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IDENTIFICATION OF PROPERTY SUBJECT TO THE FEDERAL ESTATE TAX

*Charles L. B. Lowndes** and *Richard B. Stephens***

ALTHOUGH the federal estate tax is imposed on the "transfer" of property, the amount of the levy is a specified percentage of the taxable estate. Correct computation of the tax depends, therefore, upon accurate identification of the property included in the taxable estate. However, the determination and application of the rules governing identification are relatively uncharted areas.

Three questions must be answered in determining a decedent's gross estate: (1) Has there been a taxable transfer, that is, do any of the statutory provisions *apply* so that something is required to be included in the gross estate? (2) If a provision is applicable, what is the interest that must be included in the gross estate, or how do you *identify* the property includible in the gross estate? (3) Finally, how are the interests includible in the gross estate to be *valued*? Suppose, for example, that A transferred Blackacre to B in contemplation of death and died within three years of the transfer. Before A's death, B exchanged Blackacre for Whiteacre which B owned at the time of A's death. The first question that arises is whether there has been a taxable transfer. After this has been decided affirmatively since the transfer was made in contemplation of death, the next problem is to identify which property is includible in A's gross estate, Blackacre or Whiteacre. Finally, it is necessary to determine how to value the property included in A's gross estate.

The statutory definition of the gross estate is quite clear in designating the transfers taxed under the statute, but it is often disappointing in its failure to identify the property included in the gross estate. The definition is cryptic at its best; at its worst, it fails to communicate clear messages even to members of the tax cult. In the transactions discussed in this article the application of the definition is encountered at its worst.

The problem of the identification of the interests includible in the gross estate has received far less attention than the questions of applicability and valuation. This is probably due to the fact that in many instances, once it is decided that a particular transfer is taxed under the statute, the subject matter of the transfer is fairly obvious. However, it is becoming increasingly apparent that there are a

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number of situations in which, although it is clear that there has been a taxable transfer, it is by no means clear what interests should be included in the transferor's gross estate.

At the outset it is important to notice that identification of the property subject to the estate tax is not a single problem, but rather a multi-faceted one. In some cases identification requires the determination of whether there has been a transfer of the specific interest whose inclusion in the gross estate is in issue. In other cases identification of property included in the gross estate turns upon a determination of what interest the decedent is considered to have transferred. In still other cases, identification depends upon the possibility of "tracing" the transferred property into some other property or its product. Thus, it will be convenient to consider identification of the property included in the gross estate under these three headings, namely: (1) Has there been a transfer? (2) What has been transferred? and (3) To what extent may the property transferred be traced into other property?

I. HAS THERE BEEN A TRANSFER?

A. *Accumulated Income*

Several cases raise the question whether income accumulated in connection with an inter vivos transfer taxable under the estate tax should be included in the transferor's gross estate. Since the provisions of the estate tax which are relevant to inter vivos transfers apply only to interests transferred by the decedent, the taxability of accumulated income depends on whether the decedent transferred the income. In this connection it is important to notice that two types of transfers are taxed under the estate tax provisions. The first are transfers in contemplation of death which are taxed because of the transferor's testamentary state of mind, regardless of whether the particular transfer was completed during the transferor's life.¹ The second group consists of those inter vivos transfers which are not completed until the transferor's death, such as transfers with a reservation of a life interest, which are taxed under section 2036, transfers taking effect at death, which are taxed under section 2037, and revocable transfers, which are taxed under section 2038.

It appears to be settled that income accumulated in connection with an indefeasible transfer in contemplation of death will not be taxed as part of the property transferred in contemplation of death, because there has been no transfer of the accumulated income.²

1. INT. REV. CODE OF 1954, § 2035.

2. *Commissioner v. Gidwitz' Estate*, 196 F.2d 813 (7th Cir. 1952); *Burns v. Com-*

Since the transferor parted completely with the principal property at the time of the original transfer, he never possessed any interest in the income which accrued after the transfer and, consequently, he could not have transferred such income.

Before the recent decision of the Supreme Court in *United States v. O'Malley*,³ there was a difference of opinion among the lower courts as to whether income accumulated in connection with an irrevocable trust, under which the grantor retained power only to accumulate income or to distribute it to others, was taxable to the grantor's estate under either section 2036(a)(2) or section 2038. Section 2036(a)(2) taxes the retention of a power to designate the possession or enjoyment of, or the income from, transferred property; section 2038, in addition to taxing powers to revoke a transfer, taxes powers to alter, amend or terminate the enjoyment of the transferred property. The Sixth and Seventh Circuits took the view that the accumulated income was not taxable since a decedent who lacked the power to revoke the trust and reacquire the income could not be said to have made a transfer of accumulated income.⁴ On the other hand, the First Circuit, without closely analyzing the question whether the accumulated income could properly be said to have been transferred by the decedent, taxed the accumulated income primarily on the ground that the retention of the power rendered the entire transfer incomplete until the grantor's death.⁵ In *United States v. O'Malley*, the Supreme Court held that there was a transfer of the accumulated income which required its inclusion in the transferor's gross estate.⁶ The Court failed, however, to make clear the precise character of this transfer.

The majority opinion in *O'Malley* pointed out that in order to tax the accumulated income under the 1939 Code equivalent of section 2036(a)(2), it was necessary to establish that the decedent "retained a power 'to designate the persons who shall possess or enjoy the property or the income therefrom;' and second [it had to be shown that] the property sought to be included, namely, the portions of the trust principal representing accumulated income, was the subject of a previous transfer" by the decedent.⁷ The Court

missioner, 177 F.2d 739 (5th Cir. 1949); Treas. Reg. § 20.2035-1(e) (1958). After refusing initially to acquiesce in these decisions, 1949-1 CUM. BULL. 5, the Commissioner has recently changed his position and substituted his acquiescence. Announcement, 1966 INT. REV. BULL. No. 24, at 6.

3. 383 U.S. 627 (1966).

4. *O'Malley v. United States*, 340 F.2d 930 (7th Cir. 1964); *Michigan Trust Co. v. Kavanagh*, 284 F.2d 502 (6th Cir. 1960); *Commissioner v. McDermott's Estate*, 222 F.2d 665 (7th Cir. 1955).

5. *Round v. Commissioner*, 332 F.2d 590 (1st Cir. 1964).

6. 383 U.S. 627, 632-33 (1966).

found that the decedent retained power to designate the income from the accumulated income because he had power to accumulate or distribute this income, and, according to *Industrial Trust Co. v. Commissioner*,⁸ this amounted to a power to designate the persons who shall take income under section 2036(a)(2). The Court then proceeded to find that the decedent transferred the accumulated income, using the following language which is sufficiently ambiguous to require repetition verbatim:

The dispute in this case relates to the second condition to the applicability of §811(c)(1)(B)—whether Fabrice had ever “transferred” the income additions to the trust principal. Contrary to the judgment of the Court of Appeals, we are sure that he had. At the time Fabrice established these trusts, he owned all of the rights to the property transferred, a major aspect of which was his right to the present and future income produced by that property. . . . With the creation of the trusts, he relinquished all of his rights to income except the power to distribute that income to the income beneficiaries or to accumulate and hold it for the remaindermen of the trusts. He no longer had, for example, the right to income for his own benefit or to have it distributed to any other than the trust beneficiaries. Moreover, with respect to the very additions to principal now at issue, he exercised his retained power to distribute or accumulate income, choosing to do the latter and thereby adding to the principal of the trusts. All income increments to trust principal are therefore traceable to Fabrice himself, by virtue of the original transfer and the exercise of the power to accumulate. Before the creation of the trusts, Fabrice owned all rights to the property and its income. By the time of his death he had divested himself of all power and control over accumulated income which had been added to the principal, except the power to deal with income from such additions. With respect to each addition to trust principal from accumulated income Fabrice had clearly made a “transfer” as required by §811(c)(1)(B)(ii). Under that section, the power over income retained by Fabrice is sufficient to require the inclusion of the original corpus in his gross estate. The accumulated income added to principal is subject to the same power and is likewise includible. . . .⁹

There are several conceivable rationalizations of the majority opinion in *O'Malley*. It is possible to conclude that any one of the three events mentioned by the Court constituted a taxable transfer of the accumulated income. It is also possible, however, that the

7. *Id.* at 630. Justices Stewart and Harlan dissented in the *O'Malley* case. They felt that the decedent “‘never made a transfer’ of the income which the corpus thereafter produced, whether accumulated or not.” *Id.* at 635.

8. 165 F.2d 142 (1st Cir. 1947).

9. 383 U.S. at 632, 633.

Court deliberately refrained from pinpointing the precise event which constituted the transfer of accumulated income because it felt that this was unnecessary; since one or more of the events which occurred obviously amounted to a transfer, it may have preferred not to specify the exact character of the transfer as long as the decision of the case before it did not require such specification. These alternative possibilities must be considered in any attempt to predict the effect of *O'Malley* upon the course of future decisions.

The language quoted from *O'Malley* could be interpreted to mean that the decedent transferred the accumulated income when he created the trust, since at that time he transferred not only the principal of the trust but also the rights to all future income. Apart from the fictitious aspect of this transfer, regarding the original creation of the trust as a transfer of the future income from the trust raises a problem in connection with indefeasible transfers. It seems to be conceded, even by the *O'Malley* Court itself, that income accumulated in connection with an indefeasible transfer in contemplation of death is not subject to the estate tax, because there is no taxable transfer of the accumulated income.¹⁰ It would appear, however, that there would be a transfer of the after accumulated income if the original transfer included both principal and future income. It is also possible to read the majority opinion as implying that the transfer of accumulated income took place when the decedent elected to accumulate the income. One awkward corollary of this proposition, if it is sound, is that it would appear that the decedent also transferred any income which he elected to distribute. This would mean that any income distributed by the decedent within three years of his death would be taxable to his estate as a transfer in contemplation of death, unless it were proved that the distribution was not, in fact, made in contemplation of death.¹¹ However, there was no suggestion in *O'Malley* that any income from the trust which was distributed before the decedent's death was taxable as part of his gross estate.

An additional possibility is that the Court's language indicates that the decedent transferred the accumulated income at his death when his power to distribute or accumulate the income from the accumulated income lapsed. Apparently, this was the view of the

10. The majority of the Court distinguished the transfer in *O'Malley* where the transfer was incomplete until the transferor's death from the indefeasible transfers in contemplation of death in the *Burns* and *Gidwitz* cases. *Id.* at 633.

11. INT. REV. CODE OF 1954, § 2035(b) contains a rebuttable presumption that transfers made within 3 years of the transferor's death are transfers made in contemplation of death.

First Circuit in *Round v. Commissioner*¹² when it equated the lapse of a power over property with the transfer of the property itself. This position may be supported by the *O'Malley* Court's remark, previously quoted, that "[t]he accumulated income added to principal is subject to the same power and is likewise includible." However, the complete context appears to indicate that the *O'Malley* Court thought that the transfer of the accumulated income took place before the transferor's death and that the Court was referring merely to the fact that the power which constituted a taxable interest existed at the decedent's death.

As noted above, it is possible that the *O'Malley* Court refrained from pinpointing the event which constituted the transfer of the accumulated income so as not to tie the hands of the Court in a future case. Although this may be a satisfactory explanation of the ambiguous language in the case, it makes it difficult to apply the decision in analogous situations. As far as the administration of the estate tax and the prediction of future results are concerned, it would simplify matters if it could be said with certainty that the same "strings" which lead to the inclusion of principal in the estate of a decedent will also require inclusion of accumulated income in his gross estate when the "strings" are attached to the accumulated income. Moreover, control over accumulated income seems to be a more equitable basis for a tax than a technical "transfer" of the accumulated income. Even though the proper result under the statute may be uncertain, the desirable result appears to be quite clear.

It seemed clear before *O'Malley* that income accumulated in connection with a revocable trust was taxable to the grantor's estate. Even the Seventh Circuit intimated that a transfer of accumulated income would be found in the lapse of the grantor's power to revoke the trust and acquire the accumulated income.¹³ *O'Malley* is completely consistent with the taxation to the grantor's estate of income accumulated in connection with a revocable trust. If it is possible to find a transfer of accumulated income in a situation in which a transferor has power to accumulate or distribute, but cannot revest such income in himself, there should be no difficulty in finding a transfer of accumulated income in those situations in which the transferor possesses power to revest the accumulated income in

12. 332 F.2d 590 (1st Cir. 1964).

13. In *Commissioner v. McDermott's Estate*, 222 F.2d 665, 667, 668 (7th Cir. 1955), the Court indicated that there would have been a taxable transfer of accumulated income if the decedent had been able to revoke the transfer and acquire the income.

himself. Income accumulated in connection with a revocable trust might also be taxed to the grantor's estate on the theory that the grantor had a power, taxable under section 2041, to appoint the income to himself. If the Regulations are correct in limiting the class of taxable powers of appointment to donated, as distinguished from reserved, powers,¹⁴ a tax under section 2041 would presumably be predicated upon the assumption that the decedent did *not* transfer the accumulated income.

According to *O'Malley*, income accumulated in connection with an irrevocable trust which gives the decedent power to accumulate or distribute the income and the income from the accumulated income will be taxed to the decedent's estate under section 2036 (a)(2) and presumably under that part of section 2038 which taxes powers to alter, amend or terminate the enjoyment of transferred property. The tax, however, must be imposed under section 2036 (a)(2) or section 2038. The accumulated income could not be taxed to the grantor of the trust under section 2041 on the theory that he possessed a taxable power of appointment over the income, that is, a general power of appointment, since he could not appoint the income to himself. Of course, if the position of the Regulations that only donated powers are taxed under section 2041 is sound, the power would not be taxable under that section in any event if the decedent were regarded as having transferred the accumulated income.

The fact that a decedent could only exercise his power to revoke a trust or to accumulate or distribute income from a trust with the consent of some other person will not prevent the accumulated income from being taxed to the decedent's estate, at least if the person required to join in the exercise of the power lacked a substantial adverse interest in the trust. Indeed, in *O'Malley* the decedent's power to accumulate or distribute the income of the trust was a joint power which could only be exercised in conjunction with the other trustees of the trust. Suppose, however, that the decedent's power over trust income could be exercised only with the consent of a person possessing a substantial adverse interest in the income. Will this prevent the inclusion of accumulated income in the decedent's gross estate? In *Reinecke v. Northern Trust Co.*,¹⁵ a transfer which could be revoked by the transferor only with the consent

14. According to the Regulations "the term 'power of appointment' does not include powers reserved to the decedent within the concept of sections 2036 through 2038" but is limited to powers donated to the decedent by some other person. Treas. Reg. § 20.2041-1(b)(2) (1958).

15. 278 U.S. 339 (1929).

of a person possessing a substantial adverse interest in the transferred property was held to be an irrevocable transfer completed during the transferor's life which was not taxable to his estate in the absence of a provision explicitly taxing such transfers. However, after the federal estate tax had been amended to tax expressly transfers revocable by the grantor alone or in conjunction with "any other person," the Supreme Court held, in *Helvering v. City Bank Farmers Trust Co.*,¹⁶ that "any other person" meant any other person, including persons possessing substantial adverse interests. After deciding that as a matter of construction the statute provided for the taxation of powers exercisable only in conjunction with a person possessing a substantial adverse interest, the Court held that the statute was constitutional. In view of *City Bank Farmers Trust Co.*, if *O'Malley* stands for the proposition that the same "strings" which will draw principal into a decedent's gross estate will also bind accumulated income to his gross estate, all transfers under which the transferor possessed power to accumulate or distribute income and the income from accumulated income will be fully taxable both as to principal and accumulated income, even though the taxable power must be exercised in conjunction with a person possessing a substantial adverse interest. If this is not the exegesis of the *O'Malley* decision and if the taxation of accumulated income where there is a power to revoke a trust or accumulate or distribute income depends upon who can exercise the power, a further complication, which has plagued both the income tax and gift tax areas, as to who possesses a substantial adverse interest in trust property will be introduced.

Although section 2037, like sections 2036 and 2038, limits the interests includible in a decedent's gross estate to those interests transferred by the decedent during his life, it is generally assumed that income accumulated in connection with a transfer which is taxable under section 2037 will also be taxed under that section, provided, of course, that the transferee's possession or enjoyment of the accumulated income is dependent upon his surviving the transferor, and provided further that the transferor possessed the requisite reversionary interest in the accumulated income.¹⁷ For example, if A transfers property to T in trust to accumulate the income from the trust during A's life and at A's death to distribute the trust property, along with the accumulated income, to A's sur-

16. 296 U.S. 85 (1935).

17. This seems to be a fair inference from examples (2) & (6), Treas. Reg. § 20.2037-1(d) (1958), although both examples deal with a situation in which § 2037 was held to be inapplicable.

viving children, or to A's estate if he has no surviving children, apparently the entire trust property, including any accumulated income, will be taxed to A's estate if his chance of outliving his children was better than five per cent at the date of his death. Whether this is a correct construction of section 2037 as far as the accumulated income is concerned depends upon whether A made a transfer of the accumulated income. One factor mitigating against a finding of such a transfer is that the original transfer was an irrevocable transfer which put the transferred property beyond the transferor's control. The transferee's chance of enjoying the transferred property depends on his surviving the transferor rather than upon any exercise of the transferor's will. There is, however, a transfer of accumulated income in the case of a transfer taxable under section 2037 in the sense that at the transferor's death his chance of reacquiring the accumulated income lapses. In other words, the transferee's possession or enjoyment of the accumulated income is held in suspense until the transferor's death. If the "strings" over accumulated income are equated with the "strings" over principal which will incur an estate tax pursuant to the reasoning in *O'Malley*, then income accumulated in connection with a section 2037 transfer appears to be taxable under that section.

As a matter of policy it seems desirable to equate the "strings" which will pull accumulated income into a taxable estate with the "strings" which make principal taxable under the estate tax. Thus, it might be desirable to amend the statute to prescribe this result explicitly instead of hoping that this result will be achieved under the vague language of the *O'Malley* case.

B. Stock Dividends

The taxation of stock dividends is a problem that has constantly plagued the income tax administrators.¹⁸ In recent years the question of how stock dividends should be treated under the estate tax has arisen in at least three situations. First, where a decedent transferred stock in contemplation of death and before his death a stock dividend was distributed to the transferee, the question arose whether the stock dividend should be included in the decedent's estate along with the original stock.¹⁹ A similar question has arisen

18. See BITTKER, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 168-78 (1959).

19. *McGehee v. Commissioner*, 260 F.2d 818 (5th Cir. 1958). The dividend was excluded from the decedent's gross estate because it represented corporate profits accumulated after the transfer of the stock and was regarded, therefore, as income accruing after the transfer.

where a decedent owned stock at his death, his executor elected to value his estate according to the alternate valuation date, and a stock dividend was distributed after the decedent's death but before the valuation date.²⁰ Whether the stock dividend should be included in the decedent's gross estate depends upon whether the stock dividend can be regarded as part of the property owned by the decedent at his death.²¹ Finally, there are several cases in which a donee of stock received a stock dividend which was transferred to the donor and donee as joint tenants. Upon the death of the donor, the question was whether the stock dividend was to be treated as part of the original stock and therefore as the contribution of the original donor to the joint tenancy, or as income accruing while the stock was held by the donee and thus as part of the donee's contribution to the joint estate.²²

All of these cases turn on the question whether the stock dividend is a part of the original stock transferred by the decedent (and is therefore includible in his gross estate), or, on the other hand, is income earned by the original stock after the transfer by the decedent (and is therefore excludible from decedent's gross estate). There are various approaches to the problem which are either suggested by or find some support in judicial decisions or Treasury Regulations.

1. *The Income Tax Statute*

A possible approach to the treatment of stock dividends under the estate tax is to follow the statutory definition of a taxable stock dividend which is found in the income tax portion of the Code. Stock dividends would then be regarded, for estate tax purposes, as part of the stock originally transferred unless they are taxable as income. Under the current Code it is expressly provided that stock

20. *Estate of Schlosser v. Commissioner*, 277 F.2d 268 (3d Cir.), *cert. denied*, 364 U.S. 819 (1960). Since the dividend was not income, as that concept was developed in early constitutional cases under the income tax Code, but a division of capital, it was included in the gross estate. The Court expressly rejected the rationale of the *McGehee* case, *supra* note 19. *Accord*, Rev. Rul. 58-576, 1958-2 CUM. BULL. 625.

21. Income accruing after a decedent's death in connection with property included in the gross estate is not includible in the gross estate even though it is valued on the alternate valuation date. *Maass v. Higgins*, 312 U.S. 443 (1941).

22. *Tuck v. United States*, 282 F.2d 405 (9th Cir. 1960); *English v. United States*, 270 F.2d 876 (7th Cir. 1959). Both cases attributed the stock dividends to the donor of the original stock upon the ground that the dividends were not "income" as that concept was developed in early constitutional cases under the income tax, but rather represented earnings of the corporation accumulated before the gift. Neither court repudiated the *McGehee* case. Indeed, it was suggested that a different result might be reached where the dividends represented earnings accumulated after the gift, a fact not proved by the taxpayer in either case.

dividends are not taxable as income unless a stockholder is given the option of taking cash or property other than the stock of the distributing corporation, or unless the dividend "is made in discharge of preference dividends for the taxable year of the corporation in which the distribution is made or for the preceding taxable year."²³ The principal merit in this approach is that it affords a comparatively certain and simple rule for handling stock dividends under the estate tax. However, the considerations which lead to classifying stock dividends as taxable income for income tax purposes have little relevance to the estate tax situation. For example, suppose that A transfers stock to B in contemplation of death. After the transfer the corporation distributes to B a one hundred per cent stock dividend which represents surplus accumulated by the corporation before the transfer. The stock dividend appears to represent part of the stock originally transferred in contemplation of death, and as such should be included in the transferor's gross estate. Does the fact that the corporation gave the stockholders the option of taking cash instead of stock, so that the dividend is taxable as income for income tax purposes have any relevance to the character of the dividend for estate tax purposes?

2. *The Constitutional Concept*

Another way of dealing with stock dividends under the estate tax is to apply the income tax doctrines developed in connection with stock dividends before the 1954 Code; as a matter of general legal theory it was then held that only those stock dividends which gave the stockholder a different proportional interest in the corporation were taxable as income.²⁴ The *original* "common law" approach had a somewhat closer relationship to the estate tax problem than the income tax statutory rule. At least in *Eisner v. Macomber*, the Supreme Court said that a stock dividend was not income when the "old certificates have been split up in effect and have diminished in value to the extent of the value of the new."²⁵ However, the judicial refinements that succeeded *Eisner v. Macomber* and the gradual attrition of the original constitutional approach make the income tax doctrines increasingly irrelevant to the estate tax prob-

23. INT. REV. CODE OF 1954, § 305; see BITTRER, *op. cit. supra* note 18, at 172-76.

24. *Strassburger v. Commissioner*, 318 U.S. 604 (1943); *Koshland v. Helvering*, 298 U.S. 441 (1936). This appears to have been the test followed in *Estate of Schlosser v. Commissioner*, 277 F.2d 268 (3d Cir.), *cert. denied*, 364 U.S. 819 (1960), and in *Tuck v. United States*, 282 F.2d 405 (9th Cir. 1960), and *English v. United States*, 270 F.2d 876 (7th Cir. 1959).

25. 252 U.S. 189, 203 (1920).

lems.²⁶ For example, suppose again that A transferred stock to B in contemplation of death, and before A's death the corporation distributed a stock dividend to B. Of what relevance is the fact that the dividend did or did not affect B's proportional interest in the corporation to the question whether the stock dividend really represents part of the original stock transferred by the decedent?

If the income tax rule is to be applied to the estate tax, it is certainly arguable that the rule which should be carried over is the common law rule rather than the statutory rule, since the estate tax unlike the income tax contains no explicit definition of an income stock dividend.²⁷ On the other hand, the principal argument in favor of transposing the income tax rule in this area to the estate tax is that it would supply a clear and simple rule for estate tax purposes, but the common law income tax test of a taxable stock dividend is neither clear nor simple.²⁸

3. *Disregarding the Corporate Entity*

The approach adopted in most of the cases dealing with the taxation of stock dividends for estate tax purposes is to look through the stock dividend to the earnings capitalized by the dividend.²⁹ To the extent that these earnings were accumulated after the date of the taxable transfer, the stock dividend is regarded as income accruing after the transfer and is consequently not includible in the decedent's gross estate. To the extent that the stock dividend represents earnings accumulated before the date of the taxable transfer, it is regarded as part of the property transferred by the decedent.

26. It is arguable, however, that these decisions rested on the wording of the statute, that *Eisner v. Macomber*, *supra* note 25, in which the court held that a stock dividend of common on common is not income in the constitutional sense, may no longer be the law, and that perhaps now any stock dividend is constitutionally taxable as income. See *Helvering v. Griffiths*, 318 U.S. 371 (1943); Lowndes, *The Taxation of Stock Dividends and Stock Rights*, 96 U. PA. L. REV. 147, 149 (1947).

27. In *Farid-Es-Sultaneh v. Commissioner*, 160 F.2d 812 (2d Cir. 1947), where the question was what the income tax section of the Code meant by a "gift", the court refused to read the definition from the gift tax section into the income tax section and, in the absence of an income tax definition, adopted the common-law definition of a gift.

28. Furthermore, the *Eisner v. Macomber* test may not have been the "common-law" test of a taxable stock dividend at all, if that case was incorrectly decided. If *Eisner* was incorrectly decided, any stock dividend is taxable as income.

29. This was the position adopted by the Fifth Circuit in *McGehee v. Commissioner*, 260 F.2d 818 (5th Cir. 1958) and it would apparently be followed by the Seventh and Ninth Circuits according to their somewhat equivocal decisions in *English v. United States*, 270 F.2d 876 (7th Cir. 1959) and *Tuck v. United States*, 282 F.2d 405 (9th Cir. 1960). On the other hand, the Third Circuit, in *Estate of Schlosser v. Commissioner*, 277 F.2d 268 (3d Cir.), *cert. denied*, 364 U.S. 819 (1960), expressly repudiated this approach.

However, there are several difficulties with this approach. First, it postulates an ability to identify the source of the stock dividend which is simpler in theory than it is in practice. This solution is reminiscent of the apportionment rule under the law of Trusts, according to which stock dividends were divided between the income beneficiary and remainderman of a trust depending upon the time when the earnings represented by the stock dividends were accumulated.³⁰ This rule proved so difficult to administer in connection with trusts that it has generally been abandoned in favor of the simpler and less equitable practice of allocating all stock dividends to corpus. Furthermore, if stock dividends are to be treated as part of the property originally transferred by a decedent to the extent that they represent earnings accumulated before the transfer, it is difficult to see why all dividends should not be apportioned in this fashion. If the corporate veil is pierced to determine what earnings are represented by a stock dividend, why should this not be done in connection with any dividend? The authors of the Regulations recognize that the problem of determining whether a corporate dividend represents part of the stock originally transferred or income accruing after the transfer goes beyond stock dividends, although they are better at recognizing the problem than at offering practical advice for its solution. Section 20.2032-1(d)(4) of the Regulations provides that when an estate is valued according to the alternate valuation date:

ordinary dividends out of earnings and profits (whether in cash, shares of the corporation, or other property) are "excluded property" and are not to be valued [that is, included in the gross estate] under the alternate valuation method. If, however, dividends are declared to stockholders of record after the date of the decedent's death with the effect that the shares of stock at the subsequent valuation date do not reasonably represent the same "included property" of the gross estate as existed at the date of the decedent's death, the dividends are "included property," except to the extent that they are out of the earnings of the corporation after the date of the decedent's death. For example, if a corporation makes a distribution in partial liquidation to stockholders of record during the alternate valuation period which is not accompanied by a surrender of a stock certificate for cancellation, the amount of the distribution received on stock included in the gross estate is itself "included property," except to the extent that the distribution was out of earnings and profits since the date of the decedent's death. Similarly, if a corporation, in which the decedent owned a substantial interest and which possessed at the date of the decedent's death accumu-

30. See 3 SCOTT, TRUSTS 1813-21 (2d ed. 1956).

lated earnings and profits equal to its paid-in capital, distributed all of its accumulated earnings and profits as a cash dividend to shareholders of record during the alternate valuation period, the amount of the dividends received on stock includible in the gross estate will be included in the gross estate under the alternate valuation method. Likewise, a stock dividend distributed under such circumstances is "included property."

The Regulations suggest a flexible standard to solve the problem of determining when corporate dividends distributed after a transfer of stock represent part of the original stock that was transferred. The suggested standard rejects the income tax approach in favor of a modified chronological earnings approach. First of all, the Regulations distinguish between ordinary dividends and other dividends, which is, of course, easier to do in theory than it is in practice, since no one has yet charted a clear line between ordinary and extraordinary dividends. Ordinary dividends, whether they take the form of cash dividends, stock dividends or dividends in kind, are regarded as income, rather than as a division of the original stock, irrespective of when the earnings represented by the dividends were accumulated. Apart from ordinary dividends, the classification of corporate distributions as part of the stock originally transferred or as income accruing after the transfer turns upon whether as a result of the distribution the original stock represents the same property as it did when the stock was transferred. The Regulations thus come closer to stating an objective than to formulating a practical test. Moreover, even if the distribution alters the character of the transferred stock it will still, according to the Regulations, be treated as income to the extent it represents corporate earnings after the date of the transfer, which means, of course, that it will still be necessary to identify the source of the distribution.

The Treasury apparently rejects the income tax test of an income dividend not only in connection with stock dividends, but in connection with other dividends as well. Thus, for example, the distribution in partial liquidation which the Regulations treat as a division of capital or, in other words, as part of the stock originally transferred, would be taxed for income tax purposes as ordinary income, since it was not accompanied by any redemption of the stockholder's stock.³¹

The present statute does not attempt to deal explicitly with the

31. See *Beretta v. Commissioner*, 141 F.2d 452 (5th Cir. 1944); BITTKER, *op. cit. supra* note 23, at 219.

estate tax problems arising out of corporate distributions. It is very doubtful, moreover, whether it affords any basis for administrative or judicial development of a clear and workable set of answers to these problems. This is an area where legislative intervention appears desirable. Congress should explore the possibilities of adapting the concepts developed in connection with the taxation of corporate distributions under the income tax section of the Code to the estate tax section.³² It seems likely, however, that the only satisfactory solution to the estate tax problems outlined above will be some arbitrary rule declaring that distributions in excess of a stated percentage, such as ten per cent, of the value of the stock within a prescribed period of time, such as a year, shall, to the extent of such excess, be regarded as part of the original stock. The legislation would be based generally upon the premise that a corporate distribution which changes the character of stock should be regarded for estate tax purposes as part of the original stock. This ideal would be embodied in an arbitrary mathematical formula in the absence of a more equitable but equally workable form of expression.

In this discussion it has been assumed that the stock dividend whose inclusion in the gross estate was in question was a dividend distributed in connection with a complete irrevocable transfer of stock, that is, a transfer in which the only basis for taxing the dividend was that it represented part of the stock originally transferred. Stock dividends distributed in connection with transfers which would result in the inclusion in the transferor's estate of accumulated income from such transfers at least to the extent that the income is accumulated rather than distributed, appear clearly to be taxable whether they represent part of the property originally transferred or income accumulated after the transfer. For example, suppose that A transferred stock to T in trust for C for life, remainder to D, and empowered T to accumulate any income from the trust during C's life. Suppose further that the trust is revocable by A,

32. It is doubtful whether the income tax distinctions between corporate distributions which are and which are not taxable as income have any real relevance to the estate tax. We have already seen that income tax analogies are not particularly helpful in determining how the estate tax should treat stock dividends. It seems that the estate tax should not adopt the income tax tests of an income dividend in connection with other types of corporate distributions. For example, a distribution in redemption of stock or in partial liquidation of a corporation will be treated as ordinary income rather than a capital distribution unless it meets the requirements laid down in § 302 or §§ 331 and 346 of the Code. But whether the dividend is treated as ordinary income or as a capital distribution under the income tax has no bearing upon whether it represents part of the stock in connection with which the distribution was made and which is deemed transferred for purposes of the estate tax.

that before A's death stock dividends are received by the trust, and that T adds them to corpus. It is clear that these dividends, along with the other trust property, will be taxed to A's estate whether they represent part of the stock originally transferred to the trustee or income accumulated after that transfer.

II. WHAT DID THE DECEDENT TRANSFER?

A. *Transfers in Contemplation of Death*

In some cases it is clear that the decedent made a taxable transfer, but the amount to be included in his gross estate is obscured by doubt as to what he transferred. *United States v. Allen*³³ is an excellent illustration of this problem. For a simplified version of the facts in *Allen*, suppose that A transferred Blackacre to B but retained a life estate in the property. Suppose also that A later relinquished the life estate to B in contemplation of death. If A dies within three years of this relinquishment, what will be included in his gross estate? The answer to this question appears to depend on what interest A transferred in contemplation of death.

As a preliminary point it seems fairly certain that nothing can be included in A's estate under section 2036. Although the literal wording of section 2036 imposes a tax whenever there has been a transfer with a retention of a life interest, without regard to whether the life interest persists until the decedent's death, it seems to be fairly well settled that a tax cannot be imposed under section 2036 if the decedent divested himself of all interest in the transferred property before his death.³⁴ If Blackacre is to be taxed to A's estate, it must be taxed under section 2035, which covers property transferred in contemplation of death. However, section 2035 provides that "[t]he value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer . . . in contemplation of death." Consequently, the critical question is what interest did A

33. 293 F.2d 916 (10th Cir.), *cert. denied*, 368 U.S. 944 (1961).

34. Rev. Rul. 56-324, 1956-2 CUM. BULL. 999; Estate of Thurston, 36 Cal. 2d 207, 223 P.2d 12 (1950); Robert J. Cuddihy, 32 T.C. 1171 (1959). In *United States v. Allen*, *supra* note 33, at 918, Judge Breitenstein, concurring, declared that § 2036 taxes a transfer with a reservation of a life interest, regardless of what happens to the life interest after the transfer: "As I read the statute, the tax liability arises at the time of the inter vivos transfer under which there was a retention of the right to income for life. The disposition thereafter of that retained right does not eliminate the tax liability." Although Judge Breitenstein's contention finds support in the literal language of § 2036, it is unlikely that it will be followed, since it goes against the underlying philosophy of the estate tax, which seeks to tax the transmission of property at death.

transfer in contemplation of death. If the interest that A transferred was her property interest, that is, her life estate, then nothing would be included in her gross estate, because the transferred interest must be valued according to its worth at A's death or upon the alternate valuation date. At either date, A's life estate would be valueless. The difficulty with this position, which was accepted by the district court in *Allen*³⁵ and rejected by the Tenth Circuit on appeal, is that it reaches an undesirable result. The purpose of including transfers in contemplation of death in a decedent's taxable estate is to prevent the decedent from avoiding the estate tax by means of such a transfer. It would seem, therefore, that the transfer should be ignored for tax purposes and the transferor's estate should be taxed as if the transfer had not taken place.³⁶ It is possible to achieve this result if the interest transferred by the decedent in contemplation of death is regarded as the interest which is attributed to him under the estate tax before the transfer. In other words, before the transfer in contemplation of death, the full value of Blackacre was taxable to A's estate; A was for tax purposes regarded as the owner of Blackacre. Since A should not be able to divest himself of this ownership for tax purposes by means of a transfer in contemplation of death, his release of the life estate in Blackacre should be regarded as a transfer of Blackacre itself, rather than a mere life estate. This is the way the Tenth Circuit analyzed the transfer in contemplation of death in *Allen*.

Actually, there was a further twist in *Allen* because when the decedent released her life estate she received as consideration for the release the value of the life estate. Her executors therefore argued that she had not made a taxable transfer because she had received adequate and full consideration for the release. Whether the consideration was adequate depends upon what was transferred. If the decedent merely transferred her life estate, there was adequate consideration for the transfer, whereas if the decedent is deemed to have transferred the whole of Blackacre in contemplation of death, then there obviously was only partial consideration for the transfer, and under sections 2035 and 2043 the full value of Blackacre less the value of the consideration received for the release of the life estate should be included in the decedent's gross estate.³⁷

35. 6 AM. FED. TAX R.2d 6128 (D. Colo. 1960); see 33 ROCKY MT. L. REV. 103 (1960).

36. "For the purposes of the tax, property transferred by the decedent in contemplation of death is in the same category as it would have been if the transfer had not been made and the transferred property had continued to be owned by the decedent up to the time of his death." *Igleheart v. Commissioner*, 77 F.2d 704, 711 (5th Cir. 1935).

37. Apart from transfers in contemplation of death, there are other situations in

Allen raises a question which goes beyond the court's decision, since the decision simply covers one aspect of the tax consequences of relinquishing in contemplation of death the taxable incidents of a transfer which is taxable under the estate tax. For example, suppose that A makes a transfer which is taxed under section 2037 as a transfer taking effect at A's death and subsequently relinquishes his reversionary interest in contemplation of death. What should be included in A's gross estate: the value of his reversionary interest or the amount which would have been included in his gross estate if the relinquishment had not taken place? Obviously, if the reasoning of *Allen* is applied, the amount included in A's gross estate will be the same amount that would have been taxable to his estate if the relinquishment had not taken place. This problem is simplified whenever a taxable power to alter or amend the enjoyment of transferred property is released in contemplation of death, because section 2038 expressly provides that the amount which shall be taxable to the decedent's estate is that which would have been taxable if the relinquishment had not taken place. In fact, the express provision in section 2038 upon this point makes one wonder whether the statute carries the negative inference that a different result should be reached in those cases in which taxable incidents covered by other sections are released in contemplation of death.

Most of the cases in this area have arisen from situations involving a joint tenant or tenant by the entirety who has contributed all of the consideration for jointly held property and who has subse-

which the adequacy of the consideration for a transfer turns upon what was transferred. For example, suppose that upon her husband's death a wife transfers her community property to a trust for herself for life, remainder to her children, in return for a life estate in her husband's share of the community property. Assume that the value of the remainder in the community property transferred by the wife to her children is \$100,000, the total value of her share of the community property is \$200,000, and the value of the life estate in her husband's share of the community property, which she received from the husband, is \$100,000. At the wife's death the government contends that her share of the community property is taxable to her estate under § 2036 upon the theory that she transferred her interest in the community property during her life with a reservation of the income from the property for life. The wife's estate contends that such transfer is not taxable because it was a transfer for an adequate and full consideration. Obviously whether there was a transfer of the wife's share of the community property for an adequate consideration depends upon what she transferred. If she transferred only the remainder interest after her retained life estate, then she has made a transfer for an adequate consideration. If, however, as the Fifth Circuit held in *Vardell's Estate v. Commissioner*, 307 F.2d 688 (5th Cir. 1962), the wife is deemed to have transferred the interest which would have been taxable to her estate under § 2036 if there had been no consideration, then she must be treated as having conveyed the fee in the property for a life estate in her husband's property, and the excess of the value of her share of the community property over the value of the life estate in her husband's share of the community property is taxable to her estate.

quently transferred his interest in the joint property in contemplation of death. There are a substantial number of cases in which such transfers have been viewed as transfers in contemplation of death of the property interest which the decedent owned in the common property and in which it has been held that only the decedent's interest in the property can be included in his estate.³⁸ In other words, if A purchased Blackacre and took title in A and B as joint tenants, and later transferred in contemplation of death his half of the property to X, these cases indicate that only the half of the property which A owned and transferred is taxable to his estate. The Treasury originally took this position in the proposed regulations under the 1954 Code,³⁹ but later retreated,⁴⁰ and in view of *Allen*⁴¹ will doubtless now contend that the entire property is taxable to A's estate on the theory that for tax purposes he was the owner of the entire property and transferred the entire property in contemplation of death.

Several cases raise the interesting question of the tax effects of an inter vivos transfer by a joint tenant to whom the entire property would be taxable under section 2040, when the inter vivos transfer is taxable under the estate tax for some reason other than that the transfer was made in contemplation of death. For example, in the recent decision of *Heasty v. United States*,⁴² Mr. Creekmore and his wife held as joint tenants property which had been purchased by Mr. Creekmore. They transferred this property to be held in trust for their daughters and grandchildren reserving joint and survivor life estates to themselves. Mrs. Creekmore died in 1952 and her husband died in 1960. The Commissioner included the full value of the trust property in his estate but the district court, granting a refund, held that only half of the property was taxable to Mr. Creekmore's estate under section 2036 because he transferred only half of the property to the trust. The district court

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

39. Proposed Treas. Reg. § 20.2040-1(d), 21 Fed. Reg. 7879 (1956).

40. Although the regulations in final form contain no reference to the transfer of jointly held property in contemplation of death, they do provide that the release in contemplation of death of taxable incidents in connection with transfers taxable under §§ 2036, 2037, and 2038 will not prevent the imposition of the same taxes which would have been imposed if the release had not taken place. Treas. Reg. § 20.2035-1(b) (1958). Moreover, the Treasury has withdrawn its acquiescences in the *Brockway*, *Borner* and *Carnall* cases. Announcement, 1962 INT. REV. BULL. No. 20, at 7.

41. See *Harris v. United States*, 193 F. Supp. 736 (D. Neb. 1961); note 33 *supra*.

42. 239 F. Supp. 345 (D. Kan. 1965).

rejected the Government's argument that it should apply the reasoning of *Allen* and, since the transfer to the trust was taxable under section 2036, that it should disregard the transfer for tax purposes and tax Mr. Creekmore's estate as though he had held the property in joint tenancy with his wife at his death. The court drew a distinction between a transfer in contemplation of death and other taxable inter vivos transfers, declaring that if *Allen* did apply it was up to the Tenth Circuit to apply it. The *Heasty* court found support for this position in *Glaser v. United States*,⁴³ a case in which the Seventh Circuit reached a similar conclusion on similar facts. On the other hand, if the joint tenants convey the jointly owned property to a revocable trust, there is authority for disregarding the transfer because the trust is revocable and for including the property, as though it were held in joint tenancy, in the estate of the tenant who contributed the consideration for the property.⁴⁴

Another interesting problem arises when an insured assigns his life insurance in contemplation of death more than three years before his death and continues to pay premiums on the insurance up until the date of his death. Assuming that the assignment completely divested the insured of any incidents of ownership in the insurance, the proceeds of the insurance cannot be taxed to his estate under section 2042. Nor may the proceeds of the policy be taxed to his estate under section 2035, because that section provides that a transfer more than three years before the transferor's death cannot be taxed as a transfer in contemplation of death. However, it would appear that the premium payments made by the insured within three years of his death should be taxed as transfers in contemplation of death. The problem is how to compute the amount

43. 306 F.2d 57 (7th Cir. 1962). *Contra*, Rev. Rul. 57-448, 1957-2 CUM. BULL. 618.

44. *Estate of W. M. Hornor v. Commissioner*, 130 F.2d 649 (3d Cir. 1942). *But see* *Estate of J. C. Hornor v. Commissioner*, 305 F.2d 769 (3d Cir. 1962). The forthright solution for the problems discussed in the text lies in legislation. It should not be possible to escape the estate tax by a release in contemplation of death of the incidents of an inter vivos transfer which make the transfer taxable under the provisions of estate tax. The sections providing for the taxation of such transfers should be amended to provide, as § 2038 does, that relinquishment in contemplation of death of the interests which make the transfers taxable under those sections will not affect the taxes imposed under those sections. The basic difficulty here is that the overall policy and the literal language of the statute conflict with each other. The result is needless litigation in which the courts feel compelled to strain the statutory language to achieve desirable results. One of the authors of this paper feels that there is merit in a strict interpretation of the statute, such as that adopted in the *Heasty* and *Glaser* cases, rather than the kind of judicial rescue operation typified by the *Allen* decision, 293 F.2d 916 (10th Cir), *cert. denied*, 368 U.S. 944 (1961), on the theory that strict interpretation may prompt Congressional action.

which should be included in the decedent's gross estate. The tax should only be levied upon the premium payments themselves, since the insured only transferred these premiums within the three-year period. Indeed, since he irrevocably divested himself of the insurance policy before the three-year period commenced, these premiums were the only things which he was capable of transferring. It has been suggested on the basis of *Liebmann v. Hassett*⁴⁵ that a part of the insurance proceeds proportionate to the part of the premiums paid by the decedent within three years of his death should be included in his gross estate.⁴⁶ It is difficult, however, to see any justification for this position. It would seem to be obvious that the decedent could not have made a transfer of a proportionate part of the life insurance policy within three years of his death if he had completely divested himself of all interest in the insurance before the three year period. Furthermore, *Liebmann* does not support the suggested position. In that case a man transferred life insurance to his wife in contemplation of death, and no provision such as the current three-year cutoff prevented the imposition of estate tax on the transfer. After the transfer the wife paid several premiums on the policy and the court held, upon the death of the insured, that the part of the proceeds proportionate to the premiums paid by the wife should be excluded from the husband's gross estate. The court analogized the payment of premiums by the wife after the transfer of the policy to her in contemplation of death to improvements made by a transferee to property transferred to him in contemplation of death, the value of which are excluded from the transferor's gross estate. Whether or not this analogy is sound, *Liebmann* obviously does not say that when an insured pays premiums on an insurance policy after he has completely divested himself of any interest in the policy, he transfers a proportionate part of the policy. When the assignee in *Liebmann* paid the premiums, she was the owner of the policy. Consequently, it may have been logical to regard these payments as her contribution to the insurance proceeds, and therefore analogous to a transferee's improvements. Nevertheless, *Liebmann* has no real bearing on the problem involved in the hypothetical situation in which premium payments are made on an insurance policy by a person who has no interest in the policy.

45. 50 F. Supp. 537 (D. Mass. 1943), *aff'd.*, 148 F.2d 247 (1st Cir. 1945).

46. See LOWNDES & KRAMER, FEDERAL ESTATES AND GIFT TAXES 287 (2d ed. 1962).

B. *Transfer with Retained Life Interest*

Apparently section 2036 does not impose a tax upon a transfer in which a life estate is retained unless the transferor's life interest persists until his death.⁴⁷ However, the amount included in the gross estate under section 2036 is not limited to the value of the decedent's retained interest, but rather extends to the entire interest he transferred during his life in connection with which he retained the life interest.⁴⁸ For example, if A transfers Blackacre to B but retains a life estate, at A's death the full value of Blackacre, as distinguished from the value of his retained estate, will be included in A's gross estate.

An exception is made to the rule that the full value of the property transferred by the decedent during his life is included in his gross estate pursuant to section 2036 if the decedent retained only a contingent life estate after granting to another a life estate which is still outstanding at the decedent's death. In such a case the value of the life estate anterior to the decedent's is excluded from the decedent's gross estate on the theory that this interest in the property was not subject to the decedent's retained interest. Thus, for example, if A granted Blackacre to B for life, then to A for life, then to D in fee, and if A predeceased B, the value of Blackacre less the value at A's death of B's outstanding life estate would be included in A's gross estate.⁴⁹ There is no obvious reason why if more than one life estate preceding the decedent's life estate is outstanding at the decedent's death, the value of all preceding life estates should not be excluded from the decedent's gross estate. Nevertheless, the Regulations limit the scope of the exclusion to the preceding interests that are "actually being enjoyed" at the decedent's death.⁵⁰ Thus, if A granted Blackacre to B for life, then to C for life, then to A for life, then to D in fee, and if A died survived by B and C, only the value of B's life estate would be subtracted from the value of Blackacre includible in A's gross estate. If challenged, this interpretation might properly be rejected by the courts.

Section 2036(a)(2) provides for the imposition of a tax where a decedent transferred property and, instead of reserving the posses-

47. See note 34 *supra*.

48. *Industrial Trust Co. v. Commissioner*, 165 F.2d 142 (1st Cir. 1947). Of course, if the decedent retained a life interest in only part of the property, only this part is included in his gross estate. See *LOWNDES & KRAMER, op. cit. supra* note 46, at 158.

49. *Marks v. Higgins*, 213 F.2d 884 (2d Cir. 1954); *Commissioner v. Nathan*, 159 F.2d 546 (7th Cir. 1947), *cert. denied*, 334 U.S. 843 (1948); *Herman Hohensee*, 25 T.C. 1258 (1956).

50. *Treas. Reg. § 20.2036-1(a)* (1960). See also *Treas. Reg. § 20.2036-1(b)(ii)* (1960).

sion or enjoyment of the property directly, retained a power (either alone or in conjunction with any person) to designate the possession or enjoyment of the property. For the purpose of determining the amount includible in the gross estate under section 2036(a)(2), the power to designate possession or enjoyment of the transferred property is equated to the direct reservation of possession or enjoyment of the property. That is, section 2036 (a)(2) is interpreted as requiring the inclusion in the decedent's estate of the full value of the property to which that power attaches rather than merely the value of the power retained by the decedent. Thus, for example, if A transferred property to T in trust for C for life, remainder to D in fee, and if A retained power to direct the trustee to accumulate the income from the trust property, the full value of the trust property, not merely the value of the income subject to A's retained power, will be included in A's gross estate.⁵¹

C. Revocable Transfers

Section 2038 taxes a transfer made by a decedent during his lifetime if the enjoyment of the transferred interest is subject to alteration, amendment, revocation or termination at the decedent's death by virtue of a power exercisable by the decedent either alone or in conjunction with any other person. Although most of the transfers which are taxable under section 2038 are also taxable under section 2036(a)(2), the amount against which the tax is levied under section 2038 is limited to the property interest actually subject to the power, unlike the amount included in the decedent's gross estate under section 2036—the value of the property transferred by the decedent in connection with which he reserved the power. For example, suppose that A transferred property to T in trust for C for life, remainder to D, and retained a power to substitute another beneficiary to receive the trust income during C's life. If A dies survived by C, both section 2036 and section 2038 apply to the transfer. Under section 2036(a)(2), since A retained a power to designate the income from the trust for a period which did not in fact end before his death, the full value of the trust property is includible in his gross estate. However, under section 2038 only the value of the interest subject to A's power, that is, the value of C's life estate, would be included in A's gross estate. Since these alternate sections produce such different results it is quite clear which one the government will seek to apply.

51. *Industrial Trust Co. v. Commissioner*, 165 F.2d 142 (1st Cir. 1947); Treas. Reg. § 20.2036-1(a) (1960).

Although it seems settled that under section 2038 the interest subject to the power at the decedent's death is the basis upon which the amount includible in his gross estate is determined, it is not always easy to define precisely the scope of that interest. For example, suppose that A transferred property to T in trust, the terms of the trust being to pay C the income from the trust property during C's life and at C's death to pay over the trust property to D and his heirs. Suppose also that A retained a power to terminate the trust at any time during C's life and to direct the trustee to pay over the trust property to C free and clear of the trust. If A predeceases C, what amount should be included in A's gross estate? It is arguable that only the value of D's remainder should be taxed to A's estate, since A could not in any event deprive C of the enjoyment of the property during his life.⁵² However, according to the statute a tax is due when the decedent possessed at his death a power to "change" the "enjoyment" of the transferred property. It would appear that C's enjoyment will be changed if his interest as an income beneficiary is converted into that of an owner in fee simple. Although the point may not have been squarely in issue in *Lober v. United States*,⁵³ the Supreme Court implied in its decision in that case that the full value of the trust property would be taxed to the decedent's estate in the hypothetical situation.

In *Commissioner v. Hager's Estate*,⁵⁴ A during his life transferred property to T in trust for B for life, remainder to C in fee. A retained a power to accumulate the income from the trust during B's life and add it to the remainder. The Third Circuit held that the remainder as well as the life estate was taxable to A's estate under section 2038. The correctness of that decision is doubtful. The decedent did not have a power to change the enjoyment of the remainder; he could merely create an additional remainder interest. It would appear that the original remainder should not be included in A's gross estate, and apparently the case was finally compromised on appeal on this basis.⁵⁵

52. Cf. *In re Inman's Estate*, 203 F.2d 679 (2d Cir. 1953).

53. 346 U.S. 335 (1953).

54. 173 F.2d 613 (3d Cir. 1949).

55. Covey, *The Klauber Case and Sections 2036(a)(1), 2037 and 2038 of the 1954 Code*, 5 TAX COUNS. Q. 129 (1961) makes this comment about the *Hager* case:

The decision was in error for in no event did decedent retain a power to affect the enjoyment of the original principal of the trust. This fact is reflected by the subsequent proceedings in the case itself. It was settled during the pendency of the estate's petition for certiorari on the basis of the value of the trust at the decedent's death reduced by the original principal of the trust being included in decedent's gross estate.

Id. at 164.

D. Transfers Taking Effect at Death

Section 2037 taxes a transfer by a decedent during his lifetime as a transfer taking effect at death if the transferee's possession or enjoyment of the transferred property is dependent upon his surviving the transferor and if the transferor retained a reversionary interest in the property the value of which reversionary interest immediately before the decedent's death exceeded five per cent of the value of the transferred property. Although retention by the decedent of a reversionary interest until his death is a prerequisite for the imposition of a tax under section 2037, the amount included in the decedent's gross estate is not limited to the value of the reversionary interest that lapses at his death, but rather extends to the full value of the property which was transferred by the decedent during his life and which meets the survivorship and reversionary interest requirements.⁵⁶ However, only property interests that meet both the survivorship and reversionary interest requirements are included in the decedent's gross estate under section 2037. Thus, if A transferred property to T in trust for C for life, remainder to C's surviving children, with remainder in default of such children to A or A's estate, nothing would be taxed to A's estate under section 2037 as a result of the trust, since the possession or enjoyment of the beneficiaries was not dependent upon their surviving A. C is entitled to enjoy the property as long as he lives, whether or not he survives A. C's children are entitled to possess the property if they survive C, whether or not they survive A.⁵⁷ Of course, the fact that property is not taxable under section 2037 does not mean that it may not be taxed under some other section of the statute. In the hypothetical case, for example, although nothing will be taxed to A's estate under section 2037, the value of A's reversionary interest in the transferred property will be taxed to his estate under section 2033 as property in which he owned at his death an inheritable interest.

56. *Fidelity-Philadelphia Trust Co. v. Rothensies*, 324 U.S. 108 (1945); *Commissioner v. Estate of Field*, 324 U.S. 113 (1945).

57. *Treas. Reg. § 20.2037-1(e), Example (1)* (1958). If only part of the property meets the survivorship and the reversionary interest requirements, only that part of the property is includible in the decedent's gross estate. For example, if H transferred property to W for life, remainder to H if he survived W, and remainder to X if H did not survive W, and if H died survived by W, only the value of the transferred property less the value of W's life estate (which is in no way dependent on her surviving H) at H's death would be included in H's gross estate. *Id.*, examples (3) & (4). See also *Arthur Klauber*, 34 T.C. 968 (1960).

E. *Transfers for Insufficient Consideration*

Generally, only gratuitous inter vivos transfers are taxed under the estate tax, since the purpose of the tax is to reach donative transactions rather than sales or exchanges. Thus, "a bona fide sale for an adequate and full consideration in money or money's worth" is expressly exempted from the taxes imposed pursuant to sections 2035 through 2038. Moreover, section 2043 provides that with respect to transfers for less than adequate consideration "there shall be included in the gross estate only the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent."

In those situations in which there is a transfer for an insufficient consideration, a problem is presented as to what part of the transfer is gratuitous and what part of the transfer is not taxable because it is for a consideration. It would appear that the equitable approach would be to handle the transfer on a proportional basis and to regard it as if it were two transfers: one, a transfer of part of the property equal in value to the value of the consideration—a nontaxable transfer for adequate consideration; the other, a completely gratuitous transfer of the remainder of the property. Thus, if A in contemplation of death transferred stock worth \$100,000 in return for land worth \$25,000, and A died within three years of this transfer, at which time the stock was worth \$200,000 and the land was worth \$40,000, only \$150,000 would be included in his gross estate with respect to the stock. The theory would be that A transferred one-fourth of the stock (the part proportionate to the value of the consideration) for adequate consideration and the remaining three-fourths gratuitously. In this situation, although the part of the property transferred gratuitously would be valued according to its fair market value at the decedent's death or at the alternate valuation date, the respective values of the transferred property and the consideration received for the transfer, which determine the proportion of the property subject to the estate tax, would be those prevailing at the time of the transfer.

Although there is some judicial support for a proportional approach to section 2043,⁵⁸ it is difficult to reconcile such an approach with the language of that section. This difficulty increases when section 2043 is read against section 2040, which, as we shall see, ex-

58. *Helvering v. United States Trust Co.*, 111 F.2d 576, 579 (2d Cir.), *cert. denied*, 311 U.S. 678 (1940). The opinion does not include a careful analysis of the controlling statutory language.

plicitly provides for a proportional treatment in those situations in which there is a transfer of jointly held property for insufficient consideration. Section 2043 is interpreted literally in the Regulations so as to require the full value, at the date of death or alternative valuation date, of the property which was transferred for an insufficient consideration, less the consideration (apparently valued at the time of the transfer), to be included in the decedent's gross estate.⁵⁹ Under the Regulations, any increases or decreases in the value of the transferred property are charged against the decedent's estate. It would seem to be more equitable to treat the part of the property proportionate to the value of the consideration for the transfer as transferred for an adequate consideration and to limit changes in value after the transfer to the remainder of the property. If the statute requires the rejection of a proportional approach, it still seems unfair to value the property transferred as of the date of the decedent's death or upon the alternate valuation date, while the consideration received for the transfer is valued as of the date of the transfer. In some cases this approach favors the taxpayer while in others it favors the government. However, these inequities do not offset each other, because different taxpayers will be involved in each case. The fact that the rule favors a taxpayer in one case is little consolation to another taxpayer who is prejudiced by its operation in a different case. For example, in the hypothetical case in the preceding paragraph, the Regulations (assuming valuation as of the date of death) would apparently require \$175,000 to be included in the decedent's gross estate; that is, his executor would be required to include \$200,000, the value at the transferor's death of the transferred stock, less \$25,000, the value at the time the transfer took place of the land received for the stock. Thus, even though \$40,000 would be included in the decedent's gross estate if he continued to own the land at his death, his estate would be given credit for only \$25,000, the value of the land at the time of the transfer. If the land decreased in value to \$5,000 before the decedent's death, the estate would still get credit for \$25,000 according to the Treasury rule. In the latter situation, of course, the rule would be prejudicial to the government, since the estate would be allowed to subtract \$25,000 from the value of the property transferred, although only \$5,000 would be included in the gross estate with respect to the land received as consideration. It seems obvious that the only really fair rule would be a proportional rule by means

59. Treas. Reg. § 20.2043-1(a) (1958); see *Vardell's Estate v. Commissioner*, 307 F.2d 688 (5th Cir. 1962).

of which a part of the transferred property equal to the value of the consideration received for the transfer would be excluded from the gross estate while the remainder of the transferred property, along with the consideration received at the time of the transfer, would be included in the gross estate, and be valued according to the appropriate values at the death of the decedent or at the alternate valuation date.

F. *Annuities Taxable Under Section 2039 and Jointly Held Property*

The problems which may arise with respect to what is includible in a decedent's gross estate when a tax is imposed under sections 2039 and 2040 involve basically an identification of what the decedent transferred. Section 2039 taxes the value of payments to be made to a beneficiary when such payments are contingent upon the beneficiary surviving the decedent if, under the contract pursuant to which such payments are required, the decedent at his death was receiving or had the right to receive payments; however, such survivor benefits are taken into account only in proportion to the decedent's contributions to the cost of the contract. Section 2040 taxes the value of jointly held property to the estate of a deceased joint tenant according to his contribution to the property. Both sections 2039 and 2040, therefore, treat the decedent as having made a taxable transfer of a part of the property passing to the surviving beneficiary or tenant proportionate to the decedent's contribution to the property. However, at this point the parallel between the two sections ceases. Indeed, the two sections apply quite different tests to determine the decedent's contribution.

Under section 2040, a deceased joint tenant is treated as having contributed any part of the joint property or consideration for the joint property which originated with him and which was not acquired from him for an adequate and full consideration in money or money's worth. For example, if A gave \$10,000 to B as a birthday gift, and later B used the money to purchase Blackacre, B taking title in B and A as joint tenants, the full value of Blackacre would be includible in A's gross estate if he predeceased B. Since the money used to purchase Blackacre originated with A and was never obtained from him by B for an adequate consideration, A would be regarded under section 2040 as furnishing the entire consideration for Blackacre. In contrast, section 2039 makes no provision for tracing in the annuity situation. Apparently as far as section

2039 is concerned, the decedent is deemed the contributor to the fund payable to the surviving beneficiary to the extent that he was the owner of the amounts paid to the fund at the time the payments were made. Section 2039 states that in the case of payments exempt from the estate tax under section 2039(c) in connection with a qualified pension, profit-sharing or stock bonus plan, contributions by the decedent's employer are not attributed to the decedent; just the opposite is true under the other provisions of section 2039 taxing unqualified plans.⁶⁰ Apart from this explicit reference to contributions made by the decedent's employer, however, no rules are provided in section 2039 for determining the decedent's contributions. Presumably, the fact that an amount which eventually was contributed to an annuity fund originated with the decedent will not lead to its being imputed to him for tax purposes if he no longer owned it, either formally or substantially, at the time the contribution was actually made. For example, suppose that H gave W \$100,000 as a wedding present. Some years later W invested this sum in a joint and survivor annuity for H and herself. If H predeceases W, nothing will be included in his gross estate because of the annuity, because he made no contribution to the purchase of the annuity. If there was an express or implied understanding between H and W at the time of the gift that the money would be used to acquire a joint and survivor annuity, the annuity would probably be taxed to H's estate upon the theory that he really contributed the consideration for the annuity.⁶¹ In the absence of any such understanding, there seems no way in which the consideration for the annuity can be traced to H. The situation under section 2039 is reminiscent of the problems that arose in connection with the taxation of life insurance proceeds when the premium payment test prevailed. Before the 1954 Code, life insurance was included in the gross estate of the insured to the extent that the insured had paid the premiums for the insurance, even though it was payable to a beneficiary other than his estate and even though the insured had divested himself of all incidents of ownership in the insurance.⁶² The rule applied in determining who paid the premiums for insurance was that the premiums were deemed to be paid by the person who was the legal and beneficial owner of the amounts used to pay the premiums, even though he had received those

60. In the case of an unqualified plan, § 2039(b) attributes to the decedent contributions made by the decedent's employer "if made by reason of his employment."

61. Cf. Treas. Reg. § 25.2511-1(h)(2) (1958).

62. INT. REV. CODE OF 1939, § 811(g)(2).

amounts from the insured, so long as there was no understanding which justified imputing the premium payments to the insured.⁶³ For example, if W took out insurance on her husband's life, retained the incidents of ownership in the insurance, and paid the premiums with money given to her by her husband, which money she was free to use for any purpose she saw fit, the premium payments would not be attributed to the insured, nor would the insurance be taxed to his estate.⁶⁴ Apparently this same type of test will prevail under section 2039 in the absence of an explicit provision for tracing such as that found in section 2040. If so, section 2039 is free from problems of identification whatever its other frailties may be.

A number of interesting questions are raised by the fact that jointly held property is traced to the tenant with whom the property or the consideration for the property originated, except to the extent that the property or the consideration was acquired from him for an adequate and full consideration. Property acquired from a deceased joint tenant or tenant by the entirety for an adequate and full consideration is not, of course, attributed to the decedent. Thus, for example, if B purchased Blackacre from A for an adequate and full consideration in money or money's worth, and if B then transferred the property to himself and A as joint tenants, Blackacre would be attributed entirely to B for estate tax purposes. However, if B acquired property from A for an insufficient consideration, and later placed the property in A and himself as joint tenants, and if A predeceased B, the statute attributes the property to the tenants on a proportionate basis.⁶⁵ Thus, for example, suppose that A sold Blackacre to B for \$25,000 when it was worth \$100,000, and later B transferred the property to himself and A as joint tenants. If A predeceases B and Blackacre is worth \$200,000 at the time of A's death and at the alternate valuation date, \$150,000 will be included in A's gross estate. Since the consideration which B paid A for Blackacre amounted to one-fourth of the then value of Blackacre, A is treated as having transferred the remaining three-fourths of the property at his death.

The process of tracing a decedent's contributions to jointly held property is complicated by the doctrine that any income from donated property, which income is contributed to the joint estate

63. Treas. Reg. § 81.27(a) (1954). The Regulation, while recognizing the possibility of indirect payment, contains no hint of a tracing requirement.

64. Estate of Albert D. Saunders, 14 T.C. 534 (1950); Estate of John E. Cain, Sr., 43 B.T.A. 1133 (1941).

65. INT. REV. CODE OF 1954, § 2040; Treas. Reg. § 20.2040-1(c)(6) (1958).

by a donee, is treated as the donee's independent contribution and is not imputed to the original donor.⁶⁶ For example, if A gave bonds to B and if B used the interest from the bonds to acquire property to which he took title in himself and A, the full value of this property would be attributed to B under section 2040. However, the doctrine that income from donated property is attributed to the donee raises difficulties when it becomes necessary to define what constitutes such income. It seems fairly clear, at least to the Treasury, that an unrealized appreciation in the value of property in the hands of a donee is not income constituting an independent contribution by the donee.⁶⁷ For example, suppose that A paid \$10,000 for Blackacre and gave it to B when it was worth \$20,000. Suppose further that when the property was worth \$30,000 B transferred it to himself and A as joint tenants. If A predeceases B, the full value of Blackacre will be included in his gross estate upon the theory that he contributed the entire consideration for the property.

It is not clear whether a gain must be recognized as well as realized under the income tax sections of the Code in order for it to be imputed to a donee under section 2040. For example, suppose that in the hypothetical case in the preceding paragraph B exchanged Blackacre when it was worth \$30,000 for Whiteacre, also worth \$30,000, and that B later transferred Whiteacre to himself and A as joint tenants. If the exchange was a taxable exchange for purposes of the income tax, then the income realized by B on this exchange will be treated as his independent contribution to the joint estate for purposes of the estate tax. Suppose, however, that the exchange was a tax-free exchange under section 1031 so that any gain on the exchange was not recognized. It is not clear whether B will be regarded as having made any contribution to the joint estate.

Another problem that arises here involves the extent to which income tax concepts should be carried over to the estate tax. In the hypothetical case in which B exchanged Blackacre for Whiteacre in a taxable exchange, B would realize an income tax gain of \$20,000 even though Blackacre increased in value only to the extent of \$10,000 while it was in his hands. This is so because in computing his gain from the exchange, B must use A's basis of \$10,000 for Blackacre rather than a basis equal to the fair market value of the property at the time he received it (\$20,000).⁶⁸ Will the gain as

66. *Harvey v. United States*, 185 F.2d 463 (7th Cir. 1950); *Estate of Ralph Owen Howard*, 9 T.C. 1192 (1947); *Treas. Reg. § 2040-1(c)(5)* (1958).

67. *Treas. Reg. § 20.2040-1(c)(4)* (1958).

68. *INT. REV. CODE OF 1954*, § 1015.

computed for income tax purposes or the gain which actually took place while Blackacre was in B's hands be used to determine the amount of B's contribution to the joint estate under section 2040? It would certainly simplify matters if income tax concepts were used in the estate tax analysis of this situation. This would mean, of course, that unless there was a gain recognized and taxed by the income tax, there would be no contribution of income by a donee to a joint tenancy for estate tax purposes. Moreover, the income contributed by the donee would be measured in terms of income recognized under the income tax provisions rather than in terms of the actual gain occurring while the donee held the donated property.⁶⁹

As we have already seen, the question whether income tax concepts should be applied to joint estates for purposes of computing the estate tax may also arise in stock dividend cases.⁷⁰ For example, suppose that A gave stock to B. Suppose also that B receives a stock dividend in connection with this stock and that B transfers this dividend to himself and A as joint tenants. Will the stock dividend be attributed to A or to B for estate tax purposes? If an income tax test is applied, the stock dividend will not be attributed to B (the donee) unless the dividend was taxable as income under the income tax. On the other hand, if the nature of the dividend for estate tax purposes is determined on the basis of the time when the earnings represented by the dividend were accumulated, the stock dividend will be attributed to B to the extent that it represents earnings accruing after the original stock transfer.⁷¹ The problem here is essentially the same as the one discussed earlier with respect to the general treatment of stock dividends under the estate tax.⁷²

Like so many legal doctrines that are simpler in theory than

69. However, what little authority there is on the point seems to indicate that the donee's contribution will be measured in terms of the actual appreciation of the donated property while it is in his hands, rather than in terms of the gain upon which he is taxed under the income tax provisions using as his basis the substituted basis of the donor. *Swartz v. United States*, 182 F. Supp. 540 (D. Mass. 1960).

70. See note 22 *supra* and accompanying text.

71. In the two cases that have raised this problem, *Tuck v. United States*, 282 F.2d 405 (9th Cir. 1960), and *English v. United States*, 270 F.2d 876 (7th Cir. 1959), the courts were not required to choose between the income tax approach and the chronological earnings approach, since the earnings represented by the stock dividends had been accumulated by the corporations before the gifts. Consequently, they said that the stock dividends would be regarded as part of the property originally transferred by the decedent, since they were not income for income tax purposes and represented earnings existing at the time of the gifts. Without definitely committing themselves the courts recognized the possibility of a different result under *McGehee v. Commissioner*, 260 F.2d 818 (5th Cir. 1958), in the case of a stock dividend representing earnings accumulated after the original gift.

72. See text accompanying notes 18-32, *supra*.

they are in practice, the tracing of the contributions of joint tenants or tenants by the entirety into jointly owned property raises practical problems of proof as well as doctrinal difficulties. Thus, how do you trace contributions made by cotenants through a fund in which such contributions are commingled? For example, suppose that A purchased Blackacre for \$20,000 and gave it to B when it was worth that amount. Suppose further that B sold the property for \$40,000 and deposited the proceeds of the sale in a bank account, from which he purchased Greenacre for \$20,000, to which he took title in his individual name, and, Whiteacre for \$20,000, to which he took title in himself and A as joint tenants. To what extent will Whiteacre be attributed to A and B for estate tax purposes? Obviously, it is impossible to determine whether A's \$20,000 or B's \$20,000 went into the purchase of Whiteacre. This must be settled by means of a presumption. A number of presumptions which could be adopted but which make no particular sense come to mind, such as first-in, first-out, or last-in, first-out, or that withdrawals were made from the commingled fund by B in the order which would minimize, or maximize, his estate tax. Perhaps the most equitable procedure in this situation would be to prorate any withdrawals from the fund in proportion to the respective contributions to the fund. According to this approach, since A and B each contributed half of the fund, the withdrawal from the fund which was used to purchase Whiteacre (the jointly owned property) would be presumed to consist half of A's funds and half of B's funds, with the result that half of the common property would be attributed to each tenant for estate tax purposes. However, there is another approach which may be required by the statute. Section 2040 puts the burden of proving that jointly held property is not attributable to a deceased tenant upon the deceased tenant's estate. The logical corollary of this provision may be that any property purchased from a commingled fund will be deemed to have come from the decedent's contributions to the fund to the extent that the amount withdrawn from the fund to acquire the property did not exceed his contribution. According to this theory, in the hypothetical case all of Whiteacre would be attributed to A if he died first, or to B if he died first, since each one contributed \$20,000 to the common fund, and the \$20,000 used to purchase Whiteacre could have come entirely from either tenant's contribution.⁷³

Even where it is clear what property each cotenant contributed to a joint estate, there may be difficulty in determining the amount

73. Cf. Estate of Albert D. Saunders, 14 T.C. 534 (1950).

of their respective contributions for estate tax purposes if changes of value intervene between the contributions. For example, suppose that H purchased Blackacre for \$10,000 and when the property was worth \$20,000 he transferred it to himself and W as tenants by the entirety. When the property had increased in value to \$30,000, W built a house upon Blackacre at a cost of \$30,000, which came entirely from her own funds. What are the respective contributions of H and W to the common property? It seems clear that the amount contributed by a joint tenant is not his cost or other basis for the contributed property, but the fair market value of the property. But as of what date is this fair market value to be determined? Is it the fair market value when the joint tenancy or tenancy by the entirety is created or when the other cotenant contributed to the property? Under the former assumption H contributed \$20,000 to the common estate while W contributed \$30,000, that is, H contributed two-fifths and W contributed three-fifths of the property. Under the latter assumption, however, both H and W will have contributed \$30,000, so that each will be deemed to have contributed one-half of the property. The estate tax Regulations offer no guidance upon this point. Under the gift tax Regulations, appreciation in jointly held property is treated as additional consideration attributable to the one who furnished the original consideration.⁷⁴ Thus, applying the gift tax Regulations, H's contribution in the hypothetical case would be \$30,000, and he would be deemed to have contributed one-half of the common property. However, it is by no means certain that the gift tax Regulations are a proper construction of the statute, or that they can be transposed to the estate tax situation.

III. TO WHAT EXTENT MAY PROPERTY TRANSFERRED BY A DECEDENT BE TRACED INTO OTHER PROPERTY?

Property transferred by means of a taxable inter vivos transfer must be valued for estate tax purposes according to its fair market value at the date of the decedent's death⁷⁵ or the alternate valuation date.⁷⁶ The fact that property transferred at one time must be valued according to its fair market value at a different time presents

74. Treas. Reg. § 25.2515-1(c)(2), Example (1) (1958). This approach often requires modification in practice as indicated in Example (3) of the same Regulation.

75. INT. REV. CODE OF 1954, § 2031.

76. INT. REV. CODE OF 1954, § 2032. It has been argued that a complete inter vivos transfer must be valued according to its value at the date of the transfer rather than the transferor's death and that to value it otherwise would be unconstitutional. This argument was rejected in *Igleheart v. Commissioner*, 77 F.2d 704 (5th Cir. 1935), and there seems to be no doubt that property transferred inter vivos will be valued in the same way as property transferred by will or intestacy.

a puzzling problem of identifying the property to be valued if the transferred property is converted into other property between the date of the transfer and the date of the decedent's death. For example, suppose that A gives Blackacre to B in contemplation of death and dies within three years of the gift. Before A's death, B exchanges Blackacre for Whiteacre which he owns at A's death. Will the value of Blackacre or the value of Whiteacre be included in A's gross estate? There is little authority on this point, which may be attributed to the fact that most inter vivos transfers that are taxed under the estate tax consist of transfers in trust, and whenever there is a transfer in trust the doctrine is fairly well settled that the property to be included in the transferor's gross estate is the property held under the trust at the date of his death rather than the property originally transferred to the trust.⁷⁷ However, it is a little difficult to see how a transfer in trust presents a problem any different from that of an outright transfer, since the statute provides that the property interests transferred by the decedent shall be included in his gross estate, and since the trust does not arise until after the transfer. If the decedent transferred an interest existing *in* a trust, there would be reason to say that he had transferred a beneficial interest in the trust res rather than any specific property. However, if he transfers property *to* a trustee the identification problem is not conceptually different from that presented in the case of an outright transfer.⁷⁸ However, the fiction that when there is a transfer in trust the interest transferred is the trust res rather than any specific trust property is so convenient⁷⁹ that it is unlikely anyone will feel called upon to challenge it strenuously.

77. This seems to be the Treasury practice although there is not much support for it in the cases. MONTGOMERY, *FEDERAL TAXES—ESTATES, TRUSTS AND GIFTS* (1949-1950) 589-94 (1950); Barrett, *Valuation for Estate Tax Purposes of Property Transferred in Contemplation of Death, When Property Is Disposed of or Changes Form Prior to Death*, N.Y.U. 9TH ANN. INST. ON FED. TAXATION 141, 142-46 (1951); Pavenstedt, *Taxation of Transfers in Contemplation of Death: A Proposal for Abolition*, 54 YALE L.J. 70, 87-90 (1944); Young, *Proposed Estate Tax Regulations*, 95 TRUSTS & ESTATES 1080, 1082 (1956). This was also the result, at least, in *Igleheart v. Commissioner*, *supra* note 76 and *Estate of B. H. Kroger*, 12 P-H Tax Ct. Mem. 1237 (1943), *aff'd*, 145 F.2d 901 (6th Cir. 1944).

78. Pavenstedt, *supra* note 77, at 88, 89, criticizes the distinction drawn by the Treasury between an outright transfer in contemplation of death, where the property originally transferred must be included in the decedent's gross estate, and a transfer in trust, where the substituted property held by the trustee at the decedent's death is included in the gross estate, as lacking any foundation in principle. The same position is taken by Barrett, *supra* note 77, at 143, and Young, *supra* note 77, at 1082.

79. However, as Pavenstedt, *supra* note 77, at 90 points out:

This may be all very well from the standpoint of facilitating the collection of revenue, but will often work out most unfairly from the taxpayer's point of view. For example, assume that decedent transferred in contemplation of death \$100,000

If there is an outright inter vivos transfer taxable under the estate tax, the statute provides that the property transferred shall be included in the decedent's gross estate. In the case of a transfer in contemplation of death where the transfer is complete at the time it is made, the property includible in the decedent's gross estate is apparently the original property transferred by the decedent rather than some other property into which the original property may be converted before the transferee's death.⁸⁰ Thus, in the hypothetical case in which A gave Blackacre to B in contemplation of death and before A's death B exchanged Blackacre for Whiteacre, it would appear under the literal wording of the statute that the value of Blackacre would be included in A's gross estate. The only way to escape this conclusion is to regard the interest transferred by A as the original property *or* its product. Although this might reach a desirable result, it is unwarranted in light of the statutory language.⁸¹

The identification problem which arises when there is a transfer in contemplation of death and the form of the property transferred changes before the decedent's death, is unlikely to arise in connection with the taxes on inter vivos transfers imposed under other sections of the statute. Most of the transfers taxable under these sections will be transfers in trust, and, as such, the property includible in the gross estate will be the trust res as of the decedent's death.

worth of prime bonds outright to his son and the same amount of such bonds to a trustee for the benefit of his daughter. The son and the trustee both sell the bonds and reinvest in, say, Kreuger & Toll, which is worthless at date of death. Under the Bureau's practices nothing will be included in the gross estate because of the trust fund, but \$100,000 will be included by reason of the outright gift.

Moreover, the adoption of the trust fund theory does not eliminate all administrative problems. For example, suppose that there is a transfer to a trustee in contemplation of death and the trustee is given power to invade the corpus of the trust in behalf of the income beneficiary, which he does to the extent of half of the trust fund before the grantor's death. It would seem that the part of the trust property paid over to the income beneficiary from the principal of the trust would have to be included in the decedent's gross estate as well as the property left in the trust at his death. Suppose that before the decedent's death the beneficiary spent this property for his support. What would be included in the decedent's gross estate? Or suppose that the beneficiary exchanged the property distributed to him by the trustee for other property before the decedent's death. Would the property distributed to the beneficiary or the substitute property held by him at the decedent's death be included in the decedent's gross estate?

80. *Humphrey's Estate v. Commissioner*, 162 F.2d 1 (5th Cir. 1947). Pavenstedt, Barrett, and Young in the articles cited in note 77 *supra*, state that this is the Treasury practice.

81. However, in *Estate of B. H. Kroger*, 12 P-H Tax Ct. Mem. 1237 (1943), *aff'd*, 145 F.2d 901 (6th Cir. 1944), the Tax Court said that where there is a transfer in contemplation of death the same rule applies to trusts and outright gifts; in both cases the amount includible in the gross estate is the value of the substituted property held by the transferee at the transferor's death.

Thus, for example, most revocable transfers taxable under section 2038 will take the form of transfers in trust.⁸² The same thing is apt to be true of transfers taxable as transfers taking effect at death under section 2037, and to a somewhat lesser extent, of transfers with a retained life interest taxable under section 2036. If there is an outright transfer, the fact that the transferred property must meet certain conditions at the transferor's death should serve to identify the property includible in the decedent's gross estate. For example, if A transferred Blackacre to B and retained a life estate in Blackacre, the fact that B exchanged his remainder in Blackacre for Whiteacre before A's death should not prevent Blackacre from being included in A's gross estate.

It is not quite clear how a taxable inter vivos transfer of money will be treated. Presumably if there is an outright transfer this will be regarded as a transfer of a certain amount of money and this amount will be included in the transferor's gross estate, irrespective of what happens to the money after the transfer.⁸³ Thus if A transferred \$100,000 to B in contemplation of death, it would seem that \$100,000 should be included in A's gross estate, regardless of whether B loses the \$100,000 after the transfer but before A's death or invests it in stock which increases greatly before A dies. If money is transferred in trust, however, it is possible that the usual doctrine, namely that the property transferred is the trust res as it exists at the transferor's death, will prevail, and the property in which the money is invested at the decedent's death will be included in his gross estate. As noted previously, it is difficult to find a doctrinal justification for the distinction between outright transfers and transfers to a trust, particularly if the only reason for taxing the transfer is that it was made in contemplation of death.⁸⁴

82. *But see* Howard v. United States, 40 F. Supp. 697 (E.D. La. 1941), *modified*, 125 F.2d 986 (5th Cir. 1942).

83. In *Humphrey's Estate v. Commissioner*, 162 F.2d 1 (5th Cir. 1947), the decedent transferred \$40,000 in cash to his sons, who lost half of that amount before his death. The court held that the \$40,000 originally transferred by the decedent had to be included in his gross estate. Pavenstedt, *supra* note 77, at 87, 88 says:

If the gift is made in cash, its value at the date of the gift is taken as the value at the date of death, regardless of whether it has been kept in a safe deposit box, destroyed by fire, profitably invested or squandered. There do not seem to be any cases on this point [the article was written before the decision in *Humphrey's Estate v. Commissioner*] but it is understood that a few administrative settlements have been made on this basis.

84. It might be argued that this distinction should be abandoned in the case of a transfer of cash, with the result that in both cases the amount of cash originally transferred would be included in the transferor's gross estate, regardless of what happened to the cash after the transfer. This would, of course, introduce further complications where the decedent made transfers of both cash and other property to the same trustee.

IV. CONCLUSION

No attempt has been made in this article to present a comprehensive review of all of the problems that may arise in the process of identifying property subject to the federal estate tax. The authors hope, however, they have made it clear that there is a problem here which merits more consideration than it has received from the people who make and talk about tax law. A prodigious amount of effort has been expended in delineating the transfers that are taxable under the statute. It may now be time to turn our attention to intensive investigation of what should be included in the gross estate when there is a taxable transfer. This is an area of considerable uncertainty. Two methods of dealing with the uncertainty seem obvious: one is to stand by passively in the hope that the statutory ambiguities will eventually be resolved by the courts; another is to seek Congressional clarification of the statute. It is interesting to speculate what might be done along this second line.

The problem whether income accumulated in connection with an inter vivos transfer should be included in the gross estate of the transferor could be resolved by amending the statute to provide explicitly for the taxation of such income except for income accumulated in connection with an indefeasible transfer in contemplation of death. This would mean that income accumulated in connection with transfers taxable under sections 2036, 2037, and 2038 would be covered for estate tax purposes provided that the accumulated income satisfied all the conditions, except the requirement of a transfer by the decedent, required for a tax under those sections. The basis of the tax would be that the retention of the same control over income which justifies a tax upon the principal producing the income is a sufficient reason for taxing the accumulated income.

As we have seen, there is apparently no satisfactory judicial solution to the problem whether stock dividends and other corporate distributions should be regarded for estate tax purposes as part of the stock originally transferred by a decedent, to be included in his gross estate, or as income accruing after the transfer, to be excluded from his gross estate. Applying the income tax tests for determining this issue to the estate tax situation is not particularly satisfactory because a dividend may be treated as income under the income tax although it actually represents part of the original stock in connection with which the dividend was distributed. It makes sense to treat dividends as part of the stock originally transferred when the dividends represent earnings accumulated before the transfer, although

under this approach the practical difficulty of determining the source of the dividends is encountered. The standard adopted by the Regulations for distinguishing a dividend which represents a division of capital from an income dividend according to whether the dividend essentially alters the character of the original stock as it existed at the time of the transfer, is a satisfactory expression of an objective but is not especially useful as a practical test. Perhaps the best solution is to lay down a legislative rule of thumb which will achieve approximate justice. Thus it might be wise to amend the statute by providing that to the extent that dividends distributed by a corporation within a reasonable period, such as any one calendar year, do not exceed 10 per cent of the value of stock at the time it was transferred, such dividends shall not be regarded as part of the property originally transferred.⁸⁵ Any distribution in excess of that amount would be treated as part of the property originally transferred and would therefore be included in the transferor's gross estate or otherwise taken into account as property of the decedent.

From the viewpoint of sound tax policy, few people have the temerity to challenge the proposition that a decedent should not be able to diminish his taxable estate by a transfer in contemplation of death. In view of the ambiguity which now exists as to the amount taxable when a decedent transfers or releases in contemplation of death a taxable incident of a transfer which is covered by the estate tax provisions, the statute should be amended to provide expressly that the transfer or release should be disregarded and that the same amount should be included in the decedent's gross estate as would have been included had the transfer or release not taken place. The statute might also specify the consequences which would follow from the receipt of consideration for such a transfer or release. This will mean, of course, that if a decedent gratuitously releases a retained life estate or a reversionary interest in contemplation of death, he will be taxed under section 2036 or section 2037 upon the same amount he would have been taxed upon if the release had not taken place. This result has already been achieved under the language of section 2038 in connection with a release in contemplation of death of a power taxable under section 2038. Section 2040 should be similarly amended so that a transfer in contemplation of death by a joint tenant or a tenant by the entirety of his interest in the joint property will not diminish the amount includible in his gross estate.

85. Cf. Accounting Research Bulletin No. 43, ch. 7(B) (1953), attempting to differentiate between stock dividends and stock splits.

The fact that property transferred at one date must be valued at another date for estate tax purposes may raise a serious identification question if the form of the property changes between the two dates. Although the problem looks formidable, the only really difficult situation appears to be when there is an outright transfer in contemplation of death. It might be wise to amend the statute to provide that in the above situation the amount includible in the decedent's gross estate shall be the value of the property at the time of the inter vivos transfer rather than its value at a later date. This would eliminate any problem which might arise in connection with the identification of the property includible in the gross estate. Moreover, if the decedent irrevocably parted with the property when he made the lifetime transfer, there is no compelling policy reason for charging his estate with subsequent changes in the value of the property. If the purpose of the tax on transfers in contemplation of death is to prevent a decedent from changing his situation under the estate tax by means of such a transfer, it is logical to say that the decedent should be treated as though he had never made the transfer and had retained the transferred property until his death. The corollary to this proposition is that the value of the property originally transferred, determined at the date of the transferor's death or at the alternate valuation date, should be included in his gross estate. However, the price which must be paid for this logic is complexity and confusion, and the ideal of disregarding the transfer in contemplation of death seems to be sufficiently preserved by restoring to the decedent's gross estate the value withdrawn at the time of the transfer rather than charging the decedent's estate with whatever happened to the property after he parted with it completely. This suggestion is quite consistent with the current settled principle pursuant to which any post-transfer income is excluded from the gross estate in the case of transfers in contemplation of death.