enactment of a new tax ‘break.’” Shaviro, *supra* note 55, at 279.

³⁹⁹ I.R.C. §§ 74(c)(2) and 274(j)(1). Presumably, the employer could easily avoid the deduction limitation by providing the award in such a manner that it falls outside the definition of “employee achievement award” set out in Code section 274(j)(3)(A).

no deduction for the employer, up to the dollar limitations, and allowing a deduction but no exclusion for any amount in excess of the limitations.⁴⁰⁰

While cross references to section 132(e) were added to section 102 and section 74,⁴⁰¹ the 1986 Act did not modify the exclusion for de-minimis fringe benefits. The Committee Reports do, however, discuss the scope of the exclusion provided by section 132(e). The Ways and Means Committee Report, the Finance Committee Report, and the Joint Committee's General Explanation all contain language "clarifying" that "the section 132(e) exclusion under present law for de minimis fringe benefits can apply to employee awards of low value, including traditional awards (such as a gold watch) upon retirement after lengthy service for an employer."⁴⁰² The General Explanation states that "no serious potential for avoiding taxation on compensation arises from (such) transfers," since "the award is not made in recognition of any particular achievement, relates to many years of employment, and does not reflect any expectation of or incentive for the recipient's rendering of future services."⁴⁰³

To suggest that a gold watch might be "property . . . the value of which is . . . so small as to make accounting for it unreasonable or administratively impracticable"⁴⁰⁴ is absurd. Valuable jewelry is not even remotely similar to "occasional personal use of the company copying machine, occasional company cocktail parties or picnics for employees, . . . traditional holiday gifts of property with a low fair market value, . . . and coffee and doughnuts furnished to employees."⁴⁰⁵ Particularly in view of the fact that section 74(c) potentially excludes retirement awards costing the employer as much as \$1600,⁴⁰⁶ the application of section 132(e) to such awards seems inappropriate. It would appear that Congress simply cannot admit to itself, or the taxpayers, that the traditional gold retirement watch might be taxable. If the consensus of congressional opinion is that valuable retirement awards should not be taxed, Congress should have enacted a special, broader exclusion for retirement awards instead of attempting to force such awards into a statutory pigeon hole too small to accommodate them.

⁴⁰⁰The employer might also be permitted to elect whether to deduct the cost of the award or allow the employee to exclude it from gross income. Cf. Code §§ 274(e)(2) and (3), which in effect allows employers who reimburse entertainment expenses incurred by their employees to choose between having the deduction limitations of § 274(a) apply to themselves, or, by treating the reimbursements as compensation, avoiding the limitations. If the reimbursements are treated as compensation, the employees, rather than the employer, are subject to the limitations of § 274(a).

⁴⁰¹Tax Reform Act of 1986, *supra* note 1, section 122, adding new Code §§ 74(c)(4) and 102(c)(2).

⁴⁰²H. Rep. 426, *supra* note 362, at 105; S. Rep. 313, 99th Cong., 2d Sess. 49 (1986); General Explanation, *supra* note 375, at 33.

⁴⁰³General Explanation, *supra* note 375, at 33.

⁴⁰⁴I.R.C. sec. 132(e)(1).

⁴⁰⁵H. Conf. Rep. No. 861, *supra* note 345, at 1168.

⁴⁰⁶See *supra* note 381 and accompanying text.

VII. CONCLUSION

Historically, uncertainty and inconsistency have characterized the tax treatment of gifts to employees. Courts, Congress, and the Service have all contributed to the confusion over whether an employee may exclude from gross income the value of a gift from his employer, and whether the employer may deduct the cost of such a gift as a business expense.

Gifts have been excluded from gross income by statute throughout the history of the modern income tax, but Congress has never provided a definition of the term "gift."⁴⁰⁷ Perhaps predictably, early court decisions and Internal Revenue Service pronouncements often adopted the traditional common law definition — *i.e.* a transfer of property without consideration.⁴⁰⁸ The Supreme Court narrowed this definition in *Commissioner v. Duberstein*,⁴⁰⁹ holding that an excludable gift must proceed from "detached and disinterested generosity."⁴¹⁰ The Court declined, however, to adopt objective criteria suggested by the Commissioner, including the propositions that "payments by an employer to an employee, even though voluntary, ought, by and large, to be taxable," and that "the concept of a gift is inconsistent with a payment's being deductible as a business expense."⁴¹¹ Even with the guidance provided in *Duberstein*, courts continued to reach widely varying results in seemingly similar factual situations.⁴¹²

Shortly after *Duberstein* was decided, Congress enacted a dollar limitation on the deductibility of gifts as a business expense.⁴¹³ This implied that a gift might be both deductible by the donor and excludable by the donee.⁴¹⁴ Higher dollar limits for gifts to employees, which were subsequently liberalized even further, exacerbated the confusion over the proper scope of the statutory exclusion for gifts.⁴¹⁵

By adopting a blanket rule that transfers to employees are not excludable from the employees' gross income as gifts, the Tax Reform Act of 1986 resolves much of the uncertainty that previously existed.⁴¹⁶ The Committee Reports suggest that the rule would not deny a taxpayer's exclusion of a "purely personal" gift from an individual who happens to be the taxpayer's employer, cautioning that such a gift would not be deductible by the employer as a business expense.⁴¹⁷

⁴⁰⁷ Nor does "specific and illuminating" legislative history exist. *Duberstein*, 363 U.S. 284.

⁴⁰⁸ *E.g.* O.D. 1017, 5 C.B. 101.

⁴⁰⁹ *Duberstein*, 363 U.S. 278.

⁴¹⁰ *Id.* at 285.

⁴¹¹ *Id.* at 287.

⁴¹² See *supra* text accompanying notes 100-153 and 206-299.

⁴¹³ *Supra* note 301.

⁴¹⁴ *Supra* note 313 and accompanying text.

⁴¹⁵ *Supra* notes 322-332 and accompanying text.

⁴¹⁶ I.R.C. § 102(c), *supra* note 372.

⁴¹⁷ *Supra* notes 365-66 and accompanying text.

Ironically, Congress has adopted two of the criteria that the Supreme Court declined to embrace in *Duberstein*.⁴¹⁸ In view of the intervening twenty-six years of confusion, the old saw "better late than never" seems particularly appropriate.

⁴¹⁸*Supra* notes 32-37 and accompanying text.

PAC CONTRIBUTIONS AND EFFECTIVE CORPORATE TAX RATES: AN EMPIRICAL STUDY

by
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INTRODUCTION

In recent years, a great deal of concern has been expressed that many corporations have not been paying their "fair share" of federal taxes. Especially troublesome is the fact that some profitable large corporations have been able to avoid paying corporate income taxes altogether. For example, according to a recent study by Citizens for Tax Justice, Boeing, ITT, General Dynamics, Transamerica, First Executive Corp., Mitchell Energy & Development, Greyhound, Grumman, and Lockheed successfully zeroed-out their respective income tax liabilities or received tax rebates in every year from 1981 through 1984.¹

It is commonly asserted that such large corporations have used political influence to secure special tax benefits to reduce their respective tax liabilities. The present study investigates whether, in fact, there is a relationship between corporate political influence and corporate tax liabilities. Specifically, this study examines the relationship between corporate political action committee (PAC) contributions made during the 1983-1984 election cycle and the effective corporate tax rates imposed on the related corporations in 1985.

BACKGROUND

Under the Federal Election Campaign Act of 1971, as amended,² labor unions, corporations, trade associations, and certain professional and membership organizations may establish and finance "connected" political committees to support candidates for federal office.³ In recent years, such political action

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¹ See R.S. McIntyre & D. Wilhelm, *Citizens for Tax Justice, Corporate Taxpayers & Corporate Freeloaders: Four Years of Continuing, Legalized Tax Avoidance by America's Largest Corporations 1981-1984*, at 3 (1985)[hereinafter cited as *Citizens for Tax Justice*].

² U.S.C. §§ 431 *et seq.* (Supp. 1987). The principal federal election campaign laws resulted from the following Acts: Revenue Act of 1971, Pub. L. No. 92-178, 85 Stat. 497 (1971); Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (1971); Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (1974); Federal Election Campaign Act Amendments of 1976, Pub. L. No. 94-283, 90 Stat. 475 (1976); and Federal Election Campaign Act Amendments of 1979, Pub. Law. No. 96-187, 93 Stat. 1339 (1979).

³ Such committees are allowed to solicit voluntary contributions from persons related to their sponsors. The PACs, themselves, may then contribute as much as \$5,000 for each primary or general election to a candidate for federal elective office. There is no overall limitation on the amount that a PAC can contribute to all candidates. PACs and candidates for federal office are required to file periodic reports with the Federal Election Commission.