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# NOTES

## WILL RENUNCIATION OF A BEQUEST OR FAILURE TO CLAIM A STATUTORY SHARE CONSTITUTE A TAXABLE GIFT?

In 1948 the 80th Congress amended the Internal Revenue Code in an effort to eliminate the discrimination theretofore enjoyed by residents of states which had adopted the community property system.<sup>1</sup> Substantial equalization in the estate and gift tax fields is expected to follow from the marital deduction and "gift tax splitting" privileges.<sup>2</sup> Moreover, these changes have focused attention upon a problem which caused considerable concern to conservative tax advisors even before the 1948 Tax Amendment. It has long been a doubtful question whether the renunciation of testamentary benefits would be held to constitute a taxable gift. The Act and the proposed regulations make it reasonably clear that a widow will not incur a gift tax as a result of renouncing a bequest or failing to claim her statutory share.<sup>3</sup> But what of a child who (1) renounces a legacy, or (2) fails to claim a statutory share where such right exists because of his parent's failure to mention him in the will? Will he be deemed to have made a taxable gift? The purpose of this note is to analyze the probable basis of gift tax liability in these two latter situations.

### I. WHEN IS A TRANSFER A GIFT?

In property cases decided according to principles of common law the courts will find a gift only where there is (1) a donor with legal capacity to make a gift, (2) a donee who accepts the gift, (3) a donative intent, and (4) an absence of consideration.<sup>4</sup> However, Congress and the courts have given the term "gift" a much broader meaning in the application of the tax statutes.<sup>5</sup> While there is apparently no deviation in the requirement that there be a competent donee, there have been radical changes in the other major elements of a gift so long considered necessary at common law.

1. H. R. REP. No. 1274, 80th Cong., 2d Sess. 24 (1948); SEN. REP. No. 1013, 80th Cong., 2d Sess. 26 (1948).

2. *Ibid.*; Sugarman, *Estate and Gift Tax Equalization—The Marital Deduction*, 36 CALIF. L. REV. 223 (1948); Surrey, *Federal Taxation of the Family—The Revenue Act of 1948*, 61 HARV. L. REV. 1097 (1948).

3. INT. REV. CODE § 812(e) (4); Proposed Estate Tax Reg., 13 FED. REG. 6564 (1948); 3 P-H 1948 FED. TAX SERV. ¶ 25,401.

4. *Edson v. Lucas*, 40 F. 2d 398 (C. C. A. 8th 1930); *Combs v. Roark's Adm'r*, 221 Ky. 679, 299 S. W. 576 (1927); *In re Greenberg's Will*, 286 N. Y. Supp. 56, 158 Misc. 446 (Surr. Ct. 1936).

5. *Comm'r v. Wemyss*, 324 U. S. 303, 65 Sup. Ct. 652, 89 L. Ed. 958 (1945); *Smith v. Shaughnessy*, 318 U. S. 176, 63 Sup. Ct. 545, 87 L. Ed. 690 (1943); *Comm'r v. Hogle*, 165 F. 2d 352 (C. C. A. 10th 1947); *Comm'r v. Beck's Estate*, 129 F. 2d 243 (C. C. A. 2d 1942).

The often-repeated requirement that the donor have legal capacity may be questioned since from early times courts of equity, under certain circumstances, have authorized the gratuitous transfer of an incompetent's property.<sup>6</sup> In *City Bank Farmers Trust Co. v. McGowan*,<sup>7</sup> the Supreme Court left no doubt that a tax could be imposed upon such transfers. In that case property of an incompetent was transferred pursuant to a court order, the court by statute being empowered to act as *parens patriae*. The Supreme Court held that the transfer was a gift in contemplation of death, stating that where "the court is to substitute itself as nearly as may be for the incompetent, and to act upon the same motives and consideration as would have moved her, the transfer is, in legal effect, her act and the motive is hers."<sup>8</sup>

The Supreme Court negated two further essential elements of a common law gift in *Commissioner v. Wemyss*<sup>9</sup> and *Merrill v. Fahs*.<sup>10</sup> These cases, decided on the same day, involved elements of donative intent and consideration. In the *Wemyss* case a widow was beneficiary of a trust so long as she remained unmarried. She subsequently entered into a prenuptial contract with her proposed second husband whereby he transferred to her sufficient securities to make up for the loss of the trust income which she would suffer upon her marriage to him. The Court held that the transfer of the securities was a "gift" under sections 501 and 503 of the Internal Revenue Code<sup>11</sup> and that the transferor received no money equivalent even though the transferee suffered a substantial detriment in giving up her life benefits from the trust. In interpreting these sections, the Court stated: "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 'gifts' in its broadest and most comprehensive sense. . . . Congress chose not to require an ascertainment of what too often is an elusive 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

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6. *In re Hudelson*, 18 Cal. 2d 401, 115 P. 2d 805 (1941); *In re Flagler*, 248 N. Y. 415, 162 N. E. 471 (1928); *In re Carysfort*, Craig & Ph. 76, 41 Eng. Rep. 418 (Ch. 1840); 32 C. J., Insane Persons § 435 (1923). See Notes, 160 A. L. R. 1435 (1946), 59 A. L. R. 653 (1929).

7. 323 U. S. 594, 65 Sup. Ct. 496, 89 L. Ed. 483 (1945).

8. *Id.* at 599. See also, *Comm'r v. Greene*, 119 F. 2d 383 (C. C. A. 9th 1941); *City Bank Farmers Trust Co. v. Hoey*, 101 F. 2d 9, 10 (C. C. A. 2d 1939) ("It is clear . . . that the transfers of the property of the incompetent to her daughter and to her grandchildren were gifts").

9. 324 U. S. 303, 65 Sup. Ct. 652, 89 L. Ed. 958 (1945); 1 TAX L. REV. 107 (1945).

10. 324 U. S. 308, 65 Sup. Ct. 655, 89 L. Ed. 963 (1945); 19 TEMPLE L. Q. 513 (1946).

11. These sections are now §§ 1000, 1002 of the INT. REV. CODE.

value 'shall, for the purpose of the tax imposed by this title, be deemed a gift.' " <sup>12</sup>

The question then is: What is the meaning of "in money or money's worth" for purposes of gift taxation? According to Treasury Department interpretation of section 1002 "consideration not reducible to a money value, as love and affection, promise of marriage, etc., is to be wholly disregarded. . . ." <sup>13</sup> Apparently this would suggest that a consideration measurable in monetary terms and sufficient to create a valid contract at common law would not be disregarded. However, in the *Merrill* case <sup>14</sup> the Supreme Court held that a relinquishment of dower rights, which was adequate consideration to create an enforceable contract at common law, was not consideration in money or money's worth. These two decisions emphasize the Court's disregard of the traditional common law requirements of a gift. In dispensing with these requirements, Congress' purpose was construed to impose gift tax liability on any inter vivos transfer of property where the transferor does not receive in return the equivalent value, in money or money's worth, of the property transferred. <sup>15</sup>

*Brown v. Routsahn*, <sup>16</sup> decided on a fact situation that arose prior to the passage of the gift tax sections of the Code, suggests that even in tax law the requirement that the donee must accept the gift may still be important. In that case the Tax Board, affirming the Commissioner, held that the husband's renunciation of a bequest given in lieu of curtesy was a gift in contemplation of death to the residuary legatee. In reversing, the circuit court of appeals pointed out that the "decedent never . . . had control of the property as donee. All that he had was a right to accept . . . [and] an equal right to reject. . . . He did reject. . . . What it [the Government] did was to collect a tax, not upon the transfer of an interest in property, but upon the exercise of a right to refuse a gift of the property. This we think it had no right to do." <sup>17</sup> It may well be questioned, however, whether the court would apply the rigid common law rules of property to this factual situation today.

## II. THE 1948 AMENDMENT

Because the gift tax was passed to tax transfers of property which escaped taxation on the donor's death, the Court on numerous occasions has held that

12. *Comm'r v. Wemyss*, 324 U. S. 303, 306, 65 Sup. Ct. 652, 89 L. Ed. 958 (1945). For a discussion of this "more workable external test" see *Rand, What is a Gift?* 34 Ky. L. J. 99 (1946).

13. U. S. Treas. Reg. 108, § 86.8.

14. 324 U. S. 308, 65 Sup. Ct. 655, 89 L. Ed. 963 (1945).

15. *Comm'r v. Wemyss*, 324 U. S. 303, 65 Sup. Ct. 652, 89 L. Ed. 958 (1945); *Merrill v. Fahs*, 324 U. S. 308, 65 Sup. Ct. 655, 89 L. Ed. 963 (1945); *Comm'r v. Bristol*, 121 F. 2d 129 (C. C. A. 1st 1941); H. R. REP. No. 708, 72d Cong., 1st Sess. 47 (1932); SEN. REP. No. 655, 72d Cong., 1st Sess. 50 (1932).

16. 63 F. 2d 914 (C. C. A. 6th 1933), *cert. denied*, 290 U. S. 641 (1933).

17. *Id.* at 917.

the estate tax and gift tax provisions must be considered *in pari materia*.<sup>18</sup> Thus consideration of the estate tax sections of the Code—particularly the 1948 Amendment—is relevant in an analysis of possible gift tax liability.

Section 812 (e) (4) deals with disclaimer by a spouse or any other person. While the obvious purpose of Congress in passing this section was to prevent widespread avoidance of estate tax by post-mortem reallocations within the family group to obtain the maximum marital deduction, the language used also indicates the status of such spouse or third person with respect to possible gift tax liability.

Part (A) of section 812(e)(4) provides that where a spouse renounces a bequest, or refuses a statutory share, such bequest or share is to be considered as having passed directly from the decedent to the person receiving such interest.<sup>19</sup> The Treasury Department, in the recently proposed Estate Tax Regulations, treats fully the nature of such disclaimer and further emphasizes that the interest disclaimed will not be treated as passing to or through the spouse.<sup>20</sup> The objective here is to limit the availability of the marital deduction. In view of these express pronouncements of Congress and the Treasury Department, it seems reasonably clear that a spouse will not be subject to a gift tax on the transfer of an interest which is regarded as never passing to her.

Part (B) of section 812(e)(4), however, dealing with renunciation by "any person other than a surviving spouse," suggests the opposite result.<sup>21</sup> This section provides that when any person other than a surviving

18. *Merrill v. Fahs*, 324 U. S. 308, 65 Sup. Ct. 655, 89 L. Ed. 963 (1945); *Smith v. Shaughnessy*, 318 U. S. 176, 63 Sup. Ct. 545, 87 L. Ed. 690 (1943); *Sanford v. Comm'r*, 308 U. S. 39, 60 Sup. Ct. 51, 84 L. Ed. 20 (1939); *Burnet v. Guggenheim*, 288 U. S. 280, 53 Sup. Ct. 369, 66 L. Ed. 748 (1933); H. R. REP. No. 708, 72d Cong., 1st Sess. 28 (1932); SEN. REP. No. 665, 72d Cong., 1st Sess. (1932). See also Warren, *Correlation of Gift and Estate Taxes*, 55 HARV. L. REV. 1 (1941).

19. "(A) By surviving Spouse.—If under this subsection an interest would, in the absence of a disclaimer by the surviving spouse, be considered as passing from the decedent to such spouse, and if a disclaimer of such interest is made by such spouse, then such interest shall, for the purposes of this subsection, be considered as passing to the person or persons entitled to receive such interest as a result of the disclaimer." INT. REV. CODE § 812(e)(4).

20. "Sec. 812(e)(4)(A) provides that where the surviving spouse makes a disclaimer of any property interest which would otherwise be considered as having passed from the decedent to such spouse, such disclaimed interest is to be considered as having passed from the decedent to the person or persons entitled to receive such interest as a result of the disclaimer. A disclaimer is a complete and unqualified refusal to accept the rights to which one is entitled. . . .

"Where the surviving spouse is obliged to elect between a property interest offered to her under the decedent's will or other instrument and a property interest to which she is entitled . . . of which adverse disposition was attempted under such will or other instrument, the property interest which such spouse elects to renounce or relinquish is not considered as having 'passed from the decedent to his surviving spouse.'" Proposed Estate Tax. Reg., 13 FED. REG. 6564 (1948), 3 P-H 1948 FED. TAX SERV. ¶ 25,401.

21. "(B) Disclaimer By Any Other Person.—If under this subsection an interest would, in the absence of a disclaimer by any person other than the surviving spouse, be considered as passing from the decedent to such person, and if a disclaimer of such interest is made by such person and as a result of such disclaimer the surviving spouse is entitled to receive such interest, then such interest shall, for the purposes of this sub-

spouse disclaims, and the interest so disclaimed passes to the surviving spouse,<sup>22</sup> the interest is treated as passing from the decedent to the disclaimant. As this interest for estate tax purposes passes to the disclaimant, and as the surviving spouse actually acquires title to this property, the logical application of this section would suggest a gift tax on the shift of interest from the disclaimant to the parent. There will be, however, few instances where children of the decedent will disclaim in favor of their parent because the marital deduction would not be available if the parent receives the interest as the result of a disclaimer. The common situation will be where the testator leaves his entire estate to his spouse with no provision for or mention of the children. Under the law of practically all states any child born after the execution of the will may claim his intestate share; and, in a large number of the states any child not mentioned in the will, even if living at the date of its execution, may likewise claim his intestate share.<sup>23</sup>

This approach to the disclaimer problem seems equally applicable here, *i.e.*, that the failure to claim will not prevent the imposition of a gift tax unless there is some merit to the distinction between action and non-action. Such distinction fails if liability is based on the doctrine of constructive receipt.

The doctrine of constructive receipt has received wide recognition in the field of income taxation.<sup>24</sup> In *Corliss v. Bowers*,<sup>25</sup> an early income tax opinion involving the taxation of income to the grantor of a revocable trust, Mr. Justice Holmes stated: "The income that is subject to a man's unfettered command and that he is free to enjoy at his own option, may be taxed to him as his own income whether he sees fit to enjoy it or not."<sup>26</sup> Thus, the fact that a person does not actually receive income will not necessarily exempt him from in-

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section be considered as passing, not to the surviving spouse, but to the person who made the disclaimer, in the same manner as if the disclaimer had not been made." INT. REV. CODE § 812(e) (4).

22. Neither the Act nor the proposed regulations deal with the situation where on disclaimer the interest passes to a person other than a spouse since this is immaterial for estate tax purposes.

23. ATRINSON, WILLS 95 (1937); 4 VERNIER, AMERICAN FAMILY LAWS 113, 116 (1936); Mathews, *Pretermitted Heirs: An Analysis of Statutes*, 29 COL. L. REV. 748 (1929).

24. *Corliss v. Bowers*, 281 U. S. 376, 50 Sup. Ct. 336, 74 L. Ed. 916 (1930); *Blum v. Higgins*, 150 F. 2d 471 (C. C. A. 2d 1945); *Loose v. United States*, 74 F. 2d 147 (C. C. A. 8th 1934); *Schoenheit v. Lucas*, 44 F. 2d 476 (C. C. A. 4th 1930); Zysman, *Constructive Receipt of Income*, 16 TAX MAG. 715 (1938); Kaplan, *The Doctrine of Constructive Receipt—Some Observations*, 19 TAXES 547 (1941); 2 MERTENS, FEDERAL INCOME TAXATION §§ 10.01-10.18 (1942).

This doctrine has been incorporated into U. S. Treas. Reg. 111, § 29.42-2, which states: "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition."

25. 281 U. S. 376, 50 Sup. Ct. 336, 74 L. Ed. 916 (1930).

26. *Id.* at 378.

come tax liability. The test is simple: Is the income available to the taxpayer; is it unqualifiedly subject to the taxpayer's demand?<sup>27</sup>

Will the doctrine be extended to other fields of taxation? It never developed in the estate tax field because prior to 1942 the statute specifically required the exercise of a general power of appointment before the property subject to the power could be included in the gross estate.<sup>28</sup> Thus Congress indicated that the mere power to dispose of property should not be taxed. Here was a statutory prohibition to the application of the doctrine of constructive receipt. In 1942, Congress amended section 302(f) and included within the coverage of the tax all property subject to powers (other than specifically defined limited powers), whether exercised or not.<sup>29</sup> Thus the occasion for the application of this judicially developed doctrine has never arisen.

In view of the estate tax regulation dealing with disclaimer by persons other than spouses, there appears to be a strong likelihood that the courts will extend this doctrine to situations where the husband dies leaving a will and there is a pretermitted child, or, a child living at the time the will was executed but who is not mentioned in the will.<sup>30</sup> If he does not claim his statutory share, should he be held to have so constructively received it that its devolution to another under the will of the parent will constitute a taxable gift?<sup>31</sup> Is it any less subject to his "unfettered command"? Is he any less

27. *Loose v. United States*, 74 F. 2d 147 (C. C. A. 8th 1934) (citing numerous cases applying this test); 1 PAUL AND MERTENS, LAW OF FEDERAL INCOME TAXATION § 9.02 (1934).

28. "Sec. 32. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated. . . ."

"(f) To the extent of any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of, or intended to take effect in possession or enjoyment at or after, his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. . . .," 44 STAT. 70, 71 (1926).

The Supreme Court in *Helvering v. Grinnell*, 294 U. S. 153, 155, 55 Sup. Ct. 324, 79 L. Ed. 825 (1935) pointed out that "[t]he crucial words are 'property passing under a general power of appointment exercised by the decedent by will.' Analysis of this clause discloses three distinct requisites—(1) the existence of a general power of appointment; (2) an exercise of that power by the decedent by will; and (3) the passing of the property in virtue of such exercise."

29. This section is now § 811(f) of the INT. REV. CODE. "The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States . . ."

"(f) Powers of Appointment.—"

"(1) In general.—To the extent of any property (A) with respect to which the decedent has at the time of his death a power of appointment, or (B) with respect to which he has at any time exercised or released a power of appointment in contemplation of death, or (C) with respect to which he has at any time exercised or released a power of appointment by a disposition intended to take effect in possession or enjoyment at or after his death, or by a disposition under which he has retained for his life or any period not ascertainable without reference to his death. . . ."

30. See note 23 *supra*.

31. He is treated as having constructively received it for estate tax purposes.

"free to enjoy [it] at his own option" than was the grantor in *Corliss v. Bowers*?<sup>32</sup>

It may be argued that this doctrine should not apply to gift taxation because it disregards the privilege of such child to reject or waive his statutory rights.<sup>33</sup> But this objection to gift tax liability seems formal and technical in the light of our developing tax philosophy where the emphasis is on control, not title; on practicalities, not technicalities. The law of taxation "is not so much concerned with the refinements of title as it is with actual control over the property taxed . . ." <sup>34</sup> and the courts will look through legal niceties and formal dispositions of property in order properly to affix tax liability.

In the situation where a child is entitled to a statutory share, he is the only person who has power to control its disposition. If he accepts the share and then gives it away, clearly he would be subject to gift tax liability. If he fails to take this share and permits it to go to another, is it not equally clear that he has made a gift? Here also he had complete power to control the disposition of the property. That he exercised this power in a negative rather than a positive manner in the transfer of the interest should not preclude the imposition of a gift tax. The end result is the same, *i.e.*, the transfer of the interest to the residuary legatee at the sole pleasure of the pretermitted heir or omitted child.

#### CONCLUSION

Because the courts may apply the doctrine of constructive receipt to situations where there is a pretermitted or omitted child, conservative tax advisors should take steps to avoid this possible basis of gift tax liability. One practical solution to the problem is to examine all wills in light of state statutes to determine if they contain references to existing and pretermitted children. Express mention of such children is enough to deprive them of any statutory share of their parents' estate.<sup>35</sup> If the children have no right to a statutory share, they clearly have no interest subject to their unqualified control. And as there is no unqualified control, there is no basis for the application of the constructive receipt doctrine.

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32. 281 U. S. 376, 50 Sup. Ct. 336, 74 L. Ed. 916 (1930).

33. *Cerf v. Comm'r*, 141 F. 2d 564 (C. C. A. 3rd 1944); *Brown v. Routzahn*, 63 F. 2d 914 (C. C. A. 6th 1933), *cert. denied*, 290 U. S. 641 (1933).

34. *Corliss v. Bowers*, 281 U. S. 376, 378, 50 Sup. Ct. 336, 74 L. Ed. 916 (1930); *Burnet v. Guggenheim*, 288 U. S. 280, 53 Sup. Ct. 369, 77 L. Ed. 748 (1933); *Chase Nat'l Bank v. United States*, 278 U. S. 327, 49 Sup. Ct. 126, 73 L. Ed. 405, 63 A. L. R. 388 (1929); *Saltonstall v. Saltonstall*, 276 U. S. 260, 48 Sup. Ct. 225, 72 L. Ed. 565 (1928); *Sunnen v. Comm'r*, 333 U. S. 591, 68 Sup. Ct. 855, 92 L. Ed. 673 (1948).

35. 1 PAGE, WILLS § 528 (3d ed. 1941); ATKINSON, WILLS § 47 (1937).