FEDERAL ESTATE AND GIFT TAXATION

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DURING the year 1959 the legislative, administrative, and judicial mills ground out the usual amount of grist for federal gift and estate taxes, but very little, if any, of the produce seems exceptional or of major importance.

I

LEGISLATION

Congress passed several amendments, all of which are distinctly minor in character, affecting these taxes. Thus, Section 2053(d) of the 1954 Code, which was added in 1956, was enlarged by an amendment. This section permits the executor, under certain circumstances and within a specified time, to elect to deduct from the value of the gross estate the amount of any death taxes upon public, religious or charitable transfers (under section 2055) if the resulting decrease in the federal estate tax inures solely to the benefit of a charity or is equitably apportioned among all the transferees of the estate. Previously the section applied only to death taxes of a state, the District of Columbia, or a territory. The 1959 amendment extends the deduction allowed by the section to death taxes of a foreign country imposed on such a charitable transfer in respect of any property of a United States citizen or resident situated within the foreign country and included within the gross estate. If the executor elects this deduction, this constitutes a waiver of any credit for these taxes under sections 2011 and 2014. The amendment is retroactive, applying to estates of decedents dying on or after July 1, 1955. Obviously, the benefits of this amendment will go to an extremely limited group.

Another 1959 amendment relates to section 2038, adding a new subsection (c). The new subsection, retroactive to estates of decedents dying after August 16, 1954 (the effective date of the 1954 Code),

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3 Within the prescribed period for assessment of the federal estate tax under § 6501.
relates to any person who has been continuously mentally incompetent for a period beginning at least three months prior to December 31, 1947, until the date of his death. Any powers possessed by such person to change the beneficiaries of a trust he has created do not result in the trust property being included in his gross estate, provided he had no power (either alone or in conjunction with another person lacking a substantial adverse interest) to revest title to the property in himself. This amendment, of benefit to only a limited group, extends to the 1954 Code a parallel provision of the 1939 Code.6

Certain other changes have been made to reflect the admission to statehood of Alaska.7 Presumably similar changes will be enacted later for Hawaii.

Of more importance, perhaps, are four bills now pending in Congress. One is an attempt to deal in a comprehensive fashion with the priority and effect of federal tax liens and levies.8 Another, passed by the House on September 9, 1959, provides that residents of United States possessions who become United States citizens solely by reason of their connection with the possession (through birth or residence within the possession or by being a citizen of the possession) are, for federal estate and gift tax purposes, nonresident aliens,9 so that they are subject to estate and gift taxes only for property situated in the United States but not for property situated in the possessions or elsewhere.

A bill10 passed by the House on August 18, 1959, amends Section

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8 H.R. 7914, 86th Cong., 1st Sess. (1959). This would amend §§ 2205, 2501, 6323-25, 6332 and 7403 of the Code and add a new § 7431. The bill: (1) broadens the priority rules to include specifically certain financial instruments (such as factors and inventory liens, trust receipts, equipment trusts) in the priority area now provided for mortgagees, pledgees, and purchasers of certain securities, (2) adds a new provision for the liability of a donee for a donor's unpaid gift taxes, and (3) adds a new provision for liability of a decedent's surviving spouse, trustee, tenant, beneficiary of a power of appointment, transferee or beneficiary, for decedent's unpaid estate taxes to the extent of the value of property included in the gross estate.
9 H.R. 5547, 86th Cong., 1st Sess. (1959). The bill amends § 2106(a)(3) to give these persons an exemption of either (a) $2000, or (b) a proportion of $60,000 fixed by the ratio of the value of the gross estate situated in the United States to the value of the entire gross estate, whichever is greater. Other citizen residents of such possessions are now taxed as United States citizens under the amendments made to the 1954 Code by the Technical Amendments Act of 1958, § 102 [adding §§ 2208 and 2501(b) to the 1954 Code]. For the problem involved, see 34 N.Y.U.L. Rev. 216 nn.11-12, in 1958 Ann. Survey Am. L. 317 nn.11-12 (1959).
2056 of the 1954 Code retroactively for estates of decedents dying after December 31, 1958, to provide that a marital deduction is permitted for allowances, or awards, which, pursuant to local law, are paid within fifteen months from the date of decedent's death to a surviving spouse or the estate of such spouse. It amends section 2056(b) to state that such an allowance is not a terminable interest if it is in fact paid to the surviving spouse or the estate of such spouse. It also amends section 2056(e) to provide that such an allowance is property passing from the decedent. At present, the Treasury concedes that the allowance is an interest passing from the decedent, but contends that applicable local law determines whether or not it is a terminable interest, subject to abatement or termination upon death or remarriage of the surviving spouse. The proposed amendment seems desirable to obtain, insofar as possible, a uniform nationwide rule on this issue.

Perhaps the most interesting proposal is a bill which would in effect extend the principle of the marital deduction to all children of a decedent. The bill would add a new Section 2057 to the Code to allow a deduction for the value of any interests passing to decedent's surviving children to the extent that the interests were included in the gross estate and were not terminable interests (i.e., a life estate, or life insurance proceeds with a power of appointment, and a survivorship condition) or interests in unidentified assets. The deduction would be limited to a maximum for any one child of 5 per cent of the adjusted gross estate.

The marital deduction was part of a broad plan to eliminate discrimination between the common-law and community-property states. The proposed bill has no relationship to any such discrimination, and any analogy to the marital deduction is misleading. In the case of the marital deduction, the 50 per cent maximum limitation, the terminable interest and unidentified assets rules, the requirements that the property pass from decedent and be included in his gross estate, all logically relate to the elimination of such discrimination. The 5 per cent limitation of the proposed bill seems a fairly arbitrary figure. If the bill is sound, why should it not apply to all descendants (grandchildren, etc.), to transfers from children to parents, and to transfers

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among brothers and sisters? Why is there any need for a terminable interest rule? The bill, unlike the marital deduction, applies to transfers from one generation to another, and seemingly would allow property to be handed down from generation to generation in perpetuity tax-free, subject to the 5 per cent per child limitation. In effect, it would change the federal tax from an estate to an inheritance tax in this respect. There seems no justification for such a proposal in view of the liberal $60,000 exemption, as well as the widespread use of the marital deduction and of life estates to avoid the federal estate tax.

II

CASES AND RULINGS

In *Mandel v. Sturr,*\(^{14}\) under a partnership agreement a deceased partner’s share in the firm assets was payable to his estate in forty equal monthly installments with interest at 6 per cent per annum. The executor and the surviving partner entered into a new agreement about six months after decedent’s death, no payments having been made in the interim, providing that decedent’s share of the firm assets (valued at about $153,000) would be paid at once to the estate in full, plus $12,500 for interest, and an additional $10,000 as settlement of any claim of the estate to the firm’s post mortem profits. The $153,000 valuation was not questioned, and this sum was included in decedent’s gross estate.

However, the court excluded from the gross estate the $12,500 paid as interest on the ground that it represented earnings accrued after the date of death on the decedent’s capital account, the same as interest accruing after the date of death on bonds owned by a decedent. This seems correct, provided that the valuation of the capital ($153,000) took into account its post mortem interest-earning capacity. The $10,000 was also excluded by the court from the gross estate on the ground that it represented a new right for damages, not existing at decedent’s death, caused by the survivor’s failure to carry out the initial agreement, rather than a settlement of the estate’s established right, created prior to decedent’s death, to firm profits after death. The distinction seems to be incorrect as the dissent points out. There was little evidence to support the speculation of the majority opinion that the $10,000 was paid as damages for the delay in carrying out the original agreement, rather than as the estate’s share of the firm profits after death.

The Court of Claims held that Panama Canal loan bonds were not exempt from the estate tax because of a statutory provision exempting them from "all taxes or duties of the United States." The opinion, following prior decisions, correctly pointed out that the federal estate tax is levied upon the transfer of the bonds, not upon the bonds themselves, and construed the exemption as limited to taxes upon the bonds themselves.

The Fourth Circuit held the attempted transfer of certain land by decedent to his children prior to his death void under local law for failure to record. The land was included in his gross estate. A contention that the transfer was made for valuable consideration was rejected for lack of evidence. Another decision excluded from decedent's gross estate property held by decedent as a trustee under a resulting trust for her son. Both cases followed local law.

In Silverman v. McGinnes certain United States Savings Bonds were duly registered as payable to decedent and his wife or his children as co-owners. Later decedent delivered the bonds to his wife and children, telling them (and also writing them) that he was giving the bonds outright to them. The bonds were not reissued in the name of the donees. Certain Treasury Regulations (1) provided that registration was conclusive of ownership of the bonds and (2) prohibited their transfer. The court construed the regulations as applying only to the payment of the bonds by the government and not to rights of individuals between themselves to the bonds. The bonds were excluded from decedent's gross estate, since under local law the estate held the bonds as trustee for the donees.

As usual, the government continued to lose more contemplation of death cases than it won.

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In *Estate of McNichol v. Commissioner* the decedent executed warranty deeds conveying outright certain income-producing real estate to his children, and orally agreed with them that he would receive all income from the property during his life. Decedent in fact did receive the income. The property was included in his gross estate under Section 811(c)(1)(B) of the 1939 Code (now Section 2036 of the 1954 Code) on the ground that he had retained enjoyment of it for his life. The court rejected the argument that decedent had no "right" to the income because the oral trust could not be enforced under local law. Quite properly, the court refused to follow *Nichols v. Coolidge* on this point. Rather, the court held, section 811(c)(1)(B) should apply because decedent retained possession or enjoyment of the transferred property for a period which "cease[d] only with his death." The transfer clearly fell within the statutory language of one where a decedent retained possession or enjoyment of the transferred property for a period which did not "in fact end before his death."

In *Estate of Cardeza* the court found that because decedent's reversionary interest had no ascertainable value under applicable valuation principles, it was not taxable under the 1939 Code. A different result might well have been reached under Section 2037 of the 1954 Code, where the committee reports state a reversionary interest is not to be considered as having no value simply because it cannot be valued actuarially, provided the property could have reverted "under contingencies that were not remote."

The doctrine of cross, or reciprocal, trusts was applied in several cases.

Where a settlor-trustee retained power to determine the ultimate recipient of accumulated income as well as corpus, even though he retained no power to revest either in himself, the income accumulated prior to his death was included in his gross estate.

If a grantor gives a power to revoke or alter a trust solely to a third person, it is generally held that the trust is not taxable under

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23 274 U.S. 531 (1927).
26 Estate of Moreno v. Commissioner, 260 F.2d 389 (8th Cir. 1958); Laura Carter, 31 T.C. 1148 (1959). See Lowndes & Kramer, supra note 13, at 204-14.
sections 2036 or 2038, even if the third person has no substantial adverse interest. Two opinions, following a prior decision, have held that, if the grantor gives such powers to an independent trustee, but reserves the right to make himself the trustee, then the trust is reached by sections 2036 and 2038 even if the grantor never does become a trustee. What if the grantor had no power to make himself trustee but unlimited power otherwise to change trustees? As a practical matter, he could then remove any trustee who refused to do the grantor's bidding and appoint a new, more subservient trustee.

A more than usually interesting case is State Street Trust Co. v. United States. Here the settlor (according to the court) as a co-trustee had the following powers: (1) to exchange trust property for other property without reference to the value of the properties, (2) to invest in nonlegal securities yielding no income at all or a very high rate of income, and even in wasting investments without restriction as to the amount invested in any class of securities, (3) to allocate accretions (such as capital gains and stock dividends) to corpus or income. The trustees were liable only for wilful acts or defaults but not for errors of judgment, no matter how gross.

Over a strong dissent, the court held the trust should be included in the grantor's gross estate. The court conceded that a local equity court would have exercised at least some control over the broad discretionary powers given the trustees, and even that perhaps no single power alone would have resulted in inclusion in the settlor's gross estate. Considering all the powers, however, it believed the settlor-trustee had such broad discretion to shift economic benefits between the life tenants and remaindermen that in effect decedent had the right to designate who should possess or enjoy the property or income under section 2036. The dissenting opinion pointed out that the powers in question were ones often conferred for administrative purposes on local trustees and would be required by local courts to be exercised fairly by the trustees as between the remaindermen and life tenants.

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29 Clark v. United States, 267 F.2d 501 (1st Cir. 1959); Van Beuren v. McLoughlin, 262 F.2d 315 (1st Cir. 1958), cert. denied, 359 U.S. 991 (1959). The Clark case was remanded to the district court to determine if local law would forbid the grantor, if she made herself trustee, from exercising the power to terminate the trust.
32 263 F.2d 635 (1st Cir. 1959). See Lowndes & Kramer, supra note 13, at 142-44, 149, 188-91.
The case points up sharply the unsatisfactory nature of the rule that a discretionary power in the grantor is one subject to sections 2036 and 2038, but so-called nondiscretionary powers (those subject to a fixed external standard) are not. Actually, almost every power contains a certain amount of discretion (within the limits set by any standard). A court will intervene only if the so-called nondiscretionary power is exercised unreasonably. On the other hand, even powers absolute in terms are often subject to some judicial control to prevent their exercise fraudulently or in bad faith.

Perhaps the distinction between so-called discretionary and nondiscretionary powers should be abandoned, and every power which in fact gives the settlor substantial discretion and control over the ultimate disposition of income or corpus be placed under sections 2036 or 2038. This, of course, would leave the problem of contingent powers. Should a power subject to a contingency be within sections 2036 and 2038 except when the contingency is wholly beyond the settlor’s control—one which is self-defining and not definable by the settlor—so that again he has no substantial control over the ultimate disposition of corpus or income? The truth is that by carefully following local law a competent lawyer can usually give a settlor all the control he desires over the trust and the beneficiaries and still avoid an estate tax, by using the right words of art to establish standards which set illusory limits on the settlor’s powers. Therefore, to impose a tax where the settlor retains only commonly used administrative powers seems unfair and in the nature of a tax trap. Such powers are not and will not usually be allowed by an equity court to be used to prefer deliberately one beneficiary over another.

Another troublesome aspect of the State Street Trust decision is that it completely ignores the holdings in Reinecke v. Northern Trust Co. and Duke v. Commissioner to the effect that mere retention of

33 Jennings v. Smith, 161 F.2d 74 (2d Cir. 1947). Cf. Lowndes & Kramer, supra note 13, at 169-69, 197-99. See Treas. Reg. §§ 20.2036-1(b)(1)(ii), (b)(3)(iii), and 20.2038-1(b) (1958). In the State Street Trust case, the settlor actually had a power to invade corpus for the “comfortable maintenance and/or support” of the life tenants. Did not this power actually give more control to the settlor over payment of income and corpus than the administrative powers emphasized by the court? The government did not rely upon this power of invasion in the appellate court, since the district court had found that under local law this was a so-called nondiscretionary power, controlled by a fixed standard. Did not this standard still leave the grantor more real discretion than the other administrative powers? How often are trustees ever called to account by beneficiaries under trusts with so-called standards?


substantial administrative powers over a trust does not make the transfer taxable as one taking effect at death. It is not clear whether the majority inadvertently overlooked these cases or considered them inapplicable under the 1954 Code or to the particular circumstances in the instant case. Certainly it would have been helpful if the court had given some indication of why these cases were not followed.

Employee benefits continued to raise problems under the 1939 Code. In one case the entire amount paid decedent's widow under retirement income policies issued by an insurance company to decedent pursuant to a pension trust agreement was included in his gross estate. The court held the entire proceeds amounted to insurance, refusing to segregate into separate portions the reserve (equal to the amount of the employer's contributions) and risk portions of the benefit, and imposed a tax under section 811(g) because the decedent had retained an incident of ownership—the power to change the beneficiaries. On the other hand, another case refused to consider an annuity policy as insurance, and included in the employee's gross estate only the amount of the benefits paid the employee's beneficiary represented by his contributions, excluding the amount represented by the employer's contributions, even though the employee had the right to change the beneficiary. The court held that the employer's contributions were voluntary ones, not required by any contract with the decedent, and that therefore there was no transfer by decedent as required under sections 2036 and 2038. The result, even if in accord with other cases, seems questionable.

In Tuck v. United States the decedent husband had given the wife about 4,400 shares of stock. She received a stock dividend of about 29,000 shares, and later she transferred all the stock to decedent, who in turn transferred it to his wife and himself as joint tenants. The evidence indicated that the stock dividend was the only one ever declared by the company and that it capitalized profits earned prior to the initial transfer of the stock to the wife. The court included the stock dividend in decedent's gross estate under section 2040. The

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40 If paid in cash, the cash dividends would ordinarily be excluded. Ralph Owen Howard, 9 T.C. 1192 (1947). Cf. Harvey v. United States, 185 F.2d 463 (7th Cir. 1950). The Regulations include unrealized capital gains, but exclude realized capital gains. Treas. Reg. §§ 20.2040-1(a)(2), (c)(4), (c)(5) (1958). Would the stock dividend be realized...
Tax Court, following a Treasury ruling, has held that stock dividends paid within a year of decedent's death are included in his gross estate (if the alternate valuation date is used) even if they represent post mortem earnings, provided the dividends are a mere proliferation of capital.

There is thus a square contradiction in reasoning between the Tuck opinion and that of the Tax Court. The former makes the treatment of a stock dividend depend upon when the earnings capitalized by the dividend were earned and includes the dividend in the gross estate only if earned prior to decedent's death (or prior to his inter vivos transfer, if an inter vivos transfer is involved under the estate tax). The Tax Court treats the stock dividend as capital regardless of when the capitalized profits were earned and includes the dividend in the gross estate if earned within a year after decedent's death when the alternate valuation date is used (or if earned after the inter vivos transfer, but before decedent's death). This difference in the way stock dividends are regarded leads to opposing conclusions as to whether or not they are to be included in the decedent's gross estate under certain circumstances.

Contrary to the Regulations, the Fifth Circuit, in a questionable opinion, has ruled that a trust created before 1942 but revocable by the settlor until 1946, and which gave the decedent a general power of appointment, was not taxable under section 2041 when the power was not exercised because the power was a pre-1942 power.

The Second Circuit affirmed per curiam a Tax Court opinion sustaining the constitutionality of the premium payment test under the 1939 Code for inclusion of proceeds of insurance on decedent's life payable to beneficiaries other than his estate. A district court


41 John Schlosser, 32 T.C. No. 25 (April 30, 1959). The Tax Court refused to follow the McGehee case, supra note 40.


44 United States v. Merchants Nat'l Bank, 261 F.2d 570 (5th Cir. 1958).

preferred to follow the dubious reasoning to the contrary of the Seventh Circuit.\footnote{76}

Under section 2042 proceeds of insurance on decedent's life payable to a corporation of which he was president were included in his gross estate because he had the power to change the beneficiary, even though the power could only be exercised with the consent of the corporate beneficiary which paid all the premiums and had physical possession of the policy. Decedent had retained an incident of ownership.\footnote{77}

Two recent cases illustrate the fact that the value at decedent's death of an interest in insurance policies on the life of someone else may be included in decedent's gross estate if decedent predeceases the insured and has incidents of ownership in the policy. This was true in the case of insurance on a husband's life purchased with community property funds. When the wife predeceased her husband, half of the cash surrender value of the policy was included in her gross estate when she owned half of the policy under the local community property law.\footnote{78}

The problem of the effect upon gift and estate taxes of disclaimers and renunciations of gifts, bequests, and inheritances is still a troublesome one. A district court quite properly refused to exclude property from a decedent's gross estate which had been willed to her upon the death in 1938 of her former husband, where the only evidence of a renunciation was a written notation made by her on a copy of his will in 1949, and where she had mingled the property with her own and received all income from it until her death in 1953. Only after her death did her executor attempt to establish the disclaimer.\footnote{79}

Olson v. Reisimer\footnote{80} involved a situation where a husband and wife who owned real property as joint tenants severed by contract


\footnote{80} 170 F. Supp. 541 (E.D. Wis. 1959). Cf. Robert J. Cuddihy, 32 T.C. No. 110 (1959) (decedent over three years before death released his retained life estate to remaindermen for its then actuarial value; entire trust excluded from gross estate).
the tenancy during their lives. Each further contracted to give the other a life interest in the one-half of the property now owned outright by the former, if the latter would devise the remainder in his or her half of the property to their son. Both spouses had contributed consideration for the original purchase of the property. The court, without discussing the question of their proportionate contributions, ruled that the severance of the tenancy was supported by adequate and full consideration.

Now, the husband may have received adequate consideration if the interest he conveyed to his wife in the joint property were of no greater value than the interest she conveyed to him. But, if the husband originally furnished more than half the consideration for the purchase of the property, might not more than half of it have been included in his gross estate if the inter vivos transfer was one subject to the estate tax (as one in contemplation of death)? His estate would be depleted then, since the consideration he received would be less than what was taken out of his estate by the transfer to his wife.

Furthermore, should the husband's agreement to devise a remainder in his half in return for a life interest in the wife's half be exempt from section 2036 on the ground that his transfer to the son is supported by adequate and full consideration (i.e., that actuarially the value of the life estate exceeded the value of the remainder)? The court so held, but the opinion overlooks one difficult point. Obviously, the life estate given to the husband by the wife is consideration. But is it full consideration? Must the consideration equal only the value of what he transferred—the remainder given the son—or the value of what may escape the estate tax because of this transfer—namely, the entire value of his half of the property? Where he reserves a string over the property—his retained life estate in his one-half—must the consideration to remove the entire half of the property from section 2036 equal only the value of the remainder, as the court assumes? Rather plainly, the test for adequacy of consideration should be one which will prevent depletion of the estate: does the consideration received compensate in full for what is taken out of the estate? Here he has received full consideration, for the income from the life interest in his wife's estate has either prevented other depletion of his estate or, if not consumed, is part of his gross estate.

On the other hand, it may be seriously questioned if the doctrine of consideration should be so routinely applied to this type of intra-family transaction. It is rather unlikely, where a small family group is involved, that there was in fact any real arm's length bargaining. Instead, there is simply an ordinary family disposition of property because of love and affection. The remainderman is the son, the natural object of the parents' bounty. The net result of the decision is to reduce sharply the cost of the transfer, even though it is probably motivated, not by business reasons, financial considerations, or the receipt of consideration, but primarily by family love and the desire of parents to provide for their children. Absent actual proof of arm's length bargaining between the spouses, should the doctrine of consideration operate here to exempt this type of family transfer from the estate tax?

The Third Circuit denied a deduction for certain claims barred by the local statute of limitations, but voluntarily paid by the executor to relatives of decedent, where there was no proof, as required by local law, that the claims had been allowed in the audit of the estate in the local probate court.\(^\text{52}\)

The Treasury has ruled that that portion of administration expenses attributable to the earning of tax exempt income, if not allowable as a deduction for income tax purposes, may be allowed as an estate tax deduction, even if the other administration expenses are allowed as an income tax deduction.\(^\text{53}\) A district court has made the questionable ruling that where decedent devised one-half of his estate to his minor children, pursuant to a provision in a previous divorce settlement between himself and his wife, the devise could not be deducted as satisfying claims against his estate, even if the children had legally enforceable rights based upon adequate consideration.\(^\text{54}\) The court felt that the language of the will indicated that decedent did not intend the devise to be solely in satisfaction of the claim against his estate.

Deductions for charitable bequests continue to raise three major problems: First, whether the beneficiary is a public, charitable, or religious organization of the type required for the deduction allowed by section 2055;\(^\text{55}\) Second, where there is a contingent bequest to a

\(^{52}\) Wolf v. Commissioner, 264 F.2d 82 (3d Cir. 1959).


\(^{55}\) Rosamond Gifford Charitable Corp. v. United States, 170 F. Supp. 239 (N.D.N.Y.)
charity, whether the possibility that the charity will not receive the bequest is so remote as to be negligible; if it is not, the deduction is denied. Third, where there is a charitable remainder with a power to invade or divert principal in favor of a noncharitable life beneficiary, whether it is both legally (power limited by some ascertainable standard) and factually (under the circumstances of the case, and in view of the standard, little chance charity will not take) certain that the charity eventually will take some principal; if it is not, the deduction is denied. Usually, local law is decisive as to whether there is an ascertainable standard limiting the power to invade so as to make it legally certain that the charity will eventually take.

The marital deduction still gives rise to considerable litigation. If a surviving spouse has, by inter vivos contract with decedent, agreed to deed her share of jointly-owned real estate to his executor at decedent's death in return for a life interest in his entire estate, none of the jointly-owned property, all of which was paid for by decedent, qualifies for the marital deduction. The widow in effect has a bare legal title subject to a constructive trust in favor of decedent's estate, in which her only interest is a terminable one—a life estate. So, too, where the insured made an inter vivos assignment of insurance policies to his wife and stipulated that if she predeceased him the proceeds should be paid to his children, the interest was a terminable one for which no marital deduction under the gift tax was allowed.  

1958) (deduction allowed for bequest to corporation to be organized for “religious, educational, scientific, charitable or benevolent uses”); Rev. Rul. 59-152, 1959 Int. Rev. Bull. No. 18, at 9 (deduction would be allowed for bequest to state bar association, when it was exempt from the federal income tax: the state bar was integrated). Moffett v. Commissioner, 269 F.2d 738 (4th Cir. 1959) (deduction denied when chances were either 191 in a 1000 or 290 in 1000 that charity would receive nothing because decedent’s widow, age fifty at his death, might live thirty years longer and exhaust principal); John C. Polster, 31 T.C. 874 (1959) (deduction denied where church had to raise over $750,000 to obtain bequest); Rev. Rul. 59-143, 1959 Int. Rev. Bull. No. 17, at 13 (deduction allowed for bequest conditioned on failure of issue by decedent’s childless daughters, who were both over fifty-four years of age; one was single, one married; what about possibility of adopted or step children?). See Lowndes & Kramer, supra note 13, at 367-70; Treas. Reg. § 20.2055-2(b) (1958).  


Where the surviving spouse is given a life interest coupled with a power, her interest does not qualify for the marital deduction under the life estate-power of appointment exception if her power of invasion is a restricted one, limited by a standard such as her maintenance, support and comfort.\textsuperscript{60} Indeed, according to the Treasury, a mere unlimited power to consume and use principal is not sufficient; there must be an unlimited power in the surviving spouse to appoint unconsumed principal to herself or to dispose of it to others of her own selection.\textsuperscript{61}

The Tax Court faced a troublesome question on this issue recently.\textsuperscript{62} Decedent gave his widow the life income from a trust, coupled with a power to withdraw principal not in excess of $5000 a year.\textsuperscript{63} The court denied a marital deduction for the present value of the widow's right to withdraw $5000 annually for the rest of her life. The case arose under the 1958 amendments to the 1939 Code allowing a marital deduction for a life estate-power of appointment exception if the surviving spouse has a power of appointment over the specific portion of the property in which she has the entire life interest.\textsuperscript{64} The court argued that the widow had no power over "such specific portion," as required by the statute, because she had no power to appoint the specific portion from which she was specifically entitled to the life income. Yet since the spouse had the right to all the income, she certainly had the right to the income from the specific portion she could appoint. The Treasury Regulations deny the deduction here on the ground that the specific portion is designated as a fixed dollar amount, rather than as a fraction or percentage of the whole interest involved.\textsuperscript{65}

Where a surviving spouse accepted $10,000 in settlement of certain claims she had against decedent's estate, a marital deduction was denied for this payment, since the spouse's claims at most amounted to a mere life estate, a terminable interest.\textsuperscript{66} The Treasury has ruled

\textsuperscript{60} Ralph G. May, 32 T.C. No. 38 (May 26, 1959) ("comfort, happiness, and well-being"); E. W. Noble, 31 T.C. 888 (1959).

\textsuperscript{61} Ralph G. May, supra note 60; Elwood Comer, 31 T.C. 1193 (1959); Treas. Reg. § 20.2056(b)-5(g)(3) (1958).


\textsuperscript{63} The exercise of the power would be tax free, since the widow could not make a gift to herself. The lapse or failure to exercise the power would also be exempt from the gift tax since it is limited to $5000 a year. At her death, the widow's estate will be taxed on only $5000 (if she has not exercised her withdrawal power in that year). Int. Rev. Code of 1954, §§ 2041(b)(2), 2514(e); Treas. Reg. § 20.2041-3(d)(3) (1958).

\textsuperscript{64} Section 812(e)(1)(F) of the 1939 Code, as amended by the Technical Amendments Act of 1958, § 93, 72 Stat. 1668.

\textsuperscript{65} Treas. Reg. § 20.2056(b)-5(c) (1958).

that the marital deduction may not be waived by the estate of the first of the two spouses to die in order to reduce the value of the estate of the spouse who dies last and to give that estate a credit for a tax on prior transfers.\textsuperscript{67}

Decisions under the 1939 Code conflict as to whether insurance proceeds may be divided into two funds, one of which qualifies for the marital deduction, where the proceeds are payable for a term certain to the surviving spouse and thereafter to her for life, but in the case of her death within the term certain the remaining proceeds are payable to children. The problem is whether a deduction is allowed for the amount of the proceeds used to fund the contingent life annuity for the spouse after the term certain.\textsuperscript{68}

The Treasury issued a new ruling\textsuperscript{69} discussing the valuation of stock in closely-held corporations. This ruling, like a previous one, stressed that "all available financial data" and "all relevant factors affecting the fair market value" must be considered. Among the factors to be taken into account are: (1) the nature of the business and its history, (2) the economic outlook in general and for the industry involved in particular, (3) the book value of the stock and the financial condition of the business, (4) earning capacity, (5) dividend-paying capacity, (6) the presence or absence of good will or other intangible values, (7) sales of the stock and the size of the block of stock to be

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valued, (8) the market price of stocks of corporations engaged in the same or similar lines of business if their stocks are actively traded in a free market, and (9) restrictive agreements.

Two rulings of the Treasury concerning the annual exclusion and gifts to minors are of interest. First, the Treasury stated that, although the Regulations assert that a gift qualifies under section 2503(c) for an exclusion even if the donee upon reaching twenty-one may extend the term of the trust, the exclusion will not be allowed when the donee upon reaching twenty-one may either demand distribution of the corpus or elect to extend the trust and receive distribution according to the terms of the trust. The trust terms involved provided that, if the donee elected at twenty-one to extend the trust, he would receive the corpus in three equal distributions at the ages of twenty-five, twenty-nine, and thirty-three. The ruling states that the Regulations allowing the exclusion apply only where the donee may extend the terms of the trust upon any conditions he chooses, and not where he may extend the term of the trust only upon conditions specified by the donor. The ruling also stated that a power to demand distribution of the corpus at twenty-one does not satisfy the requirement of section 2503(c) that the property must pass to the donee at twenty-one, as it is only a general power of appointment not exercisable until the donee is twenty-one. What if there is also a provision in the trust giving the property to the minor's estate if he dies before twenty-one?

In the other ruling the Treasury concluded that a gift in trust for a minor where the trustee is required to use the property (income and corpus) for the donee's benefit in accord with the donee's needs and best interests, as if the trustee held the property as the minor's guardian, is a present interest which qualifies for the exclusion. All undistributed property was to pass to the donee at twenty-one, or to his estate if he died before then. The ruling carefully distinguished the situation from a trust where the trustee has only a discretionary power to expend trust property for the minor's benefit as if the trustee held the property as guardian. The decisive factor was said to be the difference between giving the trustee discretion to expend the trust property as guardian and directing the trustee to use income and

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73 Street v. Commissioner, 261 F.2d 666 (5th Cir. 1958); Stifel v. Commissioner, 197 F.2d. 107 (2d Cir. 1952); CamielThorrez, 31 T.C. 655 (1958); Rev. Rul. 54-91, 1954-1 Cum. Bull. 207.
principal for the needs and best interests of the donee. As a practical matter, the difference seems one of form rather than substance.

The Tax Court showed a commendable tendency to restrict narrowly its holding\(^7\) under the 1939 Code (overruled in the 1954 Code\(^7\)) that a gift in trust of income to beneficiaries for a fixed period, with remainders to them upon termination of the trust, does not qualify for the annual exclusion even as to the income interests, when the trustees have discretion to distribute corpus to the beneficiaries before termination of the trust because it is impossible to ascertain the exact value of the income interest in view of the power to invade the corpus. Thus, the Tax Court allowed the exclusion when the trust could be ended prior to the fixed term only by the unanimous consent of three adult life beneficiaries, arguing that this meant each beneficiary had a power to prevent diminution or destruction of his life interest.\(^7\)

The lack of correlation between the income tax and the gift and estate taxes no doubt amazes the ordinary taxpayer. Thus a taxpayer in 1941 transferred interests in a partnership to four members of his family and filed a gift tax return. Thereafter he claimed a specific exemption of about $8000, the net amount of the gifts. In subsequent litigation the taxpayer was held liable for the income tax on the income of these partnership interests.\(^7\) When the taxpayer, after making other gifts in 1951, attempted to claim the full $30,000 exemption and to disregard the 1941 transfers, the court refused to let him do so, although it found rather awkward certain language used in the income tax opinion about the failure to make "completed gifts."\(^7\) Perhaps, if he had formally rescinded the gifts, he might have fared better.\(^7\) If the income tax decision was based upon a finding that the alleged transfers were shams, then the lack of a taxable transfer should have prevented a gift tax. If, however, the income tax decision went upon the theory that, in spite of genuine transfers and the creation of a valid partnership under local law, there was no genuine business partnership, but simply an income tax avoidance transaction, then the gift tax seems warranted.\(^8\)

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\(^7\) See La Fortune v. Commissioner, 263 F.2d 186 (10th Cir. 1958), affirming 29 T.C. 479 (1957).

\(^7\) Section 2503(b) of the 1954 Code allows the exclusion here so long as only the income beneficiary may receive corpus.


\(^7\) Camiel Thorrez, 5 T.C. 60 (1945), aff'd, 155 F.2d 791 (6th Cir. 1946).


\(^7\) But cf. William H. Board, 14 T.C. 322 (1950); Walter H. Lippert, 11 T.C. 783 (1948), rev'd per stipulation, 184 F.2d 672 (8th Cir. 1950) (per curiam).

\(^8\) Lowndes & Kramer, supra note 13, at 750-53.