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INCOME AND GIFT TAXATION OF DIVORCE PROPERTY SETTLEMENTS

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of the Denver Bar

The itching palm of the tax collector may materially increase the woe of the unhappy spouse facing a divorce and property settlement. For example, suppose that a husband and wife, in connection with a contemplated divorce, agree that the husband will pay the wife the sum of $450,000 by transferring to her corporate stock for which he had paid $150,000. The door is open to the Commissioner to assert that upon the transfer the husband has realized a taxable gain of $300,000. Whether the agreed settlement is made in cash (thus eliminating the income taxable gain feature) or in property, the Commissioner may, none the less, assert that a taxable gift was made in some amount. Bureau efforts to tax transfers in connection with divorce settlements are of comparatively recent origin, and the case law is in an early stage of development. Future litigation will be required to settle many of the questions. However, some pitfalls can presently be anticipated and avoided since the tax result of settlements in connection with divorce largely depends upon the language of the instruments and the divorce decree.

It is a well settled general principle of income tax law that a taxable gain or loss may be "realized" where property is transferred in payment or satisfaction of a legal obligation. For example, suppose a taxpayer owed a debt of $100 which he paid by transferring to his creditor a share of stock which was worth $100 but which he had earlier purchased for only $25. By his transfer of property which cost him $25 to settle an obligation of $100, he has "realized" a gain or profit of $75 which is taxable income. And whether the gain is taxable as ordinary income or as a long term capital gain depends upon the nature of the property transferred in settlement of the obligation. This principle has been applied in a great variety of factual situations and in many instances, where the claim or obligation satisfied was an unliquidated one, it has been held that the value or amount of the unliquidated claim was the equivalent of the fair market value of the property transferred in satisfaction thereof.

This principle has been applied to divorce settlements by the Second and Third Circuit Courts, and in each instance certiorari was denied. The first case was *Commissioner v. Mesta* [1] wherein a

[1] 123 F. (2d) 986, 28 AFTR (C.C.A. 3rd, 1941) (Reversing 42 B.T.A. 933), cert. denied 316 U. S. 695.

settlement agreement was made very shortly after a wife had filed a divorce action. Under the settlement agreement the husband agreed to deliver to his wife certificates for 5,200 shares of corporate stock and certain other personal property. The contract contained provisions under which the parties agreed to release and discharge each other from all claims or demands; and it specifically provided that the property to be conveyed to the wife was "in full settlement and satisfaction of all claims and demands on the part of Mrs. Mesta for her maintenance and support, and in lieu of all rights which she may now have, or hereafter acquire, against the property of Mr. Mesta, as wife, widow, or in any manner arising out of or resulting from the relationship of husband and wife * * * ". Shortly thereafter a hearing was had upon the divorce action and a final decree was entered. The decree did not incorporate the agreement or make any provisions for alimony or support, it being the law of that jurisdiction (Pennsylvania) that permanent alimony could not be decreed when an absolute divorce is granted. Pursuant to the contract and after the entry of the decree, the taxpayer husband transferred and delivered the stock and other property to his wife. The fair market value of the stock so transferred was $157,000, whereas its original cost to the taxpayer husband was only about $7,500. The Commissioner assessed an income tax contending that the husband, by this transfer, realized a gain in the amount of the difference between cost and fair market value, which gain (about $150,000) was taxable as a long term capital gain. The Circuit Court held that the taxpayer and his wife had reached an agreement whereunder the taxpayer contracted to give his wife shares of stock and other consideration in lieu of a legal obligation to support her; that the contractual obligation thus imposed upon him was merely a substitute for the obligation imposed by the law of Pennsylvania to support his wife; and that he therefore delivered the stock in partial discharge of this obligation. The court went on to hold that Mesta thereby realized a taxable gain. In answer to the contention of the taxpayer and the holding of the Board of Tax Appeals below, that there was no way to measure the amount or value received by the taxpayer upon the disposition of the stock, the court said:

> The fair market value of the property or the benefit received by Mesta for the stock may be difficult to ascertain, but in the absence of any other value being shown we think it is proper to take fair market value. In the case at bar the amount of the taxpayer's obligation to his wife was fixed in part in terms of stock by the parties themselves who really dealt at arm's length with one another. It was so found by the Commissioner, and the taxpayer has not rebutted the presumption that the Commissioner's ruling is correct. We think that we may make the practical assumption that a man who spends money or gives property of a certain value for an unliquidated claim is getting his money's worth.

MESTA CASE FOLLOWED IN SECOND CIRCUIT

The second of the two cases above referred to is *Commissioner v. Halliwell.*[2] In this case the wife had commenced an action for divorce. While the action was pending, the taxpayer and his wife agreed, subject to approval of the court, that in the event of divorce she should have custody of the minor child and he would pay her as alimony and for support of the child a lump sum consisting of cash and certain securities which were specifically described. On the date the agreement was executed the wife also executed a release of all rights to share in her husband's estate upon his death. Thereafter a divorce decree was entered awarding the wife an absolute divorce with custody of the child and containing findings as to the value of the husband's estate. The decree recited that "securities and cash of the approximate value of $462,551 are a reasonable portion of the defendant's estate to be assigned to the plaintiff as provided by and in compliance with the terms of the agreement aforesaid." The decree also directed the husband to transfer to the wife, "as alimony and in full (sic, discharge) of his obligation for the support of said minor child," the specified securities and cash; and it adjudged that upon delivery thereof the husband should be "discharged of all past or future obligations for the support of" the wife and child. At the date of delivery the securities were worth some $462,000, whereas cost to the taxpayer husband was only $150,000. As in the *Mesta* case, *supra,* the Commissioner asserted that the husband realized a taxable gain of over $300,000, being the difference between the cost of the securities transferred and their value at the time of such transfer. The Second Circuit sustained the Commissioner, expressly agreeing with and following the decision in the *Mesta* case.

These two cases indicate that subsequent litigation may be expected to apply to divorce settlements the general principle of income tax law that a transfer of property in satisfaction of an existing legal obligation is a transaction producing a taxable realization of gain. However, the scope of the application of this principle is presently in doubt. In the light of subsequent gift tax cases, it is possible that a transfer to obtain release of *support rights* may be a satisfaction of a legal obligation and hence a taxable realization of gain, whereas a transfer in settlement of *marital property rights* may be simply a gift which does not produce "realization" of gain.[3] But it is also possible that a transfer *pursuant to a*

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[2] 131 F. (2d) 642, 30 AFTR 442 (C.C.A. 2d, 1942) (Reversing 44 B.T.A. 740), cert. denied, 319 U. S. 741.

[3] The possibility that the making of a gift is a transaction which produces a taxable "realization" of gain is not within the scope of this discussion. Based upon language in Helvering v. Horst, 311 U. S. 112, 61 S. Ct. 144, 24 AFTR 1058 (1940), the Commissioner ruled in 1948 that a farmer donating raised products to a charitable organization is required to include in gross income the fair market value of such products (I.T. 3910, 1948-1 Cum. Bull. 15), and that a livestock raiser who made a bona fide gift of raised cattle to his son is required to include in gross income the fair market value of the raised cattle (I.T. 3932, 1948-2 Cum. Bull. 7). These rulings illustrate an extension of the concept of "realization" of gain. Such extension is of doubtful validity in regard to gifts generally.

divorce decree may result in a taxable realization of gain irrespective of the nature of the rights settled by the decree.

THE GIFT TAX CONSEQUENCES

Before considering some of the cases involving the gift tax aspects of divorce settlements, the Supreme Court's gift tax decisions involving antenuptial settlements require brief mention.

The gift tax statute provides that a tax shall be imposed upon "the transfer * * * of property by gift" [4] and that:[5]

> Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this chapter, be deemed a gift * * * .

The Regulation [6] thereunder states that transfers reached by the statute are not limited to those where a common law "consideration" is absent but embraces as well:

> * * * sales, exchanges, and other dispositions of property for a consideration in money or money's worth to the extent that the value of the property transferred by the donor exceeds the value of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. A consideration not reducible to a money value, as love and affection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift.

In 1945 the Supreme Court in two companion gift tax cases [7] held that the release before marriage of prospective marital property rights did not constitute "consideration" and that an antenuptial settlement was a taxable gift. In *Merrill v. Fahs*, the taxpayer, twice married and about to marry again, contracted with his prospective bride to set up certain trusts for her benefit in return for her release of all rights that she might acquire in his property as his wife or widow, excepting her right to maintenance and support. The parties married, and the legally enforceable agreement was performed. The Commissioner assessed a gift tax upon the full value of the property transferred. The Supreme Court upheld the Commissioner, holding that the bride's release of dower and other marital rights did not constitute "adequate and full consideration" within the meaning of the gift tax statute set forth above. In reaching this result, the Supreme Court construed the gift tax as being in *pari materia* with the Federal Estate Tax statutes. The estate tax in several sections uses sim-

[4] I.R.C. Sec. 1000.
[5] I.R.C. Sec. 1002.
[6] Regulations 108, Sec. 86.8.
[7] Merrill v. Fahs, 324 U. S. 308, 65 S. Ct. 655, 33 AFTR 587 (1945); and Comm. v. Wemyss, 324 U. S. 303, 65 S. Ct. 652, 33 AFTR 584 (1945).

ilar phraseology, that is, "adequate and full consideration in money or money's worth." But it also contained an express provision stating that "a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration in money or money's worth". The effect of the Supreme Court's decision in the *Merrill* case was thus to read into the gift tax statute the express provision which appeared in the estate tax act that a release of dower, etc. does not amount to a consideration.

In the other case, *Comm v. Wemyss*,[8] the antenuptial agreement was negotiated for the reason that the taxpayer was about to marry a widow whose right to income from her deceased husband's trust would cease upon her marriage. Because of her unwillingness to suffer the loss of her trust income by remarriage, the taxpayer agreed to transfer to her certain property. The Commissioner asserted a gift tax on the full value of the property so transferred, and here again the Supreme Court sustained the Commissioner. In this case the Circuit Court of Appeals had reversed the Tax Court, holding that the transfer was not a taxable gift because the prenuptial agreement was an arm's length bargain without any donative intent. To this the Supreme Court said:

> Had Congress taxed 'gifts' simpliciter, it would be appropriate to assume that the term was used in its colloquial sense, and a search for 'donative intent' would be indicated. But Congress intended to use the term 'gift' in its broadest and most comprehensive sense. (Committee reports and cases cited). Congress chose not to require an ascertainment of what too often is an illusive state of mind. For purposes of the gift tax it not only dispensed with the test of 'donative intent.' It formulated a much more workable external test, that where 'property is transferred for less than an adequate and full consideration in money or money's worth,' the excess in such money value 'shall, for the purpose of the tax imposed by this title be deemed a gift * * *.' And Treasury Regulations have emphasized that common law considerations were not embodied in the gift tax.

DONATIVE INTENT NOT CONTROLLING

Not only did the Supreme Court thus eliminate any requirement of donative intent, at least insofor as an antenuptial agreement is concerned, but it also, in the *Wemyss* case, went on to approve the Tax Court's finding that the transfer in the circumstances of that particular case was not one made in the ordinary course of business within the meaning of the above-quoted Regulation. And the Supreme Court made it clear that the "consideration" required to prevent a transfer from being a gift is a money consideration of benefit to the donor and that a detriment to the donee is not an adequate and full consideration in money or money's

[8] See note 7 *supra*.

worth. In reaching this conclusion, the court emphasized the point that the gift tax is aimed to reach those transfers which withdraw property from the donor's estate for estate tax purposes and that to hold otherwise would defeat the purpose both of the gift tax and estate tax statutes.

The Tax Court had earlier held that antenuptial transfers or payments for release of dower or curtesy by an intended spouse were taxable gifts. However, in 1943, in *Herbert Jones,*[9] the Tax Court made a distinction between antenuptial agreements and divorce settlements. In that case, prior to suit for divorce, the taxpayer and his wife through their attorneys had negotiated a property settlement to be effective upon the granting of the divorce. The divorce complaint alleged and the answer admitted that "all property rights of plaintiff and defendant have been settled and adjusted and no order of the court is requested in reference thereto". An absolute divorce decree was subsequently entered, whereupon the parties executed an agreement witnessing the fact that the taxpayer had paid over to his wife cash and property of a value of $122,000 effecting a complete, full and final settlement of all claims of each in the property of the other. The Commissioner asserted a gift tax upon the full amount of $122,000. The Tax Court held that the payment and transfer did not constitute a taxable gift. It distinguished the case of an antenuptial settlement by regarding the payment as having "occurred in satisfaction of the wife's right to support by her husband and as an incident of their divorce." In this view, the Court regarded the transfer as being in settlement of a present and existing liability of the husband to support the wife, in contrast to an inchoate or indefinite right of dower which, prior to or during marriage when no divorce is contemplated, may be too uncertain and indefinite to be then measured in terms of money. The Court regarded the settlement of the wife's right to support as being a *quid pro quo* for the transfer and as constituting a consideration in money or money's worth for the purpose of the gift tax statute. Also, the Court viewed the settlement as having been made in an arm's length business transaction for consideration, without donative intent, and therefore not a "gift" within the meaning of the statute. The opinion also contained a suggestion that if the transfer had been in satisfaction of a decree of divorce containing a provision for the wife's support, that factor would supply consideration in money or money's worth and prevent the transfer from being a gift.

Despite the Commissioner's opposition, the Tax Court thereafter held in several cases that a release by a spouse of the marital right to support is the release of an existing, legally imposed obligation which can be valued in money and which constitutes a

[9] 1 T.C. 1207 (1943).

"consideration in money or money's worth" within the meaning of the gift tax statute and that a transfer for release of support rights is thus not a taxable gift. After the Supreme Court's decisions in the *Merrill* and *Wemyss* cases, *supra,* the Commissioner adopted this view, ruling in E.T. 19 (1946) that for the purpose of the gift tax a release of support rights may constitute "consideration in money or money's worth". That ruling, however, makes a clear cut distinction between support rights and marital property or inheritance rights. Under E. T. 19 the Commissioner's position is as follows:

(a) A release of support rights may constitute a consideration in money or money's worth;

(b) The Bureau will determine the reasonable value of the support rights, and the excess of the value of the property transferred over the value of such support rights will be taxed as a gift;

(c) A release of property rights or inheritance rights is not "consideration in money or money's worth" to any extent;

(d) In the absence of a reasonable allocation made by the parties in connection with such a settlement, the Bureau will make its own reasonable allocation between the amount transferred for release of support rights and the amount transferred for release of other marital rights.

THE TAX COURT AND THE COMMISSIONER AT VARIANCE

The Tax Court has not, however, followed this ruling in regard to marital property rights. Stemming from its language in the *Jones* case, *supra,* the Tax Court's subsequent opinions contain statements to the effect that where married persons deal with each other over settlement of their respective rights and obligations arising out of the marriage, then the settlement is a business transaction, negotiated at arm's length, and is without donative intent and is therefore not a gift within the meaning of the statute. This attitude has been evident particularly in those cases where the negotiations were conducted through attorneys and where the settlement was arrived at only after bargaining between them and especially in the cases where some bitterness or hostility between the husband and wife was evident.

Likewise stemming from its language in the *Jones* case, but largely upon the authority of the Second Circuit Court's decision in *Commissioner v. Converse,*[10] the Tax Court has held that an obligation relating to marital property rights imposed by an agreement incorporated in a divorce decree constitutes "an adequate and full consideration in money or money's worth" and that a transfer in settlement thereof is not a taxable gift. In the *Converse* case,

[10] 163 F. (2d) 131, 35 AFTR 1607, (C.C.A. 2d, 1947).

a husband and wife had entered into a separation agreement under which the husband agreed to pay $1,250 per month to the wife during her lifetime in consideration for her release of all marital rights. Thereafter the wife sued for divorce in Nevada, alleging in her complaint that she and her husband had already agreed to a settlement of property rights. The husband appeared and by answer denied that the agreement was fair and just and alleged that a single payment would be for the best interest of the parties. After the trial in which this was one of the issues litigated, and during which the parties had agreed upon the amount of a single payment, the divorce court entered a decree of absolute divorce. Such decree ordered the husband to pay the wife $625,000 in cash in lieu of the monthly payments as provided by the separation agreement. The decree amended the agreement to this extent but otherwise incorporated it into the decree. The Tax Court held that no taxable gift resulted upon the authority of its earlier decision in the *Jones* case, despite the fact that the *Converse* case arose after the Supreme Court decisions above mentioned. Between the time of trial in the Tax Court and the decision on appeal, the Commissioner had issued E.T. 19. Therefore, on appeal, the Commissioner contended that the payment was a gift to the extent that it exceeded the reasonable value of the wife's right of support and that the case should be remanded for a finding by the Tax Court as to such value. The Second Circuit affirmed the Tax Court, but not on the Tax Court's distinction between antenuptial and postnuptial agreements. The Circuit Court held the divorce Court's decree, upon litigation of the issue, was a money judgment and that the payment was not a gift because it was made in discharge of the judgment debt which would have been deductible for estate tax purposes, had it remained unpaid at Converse's death:[11]

> The underlying reason for taxing as gifts transfers made only in consideration for the release of marital rights in accordance with antenuptial agreements, as shown by the Wemyss and Merrill cases, is that the estate and gift tax statutes are in pari materia. Sanford's Estate v. Commissioner, 308 U. S. 39, 60 S. Ct. 51, 84 L. Ed. 20. Where, as here, there was the discharge of a money judgment which, had it remained unpaid until it became a debt against the respondent's estate, would have been allowed as a deductible claim in computing an estate tax, the transfer which discharged that debt during the respondent's life is not taxable as a gift. On the contrary it was the payment of a liquidated debt created by the judgment and the discharge thereby of the respondent's obligation to pay that debt was an adequate and full consideration in money or money's worth for the transfer.

Thus, the Tax Court has held, contrary to the Commissioner's ruling in E.T. 19, *supra,* that transfers in settlement of both support and property rights are not taxable gifts where negotiated

[11] See note 10 *supra*.

in an arm's length fashion, and that transfers in settlement of marital property rights only (support rights being eliminated) are not taxable gifts where made pursuant to a divorce decree or pursuant to a negotiated settlement agreement incorporated into a divorce decree. See *Edward B. McLean* [12] and *Norman Taurog.*[13]

In the *Taurog* case the taxpayer husband and his wife entered into a settlement agreement under which community property of a value of about $236,000 was to be divided, $118,000 worth to be given over to the wife. In addition, the husband agreed to pay the wife stipulated annual amounts as and for her future support and maintenance during her lifetime or until her remarriage. Subsequently a decree of divorce was obtained which incorporated by reference, approved, and adopted the settlement agreement previously negotiated. The Commissioner assessed a gift tax on the $118,000 worth of property set over to the wife in settlement of her property rights. But the Tax Court held the transfer was not a gift, relying principally upon the Second Circuit's decision in *Converse,* saying:[14]

> The Court thereupon based its decision squarely upon the proposition that the amount which the taxpayer in that case paid to his divorced wife was paid to her in pursuance of the judgment of a Court of competent jurisdiction and therefore was in discharge of an obligation 'and the discharge thereby of the respondent's obligation to pay that debt was an adequate and full consideration in money or money's worth for the transfer.'

Both in the *Taurog* case and in the *McLean* case the Tax Court stated that E.T. 19 was invalid insofar as it does not also except (as constituting full and adequate consideration) transfers made to settle presently enforceable claims.

COURT OF APPEAL OVERRULES TAX COURT

However, in July of last year, the Second Circuit seriously impeached the validity of the Tax Court's prior decisions along the lines above mentioned. In *Commissioner v. Estate of Josephine S. Barnard* [15] a husband and wife had entered into a separation agreement whereunder the wife promised to pay the husband the sum of $50,000 in return for his relinquishment of any claims on her property "so that her estate shall go and belong to the person or persons who become entitled thereto by will," etc. The agreement also provided that in the event of a divorce or decree of separation between them, the agreement could be incorporated into such decree, but that no such insertion should alter or affect the terms and conditions of the agreement. At the time the writ-

[12] 11 T. C. ......, (1948) CCH Dec. 16,620.
[13] 11 T. C. ......, (1948) CCH Dec. 16,729.
[14] See note 13 *supra.*
[15] 49 Prentice-Hall par. 72,554 (C.A. 2d, 1949).

ten agreement was executed, the parties entered into an oral agreement to the effect that if the wife should obtain a divorce, she would pay an additional $50,000 into a previously established trust of which the husband was the life beneficiary. About two months later the wife obtained a Nevada divorce. The decree incorporated the written agreement but contained no provision in regard to the payment required by the parties' oral agreement. After the decree was entered, the wife made the $50,000 payment to the trust pursuant to the oral agreement. The Commissioner assessed a gift tax upon both of the $50,000 payments. The Tax Court held that the $50,000 paid pursuant to the written agreement, which was subsequently incorporated into the divorce decree, was not a taxable gift, but that the $50,000 payment made pursuant to the oral agreement was taxable as a gift. The Second Circuit, upon cross-appeals, held that both of the payments were taxable as gifts. In so holding the Circuit Court opinion made the following points:[16]

1. Upon the authority of *Merrill v. Fahs, supra,* a relinquishment of marital property rights is not "adequate and full consideration" for the purposes of the gift tax.
2. No distinction can be made between an antenuptial settlement and a settlement upon a separation agreement. The latter is no more of a business transaction than the former. Even though negotiated through bargaining, a transfer pursuant to a separation agreement is not a transaction made in the ordinary course of business which is *bona fide,* at arm's length, and free from donative intent so as to be considered under the statute or regulation as being made for an adequate and full consideration in money or money's worth.
3. The mere fact that the separation agreement provisions were incorporated in the divorce decree does not supply the otherwise missing consideration so as to make the payments not a gift. Specifically, the Court distinguished its earlier decision in *Converse* by pointing out that in that case the divorce court had decreed a lump sum payment in lieu of monthly payments provided for by the separation agreement and that as a result the decree created of its own force a judgment debt owed by the taxpayer. In contrast, in the instant case the payment was made pursuant to the agreement before divorce proceedings were instituted and furthermore the agreement itself provided that it would not be affected by inclusion in a decree.
4. The Circuit Court expressly approved the dissent of Judge Disney in such cases as *McLean* and *Taurog,* above men-

[16] See note 15 *supra.*

tioned, and also stated that the *Converse* case had been cited well beyond the scope of its decision in some of the Tax Court's opinions.

SUMMARY OF WHERE WE STAND

The relatively recent litigation of income and gift tax issues in connection with lump sum and property settlements upon divorce leaves many questions unanswered. In general the Commissioner's position on the gift tax aspect under E.T. 19 appears to be fairly sound. The distinction between support rights as constituting "consideration" for purposes of the gift tax and marital property or inheritance rights as not constituting such a consideration is probably justified. The Tax Court's emphasis on the factors of a lack of donative intent and the presence of arm's length bargaining as negativing a taxable gift in instances involving transfers wholly or partially in settlement of marital property rights incidental to divorce appears unjustified.

A wife's right to support is a presently existing, legal obligation imposed upon the husband, the release of which probably constitutes a "consideration in money or money's worth" for the purposes of the gift tax. The wife's right to support can be valued partially through the use of actuarial tables which take into account the husband's life expectancy, the wife's life expectancy, and the possibility of the wife's remarriage. For income tax purposes a transfer of property (not cash) in settlement of support rights may give rise to a taxable gain on the part of the transferor, whether or not such transfer is pursuant to a decree.

Where the husband and wife through actual negotiation and arm's length bargaining arrive at an agreed or compromised value to be placed upon the wife's right to support, such agreed value incorporated into a separation agreement will probably be accepted by the Commissioner unless it is manifestly unreasonable. Such an evaluation of the wife's right to support would be less likely to be questioned if it is subsequently incorporated into a decree of divorce and if the payment or transfer is made in satisfaction of the decree. A value fixed by a divorce court upon litigation of the issue would probably be immune from attack. Where a lump sum settlement or payment is made pursuant to a settlement agreement and no allocation is made by the parties as to the portion thereof attributable to a release or satisfaction of the wife's right to support, the Bureau will make its own evaluation of the right of support.

A release of marital property rights probably does not constitute an "adequate and full consideration in money or money's worth" within the meaning of the gift tax statute. A payment or a transfer of property to obtain a release of such marital property rights now appears taxable as a gift, even though such payment

or transfer may be made pursuant to a settlement agreement which is negotiated in the same manner as if the parties were strangers to one another and after bargaining and negotiation through attorneys. The absence of an actual donative intent is immaterial, and the transaction is not one in the ordinary course of business negotiated at arm's length within the meaning of the Regulation. For income tax purposes a transfer of property in release of marital property rights should likewise be construed as a gift and not as a satisfaction of a legal obligation; hence, no taxable gain should arise by virtue of the transfer.

However, if settlement on account of marital property rights is made pursuant to a decree, so that the payment or transfer may be regarded as being in satisfaction of the obligation imposed by the decree, then the opposite result may follow—the payment or transfer may not be a taxable gift, and if property is transferred, a taxable gain may arise.

Although the present confused state of the litigation now precludes decisive tax predictions, some suggestions can be made for avoiding or minimizing income and gift taxes on contemplated settlements:

(a) If the settlement contemplates payment of cash only, no income tax on the husband can arise by virtue of the payment. Gift tax can be avoided by making the payment in discharge of a legal obligation of the husband. All or substantially all of such payment should be allocated to discharge the wife's rights of support, and preferably the payment should be pursuant to and in satisfaction of a money judgment for such support contained in the decree.

(b) Where a contemplated settlement involves transfer of property, or property and cash, a comparison of potential income and gift taxes upon the husband is necessary. If the property has a "basis" considerably less than present fair value, and especially if the property is not a "capital asset", the potential income tax on a possible gain will make it advisable to attempt to avoid the taxable gain by clearly making a gift of such property. Such a gift should be made prior to divorce to obtain benefit of the so-called marital deduction under the recent admendment of the gift tax statute. In such case a negotiated reasonable value of the wife's right of support should be reached and be satisfied with cash and property in order of preference as follows: (1) cash; (2) property having a basis equal to present value; (3) property having a basis less than present fair value but of a kind which, if sold, would produce gain taxable as a long term capital gain. Low basis property and espe-

cially low basis "ordinary" assets should not be transferred to satisfy the wife's right of support or to satisfy a decree if it can be avoided. An outright gift of such property to the wife is likely to be preferable taxwise.

(c) In most instances it will be desirable to fix specifically the value of support rights by negotiated agreement and to incorporate a finding of such value into the divorce decree.

SOME WILL DRAFTING POINTERS ON MARITAL DEDUCTION

T. RABER TAYLOR
of the Denver Bar

The federal estate tax is a tax on the right to transfer property. Death is the taxing event. The transfers taxed include those becoming effective at death, e. g. by will or joint tenancy, and some lifetime transfers prompted by the certainty of death, e. g. transfers in contemplation of death. Within the threat of the tax is any property or interest in property of the deceased person. Property includes life insurance, co-owner saving bonds, tenancies with right of survivorship and other non-probate property, as well as all probate property. These are included in the gross estate.

The tax, fortunately, is not computed on the gross estate but only on the net estate. The net estate is equal to the gross estate less the specific exemption and deductions. The specific exemption, since 1942, is only $60,000. There is no exemption for life insurance. Deductions from the gross estate are allowed for debts, claims (including the $2,000 Colorado widow's support allowance), funeral expenses and expenses of administration.

The specific $60,000 exemption means that a family with less than $60,000 of worldly goods, including life insurance, has no federal estate tax problem. The higher prices since 1942 have swept many families into the range of the federal estate tax. Middle class married couples have not received any reduction in estate tax rates, but they have received the tax relief afforded by the "marital deduction" created by Congress in 1948.

The marital deduction was created by Section 812 (e) of the Internal Revenue Code. Just to set it out would take four pages of this size print. Many more pages of regulation interpret it.[1] Within the limits of space, therefore, the marital deduction can only be defined and a few will-drafting problems considered.

The marital deduction is a deduction from the gross estate. It

[1] Regulation 105, Section 81.47.