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Charles L. B. Lowndes

I.

The Impractical Program.

Reforming the federal estate tax appears to be one of those things which everyone talks about, but no one does anything about. Perhaps the reason for the lack of positive results in this area is that the proposals for reforming the tax are conceived upon such a grand scale that they tend to inhibit immediate action. Most of the current plans for reforming the federal estate and gift taxes envisage far-reaching changes which are difficult to sell to Congress in the absence of some social or economic cataclysm which shakes the confidence of the nation in its tax system.

The difficulty in inducing Congress to undertake major revision of the federal estate tax raises the question of whether anything at all should be done about the tax. In addition to the basic objections to the tax, there are a number of inequities and ambiguities which are directly related to particular provisions of the current law and which could be eliminated easily by the addition of a few fairly simple phrases to the statute. It seems only sensible to do what we can to improve the present statute instead of waiting passively for the millennium to bring a new and perfect system of taxing estates.

The espousal of a program of limited reform of the federal estate tax must not, however, be allowed to obscure the need for more radical revision. There is some danger that the alleviation of the more glaring defects in the current law may create a complacency.

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about the estate tax which will sidetrack the drive for more extensive reform. In order to prevent the proposals for major reform from being lost sight of in the presentation of a program for limited revision of the tax, it will be well to summarize these proposals as an introduction to the limited program.

There is rather surprising unanimity about the major defects in the federal estate tax and what should be done about them. Most of the commentators are agreed that the present system of taxing gifts and estates has three serious drawbacks. First of all, separate estate and gift taxes create an unfair discrimination in favor of inter vivos gifts, which are taxed much less severely than testamentary transfers. This is due not only to the rate differential between the two taxes, but to the fact that the gifts which a man makes during his life come off the top bracket of his estate and usually fall into a comparatively low bracket under the gift tax. Moreover, the estate tax is computed upon the basis of the estate which a man leaves at his death (including the amount of the tax itself), rather than the net amount which passes to his beneficiaries, as the gift tax is. The fact that inter vivos gifts and testamentary transfers are taxed under separate taxes also raises an acute problem in connection with gifts in contemplation of death.

Since gifts in contemplation of death are taxed under the estate tax, it becomes necessary to determine when a gift is in contemplation of death. Due to the fact that the test of a transfer in contemplation of death is the subjective state of mind of a subject who has ceased to exist, this is a difficult determination to make.

The second objection which most scholars urge against the federal estate and gift taxes is the lack of correlation between these taxes and the income tax. Ideally, when a man parts with his property so as to incur a gift tax, this should remove the donated property from his taxable estate, and it should also relieve him from any further obligation for the income tax upon the income from the donated property. There is, however, very little consistency between the income, estate and gift taxes. The same transfer may be subject to both the estate and gift taxes, and the fact that property has been given away so as to incur a gift tax...
upon the gift will not necessarily relieve the donor from the income tax upon the income from the donated property.\(^5\)

Finally, there is rather general agreement that a transfer tax should be imposed every time property is transmitted from one generation to another and that the federal estate and gift taxes are defective in that they make it possible to avoid successive taxes by creating successive estates.\(^6\) If, for example, \(A\) leaves his estate to his son \(B\), who in turn leaves the estate to his son, \(C\), the property will be subjected to an estate tax at \(A\)'s death and again at the death of \(B\). If, however, \(A\) leaves his property to \(T\) in trust for \(B\) for life and then to \(C\), the property will escape a tax at \(B\)'s death. Although most commentators seem to feel that there should be a tax when the enjoyment of the property passes from \(B\) to \(C\) in both situations, there is less certainty as to how this should be achieved.

Nearly everyone appears to be persuaded that the revenue from the federal estate and gift taxes can, and should, be increased by tightening up the taxes.\(^7\) Along with this sentiment, however, there appears to be a substantial measure of agreement that the primary purpose of the taxes is to prevent undue concentrations of inherited wealth and the fiscal aspects of the taxes are subordinate to their social objectives.\(^8\)

There does not appear to be any great enthusiasm for a federal inheritance tax instead of a federal estate tax, or for a federal inheritance tax to supplement the estate tax.\(^9\) Most of the commentators seem to feel that the same basic objections of separate taxes upon inter vivos gifts and testamentary transfers, lack of correlation in taxing income, gifts and testamentary transfers, and the avoidance of successive taxes by successive estates, which are by-products of the federal estate tax, would also exist in connection with a federal inheritance tax.\(^10\) None of the really basic objections to the present system of taxing gifts and estates would be overcome either by substituting an inheritance tax for the estate tax, or supplementing the estate tax by an inheritance tax. Some scholars seem to think that since an inheritance tax is based upon the amount which the particular legatee or devisee receives and his relation to the decedent, it is a more equitable tax than an estate tax, and it offers a decedent

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6. See Surrey, supra note 2, at 18-23.
7. Id. at 22; De Wind, supra note 3, at 81.
9. Id. at 165, 166.
10. Ibid.
greater incentive to disperse his estate among a greater number of beneficiaries than an estate tax does. However, most commentators regard an estate tax as easier to administer than an inheritance tax, as productive of more revenue than an inheritance tax, and probably a better antidote against undue concentrations of inherited wealth than an inheritance tax, because it is calculated to absorb a larger portion of such wealth.

The agitation which existed at one time for abandoning the death tax field to the states seems to have abated. Even the states appear cognizant of the stabilizing effect which the federal estate tax, in conjunction with the credit for state taxes, has in chilling bidding among the states for wealthy residents by offering them death tax advantages.

No one seems to be very happy about the marital deductions under the estate and gift taxes in their present form. There is, however, a rather surprising acquiescence in favor of allowing property to be transferred tax-free from one spouse to another. In fact there appears to be some tendency to convert the marital deduction into a complete exclusion of interspousal transfers, upon the theory that property should only be taxed when it is transmitted from one generation to another, or from one family unit to another.

As far as solutions for the major problems presented by the present system of taxing gifts and estates are concerned, most commentators appear to be agreed that the federal estate and gift taxes should be combined into a single integrated tax upon donative transfers. The integrated tax would be a cumulative tax which would follow the general mechanics of the gift tax. The tax would be imposed upon the gifts made during the calendar year and each year the gifts of the current year would be aggregated with the gifts made in previous years to determine the rate of tax upon the current year's gifts. The estate which a man left at his death would be treated as his final gifts and added to the gifts made during his life to determine the rate of tax upon the property transferred at his death.

The advantages claimed for the integrated tax are that first of all it would eliminate the differential which exists at the present

11. Id. at 160, 161.
14. Federal Estate and Gift Taxes: A Proposal for Integration and For Correlation with the Income Tax (1947), prepared jointly by an Advisory Committee to the Treasury Department and by the Office of Tax Legislative Counsel. See Surrey, supra note 2, at 10; De Wind, supra note 3, at 104. See also the articles cited by De Wind supra note 3, at 81, footnote 9, most of which favor integration.
time in favor of inter vivos gifts. It would also solve the problem of gifts in contemplation of death by eliminating the problem. Since a gift would be taxed in the same way, regardless of whether or not it was in contemplation of death, it would no longer be necessary to determine whether a gift was in contemplation of death.

An added advantage of the integrated tax is that it eliminates the lack of correlation between the income, estate and gift taxes. Although both inter vivos gifts and testamentary transfers will be taxed under the same tax, it will still be necessary to determine when the transfer was made in order to determine when the tax is due. In general, the proponents of the integrated tax propose to solve this problem by relating the tax to the income tax. A transfer will become complete and taxable under the integrated tax when the transfer results in shifting liability for the income tax upon the income from the transferred property from the transferor to the transferee. The correlation of the transfer tax with the income tax not only determines when a transfer becomes subject to the transfer tax. It also solves the problem of correlating the income, estate and gift taxes.

Although there appears to be substantial unanimity about the desirability of imposing a transfer tax on property every time the enjoyment of the property descends from one generation to another, there does not seem to be any general agreement as to how this result is to be achieved. Some of the people who feel that such a tax is desirable as a matter of abstract justice, probably incline to the view that it is so difficult to achieve in practise, that they would be willing to sacrifice justice to expediency and forego the tax. Among more ardent advocates of such a tax, perhaps the majority favor some adaptation of the British system of taxing property to the estate of the life tenant at the life tenant's death, as though he were the absolute owner of the property. 15

One of the most interesting substitutes which has been suggested for the present federal system of taxing gifts and estates is the accessions tax. Mr. Rudick proposes that instead of taxing the transferor upon the transfer of property, there should be a tax upon the recipient based upon the receipt of such transfers. 16 The mechanics of the tax would follow those of the gift tax. The tax would be collected annually upon the donative transfers which the taxpayer received during the year, but the rate of tax would be graduated according to the total amount of such acquisitions which the taxpayer received in the current year and previous years. An accessions tax is sort of

15. Surrey, supra note 2, at 20, 27.
a combination of an income tax and an inheritance tax. It resembles a special sort of income tax upon the receipt of gifts and inheritances, where the rate of tax, however, is measured by the total amount of such acquisitions rather than being limited to those received during the taxable year. The tax is similar to an inheritance tax since the rate of tax is determined by the amount of property which the taxpayer receives. However, it differs from an inheritance tax in that the rate of tax is not limited by the amount of property acquired by gift or inheritance from a particular donor or decedent, but is graduated according to the total amount of such acquisitions irrespective of source.

An accessions tax would solve the problems which arise out of separate estate and gift taxes, since testamentary and inter vivos transfers would be taxed in the same way. It would also eliminate any question of whether a gift was in contemplation of death, since there would be no special tax for gifts in contemplation of death. Presumably, the accessions tax could be designed to attach to an acquisition when there was a transfer which relieved the transferor from liability for the income tax upon the income from the transferred property, so that it could be coordinated with the income tax. The accessions tax does not, however, appear to solve the problem of the avoidance of successive taxes by the creation of successive estates, although it may to some extent mitigate it.

The principal drawback of all of the plans for major reform of the federal estate and gift taxes from a practical point of view is that it may be difficult to induce Congress to act upon them within the foreseeable future. In the meantime, there are some glaring defects in the statute as it stands, which can be eliminated without affecting the basic scheme of the tax. Congress probably could be persuaded to remedy these defects in the statute and should be urged to do so.

II.

THE PRACTICAL PROGRAM.

Broadly speaking, the defects in the particular provisions of the federal estate tax (in contrast to the major deficiencies which are inherent in the tax itself) fall into two categories: inequities; and major ambiguities. There are a number of provisions in the federal estate tax which are inequitable because they are discriminatory. They impose different tax burdens upon taxpayers whose substantial situations are identical, because of some technical triviality, which lends
itself to exploitation by the sophisticated taxpayer, or his tax adviser. For example, if \( A \) conveys property to \( T \) in trust for \( C \) and reserves power to revoke the trust with the consent of \( T \), the trust property will be taxed as part of \( A \)'s gross estate under the federal estate tax. But if \( A \) gives \( T \) alone power to revoke the trust, the trust property will not be included in \( A \)'s gross estate, although from a practical point of view there is not the slightest difference between the two dispositions.\(^{17}\)

In addition to the discriminatory features of the federal estate tax, the statute contains some major ambiguities which could, and should, be eliminated by legislation. It is, of course, impossible to draft a statute which will not require some interpretation and is completely free from ambiguities. It would not be feasible to ask Congress to clarify every trivial uncertainty in the phrasing of the estate tax. When, however, major ambiguities in the statute develop and become clearly defined over the course of time, it seems foolish to let them continue to harass government and taxpayer indefinitely, when they could be eliminated easily by legislation. There is the further advantage to clearing up ambiguities in a tax statute by legislation, rather than administrative or judicial construction, that the ambiguity can be resolved on its merits, by considering the wisest solution for the specific problem, rather than by speculating about the obscure syntax of the statute or the mythical intention of the legislature. An example of one of the uncertainties in the statute which is currently creating a good deal of litigation and which could be quickly and wisely disposed of by legislation, is the kind of power which must be given to a surviving spouse to qualify a gift of a life estate and a power of appointment for the marital deduction.\(^{18}\) If the real purpose of requiring the surviving spouse to have a certain kind of power of appointment to qualify the disposition for the marital deduction is to make sure that the property given to her will be exposed to an estate tax at her death, it would seem sensible to deal directly with this problem by amending the statute to provide that a power which is taxable under section 2041 will qualify for the marital deduction under section 2056, instead of trying to define the power of appointment required by the marital deduction by a piecemeal process of judicial definition.

\(^{17}\) Lowndes & Kramer, op. cit. supra note 5, at 179.

\(^{18}\) See Commissioner v. Ellis' Estate, 252 F.2d 109 (3d Cir. 1958); Estate of Pipe v. Commissioner, 241 F.2d 210 (2d Cir. 1957).
A.

The Gross Estate.

Since most of the deficiencies in the particular provisions of the federal estate tax are connected with the gross estate, the most convenient way to approach them will be to take up the specific sections of the statute dealing with the gross estate first. After that we can consider several of the sections dealing with deductions and what may be done to improve them.

(1) Sections 2031 and 2032.

Sections 2031 and 2032 of the 1954 Code provide that property included in the gross estate shall be valued according to its fair market value at the date of the decedent's death or the alternate valuation date, if that date is selected for valuing the estate. Neither section specifies explicitly, however, what property should be included in the gross estate. It is fairly obvious that the property which a man owns at his death will be included in his gross estate. There is considerable confusion, however, as to what property should be included in the gross estate where the decedent transferred property by a taxable transfer during his life and the transferee converted the property into other property before the transferor's death. Suppose, for example, that A transferred Blackacre to B in contemplation of death, but before A’s death, B exchanged Blackacre for Whiteacre. Should the fair market value of Blackacre or Whiteacre be included in A's gross estate? It is clear, of course, that the property which is included will be valued according to its fair market value at the date of the transferor's death, or the alternate valuation date, and not according to its fair market value when the inter vivos transfer was made. It is not clear, however, whether the original property which was transferred, or the product of the original property in the transferee's hands at the decedent's death, should be included in the gross estate.19

The proper way to solve this problem would be to amend the statute to provide explicitly that when property is transferred by a taxable inter vivos transfer, the property which must be included in the transferor's estate is the original property, if that is still in the transferee's hands at the time of the transferor's death, or any product of the original property in the transferee's hands at the transferor's death, if the transferee has sold or exchanged the original property.

19. LOWNDES & KRAMER, op. cit. supra note 5, at 473.
It seems to be settled that where a decedent transfers property in trust during his life, the property which is included in his gross estate is the property in the trust at the time of the decedent's death. It is difficult to see any reason for discriminating against the outright transferee by applying a different rule to outright transfers.

It is arguable, of course, that a transfer in contemplation of death should be treated as though the transfer had never taken place, and if the decedent had not made the transfer, he would still have owned the original property transferred in contemplation of death at his death, and this property, therefore, should be included in his gross estate. The argument would seem equally applicable, however, to a transfer in trust. Moreover, there is no particular reason to assume that if the decedent had not transferred the property in contemplation of death, he would not have exchanged it for other property before his death. It seems obviously inequitable to tax property to a decedent estate where neither the decedent nor his transferee owns the property at the decedent's death. For example, suppose that in the case where A gave Blackacre to B in contemplation of death, B exchanged Blackacre for Whiteacre when both Blackacre and Whiteacre had fair market values of $10,000. Later oil is discovered on Blackacre and at the time of A's death it is worth $1,000,000. It seems manifestly unjust to tax A's estate upon the million dollars represented by Blackacre, when actually by any sensible definition of the estate it only includes Whiteacre.

If the product of property transferred by a taxable inter vivos transfer is included in the transferor's gross estate, it will be necessary to identify the product or to trace the original property into the product. However, if the original property, instead of the product, is included in the transferor's gross estate, it will be necessary to trace the original property. It is not difficult to imagine a situation where the original property has been sold or exchanged and it will be more difficult to trace the original property than it will be to trace the product of the original property in the transferee's hands. It is possible, of course, that where the original property is sold or exchanged it may prove impossible to trace the proceeds of the sale or exchange. Instead of trying to provide for this situation explicitly by some statutory provision providing that the tax shall be based upon the amount received on the sale or exchange, it would probably be better simply to lay down the general principle in the statute that the product of the original property, rather than the original prop-

20. Id. at 472.
erty itself, is to be included in the transferor's gross estate, and let
the courts apply this principle to the unusual situation. 21

(2) Section 2033.

The remaining sections under the gross estate deal with the
transfers which are taxable under the statute. Section 2033 of the
1954 Code taxes property which a decedent transfers at his death in
the following terms:

The value of the gross estate shall include the value of all
property (except real property situated outside of the United
States) to the extent of the interest therein of the decedent at
the time of his death.

The courts have construed this section as limited to transfers
by will and intestacy of property interests which the decedent owned
at his death. Although this is probably a fair interpretation of the
intention of Congress, it fails to reach a number of situations where
a tax should be imposed, but which escape the tax under the narrow
language of section 2033.

For example, the Service has ruled that social security benefits
paid upon the death of a deceased employee are not taxable under
the federal estate tax because "... the decedent has no control over
the designation of the beneficiaries or the amounts payable to them.
The beneficiaries and the amounts payable to them are fixed by the
provisions of the Social Security Act, as amended, and the payments
are made directly to the beneficiaries." 22 In the same way, a right
of action for wrongful death has been excluded from the decedent's
gross estate, 23 and this exclusion has been extended to payments for
death due to an occupational disease under a workmen's compensation
act. 24 There has been great confusion and uncertainty as to whether
payments to an employee's beneficiaries under a pension plan, 25 or

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21. When income is accumulated in connection with property transferred inter
vivos, or the transferee makes improvements to the transferred property, the question
arises as to whether the income, or the value of the improvements, should be included
in the transferor's gross estate. This is somewhat similar to the question of whether
the property originally transferred, or its product in the hands of the transferee at
the date of the transferor's death, should be included in the gross estate of the
transferor. See LOWNDES & KRAMER, op. cit. supra note 5, at 469. The Regulations
under the 1954 Code provide that the value of any improvements or additions made
by the transferee to property transferred in contemplation of death shall not be in-
Regulations under the 1939 Code applied the same rule to all inter vivos transfers.
Treas. Reg. 105, § 81.15(c) (1953).

27242, 1952-1 CUM. BULL. 160.
under a deferred compensation agreement are taxable as part of an employee's gross estate under section 2033, when the employee's rights to payment were "forfeitable" during his life.

It is difficult to see any reason why a benefit which arises because of the death of a decedent should not be included in his gross estate. Why, for example, should we tax the earnings which a man accumulates during his life and passes on to his dependents and exempt the damages which are given to his dependents for his wrongful death in lieu of such earnings? Any hardship which might be caused by taxing things like social security benefits, damages for wrongful death, or payments to the beneficiaries of a deceased corporate executive are amply guarded against by the $60,000 exemption under the estate tax. If the language of the statute is not broad enough to tax interests created by a decedent's death, then it should be amended to explicitly tax any interests acquired because of the death of the decedent. At one time the antecedent of section 2033 limited the tax imposed by that section to interests which the decedent owned at the time of his death which after his death were "subject to the payment of the charges against his estate and the expenses of its administration and . . . to distribution as part of his estate." The provision limiting the tax to property which was subject to administration and distribution as part of the estate proved too restrictive and had to be deleted. In much the same way it would appear now that the limitation of the tax to interests which the decedent owned at his death is too restrictive, and the statute should be amended to include not only such interests, but any interests created by the decedent's death as well.

If section 2033 is amended to include in a decedent's gross estate any interest which is acquired because of the death of the decedent, someone is fairly sure to challenge the constitutionality of the amendment. The two arguments which appear most likely to be urged against the constitutionality of the new tax would be that it is a direct tax, which is unconstitutional because it is not apportioned, and that it violates due process. Neither argument should bother a court which is not pre-determined to strike down the tax. The proponents of direct tax thesis would argue that since there was no transfer from the decedent, the tax is a direct tax upon the property acquired after the decedent's death, and is unconstitutional, because it is not apportioned. The obvious answer to this argument is that the tax is not

upon the property acquired by virtue of the decedent's death, but upon the privilege of acquiring the property. There is no doubt but that there is a transfer here, which is the subject of the tax, although it may be less obvious that the transfer proceeds from the decedent. Actually, however, the transfer originates with the decedent, since it is his efforts, or in the case of an action for wrongful death, his life, which is the generating source of the transfer, even though he may lack technical legal title to the transferred property.

As far as due process is concerned, there certainly would not be anything unreasonable or arbitrary in including the benefits which are acquired because of the death of a decedent in the decedent's gross estate. In fact it is much more discriminatory as far as other taxpayers are concerned to exclude things which are really part of the wealth a man leaves at his death, like social security benefits and payments under pension plans, from his gross estate, than it is to include them. Moreover, unless such benefits are taxed, enterprising taxpayers will constantly devise new methods to avoid the estate tax and there will be a progressive erosion of the estate tax base. Obviously, taxing benefits acquired because of the death of a decedent as part of the decedent's gross estate, is a reasonable method of preventing avoidance of the estate tax and does not, therefore, violate due process.28

(3) Section 2034.

Section 2034 of the 1954 code deals with the taxation of dower and curtesy and their statutory equivalents. Although section 2034 is worded affirmatively to provide that marital interests of a surviving spouse shall be included in the gross estate of a deceased spouse, practically it operates in a negative fashion to prevent the subtraction of dower and curtesy and their statutory substitutes from the taxable estate of the decedent. Apparently section 2034 achieves the results it is intended to achieve and it is not in need of amendment.

(4) Section 2035.

Section 2035 of the 1954 code provides that transfers in contemplation of death shall be included in the gross estate of the transferor. Section 2035 does not define gifts in contemplation of death, nor does it furnish any assistance in solving the perplexing problem of how to determine whether a specific transfer is in contemplation

of death, apart from several statutory presumptions. Section 2035(b) contains a conclusive presumption that a transfer more than three years before the transferor's death is not in contemplation of death, along with a rebuttable presumption that transfers within three years of the transferor's death are in contemplation of death. Since the latter presumption is rebuttable, however, it still leaves the difficult question of whether a particular transfer within three years of the transferor's death is in contemplation of death. Apart from integration of the estate and gift taxes, the only solution for the problem of taxing transfers in contemplation of death appears to be to amend the statute to convert the rebuttable presumption that a transfer within three years of the transferor's death is in contemplation of death into a conclusive presumption. It is true that the Supreme Court held that a similar presumption was unconstitutional in *Heiner v. Donnan*, but it is unlikely that the Court would follow *Heiner v. Donnan* today. It is difficult to see any great hardship in taxing a gift shortly before the donor's death under the estate tax, even if the gift was not motivated by the thought of death, since the donor had the enjoyment of the donated property during most of his life, and it would have been taxed to his estate if he had not made the gift. If, moreover, it is fair to protect taxpayers from the threat of having a transfer made more than three years before a decedent's death taxed as a transfer in contemplation of death, it is difficult to see why it would not be equally fair to relieve the government from the burden of litigating whether a transfer within three years of the transferor's death was in contemplation of death. *Heiner v. Donnan* held that a conclusive presumption that a transfer within a prescribed period of the transferor's death was in contemplation of death was unconstitutional, because it taxed some inter vivos transfers under the estate tax, while other transfers, precisely similar except for their proximity to the decedent's death, escaped the tax, and this created an unreasonable classification which violated due process. Since *Heiner v. Donnan* was decided, however, the Supreme Court has held upon several occasions that it was constitutional to tax purely inter vivos transfers under the estate tax, where this was a reasonable means of preventing avoidance of the tax. This is, of course, precisely the reasoning which the dissenters relied upon to sustain the constitutionality of the conclusive presumption in *Heiner v. Donnan*. It seems highly unlikely that after repudiating the reasoning in *Heiner v. Donnan*,

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29. 285 U.S. 312 (1932).
the Supreme Court would again condemn a conclusive presumption that a transfer within a reasonable time of the transferor's death was in contemplation of death in view of the continually mounting evidence of the government's inability to enforce the tax upon transfers in contemplation of death without the aid of such a presumption.

Section 2035 provides that the "value of the gross estate shall include the value of all property . . . to the extent of any interest therein of which the decedent has at any time made a transfer . . . in contemplation of death." An interesting question arises under this language as to what should be included in a man's estate, where during his life he made an inter vivos transfer which is taxable under the estate tax, and then in contemplation of death he releases the power or interest which made the transfer taxable. It is arguable that in this case only the value of the interest released in contemplation of death should be included in the decedent's gross estate under section 2035. For example, suppose that $A$ transferred Blackacre to $B$, retaining a life estate, and that later he released this life estate in contemplation of death, within three years of his death. Should Blackacre be included in $A$'s estate, or only the value of the life estate (worthless at $A$'s death) which he released in contemplation of death? Although it seems plain on principle that a man should not be able to avoid a death tax by a transfer in contemplation of death, this is not so clear under the wording of the statute. It has been held in connection with the transfer of the interest of a joint owner in jointly held property in contemplation of death that only the interest which was transferred in contemplation of death is includible in the transferor's gross estate, and not the value of the entire joint property, which would have been included if the transfer in contemplation of death had not occurred. Moreover, section 2038, which taxes revocable transfers, provides explicitly that if a power, which is taxable under section 2038, is released in contemplation of death, the property to which the power attached, and which would have been included

included in the decedent's gross estate if the transfer in contemplation of death had not occurred, shall be included in his gross estate, rather than merely the value of the power which was released in contemplation of death. The presence of such language in section 2038, together with the absence of similar language in the other sections of the statute taxing inter vivos transfers, and the ambiguous wording of section 2035, afford some basis for the argument that where the interest or power which makes an inter vivos transfer taxable is released in contemplation of death, only the value of the interest transferred in contemplation of death should be included in the decedent's gross estate. To settle this question definitely, and also to reverse the cases which have held that where a joint owner transfers his interest in contemplation of death only his interest in the joint property is taxable as part of his gross estate, section 2035 should be amended to provide explicitly that the release of any power or interest which makes an inter vivos transfer taxable shall not affect the taxability of the transfer, which shall still be taxed to the same extent that it would have been taxed if the transfer in contemplation of death had not taken place.

(5) Section 2036.

Section 2036 of the 1954 code is designed to tax a transfer where the transferor retains a life estate, or its equivalent, in the transferred property. There are several ambiguities in section 2036, which should be cleared up. It would also appear that section 2036 does not reach all of the transfers which it should reach.

The literal wording of section 2036 would impose a tax where a man during his life transferred property and retained a life estate, even though he released the life estate before his death and the release was not in contemplation of death. If, for example, A transferred Blackacre to B and his heirs, retaining a life estate, which A released more than three years before his death, the transfer would be taxable under the literal wording of section 2036, since section 2036 imposes a tax where the transferor transferred property and retained a life estate, without expressly providing that the life estate must be outstanding at the time of the transferor's death. In this connection,
it is interesting to contrast the phrasing of section 2036 with that of 2038. Section 2038 provides for a tax where at the date of his death the decedent had power to alter or revoke the transfer. Section 2036 taxes a transfer under which the transferor retained a life estate. There is no requirement that this life estate should persist until the transferor’s death. It seems reasonably clear that a tax should not be imposed upon the basis of a transfer with a reservation of a life estate if the transferor divests himself of the life estate before his death, and this is not done in contemplation of death. In order to clarify any ambiguity in the present statute upon this point, however, it might be well to amend section 2036 to provide explicitly that a tax should not be imposed upon a transfer where the transferor retained a life estate, unless the life estate were outstanding at the transferor’s death, or had been released by the decedent in contemplation of death.

Section 2036 provides for a tax where the decedent transferred property during his life and retained the possession or enjoyment of the property “for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.” For many years the Regulations construed any period “which does not in fact end before his death” to require a reservation of an interest in the transferred property “for such a period as to evidence his intention that it should extend at least for the duration of his life.” The present Regulations omit this interpretation, which had some basis in the Committee Reports accompanying the 1932 Act. Presumably this omission indicates an intention to apply section 2036 to any transfer where the transferor failed to divest himself of possession of the transferred property before his death. Although this interpretation of the statute finds possible support in Ambrose Fry, it is not clear that it reaches a just result or that it is a sound construction of the statute in view of the settled administrative construction to the contrary for so many years. It might be desirable to amend the statute to provide explicitly that a decedent will only be regarded as having retained possession or enjoyment of property for any period which does not in fact end before his death where he reserved the possession or enjoyment of the property for a period which evidenced an intention to retain such possession or enjoyment for the duration of his life.

37. See Lowndes & Kramer, op. cit supra note 5 at 140.
38. 9 T.C. 503 (1947).
Perhaps the most serious objection to section 2036 is that it does not reach certain transfers which are in substance, though perhaps not in form, transfers with a reservation of a life interest. If, for example, a father has $100,000 worth of bonds, which pay 5 per cent interest, and he transfers these bonds to a trustee to pay him the income from the bonds during his life, and after his death to distribute the bonds to his son, the transfer in trust will be taxed to the father’s estate as a transfer with a reservation of a life interest. If, however, the father transferred the bonds to his son in return for the son’s promise to pay him an annuity of $5,000 a year, this would be treated as a purchase of an annuity by the father and the bonds would not be included in his gross estate. 39 It is clear that if a man buys an annuity from a commercial annuity company, he is really exchanging his money or property for the annuity. There is no reason to tax the annuity to his estate if it is a straight life annuity which ceases at his death, because he does not transmit anything at his death. Where, however, a man transfers property to a natural object of bounty in return for an annuity approximating the income from the transferred property, it seems clear that in substance the transaction is closer to a transfer with a retention of a life estate than the purchase of an annuity. So far the cases have held that if the transferor retained no interest in the transferred property the family annuity represents a non-taxable purchase of an annuity, rather than a taxable transfer with a reservation of a life estate. 40 Instead of judging the character of the transaction by technical concepts of the law of property, it would seem more satisfactory to tax it according to its substantial effect. Section 2036 should be amended to provide that in the case of any transfer of property to anyone, except a person in the business of selling annuities, in return for an annuity, the transaction should be taxed as a transfer with a reservation of a life estate. If the annuity equals or exceeds the income from the transferred property (or a fixed rate of return, such as four or five per cent, in the case of a transfer of money), then the entire amount transferred should be taxable to the transferor’s estate. If, on the other hand, the annuity amounts to less than the income yielded by the transferred property, then part of the property necessary to produce the amount of the annuity should be taxed as a transfer with a reservation of a life estate, and the excess over this amount should be treated as an absolute gift. For example, suppose that A transfers

40. Ibid.
$100,000 worth of 5 per cent bonds to his son B in return for B's promise to pay A an annuity of $3,000 a year. Since $60,000 (or 30%) of the transferred property would yield $3,000 a year, only this amount should be taxed to A's estate as a transfer with a reservation of a life interest.

A person who is too old to be insurable can purchase a single premium policy of life insurance, if he purchases an annuity from the insurer at the same time. The premiums paid for the insurance policy and the annuity policy will cover the death benefit under the insurance policy, while the annuity can be paid from the interest which the insurer can earn on these premiums. Consequently, the insurance company is willing to sell the insurance because there is no insurance risk. If the purchaser lives the annuity can be paid out of the interest on the premiums for the two policies. If he dies, the death benefit is covered by the premiums paid for the policies. In Helvering v. LeGierse41 the Supreme Court recognized that the insurance policy in this situation did not really represent insurance, because there was no insurance risk. The court treated the transaction as what it really was, a deposit with the insurance company under which the company undertook to pay interest on the deposit to the insured during his life, and at his death to pay over the deposit to his designated beneficiary. In Fidelity-Philadelphia Trust Co. v. Smith,42 however, the Supreme Court held that where a decedent had purchased an annuity and a single premium insurance policy under this arrangement and had made an irrevocable assignment of the insurance before his death, the insurance was not taxable as part of his gross estate. The Court held that the annuity and the insurance were distinct contracts, because the company would have sold the annuity without the insurance (although it would not have sold the insurance without the annuity), and that when the decedent irrevocably assigned the insurance this removed it from his gross estate. It seems clear that the statute should be amended to recognize the annuity-insurance combination, such as that in the Fidelity-Philadelphia Trust Company case, for what it really is, a transfer with a reservation of a life interest, and to tax it as such explicitly.

One of the interesting problems which arises in connection with section 2036(a)(2) is whether the retention of a contingent power will incur a tax under that section. Section 2036(a)(2) provides for a tax upon transfers where the transferor retained for his life,

41. 312 U.S. 531 (1941).
42. 356 U.S. 274 (1958). Earlier, the Seventh Circuit reached the same conclusion in Bohnen v. Harrison, 199 F.2d 492 (1952), which was affirmed without opinion by an evenly divided Supreme Court, 345 U.S. 946 (1953).
or the equivalent statutory period, "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." If A during his life transfers property to T in trust to pay the income from the property to B, or to whomsoever A shall designate, during A's life, and at A's death to pay over the trust property to C and his heirs, it is clear that the trust property will be taxable to A's estate under section 2036(a)(2). But suppose that A provides that T shall pay over the income from the property to B unless B predeceases A, and that if B does predecease A, then T shall pay over the income from the property to whomsoever A designates during his life, and at A's death shall distribute the property to C and his heirs. If A predeceases B, will the trust property be taxable to A's estate? The Regulations indicate that it will. This is a problem which also arises under section 2038, and it may be considered more conveniently under that section, when section 2038 can be compared with section 2036.

(6) Section 2037.

Section 2037 of the 1954 Code represents the current solution for the tax upon transfers intended to take effect in possession or enjoyment at or after the death of the transferor. Under section 2037 a transfer will not be taxed, unless the possession or enjoyment of the transferee was dependent upon surviving the transferor and the decedent retained a reversionary interest in the transferred property, whose value at the time of his death exceeded 5 per cent of the value of the transferred property. Section 2037 also contains an escape clause to the effect that a transfer otherwise taxable under section 2037 will not be taxable, if possession or enjoyment of the transferred property could have been obtained by any beneficiary during the decedent's life through the exercise of a general power of appointment (as defined in section 2041), which was exercisable immediately before the decedent's death.

Section 2037 raises an interesting question as to the real basis for taxing transfers taking effect at death and the wording of the exception to the tax.

Under the 1939 Code, as amended by the Technical Changes Act of 1949, a transfer under which the possession or enjoyment of the transferee was dependent upon surviving the transferor, was taxable, even though the transferor retained no interest in the transferred property.

property. It is arguable that the real basis for a tax under section 2037 is the fact that possession or enjoyment of the transferred property is suspended during the transferor's life and that a tax should be imposed in such a situation without the additional requirement of a minute (5 per cent) reversionary interest.

Apart from the wisdom of requiring a reversionary interest as a necessary condition for the tax under section 2037, the exception to the tax is obscurely worded and of dubious merit. Contrary to the literal language of the statute, it seems clear that any general power by which possession or enjoyment of the transferred property may be vested in a beneficiary during the transferor's life will not preclude a tax under section 2037. Obviously, the retention of such a power by the decedent will not have this effect. If, for example, A transferred property to T in trust to accumulate the income from the trust property during A's life and at his death to pay over the property to A's then living children and in default of such children to distribute the property to A's estate, A could not avoid having the property taxed to his estate by retaining power to alter or amend the trust in any way in which he saw fit. Moreover, the express provision for avoiding the tax by a general power creates a grave doubt as to whether or not a special power which prevents a reversionary interest retained by the decedent from being worth more than 5 per cent of the transferred property will avoid the tax, although it seems obvious that it should do so. Suppose, for example, that H conveyed property to T in trust to accumulate the income from the trust property during H's life and at H's death to distribute the property, along with the accumulated income to H's then living children, and in default of such children to pay over the property to H's estate. If H also provided that his wife, W, might terminate the trust at any time and vest the trust property in H's then living children, would this prevent a tax under section 2037 because it would make H's reversionary interest worthless? Apart from the question of whether a special power

45. Section 2040 taxes life insurance payable to beneficiaries other than the executor of the insured to the estate of the insured, if the insured possessed a reversionary interest in the insurance worth more than 5 per cent of the value of the policy immediately before his death. Despite the fact that section 2040 does not expressly provide that the insurance will not be taxed to the insured's estate where there is a power to vest possession of the insurance in a beneficiary during the insured's life, the regulations provide that "the decedent would not be considered to have a reversionary interest in the policy of a value in excess of 5 per cent if the power to obtain the cash surrender value existed in some other person immediately before the decedent's death and was exercisable by such other person alone and in all events." Treas. Reg. § 20.2042-1(c)(3) (1958). If the existence of a power to obtain possession of insurance during the insured's life prevents taxing the insurance to the insured's estate, because it prevents his reversionary interest
may avoid a tax under section 2037, it is difficult to see why the statute requires that the general power, which will preclude a tax, must be in existence at the time of the transferor's death, unless Congress wanted to create a tax trap for unwary taxpayers. Suppose, for example, that in the hypothetical case where \( H \) created the trust to accumulate the income from the trust property during his life for his surviving children, he gave his wife, \( W \), power to alter or amend the trust in any way in which she saw fit, in order to prevent a tax under section 2037. If \( W \) outlives \( H \), the power will be in existence at \( H \)'s death, and the trust property will not, therefore, be taxable to his estate under section 2037. If, however, \( W \) predeceases \( H \), then the trust property will not only be taxable to her estate, since she had a general power of appointment over the property, it will once again become taxable to \( H \)'s estate under section 2037, since the power which might have prevented a tax was not in existence at \( H \)'s death. If the reason why the power prevents a tax under section 2037 is because the decedent has surrendered control over the property, it is difficult to see what difference it should make whether this power continues until his death, since he has given up control of the property during his life. It is true that the reversionary interest which \( H \) retained in the property may be worth more if \( W \) predeceases \( H \) and can no longer destroy the reversionary interest. The destruction of \( W \)'s power to defeat \( H \)'s reversionary interest might increase the amount which should be taxed to \( H \)'s estate because of his ownership of the reversionary interest under section 2033, but it is difficult to see why it should make the property taxable to his estate under section 2037.

(7) Section 2038.

One of the most glaring inequities under the federal estate tax, as it is presently phrased, is the rule that a transfer which can be altered or revoked by one other than the transferor is not taxable under the estate tax. Section 2038 of the 1954 Code provides that a transfer which a decedent made during his life shall be taxable to his estate where the enjoyment of the transferred property "was subject at the date of his death to any change through the exercise of a power . . . by the decedent alone or by the decedent in conjunc-

from having any value, it would seem that a similar power should have the same effect under section 2037, irrespective of whether or not it was a general power.

The existence of the special power to terminate the trust in the hypothetical case in the text should also preclude a tax under section 2037, since this would not be a case where possession or enjoyment of the transferred property could be obtained "only by surviving the decedent." The children of \( H \) could possess or enjoy the property during the decedent's life if the power was exercised in their favor.
tion with any other person . . . , to alter, amend, revoke or terminate.” The courts have construed this provision literally to exclude a transfer which can be altered by one other than the transferor, without his concurrence. Although it seems arguable that even under this narrow construction it would be possible to tax a transfer which could be altered or revoked by one lacking any substantial adverse interest in the transferred property, upon the theory that the transfer was in substance revocable by the transferor who created the power, the Regulations do not distinguish between powers held by adverse and non-adverse persons, but state flatly that “section 2038 does not apply . . . to a power held by a person other than the decedent.”

The only difference between a trust which can be altered or revoked by the grantor in conjunction with the trustee of the trust and a trust which can be revoked by the trustee alone, is that the grantor in the case of a joint power has a veto over the revocation or alteration of the trust. Where the power is a power to revoke the trust, this seems immaterial, since even if the trust is revoked without the grantor’s consent, he can immediately recreate the trust. Theoretically, there may be a difference between a power to alter the trust which can only be exercised by the grantor in conjunction with the trustee and such a power in the trustee alone, since where the grantor must participate in the exercise of the power, he has a veto against the trustee diverting the trust property from the uses for which it was originally granted. Since, however, the trustee was selected by the grantor and is presumably subservient to his wishes, there is little practical difference between a power to alter a trust which must be exercised by the grantor and the trustee and such a power in the trustee alone. Moreover, it seems absurd to impose a tax, as section 2038 does, upon a transfer which the transferor can only revoke in conjunction with a person possessing a substantial adverse interest in the transferred property, and to refuse to tax a transfer which can be revoked by a non-adverse person alone, since the transferor obviously has a greater measure of control over the transferred property in the latter than in the former situation. The only practical effect of limiting the tax under section 2038 to a situation where the grantor must participate in the exercise of a power to alter or revoke a transfer is to make it possible to avoid a tax upon a revocable transfer by vesting the power to alter or revoke the transfer in one other than the grantor.

46. LOWNDES & KRAMER, op. cit. supra note 5, at 179.
It seems clear that section 2038 should be amended to provide for a tax upon a transfer which can be revoked by a person lacking a substantial adverse interest in the transferred property, even though the transferor is not required to concur in the exercise of the power. This would to a certain extent reconcile the income tax and the estate tax since the income from a trust which can be revoked by a non-adverse person is taxable to the grantor of the trust. Since the estate tax provides for a tax in the case of a transfer which can be revoked by the grantor and any other person, including a person possessing a substantial adverse interest in the transferred property, it would seem that if the statute is to be extended to powers which can be exercised without the participation of the decedent, it should be extended to a power exercisable by any person, including even a person having a substantial adverse interest in the transferred property. This would also continue to avoid the problem of what amounts to a substantial adverse interest under the estate tax.

Section 2036 also provides for a tax where power to designate the income from or enjoyment of transferred property was retained by the decedent alone or the decedent in conjunction with any other person. Presumably any other person in this context includes a person possessing a substantial adverse interest in the transferred property, but it would not include a situation where power to designate income or possession was vested in one other than the decedent. If section 2038 is to be amended to extend the tax under that section to a power exercisable by one other than the decedent, it would seem that a similar amendment should be made to section 2036.

Section 2042(2), which taxes insurance to the estate of the insured, provides that insurance even though payable to beneficiaries other than the insured's executor shall be taxed to his estate if the insured "possessed at the date of his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person." It might be wise to extend the tax to insurance where incidents of ownership are vested at the death of the insured in one who possesses no adverse interest in the insurance. To extend it, however, to a situation where anyone possessed incidents of ownership at the decedent's death would make insurance taxable to the estate of the insured regardless of how completely he divested himself of the insurance during his life, and goes too far.

For many years there has been considerable confusion as to whether or not a contingent power to alter or revoke a transfer will attract a tax under section 2038. For example, suppose that $A$ transferred property to $T$ in trust to pay the income from the property
to B for life, remainder to C and provided that he should have power to revoke the trust if he outlived B. According to the cases, but not the Regulations, under the 1939 code, if A predeceased B, the trust property would not be taxable to his estate, because the contingency upon which the power could be exercised had not occurred at A's death, and the power was not, therefore, in existence at his death.49 The Regulations under the 1954 Code finally concede that "section 2038 is not applicable to a power the exercise of which was subject to a contingency beyond the decedent's control which did not occur before his death (e.g., the death of another person during the decedent's life)."50 The Regulations take the same position with regard to a power of appointment under section 2041, which is not treated as in existence at the donee's death, and taxable under section 2041, if it is subject to a contingency beyond the control of the donee which did not occur before the donee's death.51 On the other hand, they indicate that the fact that the power to designate the income from or the possession or enjoyment of property is contingent will not prevent a tax under section 2036.52 A possible basis for this distinction, although it seems very tenuous, might be that sections 2038 and 2041 provide expressly that the powers taxed under those sections shall be deemed to be in existence at the decedent's death, even though the exercise of the power was subject to a precedent giving of notice or the power could only take effect a specified period after the exercise of the power, and the notice was not given or the power was not exercised before the decedent's death, while section 2036 contains no such language. Since sections 2038 and 2041 expressly provide that certain contingencies shall not prevent a power from being taxable under those sections, it might be argued that there is an implication that any contingencies not mentioned by those sections will prevent a tax. On the other hand, since there is no such language in section 2036, there is nothing in section 2036 which precludes taxing a contingent power. Perhaps a sounder ground for distinguishing section 2036 from sections 2038 and 2041 is that since the retention of a life estate, which is dependent upon the decedent surviving someone else, results in a tax under section 2036,53 it is difficult to see why the retention of a power to designate the income

from or the possession of transferred property, which is dependent upon the transferor surviving some other person, should not make the transfer taxable to the transferor's estate. Although this would afford a basis for distinguishing contingent powers dependent upon the decedent's survival under section 2036 from contingent powers dependent upon survivorship under sections 2038 and 2041, it would not necessarily afford a basis for a different tax treatment of powers subject to other contingencies. The taxation of contingent powers under the statute seems badly confused and in need of legislative clarification. There is some danger that the present position of the Regulations to the effect that a contingent power is not taxable under section 2038 may be a tax trap. A man might create a trust under which he retained a power to revoke the trust if he survived one of the beneficiaries of the trust under the belief that the trust would not be taxed to his estate if he predeceased the beneficiary, because the Regulations say that no tax will be imposed under section 2038. It is true that the Regulations warn of a possible tax under section 2036. They do not, however, indicate the possibility of a tax under section 2037, which would almost always seem to be present where there was a power to revoke a transfer and the contingency to which the power was subject was the decedent's survival of a transferee.

(8) Section 2039.

Section 2039, which taxes joint and survivor annuities, was added to the 1954 Code in an effort to reach certain employee benefit plans which had eluded the other sections of the statute. Instead of preventing avoidance of the estate tax it affords a blueprint for setting up a death benefit plan for employees which will not be subject to the tax.54

Without entering upon a protracted discussion of the demerits of section 2039, there are two principal reasons why it is completely ineffective. First of all, section 2039 explicitly exempts benefits paid to the beneficiaries of a deceased employee under a qualified pension, stock bonus, or profit sharing plan (including annuities purchased for employees of certain charitable organizations), to the extent that these benefits are purchased by the employer's contributions. The statute not only exempts these payments from the tax imposed by section 2039 but under "any provision of law," so that the exemp-

tion provided by section 2039 is a complete immunity from the estate tax.

Due to the peculiar wording of section 2039, moreover, death benefits paid to the beneficiary of a deceased employee are not taxed, even where they are not paid pursuant to a qualified pension or profit sharing plan, unless the deceased employee had a right to payments during his life. This seems strange since it would appear that a death tax should be imposed on what a man left at his death, rather than conditioned by what he was entitled to receive during his life. The reason for the curious wording of section 2039 is that it is phrased in terms of a tax upon joint and survivor annuities, and unless, therefore, the benefits paid in connection with the death of a deceased employee fit into this pattern they are not taxed.

The solution for the problems raised by section 2039 would be perfectly obvious to anyone except a lawyer. If the purpose of section 2039 is to tax death benefits paid by an employer to the beneficiaries of a deceased employee, the tax should be worded as a tax on such benefits. Section 2039 should be amended to provide simply that any payments made by an employer to the beneficiaries of a deceased employee in connection with the death of the employee are taxable as part of the decedent’s estate. There is no reason at all for exempting payments under qualified pension and profit sharing plans. The impecunious employee is protected by the $60,000 exemption under the federal estate tax. The exemption of payments under qualified plans simply serves to provide the wealthy corporate executive with a convenient means for avoiding the estate tax.

There does not appear to be the slightest sense in making the tax under section 2039 turn upon the deceased employee’s right to receive payments during his life. If the estate tax is imposed upon the estate which a decedent leaves, the tax should be measured by the benefits which his dependents receive at his death, rather than conditioned by what the decedent was entitled to receive during his life.

(9) Section 2040.

Section 2040 taxes jointly held property to the estate of a deceased joint owner according to his respective contributions to the property, rather than technical concepts of title. Thus, for example, if $H$ purchased Blackacre, paying the full consideration for the property out of his independent funds, and took title in his name and that of $W$, his wife, as tenants by the entirety, the full value of Blackacre would be taxed to $H$’s estate, if he predeceased $W$. On the other hand,
if $W$ predeceased $H$, nothing would be included in her gross estate on account of Blackacre.

Section 2040 seems to have worked satisfactorily except where a joint tenant transferred his interest in the jointly held property in contemplation of death. Despite the fact that it would seem obvious that a man's estate tax liability should not be affected by a transfer in contemplation of death, an increasing number of cases hold that liability for the tax under section 2040 may be minimized by a transfer in contemplation of death. That is, they hold that where a joint tenant transfers his interest in the joint property in contemplation of death, only the interest which he transferred in contemplation of death is taxed to his estate, and not the interest in the jointly held property which would have been taxed to his estate under section 2040 if the transfer in contemplation of death had not taken place. For example, suppose that $A$ buys Blackacre and takes title in his name and that of $B$ as joint tenants. If before taking any further steps $A$ dies, the entire value of Blackacre will be taxed to his estate under section 2040. But if before his death, in contemplation of death, $A$ transferred his interest in Blackacre to $B$, so that the joint tenancy no longer existed at his death, there are a substantial number of cases which hold that only the half interest which $A$ transferred to $B$ in contemplation of death need be included in his gross estate under the federal estate tax. This seems clearly opposed to the idea of taxing transfers in contemplation of death in order to prevent the avoidance of the estate tax by means of such transfers, and it should be corrected by legislation. Any such amendment to the statute should, however, take the form of a general amendment to section 2035, which taxes transfers in contemplation of death, to provide that the release in contemplation of death of any interest or power reserved in connection with a taxable transfer under the estate tax should not affect the taxability of the original transfer. If only section 2040 were amended to provide that where a joint owner transferred his interest in the jointly owned property in contemplation of death, he should be taxed as though the transfer had not taken place, this might create an almost overwhelming inference that where powers and interests in connection with the transfers taxed under other sections of the statute were released in contemplation of death, only the value of the power or interest transferred in contemplation of death should be included in the decedent's gross estate.

55. See note 31, supra.
Section 2041.

Section 2041, which taxes powers of appointment so gently that it scarcely taxes them at all, represents a policy judgment which was made when the 1951 Powers of Appointment Act repudiated the more stringent tax on powers of appointment initiated by the 1942 amendments to the estate tax. The justification for the present system of taxing powers of appointment is that it would not increase the revenue from the tax if they were taxed more strictly; it would simply mean that lawyers would not be as free to make wise and flexible family settlements by the liberal use of non-taxable powers of appointment. It is true that it is possible to give the income beneficiary of a trust the substantial advantages of the fee simple ownership of the trust property, without subjecting the property to an estate tax at his death, by the use of special non-taxable powers of appointment. If powers of appointment were taxed more strictly, however, successive estate taxes would still be avoided by the creation of successive estates without powers of appointment. There would be no increase in the yield from the estate tax, but only an increase in the number of unwise and rigid family settlements. It is possible to quarrel with the philosophy behind section 2041. However, the real difficulty in connection with taxing powers of appointment seems to lie in the fact that successive estate taxes can be avoided by the creation of successive estates. Until some system is devised for taxing property each time the enjoyment of the property descends to a new generation, there is not much use in tinkering with the tax on powers of appointment.

Section 2042.

Under the 1939 Code, life insurance payable to beneficiaries other than the insured's executor was taxable to the estate of the insured, if the insured either possessed incidents of ownership in the insurance at his death, or paid premiums for the insurance during his life. Under section 2042 of the 1954 Code the premium payment test is abandoned. Section 2042 only taxes insurance payable to beneficiaries other than the estate of the insured to the estate of the insured when the insured possessed incidents of ownership in the in-

56. See Griswold, Powers of Appointment and the Federal Estate Tax, 52 Harv. L. Rev. 929 (1939); Leach, Powers of Appointment and the Federal Estate Tax — A Dissent, 52 Harv. L. Rev. 961 (1939); Griswold, In Reply, 52 Harv. L. Rev. 967 (1939); Leach, Rejoinder, 52 Harv. L. Rev. 969 (1939).
57. 65 Stat. 91 (1951).
58. See Leach supra note 56.
surance at his death. The elimination of the premium payment test as a basis for taxing life insurance opens a substantial loophole in the estate tax. There is no limit upon the amount which a man may pass to his heirs tax-free by investing in life insurance and irrevocably assigning the insurance before his death.

The deletion of the premium-payment test in the 1954 Code was justified by a completely false analogy. In the House Report, which accompanied the 1954 Code, the Republican majority sought to justify the elimination of the premium-payment test upon the ground that property other than life insurance is not taxed to a decedent's estate where the decedent parts irrevocably with the property during his life, and consequently life insurance should not be taxed to the estate of the insured unless the insured retains incidents of ownership in the insurance. The Democratic minority pointed out the fallacy in this reasoning, declaring:

"But life insurance is not like other property. It is inherently testamentary in nature. It is designed, in effect, to serve as a will, regardless of its investment features. Where the insured has paid the premiums on life insurance for the purpose of adding to what he leaves behind at his death for his beneficiaries, the insurance proceeds should be included in his estate.

We predict that if this provision becomes law, it will virtually do away with the estate taxation of life insurance. To avoid the tax, the insured need only assign the policy to his wife or other beneficiary . . ." 60

It is perhaps worth pointing out that the loophole created in the estate tax by the elimination of the premium-payment test, like most loopholes under the tax laws, is one which is peculiarly advantageous for the wealthy taxpayer. The man of moderate means needs most of his capital to subsist on. He cannot afford to tie up substantial amounts in life insurance. However, the wealthy taxpayer can invest his surplus wealth in life insurance and pass this on tax-free to his heirs.

Under the 1939 Code the premium payment test required the estate of the insured to include part of the proceeds of insurance payable to other beneficiaries proportionate to the part of the premiums paid by the insured. Thus, for example, if the decedent paid half of the premiums for a policy for $100,000, $50,000 would be included in his gross estate. A possible variation of the premium-payment test, which seeks to give effect to the transfer of insurance by the

60. Id. at B14, B15.
decendent during his life, would impose a tax upon part of the excess of the proceeds of the policy over the cash surrender value of the policy at the insured's death equal to the part of the total premiums paid by the insured. Although it is possible to contain one's enthusiasm for this solution, it would seem that almost any alternative would be more equitable than the present form of section 2042.

B.

Deductions.

(1) Section 2055.

The deductions under the estate tax appear to operate more equitably than the provisions dealing with the gross estate, — or perhaps the author is less cognizant of their shortcomings. In any event, the only potential amendments which come readily to mind in connection with the deductions under the estate tax are a minor addition to the deduction for charitable transfers, and somewhat more substantial alterations in connection with the marital deduction.

For some inexplicable reason section 2055, which sets forth the charitable organizations to which deductible transfers may be made under the estate tax, omits community chests. This would be less remarkable if community chests were not explicitly mentioned in the sections dealing with charitable deductions under the gift\(^\text{61}\) and income\(^\text{62}\) taxes. Presumably a bequest or devise to a community chest would be deductible under the estate tax as a transfer to the underlying charities which compose the community chest were it not for the explicit references to community chests under the income and gift taxes. Before the omission of community chests from the estate tax raises an embarrassing question as to whether gifts to such organizations are deductible under the estate tax, it might be well to amend section 2055 to provide explicitly that they are.

(2) Section 2056.

The most fascinating development in connection with the estate tax in recent years is the marital deduction. Without challenging the principle behind the marital deduction, it seems clear that it might be considerably improved.

One improvement, which would appear to be beyond controversy, would be to provide explicitly in section 2056 that a power

\(^{61}\) Int. Rev. Code of 1954, § 170 (c) (2).

of appointment which is taxable under section 2041 will meet the power of appointment requirement of the life estate-power of appointment exception to the terminable interest rule. It is difficult to see any reason why a power of appointment which subjects property passing to a surviving spouse to an estate tax as part of the surviving spouse's gross estate should not be sufficient to qualify the transfer to the surviving spouse for the marital deduction. Aside from considerations of equity, correlating the power of appointment necessary to qualify a transfer for the marital deduction with the power of appointment which is taxable under section 2041 would eliminate much of the uncertainty and needless litigation which has arisen under section 2056 as it is presently phrased.

One of the most serious objections to the marital deduction in its present form is the terminable interest rule which denies a marital deduction for a transfer to a surviving spouse unless she gets power to dispose of the transferred property as she sees fit. This has two unfortunate aspects. First of all, it creates a constant temptation to give property absolutely to a wife who is not competent to take the property in order to gain a tax advantage. Secondly, in the case of more cautious testators, who will not entrust property to an irresponsible spouse in order to take advantage of the marital deduction, the statute discriminates unfairly in favor of the man whose spouse is responsible. One way to overcome these objections would be to modify the terminable interest rule to the extent of providing that any transfer to a surviving spouse under which the surviving spouse gets the income from the transferred property for her life shall qualify for the marital deduction, but the property subject to the life estate shall be taxed as part of the surviving spouse's estate at her death. This would obviate any discrimination between testators with responsible and irresponsible spouses. It would also eliminate most of the tax traps and technical refinements in connection with the marital deduction.

63. Section 2056(b) provides that a terminable interest will not qualify for the marital deduction. Thus, for example, if a man leaves his wife the income from his estate for life, this will not entitle his estate to a marital deduction. Section 2056(b) (5) creates an exception to this rule, however, by providing that if a decedent, in addition to leaving his spouse a life estate, gives her an unqualified power to appoint the property to herself or her estate, the transfer to the surviving spouse will qualify for the marital deduction.

64. See, for example, Commissioner v. Ellis' Estate and Estate of Pipe v. Commissioner, supra note 18.