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Revenue Act of 1948, edited by Paul A. Walkin and Marcus Manoff

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REVENUE ACT OF 1948. Legislative History Series. Edited by Paul A. Wolkin and Marcus Manoff. Albany, N. Y.: Matthew Bender and Company. Pp. xxiii, 667.

The popular phrases around which the supporters of the Revenue Act of 1948 rallied to pass the bill through Congress and then to pass the bill over the veto of the President of the United States were "geographical tax equalization" and "tax reduction." For many years there had been an unequal federal tax burden upon married residents of the United States, depending

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upon whether they lived in states following the common law or the community property law. The unequal tax burden was so material that a growing number of states apparently had decided the federal tax advantages to be gained for their residents under the community property system outweighed the disadvantages encountered in changing from the common law system to the community property system. This trend among the states combined with pressure built up in prior agitation for equal tax treatment had a strong influence in moving Congress to act.

The Revenue Act of 1948 attempts to cure the unequal federal tax treatment of citizens in community property and common law states by: (1) Providing for the splitting of income between husband and wife for income tax purposes; (2) Introducing the concept of the marital deduction for estate tax purposes; and (3) The use of the marital deduction in gifts between spouses and the right to divide gifts to a third person between the husband and wife. These provisions in addition to bringing about a geographical equalization of federal taxes also result in sizeable federal tax reductions. Added to the tax reduction brought about by the equalization provisions, the 1948 Revenue Act, among other things, increases the personal exemption allowed individuals from \$500 to \$600, as well as providing an additional \$600 deduction to persons over 65 years of age and a \$600 exemption to the blind. According to the veto message of the President, the tax reduction resulting from the bill totals \$5,000,000,000.

It may be debated whether the advocates of tax reduction seized upon the vehicle of geographical equalization to accomplish their purpose or the advocates of equalization used tax reduction as a means to attain their ends. In any event the combination of forces resulted in the Congress adopting far reaching new concepts in our federal tax system.

The sections of the law providing for the splitting of income between husband and wife for income tax purposes although an important change in the tax system are not difficult to understand and the adjustment will be relatively easy. However, the new sections of the law dealing with estate and gift taxes are difficult and will require time and study for their full understanding. Nevertheless, they must be understood by every person who deals with estate and gift tax problems and require the re-examination of all existing wills and estate plans that are now in force since the new provisions of the law are effective as to decedents dying after December 31, 1947, and may result in material tax savings if properly used. Mr. Stanley Surrey, in discussing the Revenue Act of 1948, says:¹

The impact upon estate planning, upon the disposition of property within the family, is immediate and startling. Yet on passage of the

1. Surrey, *The Revenue Act of 1948*, 61 HARV. L. REV. 1117 (1948).

Act, only a relative handful of attorneys close to the theater of operations even approached awareness of what these provisions involve, and it will be many months or even years before operative understanding of all their ramifications is achieved by tax practitioners. Individuals will die, and their families will experience an unnecessarily large tax because lawyers have not had adequate opportunity to read, understand, and act.

Messrs. Wolkin and Manoff in their *Legislative History of the Revenue Act of 1948* have combined in one volume the history of the bill in its travels through the House Ways and Means Committee, the Senate Finance Committee and on the floors of the two houses of Congress. Interesting and helpful parts of the compilation are the extracts from the Hearings on the Bill before the Congressional Committees where the views and criticisms of tax lawyers and other witnesses from all parts of the country may be read and compared with the final result reached by Congress. Each provision of the Act has its legislative history arranged in sequence so that its particular history may be examined from beginning to end without going through the entire legislative history of the Act. The book is not meant for the casual reader but for the specialist who must interpret and apply the statute in estate planning and in presenting arguments before the courts and the administrative bodies of the Bureau of Internal Revenue. The practical application of the new provisions of the law will soon lead the tax practitioner to an awareness of the necessity for understanding the background contained in the legislative history of the particular section under examination and it is at that point that the compilation of Messrs. Wolkin and Manoff will prove most valuable.

In achieving geographical equality, the 1948 Act in addition to permitting the splitting of income between husband and wife introduced a new concept in our estate and gift tax law called the "marital deduction." The marital deduction for estate tax purposes is an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, if such interest is included in determining the value of the decedent's gross estate. The deduction is limited, however, to fifty per cent (50%) of the adjusted gross estate which is the gross estate less administration expenses and claims against the estate. Generally the marital deduction is one-half of the value of the adjusted gross estate where half of the property is left outright to the surviving spouse. If the decedent's adjusted gross estate is \$400,000, and he leaves an interest in property in the estate outright to his wife which is valued at \$200,000, the marital deduction is \$200,000 and his taxable estate is \$200,000. If he should leave a similar interest to his wife valued at \$300,000, the marital deduction would remain \$200,000 and his taxable estate \$200,000 due to the fifty per cent (50%) limitation. Senator Millikin, Chairman of the Senate Finance Committee, explained to the Senate

that, "Roughly speaking this deduction, which I have already described, will produce the same tax treatment when a decedent spouse in a common-law State leaves half of his property to his surviving spouse as will be obtained, under the repeal of the 1942 amendments, in cases where the surviving spouse receives an interest in community property under the operation of State law."

By the creation of the marital deduction Congress did not intend that property escape tax in both the decedent's estate and that of his surviving spouse as would happen if property, left to a wife for life, remainder to the children, were to qualify for the marital deduction. To prevent this result and cover other situations, Congress placed limitations on the right to the marital deduction which are intended to make certain that property left the wife tax-free is not subject to strings that would prevent its being taxed in her estate. Congress called property with such contingencies "terminable interests." For example, if a decedent left an interest in property to his spouse as long as she remained unmarried it would not qualify for the marital deduction since the remarriage of the wife would terminate her interest in the property and it would not be included in her estate. This possibility, even though it never occurs, prevents the property from qualifying for the marital deduction. In general, the marital deduction applies only to absolute transfers to the surviving spouse in fee simple.

Trusts have historically been a method by which husbands have disposed of their property to insure the financial security of their wives and further control the devolution of their property. Apparently for this reason an exception to the terminable interest rule was made in the case of trusts so that property left to a wife in trust might qualify for the marital deduction if certain conditions exist which will make the property, if it isn't consumed, subject to the estate or gift tax in the hands of the surviving spouse. The principal requirements are that the income must be payable to the surviving spouse annually or at more frequent intervals and that she must have the power to appoint the corpus to herself or her estate.

A similar exception to the terminable interest rule applies to proceeds under a life insurance, endowment or annuity contract. The marital deduction may be obtained if under the terms of the policy the surviving spouse is entitled to receive such proceeds in annual or more frequent installments and she has the power of appointment over the unpaid balance of the proceeds.

Other sections of the law take care of particular problems that arise from the creation of the marital deduction such as the valuation of the interest passing to the surviving spouse, the requirements where a will contains a common disaster or early death clause, the repeal of the provisions relating to property previously taxed, the effect of disclaimers, and the payments to the surviving spouse out of unidentifiable assets.

Equalization under the gift tax provisions of the Revenue Act of 1948 follows the marital deduction pattern set by the estate tax changes. The marital deduction for gift tax purposes, however, is one-half of the value of the gift to the spouse without taking into account the \$3,000 exclusion now applicable to gifts to any one person during a calendar year. Thus, if a donor makes gifts of \$10,000 to his spouse during the calendar year there will be allowed an exclusion of \$3,000 and a marital deduction of \$5,000 (half of the \$10,000 gift). The marital deduction does not affect the lifetime gift tax exemption of \$30,000 to which each donor is entitled.

In community property states gifts of community property to a third person are deemed to be made half by the wife and half by the husband and Congress in equalizing the gift tax law gives equal treatment in common law states by providing that gifts to a third person may be considered to have been made one-half by each spouse. If a father should make gifts to his son in a calendar year of \$50,000, the father and mother can compute the gift tax as though each had made a gift of \$25,000. The splitting of gifts is not mandatory but is permitted if both spouses consent to have all their gifts during the year so treated.

The new concepts introduced into the estate and gift tax law are novel and complicated and will undoubtedly be the source of much litigation extending over the next few years. The Legislative History compiled by Messrs. Wolkin and Manoff will provide a valuable tool for the tax consultant in his consideration of the many new problems that he must face as a result of the Revenue Act of 1948.

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