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ESTATE AND GIFT TAXATION OF THE MARITAL COMMUNITY: INTEGRATION OR DISINTEGRATION?

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Prior to 1948 it was immediately apparent that any discussion of federal estate and gift taxation had to be divided into the two categories of community property and common law Though an obvious attempt has been made to eliminate the major differences in tax treatment of the two systems,[1] there are still many distinctions which do not meet the eye on a casual reading of the statute. The average practitioner, and for that matter the average "tax lawyer," does not have time to explore the technicalities of the new marital deduction "equalizer" let alone suggest necessary revisions. This article is written in an attempt to show that many distinctions are still present in the statute, many faults and traps for the unwary can develop even in community property states, and that perhaps we should all be thinking of alternative solutions to the problem beyond the present geographic compromise. It is now, rather than after judicial decisions have solidified the statutory pattern, that action should be taken.

The new marital deduction system is best approached by a short review of community property tax history since the present Internal Revenue Code's basic premise is to equalize taxation among the states by making the community property concepts of split gifts and split estates available to married couples living in common law states.[2] With this in mind a logical development of the subject of federal estate and gift taxation seems to be first, to examine the community property tax background, second, to analyze the present tax structure, and third, to suggest a logical revision. Any such revision must be simple enough to be readily absorbed into the present Revenue Code without greatly upsetting established judicial concepts, and yet must lead to permanent tax improvements. I believe this can best be accomplished by revising the "marital deduction" sections of the code so as to improve the present methods of taxing the marital community while testing the new principles of integrated federal estate and gift taxation.

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[1] INT. REV. CODE § 812(e).

[2] INT. REV. CODE §§ 1000(f), 812(e), 1004(a) (3), see also SEN. REP. No. 1013, 80th Cong., 2d Sess. (1948), and 94 CONG. REC. 3498.

COMMUNITY PROPERTY BACKGROUND

A. The Pre-1942 Estate Tax.

The struggle between community property spouses and the treasury department over federal estate and gift taxation can be divided into a series of rough historical divisions each highlighted by a key case. These cases, rather than the statute, are the basis for taxation of community property spouses and form a background which explains the system used in the present statute.[3]

The first appearance of community property before the Supreme Court of the United States pre-dates the first federal income and estate tax statutes which may account for the system's resistance to full application of these taxes.[4] For about the first ten years after community property first appeared before the United States Supreme Court litigation involving it was concerned with whether community property in the United States should follow the French[5] or the Spanish System.[6] To a certain extent this confusion exists today and may still rise to plague taxpayers.[7] During this period there was no *federal* tax litigation involving community property, but it is interesting to note that tax litigation within the community property states had resulted in the states being able to tax the whole community estate as belonging to the husband.[8] At the present time the U.S. community property systems seem to be thought of more as creatures of statute rather than historical derivations from France and Spain. This proposition is not free from doubt, but a detailed analysis of the subject is beyond the scope of this paper.

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[3] Community property is conspicuous by its absence from the *taxing* provisions of the Internal Revenue Code, being covered only by the general provisions of INT. REV. CODE § 811(a) and some provisions applying to the transitional period from 1942 to 1948.

[4] Warburton v. White, 176 U.S. 484 (1900).

[5] Arnett v. Reade, 220 U.S. 311 (1911)—giving the wife only an expectancy in the marital property.

[6] Garrozi v. Dasta, 204 U.S. 64 (1907)—indicating the Spanish system gave the wife a vested interest in the property. There is some doubt as to whether this distinction is correct. See note 7, *infra.*

[7] Nevada and New Mexico seem to only have an expectancy in the wife. Hernandez v. Becker, 54 F 2d 542 (C.A. 10th 1931), Telegraphic Ruling of September 30, 1948 signed D. S. Bliss, Deputy Commissionery (not printed in the Cumulative Bulletin). See 3 P-H TAX SERV. ¶ 76,406 (1948), *Cf.* Estate of Paul Wendenhoeck v. Commissioner, 4 T.C. 124 (1944) for French; Estate of Jose Simon v. Commissioner, 40 B.T.A. 651 (1939) for Spanish.

[8] Moffitt v. Kelley, 218 U.S. 401 (1910). California probably did not have true community property at that time, but the court treated the situation as though it involved a valid community property sysem. See United States v. Robbins, 269 U.S. 315 (1926).

There is no written evidence of the Treasury's attitude on the matter from 1900 through 1917 but somehow the Treasury became convinced that the community property estate could be split for estate tax purposes.[9] The Treasury suddenly became aware that the theories of splitting the community estate could be carried over into the income tax field and the fight was on. At first, the Treasury tried to prevent a splitting of community income for income tax purposes;[10] however in 1920 the federal authorities seemed to feel they had to concede that community property income was the same as income from a partnership and could thus be split for tax purposes.[11] The courts strengthened the community property states' position in this matter by declaring that individual state concepts of community property ownership should be followed.[12] Since this splitting was done by statutory interpretation of the federal tax law, the Treasury unsuccessfully attempted to have the statute changed.[13] Thus by 1922 community property concepts had successfully edged their way into the federal tax law

As might be expected the Treasury was not satisfied with this geographical inequality of federal taxation, and the third historical period begins with the Treasury directing its efforts toward an attack on the community property spouses via the individual state laws relying on *Wardell v. Blum*[14] as authority that the individual state laws should be applied. This attack is evidenced by a series of Treasury Decisions taking first one position and then another, culminating with Attorney General Stone's famous T.D 3670 which stated that California spouses could not split their income for tax purposes.[15] The Treasury's decision was upheld by the Supreme Court so far as California community property was concerned.[16] The Treasury also defeated California taxpayers on the split estate question.[17] Since the Treasury was admittedly using a state by state basis, the other community property states were not specifically covered by this decision. The Treasury served notice, however, that all the other states would

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[9] T.D. 2450, February 1917 (not published)

[10] O.D. 347, 1 CUM. BULL. 189 (1919), later modified by O.D. 426, 2 CUM. BULL. 198 (1919).

[11] T.D. 3071, 3 CUM. BULL. 221 (1920), T.D. 3138, 4 CUM. BULL. 238 (1921).

[12] Wardell v. Blum, 270 Fed. 309 (1920), *certiorari denied* 258 U.S. 617 (1922).

[13] Seidman, LEGISLATIVE HISTORY OF THE FEDERAL INCOME TAX LAWS, 816 (1st Ed. 1938).

[14] *Supra,* note 12.

[15] Cf. T.D. 3569, III-1 CUM. BULL. 91 (1924), T.D. 3596 III-1 CUM. BULL. 101 (1924), T.D. 3670, IV-1 CUM. BULL. 19 (1925).

[16] United States v. Robbins, 269 U.S. 315 (1926).

[17] United States v. Talcott, 23 F 2d 897 (C.A. 9th 1928), *but see* Estate of George Burlitt v. Commissioner, 3 B.T.A. 1158 (1926) for Texas.

be similarly examined.[18] The climax to this litigation occurred in 1930, and the result was a complete victory for community property spouses in *Poe v. Seaborn* and its companion cases.[19] These cases all involved income tax splitting, but the case of *Hernandez v. Becker*,[20] while not allowing spouses in New Mexico to split their estates, clearly indicated that the concepts of income splitting allowed under *Poe v. Seaborn* also would allow community property spouses to split their estates for tax purposes.[21] Thus the period from 1922 to 1932 ends with the United States Supreme Court firmly establishing community property concepts in the framework of the federal tax law. It should be observed, however, that none of these decisions was based on a lack of Congressional *power to tax* the whole estate, but on the Congressional *intent to tax* from use of the words "income *of* an individual." (Italics added.)

After the community property spouses had established that their state laws were sufficient to protect the basic idea of split estates, the Treasury tried to overturn the basic premise of *Wardell v. Blum* on the theory that state laws should not govern federal tax questions.[22] Concurrently, taxation of the *command* over income theory, as established in *Corliss v. Bowers*[23] and *Lucas v. Earl*,[24] was used in an attempt to tax the command which the community property husband has over the community income. In the estate tax field the commissioner declared that the community property husband's estate should be considered as containing the whole of the community estate because he held a power of revocation as the complete manager of the community estate.[25] After a few preliminary successes, the Treasury was again completely defeated when the Supreme Court declared that community property was a separate concept not governed by the ordinary rules of federal taxation developed in non-community property situa-

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[18] 35 OPS. ATT'Y GEN. 265 (1927).

[19] 282 U.S. 101 (1930); Bender v. Pfaff, 282 U.S. 127 (1930), Goodell v. Kock, 282 U.S. 118 (1930), Hopkins v. Bacon, 282 U.S. 122 (1930). California had changed its statute and also qualified. *See* United States v. Malcolm, 282 U.S. 792 (1931).

[20] 54 F 2d 542 (C.A. 10th 1931).

[21] See note 7, *supra*, for authorities.

[22] The Commissioner had been successful on this point in fields other than community property litigation. Burnett v. Hamel, 287 U.S. 102 (1932). The question of state versus federal law in the tax field is still in doubt. *Cf.* Morgan v. Commissioner, 309 U.S. 78 (1939), Blair v. Commissioner, 300 U.S. 5 (1936), Bennett v. Scofield, 170 F 2d 887 (C.A. 10th 1948).

[23] 281 U.S. 376 (1930).

[24] 281 U.S. 111 (1930).

[25] Porter v. Commissioner, 288 U.S. 436 (1933) established this in the now community property field. *Cf.* Bank of America v. Commissioner, 90 F 2d 981 (C.A. 9th 1937) for a Treasury victory on this point.

tions. By 1938 community property was not only established as a valid tax concept, but was protected from many of the usual doctrines creating tax liability These 1938 cases and their immediate successors mark a breakoff point between the established concepts of community property taxation and the undeveloped areas because the time between 1938 and 1942 when a new statute for the taxation of community property was passed was too short to allow any new principles to completely develop.

After 1938 the Commissioner once again started the cycle of litigation based on non-community property principles of taxation and continued appeals to Congress to change the law The Commissioner had started several very successful lines of attack when the need for such attacks was removed by Congress changing the law in 1942 so as to completely (and in fact unfairly) tax the community estate. These fields of litigation opened by the Commissioner are extremely important to estate planners today since the Revenue Act of 1948[27] has restored community property taxation to this pre-1942 basis. The Commissioner's approach during this 1938-1942 period, in both the income and estate tax fields, was to examine each marital community to see whether the property was held as separate or community property This involved intricate questions of fact, and almost certain litigation, in which the Commissioner was quite successful.[28] Closely connected with this approach was the Commissioner's use of the joint property section of the Internal Revenue Code, § 811(e), to tax the entire estate to the husband by showing that the property was held as "joint" and not "community" property[29] This accusation of joint property control can be coupled with a doctrine of estoppel to make the taxpayer's burden of proof very difficult.[30] An additional method used by the Commissioner was based on the fact that the community property husband's life governs possession and enjoyment in the wife, which would make the entire estate taxable to the husband under

[26] Lang v. Commissioner, 304 U.S. 264 (1938), United States v. Goodyear, 99 F 2d 523 (C.A. 9th 1938).

[27] Pub. L. No. 471, 80th Cong., 2nd Sess. (passed April 2, 1948 over a presidential veto), 62 Stat. 110 (1948).

[28] Sparkman v. Commissioner, 112 F 2d 774 (C.A. 9th 1940), Beals v. Fontenot, 111 F 2d 956 (C.A. 5th 1940), Van Every v. Commissionery, 108 F 2d 650 (C.A. 9th 1940)

[29] United States v. Pierotti, 154 F 2d 758 (C.A. 9th 1946), Greenwood v. Commissioner, 134 F 2d 915 (C.A. 9th 1943), Horner v. Commissioner, 130 F 2d 915 (C.A. 9th 1952), Bank of America v. Rogan, 33 F Supp. 183 (N.D. Cal. 1940).

[30] Estate of George Kingdon, 9 T.C. 838 (1947).

Helvering v. Hallock.[81] This flew directly in the face of *Lang v. Commissioner*,[82] and the Commissioner was not successful in his first approach to the matter.[83] But this was not fully developed due to the passage of the 1942 Revenue Act, and its possibilities of future success are unknown. The Commissioner was also re-examining community property insurance assets and attempting to tax them completely to the husband through an "incidents of ownership" test which had been written into the regulations. This was rejected by the United States Supreme Court in the *Lang* case because the regulations were not warranted by any language in the statute; however, the "incidents of ownership" test was written into the statute by the Revenue Act of 1942 and still remains in today's Internal Revenue Code. This would mean that all insurance paid for with community property proceeds would be taxable to the spouse dying first and especially to the husband if he predeceased his wife.[84]

The above situations illustrating the 1938-1942 period are by no means exhaustive, but they do serve to point out the extremely unsettled condition of federal taxation in the community property field since in 1942 federal taxation of community property estates was still evolving.

B. The Pre-1942 Gift Tax.

Taxation of community property gifts prior to 1942 was even more indefinite than estate taxation. There were few cases involving the application of the tax and comparatively few principles can be deduced from those cases.

There are three aspects to community property gift taxation: gifts between the spouses to create "separate" property, gifts to one spouse from the other's share, and gifts by both of the spouses to a third party. The gift tax statute prior to 1942 had no special provisions for taxing community property, and at that time the main difficulty lay in defining who owned the property so that it could be determined whether a transfer had been made, and if so, by whom and to whom. When there were conveyances separating the community estate into two halves, the courts generally agreed there was no transfer if the

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[81] 309 U.S. 107 (1939).
[82] 304 U.S. 264 (1938).
[83] Estate of Daniel Arbuthnot, 1942 P-H BTA-TC MEM. DEC. ¶ 42,394 (1942).
[84] Godfrey v. Smith, 180 F 2d 220 (C.A. 9th 1950); Waechter v. United States, 98 Fed. Supp. 960 (Wash. 1951), now on appeal. These decisions are not conclusive since they are based on the 1942 Act but they indicate more than a mere possibility of complete taxation to the decedent spouse.

state law defined the community property estate as consisting of two vested inteersts.[35] Obviously, there is always a question as to what is the wife's interest in the particular property being transferred, which leads to litigation as to whether the husband gave his wife separate property or community property[36] This distinction between separate and community property is even more important when determining the amounts of gifts made by husband and wife to persons outside the marital community because of the split gift concept. There is not much historical data available, but the cases and Treasury rulings indicate that gifts of community property are to be considered as being given one-half by the husband and one-half by the wife.[37] In most community property states the wife has a right to prevent the husband from making gifts in fraud of the marital estate. A combination of the factors of separate property, fraud on the marital rights, and taxation of revocable gifts can make the field quite complex.[38]

C Estate and Gift Taxation from 1942 to 1948.

This was a period of complete taxation of the community property marital unit because the spouses were not allowed to divide the community property into two halves for purposes of computing the federal tax due. Although this system will probably never return, some relevant developments in community property taxation resulted during the period. First, it became known that states could not establish an *optional* community property system for tax splitting purposes.[39] Second, it was definitely established that Congress had the constitutional power to tax the community property states without regard to the state property laws.[40] Third, some of the cases involving application of the Revenue Act of 1942 to community property indicate trends in the law valuable in prognosticating future federal taxation of community property A complete review of these cases is not possible in this limited study, but it should be pointed out that decisions on insur-

[35] Rickenberg v. Commissioner, 177 F 2d 114 (C.A. 9th 1949), *certiorari denied* 338 U.S. 949 (1949), Estate of Ive J. Perkins, 1 T.C. 982 (1943). *But cf.* Estate of R. L. Blaffer v. Commissioner, 103 F 2d 489 (C.A. 5th 1939), *certiorari denied* 308 U.S. 559 (1939), showing how the state law will be examined.

[36] Scofield v. Weiss, 131 F 2d 631 (C.A. 5th 1942), *cf.* Estate of T. G. Hendrick, 9 TCM 581, CCH Dec. 11, 760 (M) (1950).

[37] Edward G. Mills, 12 T.C. 468 (1949), see also Letter of Deputy Commissioner D. S. Bliss, Nov. 22, 1935 (Not cited in the Cumulative Bulletin or the services, but cited in the case).

[38] *Cf.* Estate of Mrs. Matney Dyer Lucey, 13 T.C. 1010 (1949).

[39] Commissioner v. Harmon, 323 U.S. 44 (1944)

[40] Fernandez v. Wiener, 326 U.S. 340 (1945), United States v. Rompel, 326 U.S. 367 (1945).

ance,[41] joint interests,[42] control of the estate,[43] effect of the state property laws,[44] and division of the estate into separate versus community property[45] can be very helpful in future litigation involving these subjects. An interesting aspect of these cases is the boomerang effect they produce. During the period from 1942 to 1948 the taxpayer was usually attempting to prove that the particular item of property involved in tax litigation was held as separate property in order to avoid the unfavorable treatment given to community property by the Revenue Act of 1942, while the Commissioner was trying to show that all the property was held as community property. The arguments used by both sides may now be returning to haunt their original proponents.

D. Results:

This historical sketch is by no means complete, but it does indicate the key cases and major historical divisions, and can be used as a reference in examining the Revenue Act of 1948. Another point indicated by this history is that community property is not a firm basis on which to build a permanent tax structure. Furthermore, though the basic policy of protecting the wife is probably a very good one, the community property method of so doing simply does not fit common law concepts. Finally, this history indicates that the difference in tax treatment between the states grew by chance rather than planning, and once established it was recognized by the taxing authorities to be a geographical loophole in the tax structure to be closed by any means possible. The Revenue Act of 1948 did attempt to do this. It behooves community property as well as common law advocates to carefully examine it, since the 1942-1948 Revenue Acts have shown that community property spouses may be the ones to suffer the unfair tax burden if the law fails and some hastily-thought out system is substituted.

It has been pointed out before that it is almost impossible to place an artificial equalization system upon two basically different property systems because the initial impact of the tax will be different upon each system.[46] Even if this could have been accomplished, an attempt

[41] Godfrey v. Smith, 180 F 2d 220 (C.A. 9th 1950).
[42] Sullivan's Estate v. Commissioner, 175 F 2d 657 (C.A. 9th 1949).
[43] Estate of Ralph Rainger, 12 T.C. 483 (1949).
[44] Estate of A. Bluestein, 15 T.C. 770 (1950).
[45] Commissioner v. Estate of Hinds, 180 F. 2d 930 (C.A. 5th 1950), Estate of E. S. Hunt, 11 T.C. 984 (1948).
[46] Surrey, *Federal Taxation of the Family—The Revenue Act of 1948*, 61 HARV. L. REV. 1097, 1156 (1948), hereinafter referred to as Surrey.

using community property principles is still questionable because the silent premise assumed is that federal taxation of community property is a logical, well-defined system.[47] The cases indicate that the opposite is true. The system is indefinite in spots and contains a number of areas of conflict. To achieve equality by leaving the two fundamental systems intact imposing two counterbalancing taxes requires not only an ability to analyze the past history, but also an ability to prophesy the future. The draftsmen of the 1948 Act recognized these difficulties and attempted to provide a solution by means of saving clauses,[48] but as will be pointed out later even these cannot prevent diffierent tax treatment of the two systems. The draftsmen of the 1948 Act did an outstanding job. It is their premises that are questioned and not their draftsmanship.

ANALYSIS OF THE PRESENT STATUTE

This analysis is not an attempt to find fault with every possible detail of the marital deduction sections of the Revenue Act of 1948. Its purpose is to point out the sections wherein dangerous technicalities are found, and to indicate why revision is necessary Since 1948 many text and law review authors have devoted a great deal of time to the marital deduction section of the estate tax law, and various combinations of their work can be consulted for a detailed analysis of the entire statute.[49] This article will analyze briefly the use of each major section, its technical difficulties, any special inequality between common law and community property states it produces, and what its probable social effect will be.

A. Technical Difficulties and Unplanned Social Effects of the Statute.

1. *The passing of property* INT. REV CODE §§ 812(e) (1) (A), 812(e) (1) (H), 812(e) (4)

These sections set forth what is necessary to pass a *quantity* of property for which a marital deduction will be allowed. INT. REV CODE §§ 812(e) (1) (A) and 812(e) (4) are the basis for the so-called

[47] Since the whole tenor of the act is to make community property concepts available to common law spouses. See SEN. REP. No. 1013, 80th Cong., 2d Sess. (1948).

[48] See the last paragraph of INT. REV. CODE § 812(e) (2) (B).

[49] Casner, *Estate Planning Under the Revenue Act of 1948*, 62 HARV. L. REV. 413 (1949), Casner, *Estate Planning Under the Revenue Act of 1948*, 63 HARV. L. REV. 99 (1949), DeWind, *The Approaching Crisis in Federal Estate and Gift Taxation*, 38 CALIF. L. REV. 44 (1950), Nossaman, *The Impact of Estate and Gift Taxes Upon the Disposition of Community Property*, 38 CALIF. L. REV. 71 (1950), Surrey, note 46 *supra*, Trachtman, *New Marital Deduction Regulations*, 88 TRUSTS & ESTATES 337 (1949).

"quantitative test," which defines how much property must go to the spouse in order to qualify for the full 50 per cent of gross estate deduction allowed by INT. REV. CODE § 812(e) (1) (H). There are many technical traps in this area, and a close scrutiny of the regulations and legislative background is necessary to avoid obvious errors concerning such things as: who is a "spouse,"[50] what is "value,"[51] what is the effect of an election against the will,[52] what is the effect of a disclaimer,[53] and what is "the adjusted gross estate."[54] In community property states the technical problems are even greater since there are concepts of separate and community property. The deduction is allowable up to 50 per cent of the separate property of the spouses,[55] but the problem in computing the deduction immediately becomes one of what is separate property.[56] As was indicated in section I, *supra,* there are numerous areas of confusion as to how community property should be taxed. The community property executor must consider whether certain property is disqualified as a joint interest,[57] whether the testator's insurance will qualify under the new "incidents of ownership" test,[58] and whether the particular community property law gives the wife an expectancy or a vested interest. The effect of the wife's election against the will in a community property state is not settled since the regulations do not specifically cover it,[59] and the result of a community property wife's attempt to will her interest in the cash surrender value of a community property life insurance policy to someone other than her husband is incomprehensible.[60] At the present time the only safe way to handle these technical aspects is to obtain a treasury ruling or wait for the issue to be decided in court, an expensive and unsatisfactory way to close an estate.

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50 SEN. REP. No. 1013, 80th Cong., 2d Sess. (1948), p. 6.
51 INT. REV. CODE § 812(e) (1) (E); U.S. Treas. Reg. 105, § 81.47c (1942).
52 U.S. Treas. Reg. 105, § 81.47a(f) (1942).
53 INT. REV. CODE § 812(e) (4), U.S. Treas. Reg. 105, § 81.47a(g) (1942).
54 INT. REV. CODE § 812(e) (2).
55 U.S. Treas. Reg. 105, § 81.47d(b) (1942).
56 U.S. Treas. Reg. 105, § 81.47c(b) (1942) indicates that either community or separate property can be given, but cannot be figured into the computation of the gross estate.
57 Estate of De Lappe v. Commissioner, 113 F 2d 48 (C.A. 5th 1940); see also the cases cited in note 40 *supra.*
58 Godfrey v. Smith, 180 F 2d 220 (C.A. 9th 1950), Waechter v. United States, 98 F. Supp. 960 (Wash. 1951) now on appeal. It is possible that these cases may lead to a result of the community property insurance being now deductible under the marital deduction and non exclusionary under the community property rules.
59 U.S. Treas. Reg. 105, § 81.47a(f).
60 Estate of De Lappe v. Commissioner, 113 F 2d 48 (C.A. 5th 1950). *But cf.* Waechter v. United States, 98 F Supp. (Wash. 1950) for a later view.

This section produces no special inequalities other than its part in the general tax effect being a greater complication of community property technical problems.

The tax effect socially is to force common law testators to give at least one-half of their net estate to their wives, and at the same time to prevent these wives from electing against the will or disclaiming any bequest. In community property states the spouses must follow the system closely, or risk losing both the community property exclusion *and* the marital deduction.[61]

2. *Non-deductible interests:* INT. REV CODE §§ 812(e) (1) (B), 812(e) (1) (C) and 812(e) (1) (E)

These sections are to produce *qualitative* equality between common law and community property spouses[62] by limiting the type of interests allowed to qualify for the marital deduction. Since community property is automatically split, it is the common law executor who faces the most difficulty here.[63] No detailed analysis will be attempted, but a few tricky technical aspects should be noted. If the Rule in Shelly's Case has been abolished such a transfer may be non-deductible.[64] If the husband's executor purchases an interest for the wife instead of the wife purchasing it for herself, it will be non-deductible.[65] If non-deductible assets are among those given to the wife, she will not obtain the full deduction even if there are assets available to pass to her which would make a valid deduction.[66] This factor may even plague community property spouses.[67] These things become very elusive and it may mean that testators will be forced to use a set of stereotyped formulas to be certain they have not violated the act.[68] Finally, if all these problems are avoided by the executor, he still must face the mathematical problem of determining the size of the bequest, since the

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[61] This occurs through use of the artificial community property sections of the Code. INT. REV. CODE § 812(e) (2) (C).

[62] See Surrey, note 46 *supra,* at p. 1127, for origin of the term qualitative.

[63] U.S. Treas. Reg. 105, § 81.47b (1942), but see Surrey, note 46 *supra,* at p. 1125 for possible effects on community property and leaseholds.

[64] Casner, *Estate Planning Under the Revenue Act of 1948—The Regulations,* 63 HARV. L. REV. 99, 102 (1949). See note 9.

[65] INT. REV. CODE § 812(e) (1) (B) (iii).

[66] INT. REV. CODE § 812(e) (1) (C). See Surrey, note 46 *supra,* at p. 1132.

[67] This would occur if the husband has given his wife both separate and community property in a residuary bequest and it would be completely valid as community property, but it violates this section.

[68] Powers, *Marital Deduction Formulas Where the Interest of the Surviving Spouse is Effected by Taxes,* 27 TAXES 726 (1949).

interest given is the net after taxes have been subtracted from the bequest.[69]

The inequality of this section is apparent from its basic purpose, which is to require a specific mold for the common law spouse's bequests. The common law husband cannot receive the benefits of the marital deduction if he leaves a life estate to his wife with a remainder to his children. However, the community property husband may leave the entire community estate to his wife for life remainder to his children by permitting his wife to elect to take a life estate in the entire property under the will rather than her outright one-half of the community property. The estate tax would still be on two halves—one-half on the husband's death under § 811(a) and one-half on the wife's death under 811(c).[70] It thus appears that one of the chief "equality" features of the new act is nonexistent, since the community property spouses now have an advantage.

The aforementioned complexities would not be so objectionable if some beneficial social result was to be obtained, but instead of any social good being accomplished, some harm may result. The effect of these provisions is to force common law husbands to avoid necessary protections for their wives and give them complete interests in order to obtain tax benefits. Granted, for the sake of argument, that the wife should have a right to part of the marital community which she helped create, still the financially wiser husband should be allowed to protect her against herself.

3. *Special exceptions to the "non-deductible" provisions:* INT. REV. CODE §§ 812(e) (1) (D), 812(e) (1) (F), and 812(e) (1) (G).

No counsel can do a proper job of advising his client unless he carefully scrutinizes these technical pathways that avoid the prohibitions of the "terminable interest rule,"[71] Congress' method in the Revenue Act of 1948 was to give the common law spouses certain privileges, put restrictions on these privileges, and finally remove some of the restrictions put on the privileges. This complicated triple step was necessary since it became apparent that many valid testamentary

[69] INT. REV. CODE § 812(e) (1) (E), U.S. Treas. Reg. 105, § 81.47(c) (1942).

[70] See Surrey, note 46 *supra,* at p. 1150 for some elaborations on this basic scheme.

[71] INT. REV. CODE § 812(e) (1) (B). This rule prohibits a testator from giving less than a complete interest to his spouse and attempting to claim a marital deduction for it.

bequests would be inadvertently condemned by the broad language of INT. REV CODE § 812(e) (1) (B)

The common disaster clause is protected, but it must be carefully drawn. If there is a contingency that can extend the clause beyond the six months restriction, the deduction will not be allowed.[72] Since the "property previously taxed" provision is no longer in effect for marital bequests,[73] it becomes extremely important to have such a provision to avoid the trap of two taxes on the entire property passing between spouses dying in a common disaster. Under the present statute a slight misstep will cause the clause to fail, and the property to be taxed twice in a brief period of time.

INT. REV CODE § 812(e) (1) (F), on powers of appointment, is probably one of the most difficult parts to understand due to the present confusion in the law on how "settled property" should be taxed.[74] The purpose of this section is to allow the testator to limit the spouse's interest to a life estate provided he or she is given a complete power to dispose of the remainder. The first problem to be answered here is when to create marital deduction trusts as opposed to non-marital deduction trusts. The non-marital deduction trust is one that will qualify as a long term non-taxable interest through use of INT. REV CODE § 811(f) (2) [75] Next, the trust, of either type, must be examined to see whether any of its restrictive clauses will cause the trust to be taxed to the grantor.[76] In addition to these complexities produced by the general taxing sections of the estate tax statute, the marital deduction section adds a problem of how "combined powers" should be taxed (this occurs when a power of appointment qualifies as a special power of appointment, so is not taxed when exercised, and yet will receive the benefits of the marital deduction when given).[77] There is also a technical rule on unproductive assets which says that the trustee must be given a discretionary, not a mandatory, power to retain

[72] Willis, *Common Disaster Clauses,* 88 TRUSTS & ESTATES 485. The deductions will fail even if the contingency does not in fact happen.

[73] INT. REV. CODE § 811(c) (2) (B).

[74] DeWind, *The Approaching Crisis in Federal Estate and Gift Taxation,* 38 CALIF. L. REV. 79, 92, particularly note 38. See also President's Tax Message, Jan. 23, 1950, H. R. Doc. No. 451, 81st Cong., 2d Sess. (1950).

[75] Looker, *The Impact of Estate and Gift Taxes on Property Disposition,* 38 CALIF. L. REV. 44, 67 (1950).

[76] Estate of Spiegel v. Commissioner, 335 U.S. 701 (1949), Halleck v. Commissioner, 309 U.S. 107 (1949).

[77] Trachtman, *New Marital Deduction Regulations,* 88 TRUSTS & ESTATES 337, 395 (1949), note 16 in particular; Wheeler and Manheimer, *Will Combination of Powers Defeat the Marital Deduction?,* 88 TRUSTS & ESTATES 476 (1949), Trachtman, *A Rebuttal on Combined Powers of Appointment,* 88 TRUSTS & ESTATES 573 (1949).

unproductive property in the trust.[78] These brief comments by no means exhaust the possibilities of difficulties in this field, but do indicate the chief danger points.

This section produces the same inequalities mentioned in section 2, *supra*. It may be even more potent, however, if the community property wife transfers her one-half to a trust in return for receiving a life income on a trust including both halves of the community estate. In this situation the final estate tax on the passage to the children may be only a tax on the husband's one-half plus a tax on the *difference* between the wife's one-half and the value of an estate to the wife for life.[79] The common law spouse, on the other hand, loses the marital deduction for attempting such a disposition, and if he transfers to his wife by inter vivos gift in order to reach the same financial position as is enjoyed by the community property spouses he must pay a gift tax on 50 per cent of the transfer.

The result of these sections is to encourage long term matriarchal trusts[80] *or* complete freedom of transfer in the widow. It does not seem as though any thought-out social result is being accomplished by this "cross-hauling" of tax pressures. Certainly it does not accomplish geographical tax equality, or produce a great mass of venture capital, since neither women nor their trustees are very interested in the less-conservative financial undertakings.

INT. REV. CODE § 812(e) (1) (G) is designed to allow for certain types of insurance settlement options which might otherwise be condemned by INT. REV. CODE § 812(e) (1) (B). The difficulties of the community property spouses have already been mentioned.[81] The common law spouses face the tricky technical requirement that the surviving spouse must receive complete control over the proceeds or the marital deduction is lost, and this may cause the whole marital deduction to be lost through the "Unidentified Assets Section" INT. REV. CODE § 812(e) (1) (C). Although the wife may have received the full *benefit* of the insurance proceeds, she may lose the marital deduction because she doesn't have immediate full *control*.[82] Certain

[78] U.S. Treas. Reg. 105, § 81.47a(c)(5) (1942). This may be unwarranted by the statute. See Trachtman, *supra*, at p. 393.

[79] See illustration No. 2 at the end of this section. For a more complete explanation, see Surrey, note 46, *supra*, at p. 1150.

[80] It is estimated that 60 per cent of the wealth of the United States is owned or controlled by women. *What's Happening to U.S. Wealth and Women?*, New York *Times*, April 11, 1948, Magazine Section.

[81] See notes 58 and 60 *supra*.

[82] U.S. Treas. Reg. 105, § 81.47a(d) (1942).

insurance company formalities (such as proof of death) may make the wife's interest contingent and thus non-deductible. The best solution seems to be for the spouse to leave a series of separate policies with varying settlement options so that some policies will qualify for the marital deduction, and others can pass directly to the children. This will remove the possibility of double taxation of those policies which the testator wants to pass to his children. This section produces the same inequalities that are produced in the trust field. The social results may be even worse since protective clauses for the children cannot be placed in a policy without losing the marital deduction. The section also encourages giving the wife a lump sum free of protections at the husband's death since too many restrictions in the terms of the settlement option will destroy the marital deduction desired.

4. *Items not includible in the adjusted gross estate:* INT. REV CODE §§ 812(e) (2) (A), 812(e) (2) (B), 812(e) (2) (C)

INT. REV CODE § 812(e) (2) (A) is the section which defines the "adjusted gross estate." The main problem in using it is in determining whether the wife has received a bequest or the repayment of a debt.[83]

INT. REV CODE § 812(e) (2) (B) is the section designed to prevent community property spouses from taking advantage of the marital deduction.[84] There are special subdivisions covering community property testamentary bequests,[85] inter vivos transfers,[86] insurance,[87] and the ratio to be applied when "mixed" property is devised.[88] The previous discussion on insurance and joint interests has indicated that there may be areas where the property cannot be split as community property, yet will not be saved by the last paragraph of INT. REV CODE § 812(e) (2) (B) This may act as an inadvertent penalty on spouses who happen to reside in community property states.

The most dangerous part of the statute for community property spouses, however, is INT. REV CODE § 812(e) (2) (C) This section was placed in the statute to prevent easy avoidance of the community property restrictions. Without such a provision the community property spouses could convert the community property into separate

83 U.S. Treas. Reg. 105, § 81.47c(b) (1942).

84 These provisions may also affect common law spouses in those cases where the conflict of law rule refers them to the community property state law. *See* Black v. Commissioner, 114 F 2d 355 (C.A. 9th 1940).

85 INT. REV. CODE § 812(e) (2) (B) (i). See notes 7, 8, and 9 *supra.*

86 INT. REV. CODE § 812(e) (2) (B) (ii).

87 INT. REV. CODE § 812(e) (2) (B) (iii). See notes 58 and 60 *supra.*

88 INT. REV. CODE § 812(e) (2) (B) (iv)

property, come within the marital deduction section, and obtain a second splitting of each half. The section was an obvious necessity for geographic equality, but it provides some serious technical difficulties by utilizing an "artificial community property" concept.[89] The statute and regulations are silent as to the result when the marital community sells property which later is acquired by the husband or wife as separate property, or what will be the effect of termination of the community by divorce with a subsequent remarriage.[90] This difficulty becomes more pronounced when the state law itself is confused as to status of the property owned by the marital community and whether certain interests have been given to the wife.

This section produces no special inequalities beyond those mentioned in the previous sections. It promotes the policy of community property spouses remaining within the confines of the community property system which is probably a good result since this system does provide a certain amount of protection for the widow

5. *Revisions made necessary in other sections of the code:* INT. REV. CODE §§ 812(c) (2) (B), 113(a) (5) (omitting gifts).

The difficulties caused by the removal of the five-year relief provisions through passage of INT. REV. CODE § 812(c) have been mentioned in the previous discussion about legal estates, long term trusts and common disaster clauses. This section was changed by the Revenue Act of 1948 so that none of the property given to a spouse is protected against double taxation. This arbitrary decision was necessary to prevent double exemption of marital gifts. The equitable solution would have been to exclude from the protection only such items as received the benefits of the marital deduction, but such a solution would have necessitated complex tracing provisions as to whether a particular item was given as part of the marital deduction or otherwise. The result is that a testator must be extremely careful to avoid giving an aging wife any property in addition to that qualifying for the marital deduction unless it is in some form of a long term trust which will not be taxable in her estate.[91] The geographical inequalities produced by this section are obvious because the problem of property previously taxed does not even exist as to the wife's one-half of the

89 U.S. Treas. Reg. 105, § 81.47d(b) (1942).

90 Kent, *Property Settlement Agreements in Community Property States,* 1949 Tax Institute of University of Southern California (1949).

91 Looker, *The Impact of Estate and Gift Taxes on Property Disposition,* 38 CALIF. L. REV. 44, 64 (1950).

community estate. The community property husband faces no danger of incorrectly computing the amount going to his wife since he knows before death exactly how much his wife will receive tax free; furthermore, he can distribute his property to her through life estates with non-taxable powers of appointment in order that there will never be more than two taxes each on one half.

Because of this section husbands hesitate to leave their wives more than *exactly* one-half of their "adjusted gross estate." This section, therefore, works at cross purposes with the whole basic policy of protecting the wife, exemplified by allowing a 50 per cent deduction on gifts to her. This provision may be necessary to protect the tax, but it forces testators to either tie up their property in long term trusts or not to give it to their wives at all. Neither of these alternatives produces a very desirable social and economic result.

INT. REV CODE § 113(a) (5) is the section which correlates the estate tax with the capital gains tax by establishing a new basis for future taxation. The change causes the basis of *all* the community property assets to rise or fall according to their value at the first spouse's death. This may be a great advantage in times of rising prices, since a surviving spouse would find the basis of his half of the community estate raised from cost to present value, which could produce a great tax saving. During a period of falling prices, the inverse would be true, yet this is apparently constitutional.[92] At the present time, this will probably cause testators to make testamentary devises instead of inter vivos gifts, since a great saving in income tax can be effected by having the basis rise above the cost to the donor.[93]

B *Inter Vivos Transfers:* INT. REV CODE §§ 813, 1000(f), 1004(a) (3)

The gift tax has always been somewhat unwanted but necessary It performs a necessary function of protecting the income and estate tax laws, but it has been little developed or understood. The discussion here will be brief, since it is closely connected with the estate tax, and the comments already made about that tax also apply to it. However this tax is very important, and more discussion will be devoted to it in the section containing suggestions for revision.

Generally speaking, there are three parts to the gift tax marital

[92] See Surrey, note 46, *supra*, at p. 1140.

[93] Perhaps *this* is the reason for having lower gift tax rates. See Casner, *Estate Planning Under the Revenue Act of 1948*, 62 HARV. L. REV. 413 (1949).

deduction: INT. REV. CODE § 1004(a) (3) relating to the transfers to the wife, INT. REV. CODE § 1000(f) relating to transfers to third parties by the marital unit, and INT. REV. CODE § 813 which attempts to prevent double taxation.

1. *Internal Revenue Code § 1004(a) (3).*

The chief purpose of this section is to allow common law husbands to transfer one-half of their earnings to their wives at a reduced gift tax rate in order that they may be placed in the same position as their community property counterparts. A complete discussion of its action is beyond the scope of this paper, but a brief chart should indicate its basic operation.

Exhibit 1[95]

Estate Tax	*Gift Tax*	*Purpose*
812(e) (1) (A)	1004(a) (3) (A)	To give the wife one-half of husband's earnings with a 50 per cent deduction.
812(e) (1) (B)	1004(a) (3) (B) (i) 1004(a) (3) (B) (ii) 1004(a) (3) (D)	Prevent avoidance "terminable interest rule."
812(e) (1) (C)	1004(a) (3) (C)	Prevent avoidance "unidentified assets rule."
812(e) (1) (D)	....	Do not need protection against inter vivos gifts.
812(e) (1) (E)	....	Do not need protection against inter vivos gifts.
812(e) (1) (F)	1004(a) (3) (E)	To allow inter vivos as well as testamentary trusts for the wife.
812(e) (1) (G)	....	Insurance.
812(e) (2) (A)	....	General defining clause.
812(e) (2) (B) (i) 812(e) (2) (B) (ii) 812(e) (2) (B) (iii)	1004(a) (3) (F) (i)	To prevent community property spouses from enjoying the benefits of the marital deduction.
812(e) (2) (B) (iv)	1004(a) (3) (F). (iv)	Ratio of community property to separate property.
812(e) (2) (B)	1004(a) (3) (F) (ii)	Saving clause for community property dispositions.
812(e) (2) (C)	1004(a) (3) (F) (iii)	Artificial community property designation for both types of disposition.

[94] See Casner, *Estate Planning Under the Revenue Act of 1948,* 62 HARV. L. REV. 421 (1949) for a complete discussion.
[95] All References in this chart are to the Internal Revenue Code sections.

2. *Internal Revenue Code §1000(f).*

This section was designed to give common law spouses the community property ability to make split gifts to third parties. This section, however, has no prohibition preventing community property spouses from splitting their gifts, so it is possible to split the community property into two halves and give one-half away by split gifts, thus reducing the taxes on passing one-half the estate under the present progressive tax rate with the two thirty-thousand-dollar exemptions. Since many community property states provide for a division into separate property, this section may allow community property spouses to accomplish by inter vivos gift what is prohibited by testamentary gift,[96] and then perhaps pass the remainder of the estate at death as community property under the artificial community property provisions. The tax effects of this are unknown, and it is not recommended as *"safe"* estate planning.

3. *Internal Revenue Code § 813.*

This section prevents double taxation of gifts which are subject to an estate tax. It protects the marital deduction gifts only to the extent to which a tax is paid by establishing a ratio of tax to gifts.

There is ordinarily an advantage, once having paid a gift tax, to then have the gift declared to be in contemplation of death. The marital deduction system, however, may cancel part of this.[97]

4. *Social effects of the gift tax sections.*

Except for the attempt to produce a rough equality between the two property systems, there does not seem to have been any preconceived social policy behind the enactment of these sections.

It has been suggested that such things as incentive to business, spreading of income tax incidence, and the change in basis are the reasons for having inter vivos gifts treated differently than testamentary gifts. Congressional history does not indicate this was in the mind of Congress when it passed the original sections,[98] and a check of Treasury statistics reveals that testators are apparently not taking

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[96] INT. REV. CODE §§ 812(e) (2) (B) & (C) are the prohibitions on such testamentary gifts.

[97] See Surrey, note 46 *supra,* at p. 1145; also see Looker, note 91 *supra,* at pp. 46 and 47.

[98] See H. R. REP. No. 708, 72nd Cong., 1st Sess. (1932); SEN. REP. No. 665, 72nd Cong., 1st Sess. (1932).

advantage of the benefit anyway.[99] The writer has come to the conclusion, therefore, that there is no vital reason for treating inter vivos gifts differently than testamentary gifts.

C. The Statute as a Working Whole.

The effect of the 1948 gift and estate tax changes has been to give rough equality, but the following illustrations will indicate some of the unusual and unexpected results that can be obtained. The examples indicate that in many cases equality has not been achieved, and that inter vivos transfers are no longer favored as much as they were. These illustrations are not exhaustive and are not meant to label the whole act as useless; instead they are used to point up a few of the hypothetically bad situations. The exemptions and exclusions will be considered as having already been exhausted. "H" and "W" will be used as symbols for husband and wife respectively.

Exhibit 2

Common Law

H has a $1,000,000 estate
H→*W* for life→remainder to children
Estate Tax on $1,000,000 paid
or
H→*W* $500,000 inter vivos
Then follows the community property model
Extra charge: gift tax on $250,000
or
H→$500,000 to *W* for life→remainder to wife
H→$500,000 to *W* for life→remainder to children
Two taxes on $500,000 plus the risk that *W* won't give the property to the children.

Community Property[100]

H & *W* have a $1,000,000 estate
H→½*W* for life, remainder to children
A binding agreement for *W* to leave her ½ to the children
One tax on $500,000 at *H* death
One tax on $500,000 at *W* death
or possibly
One tax on $500,000 at *H* death
One tax on $500,000 minus value of wife's life interest on $1,000,000.

Instead of simply correcting the common law advantage of giving a life estate, this new system gives an advantage to the community property spouses, and at the expense of deterring a legitimate protective trust for the wife and children in common law states.

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[99] *Hearings Before Committee on Ways and Means,* 81st Cong., 2nd Sess., Exhibit 5, Note 13 (1950).

[100] See Surrey, note 46 *supra,* at p. 1150; *but see* Scofield v. Bethea, 170 F. 2d 934 (C.A. 5th 1948).

Exhibit 3

Estate Tax Equality by Splitting the Estate—Int. Rev. Code § 1004(a) (3)

Common Law

H has $1,000,000 estate
H gives $500,000 to *W*
therefore

H	*W*
$500,000	$500,000

Gift Tax paid on $250,000.

Community Property

H & *W* have a $1,000,000 estate
H & *W* convert to separate property
therefore

H	*W*
$500,000	$500,000

No Gift Tax since no transfer.[101]

The law is closer to achieving equality than before when the whole $500,000 would be taxed, but complete equality could not be achieved unless all interspousal transfers were exempted.

Exhibit 4

The Splitting of Gifts to a Third Party:

Common Law

H has a $1,000,000 estate
H gives *W* $500,000

H	*W*
$500,000	$500,000

H gives $250,000 to the children
W gives $250,000 to the children
Taxes:
H to *W*—gift tax on $250,000
Two taxes on $125,000 for the gifts to the children
Two estate taxes on $250,000 at the death of *H* & *W*.

Community Property

H & *W* have a $1,000,000 estate
H & *W* convert to separate property

H	*W*
$500,000	$500,000

H gives $250,000 to the children
W gives $250,000 to the children
Taxes:
H to *W*—0 gift tax
Two taxes on $125,000 each for the gifts to the children
Two estate taxes on $250,000 at the death of *H* & *W*
Tax saving of the gift tax on $250,000.

Exhibit 5

Comparative Advantages on Testamentary Gifts:

a. Gift to Wife at the Death of the Husband

Common Law

H has a $1,000,000 estate
H gives $500,000 to *W* during life[102]

H	*W*
$500,000	$500,000

H gives his $500,000 to *W* at death
Taxes:
Gift tax on $250,000
Estate tax on $250,000.

Community Property

H & *W* have a $1,000,000 estate

H	*W*
$500,000	$500,000

H gives his $500,000 to *W* at death
Taxes:
Estate tax on $500,000.

[101] Estate of Edward M. Mills v. Commissioner, 12 T.C. 468 (1949).
[102] It is obviously cheaper to give one gift during the life of *H*.

b. Gift to a Third Person instead of the Wife

Common Law

H has a $1,000,000 estate
H gives *W* $500,000 inter vivos

H	*W*
$500,000	$500,000
gives to	gives to
X	X

Taxes:
Gift tax on $250,000
Two estate taxes on $500,000.

Community Property

H & *W* have a $1,000,000 estate

H	*W*
$500,000	$500,000
gives to	gives to
X	X

Taxes:
Two estate taxes on $500,000.

Notice that the advantage is to the common law spouse in part "a," and to the community property spouse in part "b." Is there some reason for granting these peculiar advantages?

Exhibit 6

The Marital Deduction as a Deterrent to Inter Vivos Gifts

Alternative A Using the Gift Tax

H has a $1,000,000 estate
H gives $250,000 to charity (inter vivos gift)
H gives $500,000 to *W* at death
H gives $250,000 to children at death
Taxes:

Estate Tax on	$250,000 to children
	125,000 to *W*
Total	$375,000

Alternative B Using the Estate Tax

$1,000,000
H gives $250,000 to charity at death
H gives $500,000 to *W* at death
H gives $250,000 to children at death
Taxes:

Estate Tax on	$250,000 to children
	0 to *W*
Total	$250,000

This is true because as the gross estate becomes smaller less will qualify for the marital deduction. Is there some planning behind this, or does it just happen because of the system?

D. Evaluation of the Present Sections of the Code:

The previous discussion and examples it is felt point up the bad spots in the present law. There are many situations wherein the desired "equality" is achieved, and the method is much fairer than the pre-1942 system. The legislative craftsmen did an excellent job, considering the task they were expected to perform. However, it is submitted that the problem was insoluble due to the basic premises assumed. No one could be expected to impose a perfect artificial equality on two basically different property systems, each involving many complex methods of disposition. The premise of the plan, not its execution, was at fault.

GENERAL PROPOSAL FOR REVISION

To criticize without offering an alternative which can in its turn be criticized is a destructive approach which will not help solve the difficulties faced in the present statute. The writer, therefore, has briefly outlined in this section of the article the basic requirements of a suggested revision which he believes can be incorporated into the present Internal Revenue Code without greatly upsetting the present theories of taxation. The most severe obstacle which any statutory revision must overcome is resistance to Congressional enactment. Many fine plans[103] are now resting in Congressional pigeon-holes because they are considered too complex or too sweeping, so that to adopt them would mean the tax law would lose many of its valuable precedents. The writer realizes that a piecemeal attack on the Internal Revenue Code is theoretically not the best method of revision, but the problem presented is one of persuading Congress to enact this tax reform as well as developing the technical improvements. A transitional phase is needed wherein theories of tax integration and marital unit taxation can be tested without upsetting the present Revenue Code, because this is the only way to move forward from our present complacency.

The marital deduction section is just such a transitional touchstone. This section is an ideal testing ground because it has not become firmly fixed in the tax law by judicial interpretation; it is almost completely separated from the rest of the statute by its unusual 50 per cent exemptions and deductions; yet it provides a large enough field in which to test new theories. Suggesting any changes that would greatly alter the existing tax structure other than in the marital deduction sections has been deliberately avoided, but these sections would be completely revamped, through use of the new concepts involving a marital unit and a transfer tax. There are also some brief suggestions as to how these revisions could be correlated with the present Revenue Code. It is hoped this proposed revision does not create a new "tax monster" to replace the one we already have. This proposed revision is not a simple panacea because a complex society cannot be expected to have a simple tax structure unless it operates by administrative fiat. Even a complex society, however, should be capable of having a tax

[103] *Federal Estate and Gift Taxes—A Proposal for Integration and Correlation with the Income Tax,* Advisory Committee to the Treas. Dept., U.S. Printing Office 1947—hereinafter referred to as the Treasury proposal; DeWind, *The Approaching Crisis in Federal Estate and Gift Taxation,* 38 CALIF. L. REV. 79 (1950), hereinafter referred to as DeWind.

structure that follows certain principles of reason and fairness with enough simplicity that the "tax experts" and occasionally even the average citizen can understand it. If not then perhaps our whole society is becoming too complex for efficient administration.

This proposed solution requires three essentials: first, the creation of a marital unit with appropriate rules for its dissolution; second, the creation of a single transfer tax to replace the present dual system of estate and gift taxation; and third, a correlation of the new system with the unchanged sections of the Internal Revenue Code.

For convenience the surviving spouse is generally referred to in the feminine gender, but the same principles would apply if the husband were the surviving spouse. The specific sections to be removed or the new sections to be inserted have not been set forth because such technical draftsmanship is not appropriate until the basic ideas have been agreed upon. In general, however, the marital unit tax suggested would be put into the Internal Revenue Code in place of the present marital deduction section, INT. REV. CODE § 812(e). Present INT. REV. CODE §§ 811(c), 812(e) and 1004(a) (3) would be repealed; §§ 113(a) (5) —dealing with basis of marital property, 813 and 936 dealing with combining estate and gift taxation of the marital community, and 1000(f) on "split gifts" would be modified so as not to apply to the marital community. The effect of all these changes would be to cause all estate taxation of the marital community to be concentrated in one section of the Code.

The suggestions will be presented under four general headings: The marital unit—the transfer tax—correlation with the income tax—transition from the present law.

A. The Marital Unit.

The first suggestion is that a marital unit be created which will consist of husband and wife. This is a logical step from the present method of taxing married individuals.[104] The estates of married individuals are now taxed differently from single individuals through use of the marital deduction system and to treat married couples as a tax unit will not greatly alter the present tax structure or disrupt any great body of legal knowledge. The present income tax statute treats the marital community as a unit for tax benefits and this change would only make the estate and gift taxes conform with the income tax.

This marital unit consisting of husband and wife would not include

[104] INT. REV. CODE § 812(e) (1).

the children of the family, since they represent a new tax generation. Before marriage each individual would be subject to the present estate and gift tax laws. Upon marriage each partner would bring his or her assets into the marital community, and these assets would form the assets of the marital unit. At this time a concept entitled "the existing marital community" would be created, and transfers of the marital assets would be taxed through use of the "marital unit." This unit would not be considered any sort of artificial person, but simply a method of federal tax designation, as is done with the community property "community"[105] for many purposes of federal taxation. The "existing marital community" would last until legal separation of the spouses, death of one spouse with the subsequent remarriage of the surviving spouse, or the death of both spouses. These cut-off points are calculated to impose the transfer tax for as long a period as is consonant with the marital status of the parties. The tax will be cumulative from marriage, so it would be desirable to apply it from marriage to death, but in this day of quick and easy divorce some simple and efficient method of dissolving the unit and returning the two spouses to the status of independent individuals must be provided. Recognizing the serious effect that taxes have upon the actions of the well-to-do individuals any solution as to the tax effect of termination of the "existing marital community" must be examined to see what social consequences the proposal will produce.[106] The result produced will depend on two things: *when* the marital unit will be terminated, and *what* tax machinery will go into operation on such a termination. The tax machinery will be discussed in part B of this section; the reasons for the proposed termination at the time of legal separation are indicated below.

The termination times of legal separation, death of one party and subsequent remarriage of the other, or death of both parties are calculated to give as full effect to the transfer tax as is possible without substantially altering the present law. By such cut-off points the normal spouse will start paying a transfer tax when married and will continue making incremental tax payments upon each transfer until death regardless of whether her marital partner predeceases her. There will be no tax paid on transfers to her by the decedent husband,

[105] See RCW 26.16.030, 26.16.040 [RRS §§ 6892, 6893].

[106] I hope to provide "tax neutrality" if possible, but if not, then to produce a beneficial social result such as encouraging marriage. The views expressed in this paper are not meant to indicate that Americans no longer marry for love, but simply that a tax price or benefit will be an influencing factor which must be recognized.

and transfers he makes to persons outside the marital unit at death will be taxed by the means of the transfer tax system. In case of a subsequent remarriage by a surviving spouse, she will carry into the new marriage the tax base of the old marriage.[107] Since the transfer tax will once again be applied to the new marital unit, it is fitting that the old unit should be merged into the new one. This carries out the previous policy of applying the transfer tax from marriage until death.

Legal separation and divorce present a more difficult problem, as they involve a complete termination of the marital community which finds both parties eager to resume completely independent existences. The great danger of tax effects in this area is that divorce may be encouraged by unwise tax policies. Recognizing this danger, the writer still feels the marital community must be terminated and the spouses returned to separate status with as little tax effect as possible since they are no longer a marital unit acting as one. The legal separation cut-off point has the advantage of being certain, and it also will prevent schemes of partial separation to obtain the benefits of both the transfer tax and the estate tax.

The social results of such a section will be to promote protection of the widow and any minor children dependent upon her and to tax the passage of wealth once, and only once, a generation. Geographical tax equality between the community property and common law states will be achieved in the same manner as is accomplished under the present income tax provisions. The creation of this marital unit only recognizes the historical, economic, and social fact that the husband and wife are a unit. The proposed marital unit may be criticized as providing an incentive to marry and as binding the two spouses too closely together. Socially, this could not be termed undesirable.

B. The Transfer Tax and Its Effect on the Marital Unit.

1. *The structure of the tax:*

The basic structure of the tax will be much the same as that recommended in the 1947 Treasury Proposal[108] and very similar to that used in the present gift tax.[109] This involves one transfer tax at graduated rates based on the total amount of transfers made during life and at death. Each year's tax would be determined by establishing the total

[107] This presents some problems of social results achieved since remarriage can be encouraged or deterred by the tax rate that a widow will carry into the new marriage. See part B of this section for a more complete explanation, and a suggested solution.
[108] See the Treasury proposal, note 103, *supra*, pp. 14 and 15.
[109] INT. REV. CODE § 1001; U.S. Treas. Reg. 108, §§ 86.6 and 86.7 (1943).

amount of taxable transfers up to the year in question and adding to that the amount of net taxable transfers from the marital unit during that year to determine the total taxable transfers made. Then a tax at a graduated rate would be imposed upon the two figures obtained and the difference between the two would be the tax for the year in question.[110] This tax would be uniform on the *net* taxable amount of all transfers whether during life or at death so as to avoid any difference in the tax rate due to some taxes being computed on "net" gifts while others are computed on "gross" estates.[111] The Treasury proposal on exemptions and exclusions to give the sum of the present estate and gift tax exemptions with part of the exemption being reserved until the termination of the marital community seems to be very good.[112] The unexhausted inter vivos exemption could be carried over to also apply to the final transfer tax, since the exemption should follow the cumulative rate schedule. The exclusion should definitely be put on a per donor basis to prevent avoidance of the transfer tax by a donor making a large number of $3,000 gifts. If some exclusion on a per donee basis is necessary to obviate administrative difficulties due to Christmas and wedding gifts,[113] it should be lowered to a nominal figure of $50 to $100 which is more in line with the amount actually expended for such objects.

The rates to be used for this tax depend upon the revenue to be raised. Since this revision is to be correlated with the present statute, it is suggsted that the present gift tax rates be used. The writer realizes this will reduce the death tax rate by three-fourths, but the fact that all transfers are cumulated from marriage will probably more than offset this reduction.

The proposed system will require a more careful check of gifts than is made at present. This can be solved by adding a section to the income tax form requiring a listing of transfers made. All transfers above the $50 to $100 exclusion would have to be listed, and this would be added to the previous transfers made to determine the yearly tax. It is submitted that a transfer tax system should eventually be

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[110] See the Treasury proposal, note 103 *supra,* p. 14, for a more complete explanation.

[111] The Treasury proposal, *ibid.,* seems to maintain this distinction, but this seems to create needless confusion. How valid a policy reason is there for increasing the tax rate by a complicated "tax on the tax"?

[112] See the Treasury proposal, *ibid.,* at p. 16.

[113] See SEN. REP. No. 665, 72nd Cong., 1st Sess. 41 (1932); H. R. REP. No. 708, 72nd Cong., 1st Sess. 29 (1932). These indicate that such presents were the reason for the per donee exclusion.

substituted for the entire estate and gift tax system, but this seems to be too sweeping a change to obtain immediate congressional action.

2. *Application of the tax to the marital unit.*

The transfer tax liability will start with the marriage which establishes the "existing marital community." Each spouse will bring into the marriage his or her present gift tax cumulations and exemptions. These will be merged and will create the "point on the cumulative rate schedule" for the marital unit. This point will be at the higher point of the two separate spouses so as to neither encourage nor discourage marriage.[114] The unused gift tax exemptions would be allowed in toto, but only one $60,000 estate tax exemption would be given to the marital unit. Each year the net "gifts" made by the marital unit to someone outside the unit would be taxed.[115] Transfers between husband and wife are within the unit and would not be taxed as transfers, and those transfers from the decedent spouse to the surviving spouse also would not be taxed since the "existing marital community" continues until the death or subsequent remarriage of the surviving spouse. This is not a very radical change, since there is no income tax benefit in transferring between the spouses and the exemption from taxation of that property passing to the surviving spouse is simply an extension of the present 50 per cent deduction. As a result, the social policy of protecting the widow is accomplished without a complicated 50 per cent gift of specially defined "exempt" property. At the death of both spouses the final transfer tax is paid on the total amount of assets remaining to be passed. There are some complex variations that can be worked out by varying the type of interest given, but it is felt the basic plan is clear. Obviously, this system shifts the burden of transfer taxation to the next generation by encouraging tax free transfers to the wife which leaves the bulk of the estate intact to be taxed later at a higher rate on the progressive scale. This policy seems to be in keeping with the present American tax policy favoring protection of the widow, and at the same time, discouraging the accumulation of family fortunes.

The more difficult problems arise in determining how to tax the

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[114] There can be a number of acceptable compromises other than the one suggested such as adding the two together and dividing by two or just taking the sum of the two. The suggested solution seems to provide the greatest "neutrality" of tax operation.

[115] This is another reason for having a lower transfer tax rate, since the progressive rate will rise more steeply than at present where the two spouses each keep a separate cumulative schedule and each gift made is split into two halves. See INT. REV. CODE § 1000 f; U.S. Treas. Reg. 108, §§ 86.6 and 86.7 (1943).

effects of termination of the "existing marital community" by remarriage of a surviving spouse or by legal separation. Looking first at the problem of remarriage, a compromise is necessary. We do not wish to discourage the remarriage of likely widows because they have a high point on the "cumulative rate schedule," yet we do not wish to encourage prospective tax-dodgers marrying elderly individuals with a low tax basis in order to obtain the benefits of a transfer taxation cumulative total. On balancing the interests, it seems that the surviving spouse should take three-fourths of cumulative rate base[116] and any unexhausted exemptions, including the $60,000 death exemption, into a second marriage. This may deter some remarriages but to obtain fairness would require a complicated series of tracing provisions to determine who actually made the previous gifts.[117] This new point would be combined with the new spouse's "point on the cumulative rate schedule" in the same manner as is done in any new marriage, and the new marital unit would be covered by the transfer tax.

Divorce and legal separation must be more rigidly controlled than the above situation, since they can be planned by the parties and since the surviving parties do not desire to maintain any further connection, financial or otherwise, with each other. The date of legal separation is the cut-off point, and at that time the two spouses will become independent individuals subject to the estate and gift tax laws. The estate tax provides no problem since, by hypothesis, both parties are still alive. The gift tax is a problem, as some means must be found to translate the unit transfer tax cumulations into an individual gift tax cumulation without creating a tax benefit which would encourage such a transition via divorce. Again, tracing would be very complex, so some sort of compromise is necessary. The best solution seems to be to require *each* spouse to take three-quarters of the marital unit's "point on the cumulative rate schedule" as his point on the gift tax schedule.[118] To allow each to take one-half of the previous base would encourage divorce, but to require each to assume the full amount of the previous gifts would unfairly burden individuals, legitimately en-

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[116] See note 112, *supra*. This problem is partially alleviated by forcing the spouse to use the higher basis of the two spouses.

[117] There are many other possible compromises on this point such as dividing the "point" in half because of one surviving individual, or forcing the widow to take the whole tax burden. The answer to this problem will lie in the political tenor of the Congress passing the act.

[118] This would discourage divorces—at the same time the treasury revenues will be maintained because two people each with a three-quarters basis should just about match the unit with the progressive tax on the whole amount.

titled to (or forced into) a divorce, who have consented to many gifts to his or her ex-spouse's relatives. Assuming the above solution is accepted, the two ex-spouses would again become subject to individual estate and gift taxation and would remain so until their death or subsequent remarriage. In case of remarriage the ex-spouse would carry into it his or her gift tax liability as in any initial marriage.

C. Definition of a Transfer and Correlation with the Income Tax:

To define when a transfer has taken place is necessary, and the simple solution would be to establish a fixed definition and correlate the other sections of the Code to this definition. This would involve lengthy and radical changes in the whole code, however, which would destroy the whole purpose of this suggested revision. The best solution seems to be to define a transfer as being "any transfer . . . except no transfer shall be considered as having taken place in any case where the income tax incidence produced by the Internal Revenue Code at the time of transfer has not shifted from transferor to transferee." The gift tax serves as a protection for the income and estate taxes. There is no longer any need to protect the estate tax because the transfer tax covers that. The income tax should only be protected in those instances where the grantor is no longer required to pay income tax on the property being transferred. This protection is provided by defining the transfer tax in terms of the income tax; then there is no danger of double taxation as exists at present. This definition would not disturb the existing income tax concepts of transfer, and these judicially worked out concepts will form a basis for determining whether a transfer has been made. This has the disadvantage of tying the transfer tax to a series of complicated and confused income tax principles[119] which need correcting. The job of correcting these, however, will be a long hard-fought process which may take years,[120] and by tying the transfer tax to the income tax the two will be automatically corrected at the same time.

In correlating the transfer tax with the income tax some note must be taken as to the effect of the new system upon INT. REV. CODE § 113(a) (5) basis. This section should be changed so that any change in basis due to death occurs only at the termination of the marital unit

[119] *Cf.* Helvering v. Horst, 311 U.S. 112 (1940); Helvering v. Clifford, 309 U.S. 331 (1940); Industrial Trust Co. v. Commissioner, 165 F. 2d 142 (C.A. 1st 1947).

[120] See DeWind, note 103, *supra*, p. 93, for an indication of what needs to be done, and some proposed solutions.

by the death of both spouses. In other cases the original basis should be maintained.

The change outlined above will not involve as great a change as might be imagined. This can be revealed by a brief examination how the transfer tax would compare with the present gift tax as to the major types of taxable transfers.[121]

1. *Transfer complete for both income and gift taxation.*

The present method of taxing this type of transfers would not be greatly changed since the transfer tax incidence would be the same as the present gift tax incidence. A tax would be paid at the time of transfer on all gifts going outside the marital unit and no further tax would be paid. This type of transfer includes such things as transfers in trust wherein the grantor retains no forbidden controls over the income and complete transfers of income producing property.

2. *Transfers incomplete for both income and gift taxes under the present statute.*

There would be no tax on the original transfer since the grantor is still paying income tax on the property. There would be a tax on any incremental payments going to a party outside the marital unit, and a tax to the grantor when the incidence of income taxation finally shifts to the grantee. An example of this type is a transfer by the grantor to a third party, but with a power to "alter, amend, or revoke" retained by the grantor.[122]

3. *Transfer complete for the income tax but incomplete for the gift tax.*

As to this type of transfer the transfer tax will change the present gift tax incidence and with beneficial results. Under the transfer tax system a tax would be paid at the time of making the transfer on the value of the interest being transferred. This would be the final tax paid by the transferor and the transferee would have all future tax liability as to that property. Examples of this type are transfers in trust to someone "adverse" to the grantor (such as the right to accumulate income for the beneficiary, or a joint power in the grantor with some third party to control the trust),[123] and one of the most confused areas of the tax law wherein the grantor transfers to X for life, remainder

[121] For a more complete discussion, see the Treasury proposal, note 103 *supra*, appendices B & C, pp. 174 and 175; also see DeWind, note 103 *supra*, at p. 93.

[122] INT. REV. CODE §§ 166, 811(d), and 1000.

[123] Estate tax: Helvering v. City Bank Co., 296 U.S. 85 (1935); gift tax: Commissioner v. Prouty, 115 F. 2d 331 (C.A. 1st 1940).

to Y with a remote reversionary interest if all the named remaindermen fail to survive him.[124]

4. *Transfers incomplete for the income tax but complete for the estate and gift taxes.*

In this area the proposed transfer tax can remedy a great evil of the present tax system which often results in an unfair hardship to the taxpayer. Under the present system the grantor can be required to pay gift tax and later estate tax on property which is declared to still be his for income tax purposes. The proposed definition of a transfer would cause the present "gift tax" to be removed and no tax would be collected from a transferor until the incidence of income taxation had shifted from him to his transferee. Since a tax will be imposed some time after the physical transfer has been made the suggested tax revision will need some method of tracing and collecting the tax at the later time. There will be no difficulty if the marital unit remains unbroken since the tax applies to the unit and will be collected when the incidence of income taxation finally shifts due to the death of the transferor or some other stipulated event occurring. If there is a termination of the marital unit the problem is more difficult, but the logical approach would be to declare the transfer tax due at the time of legal separation or divorce. The amount of the tax will be predicated on the value of the property at the time of separation. By imposing such a tax at that time the transfer tax will be correlated with the gift tax basis of the spouse bearing the income tax burden. This may seem to be a new complication, but in reality it exists under the present statute in those cases where the husband and wife agree to make a split gift of community property just before a divorce occurs. There does not seem to be any authority as to whom the tax liability will follow, but the logical answer would be to have the tax liability follow the one who retains the "forbidden" controls, since the income tax liability in these cases is based on "control" and not on "ownership."

This is a difficult area to correlate, because the income tax itself is very confused, but there are established points of tax incidence being shifted which will provide a definite basis for the transfer tax. Some illustrations of this area are: a grantor irrevocably assigns the income of a trust to another for a short period,[125] the grantor transfers to a

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[124] Estate of Spiegel v. Commissioner, 335 U.S. 701 (1949); Robinette v. Helvering, 318 U.S. 701 (1943).

[125] Harrison v. Schaffner, 312 U.S. 579 (1940); Helvering v. Clifford, 309 U.S. 331 (1940).

trust or to an individual with a power in such entity to pay the grantor's obligations or insurance premiums,[126] or the grantor gives to one having no substantial adverse interest with a power in such person to apply the proceeds for the benefits of the grantor's family or capable of giving the grantor a power to alter, amend, or revoke.[127]

5. *Split transfers.*

In the previous discussion it has been assumed that the transfers were composed of one taxable interest. The "split transfers" are those transfers containing one or more taxable interests, each being treated in a different manner. These involve a number of possibilities which can best be shown by a simple illustration. Suppose a grantor, "C," gives property to "X" for life with a remainder to "Y" and "Z." Depending upon the identity of "X," "Y" and "Z" there can be a gift tax on the life estate but not on the remainder, a gift tax on the remainder but not on the life estate, an income tax on the payments *and* a gift tax on the life estate, and several other combinations.[128] This is a difficult area in which to apply the transfer tax, especially when problems of a termination of the marriage are added to the general problem. This area alone is worth a study the size of this one, so I shall simply indicate generally how the tax will work and will leave the details to a later draftsman.

The transfer tax would be imposed on all the non-income producing parts of the transfer at the time of the transfer. The tax on the income producing interest would become due when the income incidence shifted and would be based on the value of the interest at the time of the shift. Where the grantor is still paying an income tax, each *increment* of income would be considered as a gift by him to the recipient and would therefore make him liable for a transfer tax.[129] The writer realizes this rough outline will not answer every detailed question, but these principles will form a guide for the taxing of every possible transfer.

6. *Special provisions.*

There are several areas within the tax law which do not involve

[126] INT. REV. CODE §§ 167 (a), (b), (c); *see* Smith v. Shaughnessy, 318 U.S. 716 (1943).

[127] U.S. Treas. Reg. 111, § 29.22 (a) (21) (D) (1943); estate tax: Commissioner v. Irving Trust Co., 147 F. 2d 946 (C.A. 2d 1945); gift tax: Herzog v. Commissioner, 116 F. 2d 591 (C.A. 2d 1941).

[128] This term is used by DeWind, note 103, *supra*, at p. 101, and it refers to those transfers which are split into two or more taxable interests.

[129] In case of split transfers for which the income tax incidence shifts, the transfer will be treated the same as though the transfer were wholly complete and not "split."

income taxation and they are provided for in special sections under present law. The most obvious of these are settled property (powers of appointment), property unexpectedly returning to the grantor, and insurance. The problems involved in these fields are so intricate that a full discussion is obviously beyond the scope of this paper. Briefly the following is suggested as a general scheme. "Settled property" provisions which have previously enabled a testator to pass property down through several generations of unknown relatives with the payment of a single tax through use of powers of appointment should be limited so that each time property is passed to someone other than his widow, by any means, a tax is paid on that transfer. The writer realizes that a great social debate is taking place on this subject and does not wish to hang the benefits of transfer taxation on this one controversal issue, but would hasten to point out to the advocates of the "settled property system" that this suggested revision can handle "settled property" in conformity with the present law.

Property returning to the marital unit is a problem only when it returns "unexpectedly" as in the case of gift that fails. It is believed the present tests of what constitutes an "effective transfer" would provide a fair solution. If an "effective" transfer has taken place, a tax is due because the basic purpose of making the gift has been accomplished, and since the marital unit can now transfer the property again it should be considered a second gift. Again this problem should be thrashed out by Congress and settled according to the political tenor of the times.

Any transfer tax solution will need a special section devoted to insurance to correspond with the present Internal Revenue Code's insurance provisions. This field is a subject within itself but certain principles to be applied to transfer taxation are clear. Insurance creates an unusual asset which has a partial value during the life of the insured, and a different value when post-death benefits are considered. Also the so-called "ownership" of the policy can depend on a series of factors such as who pays premiums, who can choose the beneficiaries, who can assign the cash values and many others. All of these cannot be discussed, but the following general scheme is recommended. All "incidents" such as payment of premiums, receipt of benefits, and assigning of interests which take place within the marital unit shall be tax free in line with exempting all interspousal transfers. Any transfers of insurance value such as payment of premiums on insurance, rights going outside the marital unit, or transfers of beneficial interest to someone outside the marital unit should be considered as transfers by the marital unit and taxed on the "fair market value" of the right which the marital unit transfers. If it is impossible to tell whether the insurance rights are to go outside of the marital unit, taxation should be postponed until it is possible to determine the answer; then the above principles of taxing all transfers going outside the marital community and exempting those within should apply. Admittedly, this is a great glossing over of a lengthy technical field, but a detailed analysis of this topic will have to wait until another day.

D. Transition from the Present Law to the New Transfer Tax:

For unmarried individuals no special provisions are necessary since the transfer tax will start to apply to them only upon subsequent marriage. Individuals previously married, but single at the date of the act either through divorce or the death of a spouse, would be treated the same as individuals who had never been married. In both cases the regular estate and gift taxes will continue to apply to them until a new marriage is consummated. At the time of such marriage the transfer tax would apply to them in the same manner as to all other married individuals.

Individuals married at the time of passage of the act present more difficult problems of transition since they have already been taxed at varying rates upon their marital gifts. To force them to cumulate all transfers since June 7, 1932[130] would mean they paid a tax at a much higher rate upon their final transfers than an individual not covered by the transfer tax who starts his basis at zero for the estate tax. This discrepancy will always exist, but *these* spouses have not had the *advantages* of the transfer tax exclusions and exemptions, and unless some relief is given they will be paying a greater total tax than any other group.[131] A possible solution is to create all marital units as of January first of the year in which the statute is passed. This retroactive application will prevent any hurried marriages or divorces to obtain or avoid application of the new act; at the same time it will create all marital units as of one date so that prior marital transfers would not cause increased taxation. The marriages already in existence would create their "point on the cumulative rate schedule" as of

[130] The date of enactment of the present gift tax statute.

[131] See Treasury proposal, note 103, *supra,* at pp. 54 to 60 for a more complete discussion of the transitional problems involved.

January 1, 1953 in the same manner as though they were married on that date; thus they will pay the same tax on their total transfers whether or not they have given away the bulk of their estate before enactment.[132] It is true there will be a bunching of tax liability at the termination of the marital unit, but this should not be harmful because the widow has already been protected by a complete exclusion and the children are protected by the $60,000 exemption.

As between married and unmarried individuals there is a discrepancy due to the estate tax again starting at zero, but several factors operate to cancel this advantage. First, the estate tax rates are much higher than those of the transfer tax. Second, there is no complete exemption for one set of donees as exists between husband and wife. Third, the estate tax is predicated on the gross estate while the transfer tax is on the net transfers which means no "tax on a tax" is being paid. Fourth, and final, many inter vivos gifts may be included in the gross estate, thus increasing the size of the estate in spite of the decedent's efforts to give it away. Taken all together it may be cheaper tax-wise for the individual to get married!

E. Summary of the Results Produced by a Transfer Tax on the Marital Unit.

The provisions of the proposed revision are not as simple as might be desired. With the exception of the provisions relating to the inter vivos termination of the marital community the proposed tax is fair, simple, and can be followed without danger of stumbling into technical pitfalls.[133] The chief benefits of such an act will be to provide "tax neutrality" as to the time and manner of transfer,[134] produce tax equality between the community property and common law spouses, encourage protection of the wife before giving to the children, and produce unit estate taxation of what is in fact a social, economic, and historical unit by utilizing a technique similar to that successfully employed by draftsmen of the present income tax. The burden of

[132] This assumes that the transfer and gift tax rates are the same and that 1932 is kept as the first date of accumulation. The only difference in tax will be the savings previously made under the gift tax by making a series of "excluded" $3,000 gifts not allowed via the transfer tax.

[133] The proposed solution avoids the problems of contemplation of death, gift tax credits, the terminable interest rule, the unidentified asset exclusion, computation of 50 per cent of "the adjusted gross estate," and involuntary shifting of the community property laws. This list is not exhaustive but does indicate how simplification is being produced.

[134] Except in so far as protection of the wife is concerned, which is considered an important social benefit.

death taxation will be shifted from the widow to the children, but this does no more than follow the accepted American philosophy of taxing accumulated wealth being passed to the next generation. Inter vivos gifts will be removed from their favored position, but are not deterred since they are taxed in the same fashion as testamentary dispositions. This seems to be a beneficial result, because with this tax neutrality a grantor can decide, without tax pressure, whether he wants to favor the prodigal son during life or bind him to the family until the parents' death. The psychological reasons for making gifts are to a great extent unknown, and it is submitted this is a field wherein the donor should be allowed to decide for himself whether or not he desires to make an inter vivos as opposed to a testamentary gift.

CONCLUSION

This article's purpose is to provide a means of transition from our present out-moded system of death taxation to a new system of integrated transfer taxation. This system can be placed in the present statute without causing any major dislocation of established taxing concepts, and will produce a fairer and simpler tax impact on the marital community. At first blush, this plan may seem to involve radical changes, but an examination of its chief features will reveal that it merely extends existing ideas of family taxation.

It is impossible to construct any practical solution that will cover every possible problem, and this plan does not purport to do so. It is submitted to be however, a sound blueprint for a fair tax system which will improve as judicial decisions and legislative amendments place their imprint upon it. This is not a final solution and the writer hopes it will never be considered as such, for an effective law must be a living statute which changes to meet the changing needs of society. It is desired that this proposal shall become a part of a changing tax statute which will become both simpler and fairer as it is stripped to its basic premises by judicial interpretation.