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TAXATION-FEDERAL GIFT TAX-TRANSFERS MADE PURSUANT TO POSTNUPTIAL SEPARATION AGREEMENTS

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TAXATION—FEDERAL GIFT TAX—TRANSFERS MADE PURSUANT TO POSTNUPTIAL SEPARATION AGREEMENTS—Taxpayer and her husband entered into a property settlement whereby she agreed to make certain payments to him in return for his promise to relinquish all marital rights in her property. The agreement was not to become operative unless a divorce decree was entered in a then pending action, but it was further provided that "the covenants in this agreement shall survive any decree of divorce which may be entered." The subsequent divorce decree approved the agreement and directed performance of its provisions. The Tax Court, which expunged the gift tax deficiency assessed by the Commissioner, was reversed by the Court of Appeals for the Second Circuit, which held the payments subject to the gift tax. On review under a writ of certiorari, *held,* reversed. The transfers were not founded upon a promise or agreement and therefore they need not meet the requirements of an adequate and full consideration in money or money's worth. Four justices dissented. *Harris v. Commissioner of Internal Revenue,* 340 U.S. 106, 71 S.Ct. 181 (1950).

Section 1002 of the Internal Revenue Code provides that "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... be deemed to be a gift." In 1945, in two companion cases involving antenuptial property transfers in consideration for which the prospective bride relinquished all marital rights in her future husband's property,[1] the Supreme Court decided that the estate tax provisions of §812(b), relating to deductible claims against the gross estate,[2] are to be read into the gift tax; and, therefore, a relinquishment of marital rights is not a consideration "in money or money's worth," as required by §1002, when the transfer is "founded

[1] Commissioner v. Wemyss, 324 U.S. 303, 65 S.Ct. 652 (1945); Merrill v. Fahs, 324 U.S. 308, 65 S.Ct. 655 (1945).

[2] "The deduction herein allowed in the case of claims against the estate . . . shall, when *founded upon a promise or agreement,* be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth. . . . For purposes of this subchapter, 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.'" I.R.C. §812(b). Italics added.

upon a promise or agreement." However, despite these decisions, when confronted with a transfer made pursuant to a postnuptial agreement entered into in anticipation of divorce, the Tax Court consistently held that a release of marital rights constituted a valid consideration since such an agreement was the result of arms-length bargaining.[3] On the other hand, in estate tax cases involving the deductibility of a claim against the gross estate, the deductibility was held to rest not on a distinction between ante- and postnuptial agreements, but rather on whether or not the agreement had been incorporated into the divorce decree; for, being so incorporated, it was said that the transfers were not "founded upon a promise or agreement."[4] When a case concerning gift tax liability of a postnuptial agreement reached the Court of Appeals for the Second Circuit, that court, relying on the estate tax cases, held that the transfers were not gifts because payment had been directed by the divorce decree.[5] A few years later, that same circuit court expressly repudiated any distinction between ante- and postnuptial agreements and, although the agreement in that case had been incorporated into the subsequent divorce decree, the transfer was held to be taxable as being founded on a promise or agreement, in that the payments had been made under the agreement before the divorce action had been instituted and the agreement, by its terms, was to survive any divorce decree.[6] With the authorities thus confused,[7] the stage was set for Supreme Court review of the problem. The decision in the principal case definitely abolishes any distinction, for gift tax purposes, between ante- and postnuptial settlements, and, in fact, such a distinction cannot be justified in view of the statutory language.[8] Further, it

[3] Matthew Lahti, 6 T.C. 7 (1946); Clarence B. Mitchell, 6 T.C. 159 (1946); Estate of Reinhold H. Forstmann, P-H T.C. Memo. Dec. ¶47,035 (1947).

[4] Commissioner v. State Street Trust, (1st Cir. 1942) 128 F. (2d) 618; Commissioner v. Maresi, (2d Cir. 1946) 156 F. (2d) 929; Fleming v. Yoke, (D.C. W.Va. 1944) 53 F. Supp. 552, affd. (4th Cir. 1944) 145 F. (2d) 472; Estate of Swink, P-H T.C. Memo. Dec. ¶45,169 (1945), affd. (4th Cir. 1946) 155 F. (2d) 723; Edythe C. Young, Exec., 39 B.T.A. 230 (1939); Estate of Silas B. Mason, 43 B.T.A. 813 (1941); Estate of Francis B. Grinnell, 44 B.T.A. 1286 (1941); Albert V. Moore, 10 T.C. 393 (1948). The theory of these decisions is that the divorce court may disregard the agreement and make an award as it sees fit, and therefore the claim is based on the court decree rather than upon a promise or agreement.

[5] Commissioner v. Converse, (2d Cir. 1947) 163 F. (2d) 131. Since evidence was introduced and considered by the divorce court in reaching its decision as to the amount of the money judgment, this decision cannot be regarded as authority for the position that mere incorporation into the divorce decree takes the transfer out of the realm of gift tax liability. After this decision was handed down, the Tax Court, although not abandoning its distinction between ante- and postnuptial agreements completely, shifted more or less to an "incorporated into decree" theory. See, e.g.: Edward B. McLean, 11 T.C. 543 (1948); Norman Taurog, 11 T.C. 1016 (1948); William B. Harding, 11 T.C. 1051 (1948).

[6] Commissioner v. Barnard's Estate, (2d Cir. 1949) 176 F. (2d) 233, reversing Estate of Josephine Barnard, 9 T.C. 61 (1947).

[7] For more extended discussions of the problem before the principal case, see: Branch and Lauterbach, "Income and Gift Taxation of Divorce Property Settlements," 27 DICTA 53 (1950); Young, "Tax Problems Involved in Divorce," 1949 UNIV. ILL. L. FORUM 670; Rudick, "Marriage, Divorce and Taxes," 2 TAX L. REV. 123 (1947). For notes discussing the principal case at the court of appeals level, see: 36 VA. L. REV. 106 (1950); 25 N.Y. UNIV. L. REV. 659 (1950).

[8] But see 48 MICH. L. REV. 846 (1950), where the writer argues, apart from the statute, that there might well be room for such a distinction.

now seems settled that if the agreement is conditional on a divorce decree being entered, the transfer is not founded upon a promise or agreement regardless of whether or not the agreement is to survive the decree;[9] and apparently this would be so even where the agreement is not incorporated into the decree.[10] However, whether or not the single fact that the agreement is incorporated into the decree is sufficient to remove gift tax liability does not seem clear. Although the presence of the conditional element would have been enough to support the decision in the principal case, the court expressly approved the theory of *Commissioner v. Maresi*,[11] in which case the agreement, although incorporated into the decree, does not appear to have been conditional.[12] In a very recent case,[13] the Tax Court considered the conditional element to be the controlling factor in the principal case and the mere fact of incorporation to be immaterial.[14] It would seem that this is the better view for, at best, the distinction between an agreement and an agreement incorporated into a decree is nebulous,[15] especially since divorce courts seem extremely prone to adopt the agreement of the parties in its original form.[16]

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[9] Compare the dissenting opinion and also the opinion of Judge Learned Hand when the principal case was before the court of appeals, (2d Cir. 1949) 178 F. (2d) 861.

[10] "If 'the transfer' is effected by court decree, no 'promise or agreement' of the parties is the operative fact." Principal case at 111.

[11] (2d Cir. 1946) 156 F. (2d) 929.

[12] The agreement involved in the Maresi case was entered into on Nov. 13, 1931; payments were to be made each month "beginning in Nov., 1931, payment for which said month shall be made on the day of execution and delivery of these presents." The divorce decree was not entered until Jan. 9, 1932. However, it must be conceded that eminent authority is of the opinion that the agreement in this case was conditional. Commissioner v. Harris, (2d Cir. 1949) 178 F. (2d) 861. Perhaps the court felt that it was conditional in the sense that the divorce court could terminate it, or that suit could not be brought on the agreement once it was incorporated into the divorce decree. See note 4 to the dissenting opinion in the principal case, at 119-120. If this be so, then every agreement that does not expressly provide for survival would be conditional.

[13] George C. McMurtry, 16 T.C. No. 23 (1951).

[14] If this is, in fact, the view of the Supreme Court, then it would seem to call for a like result in the estate tax cases.

[15] PAUL, FEDERAL ESTATE AND GIFT TAXATION §11.24 (1942); 5 TAX L. REV. 90 (1949); Commissioner v. State Street Trust, supra note 4.

[16] Of the cases which ultimately involved an estate or gift tax question, Commissioner v. Converse, supra note 5, appears to be the only one in which the divorce court (usually a Nevada court) had in any way altered the agreement, and this was at the instance of one of the parties.