INTER VIVOS TRANSFERS: GIFTS, JOINT OWNERSHIPS, AND CONTEMPLATION OF DEATH

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"GIVING WHILE LIVING" is one of the corner stones of prudent estate planning. To have the maximum amount of a client's property available for distribution to his chosen beneficiaries, his inter vivos transfers must be based upon a consideration of numerous factors. The changes wrought by the Revenue Act of 1948 have multiplied the dangers inherent in haphazard giving.

A person has the alternatives of consuming his wealth, distributing portions of his property to the objects of his bounty while living, and disposing of it at his death. The term "estate" is often erroneously limited to that portion of the property passing at death. It should also include property distributed during a person's lifetime. The extent and manner in which a person makes inter vivos transfers will affect the ultimate total that his beneficiaries will receive from him before and after his demise.

Every transfer has tax implications. While a prudent transfer may result in a minimum tax charge, an unwise distribution may mean an unnecessary tax donation. When a taxpayer acts in such manner or so manages his affairs that unnecessary or additional taxes result, he is unwittingly making a gift, but in the form of taxes with the donee being the government. No objection exists to intentional tax donations by the taxpayer. However, the average citizen, no matter how benevolent, objects to dispensing his charity by needless tax payments. The wise utilization of inter vivos gifts will greatly assist in eliminating tax donations, whether in the form of income, gift, or death taxes. The greater the tax donations, the less will remain for his own use and for division among his selected beneficiaries.

After the lawyer has familiarized himself with the affairs of his client and has ascertained his desires and wishes, the next step is to determine the inter vivos transfers that will attain his objectives and while incurring tax charges, will avoid tax donations.

No proper plan of inter vivos distribution should be based solely upon a desire to save or avoid taxes. After having made provision for his own requirements, a client should make gifts, first because he wishes

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to provide for or assist his donees and then permit tax considerations to regulate the form or time of giving. In this manner he will attain his objectives and provide for the beneficiaries according to their needs, while refraining from making tax gifts.

A person who makes an inter vivos gift solely to save taxes may be making a transfer he will later regret. He may lose control over property that he may subsequently need, or the subject matter of the gift, through death of the beneficiary or otherwise, may find its way into the hands of a person over whom the donor has no influence or whose interests may even be adverse to the donor. In addition, no tax savings may result to the transferor. An example would be transfers creating family partnerships where the income remained taxable to the donor.[1]

ADVANTAGES OF GIFTS

Many valid reasons, aside from tax considerations, exist that should prompt a person of substantial means to make inter vivos gifts. If he makes a gift to his son or another relative, he can observe the donee's ability to handle money. He throws responsibility upon the beneficiary and prepares him for later receipt of greater wealth. By a much needed and well-timed gift, he may enable a child or other relative to enter into business or purchase an interest in an enterprise, thereby considerably increasing the donee's earning power. The course of life of many ambitious young persons might be changed by their securing ownership of several thousand dollars at an opportune time. The income return on the transfer in the hands of the recipient may considerably exceed the income on the funds while in the possession of the donor. The objection may be raised that the donee may waste the money; however, knowledge comes with experience. Also if the beneficiary dissipates a gift under the watchful eye of his benefactor, he will certainly squander a bequest or devise received after the donor is in his grave. The manner in which a recipient handles a gift may furnish indications of how much and in what form he should receive later transfers.

If the donor makes gifts during his lifetime, he has the pleasure and satisfaction of observing those close to him enjoy the benefits. "Giving while living" is bound to be more gratifying than waiting until death before helping those dear to one. Why have the beneficiaries lavish their praise *in memoriam?* It is far more pleasant to be thanked in person.

[1] Economics v. Commissioner, 167 F.2d 165 (C.C.A. 4th 1948), *cert. denied*, 335 U.S. 826, 69 Sup. Ct. 53 (1948); Commissioner v. Tower, 327 U.S. 280, 66 Sup. Ct. 532 (1946). Liability for gift tax may nevertheless exist. Walter H. Lippert, 11 TC No. 95 (1948). Michigan Court permitted return of property to donor. Stone v. Stone, 319 Mich. 194, 29 N.W.2d 271 (1947). *But cf.* Lowry v. Kavanagh, 34 N.W.2d 60 (Mich. 1948).

TAX BENEFITS

If, in addition to the above-mentioned incentives, the donor avoids tax donations by making gifts and thereby actually increases the total to be received ultimately by the beneficiaries, the prudent planner will feel impelled to make inter vivos transfers.

One of the obvious advantages of making gifts is income tax savings. If the donor, Paul Scott, transfers $20,000 to his son, Don, who has little or no income, the income from the $20,000 will be removed from Paul's highest income tax brackets, and the total retained by Paul and Don after payment of all taxes will be increased. However, since the passage of the Revenue Act of 1948, no income tax savings result if the gift is from one spouse to the other. The same benefits can be secured by filing a joint return.[2] The tax is then ascertained as though each is the owner of one-half of the total income of both, with each being entitled to one-half of the total deductions and credits. The total tax is twice the tax on the one-half.

Another benefit is the avoidance of tax donations through savings on death taxes. The gift tax rates on net gifts, after deduction of the exclusions and exemptions, range from 2¼% on the first $5,000 of a donor's taxable gifts to 57¾% on cumulative net gifts of $10,000,000 or over.[3] The rates on any particular bracket are three-fourths of the federal estate tax rates on the same bracket. Also inter vivos gifts, by diminishing the size of the decedent's net estate, reduce the amount of tax payable for such estate in its highest tax brackets. If a person transfers property by gift, insofar as such gifts are in excess of the exclusions and exemptions they are taxable at the lower gift tax rates on a cumulative basis, commencing at 2¼%, while the estate tax payable upon his death will have been reduced in its highest tax brackets by the amount of the gifts.

Gifts that come within the exemptions and exclusions are entirely free from tax. By making gifts, there is the benefit of two sets of exemptions, one in connection with the gift tax and another allowed in ascertaining the estate tax.

An additional saving results because the tax on a gift is based on the amount of the net gift exclusive of the gift tax payable, and the tax is paid out of property of the donor other than the subject matter of the gift.[4] In ascertaining the federal estate tax, the tax and the rate are based on the estate of the decedent, which includes the amount required to pay the estate tax.[5]

[2] INT. REV. CODE § 12(d).

[3] *Id.* § 1001(a)(2).

[4] *Id.* § 1001(a). Where donee paid tax, no reduction from value of gift allowed. Estelle May Affelder, 7 TC 1190 (1946).

[5] INT. REV. CODE § 810.

The Revenue Act of 1948, while adding complications, has created new avenues of tax savings for the married donor. The details and exceptions will be considered later. Briefly a gift from a married person to a third person may, with the consent of the donor's spouse, be regarded as being made one-half by the husband and one-half by the wife.[6] This results in an annual exclusion of $6,000 per person instead of $3,000[7] on gifts from a married couple to a third person, even though one spouse is the sole donor. Also benefit of the specific $30,000 exemption[8] of both spouses—making a possible total of $60,000 in combined exemptions —as well as lower gift tax rates, can now be secured. Since bargain tax rates can be had on gifts by married persons to third persons, such gifts have a special appeal. Only one-half of the value of a gift (which does not fall within a disqualifying type) made by one spouse to another is considered in computing the gift tax. The intricate problems that confront the estate planner today include that of determining what combination of types and amounts of gifts will provide the best bargain through the new possibilities, as well as the complexities, created by the gift and estate tax provisions of the Revenue Act of 1948.

Likewise, possible state tax savings should not be ignored. Illinois and a number of other states levy no gift tax. Illinois has an inheritance tax with the exemptions and rates varying, depending upon the relationship of the beneficiary to the decedent as well as the amounts inherited.[9] For example, the exemption on a bequest or devise to a niece or nephew is only $500 and the rates range from 6% to 16%. Judicious giving will also result in savings on state death taxes.

Where large amounts are transferred by gift, thought must be given to the loss of income for the remainder of the donor's life on the principal used in payment of the gift tax. To some extent, this detracts from the benefits that follow the making of gifts.

The greater the wealth of the donor, the larger the savings through prudent inter vivos gifts, but the more careful and thorough must be the required analysis. However, a point will ultimately be reached where additional gifts to a particular donee or donees will result in no further tax savings but, instead, tax donations will ensue. This varies in each case depending upon numerous factors. Among these are the marital status of the donor, his and his spouse's wealth, their earnings, their future needs and prospects, and previous gifts made by each. Others are the intended donee or donees, their financial condition and earnings, their future prospects and needs, their relationship to the donor and spouse, and the type of gift or gifts involved. Additional factors to be

[6] *Id.* § 1000(f).
[7] *Id.* § 1003(b)(3).
[8] *Id.* § 1004(a)(1).
[9] ILL. REV. STAT., c. 120, §§ 375-403 (1947).

considered are what property will pass upon the death of the donor or his wife, and which spouse will survive the other. Generally a single person by making a greater total of gifts gains more in tax savings than a husband having the same wealth who has children and predeceases his wife. Thus each situation must be separately and carefully analyzed.

Policies regarding the making of gifts must of necessity be affected by prospective tax legislation. However, predicting involves risks. Changes resulting from the Revenue Act of 1948 have made certain gifts previously made needless or tax-costly, such as gifts to spouses to save income taxes. Nevertheless, doing nothing also constitutes speculating. The failure to make gifts today may make future transfers more expensive. The increasing revenue demands of the government require additional taxes. Proposals have been advanced to integrate the gift tax with the estate tax.[10] The loss of revenue from married persons resulting from the 1948 amendments, as well as the fact that complexities have been created in connection with the gift and estate tax provisions, may encourage changes with a possible increase in tax costs.

OBJECTIVE AND NATURE OF GIFT TAX

Because a large number of persons were making inter vivos transfers to place themselves in lower income tax and estate tax brackets, the government to recoup some of the revenue lost passed a law taxing gifts.[11] The act applies to gifts made since June 6, 1932.[12] A number of amendments have been added, but the most drastic is included in the Revenue Act of 1948.

The tax is on the transfer of property by gift by an individual and is not a direct tax on property.[13] All inter vivos transactions by which property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute taxable gifts.[14] The tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is

[10] See *Federal Estate and Gift Taxes — A Proposal For Integration and For Correlation With The Income Tax*, Joint Study prepared by Advisory Committee to Treasury Department and others (1948).

[11] H. R. REP. NO. 708, 72d Cong., 1st Sess. 28 (1932), cited in footnote, Smith v. Shaughnessy, 318 U.S. 176, 179, 63 Sup. Ct. 545, 546 (1943). Previous gift tax under Revenue Act of 1924 repealed as of January 1, 1926, Revenue Act of 1926, § 1200, 44 STAT. 126 (1926).

[12] INT. REV. CODE §§ 1000(a) and 1001.

[13] *Id.* § 1000(a); U.S. Treas. Reg. 108, § 86.1 (1943); Bromley vs. McCaughn, 280 U.S. 124, 50 Sup. Ct. 46 (1929) (upheld constitutionality of 1924 Act). Regarding corporate gifts *see* U. S. Treas. Reg. 108, § 86.2(a)(1) (1943) and 2 PAUL, FEDERAL ESTATE AND GIFT TAXATION § 16.05, 1083 (1942).

[14] U. S. Treas. Reg. 108, § 86.2(a) (1942). Regarding powers of appointment, *see* INT. REV. CODE § 1000(c); U. S. Treas. Reg. 108, § 86.2(b) (1943).

real or personal, tangible or intangible.[15] There is no tax until the gift is complete.[16] Where property is transferred for less than full consideration in money or money's worth, then the amount by which the value of the property exceeds the value of the consideration is a gift.[17]

The tax is based upon the value of the property at the date of the gift.[18] A citizen or resident of the United States is subject to tax on all transfers by gift, whether the property be situated within or without the United States.[19]

EXCLUSIONS

The first $3,000 of any gift—other than gifts of future interests in property—made by the donor to any person during any calendar year is excluded in ascertaining the total amount of taxable gifts made by such donor for that year.[20] This permits the donor to give up to $3,000 per person during any calendar year to as many individuals as he desires without being required to report any such gifts. The double exclusion afforded married donors will be considered later. The obvious intention is to avoid the necessity of requiring every gift to be reported and to permit a limited latitude in the making of annual tax-free gifts to any donee.

[15] INT. REV. CODE § 1000(b).

[16] U. S. Treas. Reg. 108, § 86.3 (1943). Gift by minor imperfect during minority. Commissioner v. Allen, 108 F.2d 961 (C.C.A. 3rd 1939), *cert. denied*, 309 U.S. 680, 60 Sup. Ct. 718 (1940). Gift of donor's check incomplete until paid or negotiated for value. G.C.M. 16460, XV-1 CUM. BULL. 369 (1936). Enforceable promise to make future gifts not present taxable gift. John D. Archbold, 42 B.T.A. 453 (1940). No gift until delivery. Kate R. de Forest, 27 B.T.A. 373 (1932); Acq., XII-1 CUM. BULL. 4 (1933). Gift with reservation of power in donor to designate new beneficiaries but not beneficial to himself incomplete until relinquishment of power. Estate of Sanford v. Commissioner, 308 U.S. 39, 60 Sup. Ct. 51 (1939). Gift incomplete where donor reserves power to revest title in donor alone or in conjunction with any person not having a substantial adverse interest, Commissioner v. Prouty, 115 F.2d 331 (C.C.A. 1st 1940); but gift complete where right in third person alone, Herzog v. Commissioner, 116 F.2d 591 (C.C.A. 2nd 1941). Retained reversionary interest does not make gift incomplete. Smith v. Shaughnessy, 318 U.S. 176, 63 Sup. Ct. 545 (1943).

[17] INT. REV. CODE § 1002; U.S. Treas. Reg. 108, § 86.8 (1943). Relinquishment of marital rights under antenuptial agreement, not adequate consideration. Merrill v. Fahs, 324 U.S. 308, 65 Sup. Ct. 655 (1945). Transfers made pursuant to antenuptial agreement and to compensate prospective wife for loss of income upon her remarriage are gifts. Commissioner v. Wemyss, 324 U.S. 303, 65 Sup. Ct. 652 (1945). Release of inchoate dower, not sufficient consideration. Estate of Koert Bartman, 10 TC 1073 (1948). Transfers in ordinary course of business, not gifts. Estate of Monroe D. Anderson, 8 TC 706 (1947); Acq., 1947-2 CUM. BULL. 1. Regarding post nuptial agreements, *see* Commissioner v. Converse, 163 F.2d 131 (C.C.A.2d 1947); Edward B. McLean, 11 TC No. 66 (1948); William B. Harding, 11 TC No. 124 (1948); Estate of Josephine S. Barnard, 9 TC 61 (1947), Non-Acq., 1947-2 CUM. BULL. 6; E.T. 19, 1946-2 CUM. BULL. 166; Clarissa H. Thomson, 6 TCM 822 (1947); *Rudick, Marriage, Divorce and Taxes*, 2 TAX L. REV. 123 (1946-1947).

[18] INT. REV. CODE § 1005.

[19] U.S. Treas. Reg. 108, §§ 86.4 and 86.18 (1943). As to non-resident not a citizen, INT. REV. CODE § 1000(b); U.S. Treas. Reg. 108, §§ 86.4 and 86.18 (1943).

[20] INT. REV. CODE § 1003(b) (3).

The exclusion was $4,000 for the calendar years 1939 to 1942, inclusive;[21] and for gifts made prior to the year 1939, the exclusion was $5,000.[22]

Under the present law the annual exclusion is granted even though the gift is in trust. Where the donor conveys property in trust for the benefit of numerous beneficiaries, he is entitled to a separate exclusion for each beneficiary.[23]

No exclusion is allowed on a gift of a future interest.[24] The Treasury Regulations define future interests as including reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future time.[25] The ordinary transfer of a note bearing no interest until maturity or of a life insurance policy does not establish a future interest, but a trust or other instrument of transfer may contain limitations creating future interests as in other transfers. The test hinges on whether possession or enjoyment is to commence presently or at a future date.[26] Whether the donee has vested rights is immaterial.[27] If the enjoyment is contingent upon the occurrence of future events, then a future interest exists.[28]

SPECIFIC EXEMPTIONS

In addition to the annual exclusion previously discussed, each donor who is a citizen or resident of the United States is allowed a specific exemption of $30,000.[29] He has the option of taking all or any part of the exemption in any calendar year. However, once the total has been used, no further exemption is permitted. The specific exemption was originally $50,000,[30] but this was reduced to $40,000 for the years 1936 to 1942, inclusive,[31] and the present exemption of $30,000 applies to years commencing with January 1, 1943.[32]

Where the donor through error overvalued a gift and, as a result,

[21] INT. REV. CODE § 1003(b)(2).

[22] *Id.* § 1003(b)(1).

[23] Helvering v. Hutchings, 312 U.S. 393, 61 Sup. Ct. 653 (1941). No exclusion allowed on gifts in trust made between January 1, 1939, and December 31, 1942. INT. REV. CODE § 1003(b)(2).

[24] INT. REV. CODE § 1003(b).

[25] U.S. Treas. Reg. 108, § 86.11 (1943).

[26] United States v. Pelzer, 312 U.S. 399, 61 Sup. Ct. 659 (1941); Ryerson v. United States, 312 U.S. 405, 61 Sup. Ct. 656 (1941).

[27] Wisotzkey v. Commissioner, 144 F.2d 632 (C.C.A. 3rd 1944).

[28] Fondren v. Commissioner, 324 U.S. 18, 65 Sup. Ct. 499 (1945).

[29] INT. REV. CODE § 1004(a)(1).

[30] Revenue Act of 1932, § 505(a), 47 STAT. 247 (1932).

[31] Revenue Act of 1935, § 301(b), 49 STAT. 1025 (1935).

[32] Revenue Act of 1942, § 455, 56 STAT. 953 (1942).

exhausted her specific exemption, she was permitted to use the balance of the exemption that would have remained if the previous gift had been correctly valued.[33]

CUMULATIVE BASIS FOR TAX

The gift tax rates are applied on a cumulative basis,[34] based upon the total net gifts made after June 6, 1932, the date that the present gift tax law first became effective. To determine the tax for any one year, net gifts of preceding years must be considered. The tax for a calendar year is determined by ascertaining the tax at current rates on the total of all net gifts made after June 6, 1932, to the *end* of the calendar year in question; then by ascertaining the tax at current rates on the total of all net gifts made after June 6, 1932, to the *beginning* of the calendar year involved. The difference in the two tax figures constitutes the amount of tax for the year in question. The more taxable net gifts made in prior years, the greater will be the rate of tax on net gifts during the current and subsequent years. The annual exclusions applicable to gifts made in prior years still govern even though they differ from the present law.

However, an adjustment will be necessary in determining the tax for the current year where the donor has utilized a specific exemption in excess of $30,000 based upon a prior law. Assume the donor has made net taxable gifts of $60,000 during the year 1948 and had made net taxable gifts from June 6, 1932, to December 31, 1947, aggregating $150,000, exhausting the specific exemption of $50,000 during the year 1935. To determine the tax on the 1948 gifts, it is necessary to add $20,000 (the difference between that exemption of $50,000 and the present exemption of $30,000) to the net gifts made in prior years. This raises the net gifts for years prior to 1948 from $150,000 to $170,000, and the 1948 net gifts are taxable at the rate brackets that apply to gifts in excess of $170,000 and between $170,000 and $230,000.

MARRIED DONORS

The Revenue Act of 1948 has introduced a revolutionary concept concerning gifts in common law jurisdictions. In an effort to equalize the treatment of donors in common law states with those in community property areas, special treatment has been afforded married donors. The amendments are applicable to gifts made after April 2, 1948, the effective date of the act.[35]

[33] Katherine Schuhmacher v. Commissioner, 8 TC 453 (1947); Acq., 1947-1 CUM. BULL. 4.

[34] INT. REV. CODE § 1001.

[35] *Id.* §§ 1000(f)(1)(A) and 1004 (a)(3).

The act limits the applicability of the prior 1942 amendments regarding community property to gifts made after the calendar year 1942 and before April 3, 1948.[36] The effect is to make gifts of community property become gifts by the husband and wife in equal amounts in accordance with the ownership of such property in community property jurisdictions. This reinstates the rule existing before the 1942 amendments. The law was amended with the further objective of affording common law residents the opportunity of securing similar gift tax benefits. However, some differences in tax treatment still prevail on gifts between spouses.

GIFTS BY A SPOUSE TO THIRD PERSON

A new sub-section has been added which provides that a gift by a husband or wife to any person other than the spouse may be regarded as being made one-half by each spouse.[37] If a married man makes a gift to his son, he has the option, with the consent of his wife, of having the gift for gift tax purposes considered as coming one-half from him and one-half from his wife. This right is optional.

To secure the benefits of division, the following requirements must be met:[38]

1. At the time of the gift, each spouse must be a citizen or resident of the United States.
2. The spouses must be married to each other at the time of the gift and must not remarry during the remainder of the calendar year.
3. Consent of both spouses must cover all gifts made by either during the calendar year while married to each other and must be signified as provided in the statute and the regulations.
4. The gift must not be of an interest in property if the donor spouse creates a power of appointment, as defined in Section 1000 (c) of the Internal Revenue Code, in his spouse over such interest.[39]

If Paul and Julia marry March 1st, then the consent for such year can apply only to gifts made after the marriage. If they are divorced October 1st, then the consent is effective as to gifts made between March 1st and October 1st, provided neither remarries during the remainder of the calendar year. If either dies and the other remains unmarried for the

[36] INT. REV. CODE § 1000(d).
[37] *Id.* § 1000(f).
[38] *Id.* § 1000(f)(1).
[39] Discussed by a subsequent writer, Hubert L. Will.

remainder of the calendar year, effective consent can be signified by the surviving spouse and the administrator or executor of the decedent. If either Paul or Julia is a non-resident and not a citizen until April 1st, then gifts made prior to April 1st, even though after their wedding, cannot be included.

The consent must be signified by both spouses and may be signified at any time after the close of the calendar year in which the gift was made, but it may not be signified after March 15th following the close of such year unless no return has been filed for such year by either spouse before that date.[40] Where no return has been filed by March 15th, the consent may not be signified after a return for such year is filed by either spouse or after a notice of deficiency with respect to the tax for such year has been sent to either spouse. In view of the statutory language, doubt exists as to whether a consent signified before the close of the calendar year involved would be effective. Would a consent be valid which was signed during the year in question, pursuant to a divorce settlement, but not forwarded to the Collector of Internal Revenue until after the close of the year? A consent applies only to gifts for the calendar year involved. A new consent would be required for each year. A consent may be revoked by either spouse on or before March 15th following the close of the calendar year.[41]

If a consent is signified, each spouse is jointly and severally liable for the entire tax.[42] Thus a wife who consents may be compelled to make payment of the entire tax even though all of the gifts come out of the husband's property. A consent regarding gifts made in a particular year is also effective in computing the gift tax for future years since such gifts enter into the base for determining the tax for subsequent years.[43]

The splitting of gifts by a husband and wife to a third person offers numerous opportunities for tax savings. The annual exclusion per donee may be increased from $3,000 to $6,000. If neither spouse has used his or her specific exemption of $30,000, there is now available a combined exemption of $60,000. Very often the husband owns the bulk of the family property, and he has used all or most of his exemption while his wife's exemption remains intact. He may wisely adopt a long-range policy of making gifts to his children and grandchildren, and after securing the benefit of the combined annual exclusions, he may have one-half the value taken out of his highest gift tax brackets and placed within his wife's specific exemption or lower gift tax rates. By annual small gifts coming entirely within the exclusions, one donee may receive $30,000 in five years. However, the donor should not overly deplete his estate by gifts to

[40] INT. REV. CODE § 1000(f) (2).
[41] *Id.* § 1000(f) (3).
[42] *Id.* § 1000(f) (4).
[43] SEN. REP. NO. 1013, pt. 2, 80th Cong., 2d Sess. 33 (1948).

others than his spouse, when his wife will be his chief death beneficiary bceause too great a diminution in the amount of the marital deduction [44]

Since the gifts must be made during marriage, the making of inter vivos gifts to third persons will be encouraged before either spouse dies. Delay may mean a tax donation through a reduction of the annual exclusion, loss of all or part of a specific exemption, or higher gift tax rates. Of course, if the widow or widower remarries, the splitting is again permitted.

GIFTS BETWEEN SPOUSES

Gifts between spouses involving non-community property secure the benefit of a new deduction, a marital deduction. Provisions for this have been added to the section [45] of the Internal Revenue Code covering deductions in determining net gifts. Where the donor transfers by gift an interest in non-community property to a donee, who at the time of the gift is the donor's spouse, a deduction equal to one-half of its value is allowed unless the interest comes within one of the statutory exceptions. Thus if a husband transfers property valued at $100,000 to his wife, he is permitted a marital deduction of $50,000. This gift tax marital deduction corresponds to the estate tax marital deduction, and the provisions of the law covering it are intended to be construed in the same manner as the corresponding estate tax provisions.[46] The donor must be a citizen or resident of the United States. The donee spouse need not be either a citizen or a resident.[47]

Difficulties arise in transfers between spouses because the gift tax is ascertained upon the basis of property ownership by a particular spouse. In determining the income tax under a joint return, the ownership of the income between the spouses is immaterial. In ascertaining the gift tax on a transfer by a married donor to a third person (where the spouses elect to have the gift regarded as coming one-half from each), ownership of the property between the husband and wife is likewise irrelevant. In the latter two situations,the same rule is readily applicable to common law and community property jurisdictions and complications are avoided.

On a transfer between spouses, property ownership remains pertinent in determining the gift tax. Where community property is involved, even though the husband is the entire contributor, the wife acquires her one-half interest by virtue of the local law. She receives her property interest without the payment of any gift tax. In a common law state

[44] Marital deduction limited to 50% of the adjusted gross estate. INT. REV. CODE § 812(e)(1)(H).
allowed under the estate tax may result in total heavier taxes.

[45] INT. REV. CODE § 1004(a)(3).

[46] SEN. REP. NO. 1013, pt. 2, 80th Cong., 2d Sess. 29 (1948).

[47] *Id.* at 30.

for a husband to transfer any interest to his wife, he must give her property which he owns under local law and must pay a gift tax based upon at least one-half of its value. Since property ownership is the test for taxability, two diverse sets of statutory provisions are required, one for community property and another for property in common law jurisdictions. The efforts to secure equality in tax treatment based upon variant property ownership rules result in complications, with complete parity remaining an unattainable goal.

In an effort to secure equality, the marital deduction is allowed in connection with non-community property. However, to avoid new disparties that would arise if the marital deduction was permitted on all gifts of non-community property between spouses, exceptions have been added covering gifts that will fail to qualify for the marital deduction. For example, the gift or devise by a husband of a life estate to his wife with a remainder to their children—which has wide popularity in common law jurisdictions—would leave nothing taxable in the wife's estate upon her death. The same opportunity to avoid estate taxes upon the wife's death does not exist in the case of community property. To prevent this and similar inequalities that would otherwise arise, complex statutory exceptions were required.

Many of the problems arise in connection with trusts and powers of appointment which will be discussed by another writer.[48] However, property rights dealing with life estates and other terminable interests that are not necessarily applicable to trusts and do not involve powers of appointment will be considered.

A gift that will not qualify for the marital deduction is the transfer of a life estate or other terminable interest to a spouse in property where the donor retains an interest or transfers an interest in the same property to another donee, and by reason of such retention or transfer, the donor or such other donee may possess or enjoy any part of such property after termination or failure of the interest transferred to the donee spouse.[49] To secure the benefit of the marital deduction, the acquired interest of the donee spouse must be such that the property will become part of the donee's taxable estate upon her death unless the donee dissipates or transfers the property during her lifetime.

In the following examples, since Paul, the donor spouse, retains an interest in the property which he may possess or enjoy upon the termination of the interest of his wife, Julia, no marital deduction will be allowed for the gift to her:

1. Paul gives his wife, Julia, a life estate or a leasehold for years in a farm and retains the reversion.

[48] Hubert L. Will.
[49] INT. REV. CODE § 1004(a)(3)(B).

2. Paul purchases an annuity contract with payments to his wife, Julia, for life, with refund to him if the aggregate payments made to Julia are less than the contract cost.
3. Paul purchases an annuity contract with payments to his wife, Julia, and to him, for their joint lives and then to the survivor for life.
4. Paul conveys a farm to his son, Don, for life, with remainder to Paul's wife, Julia, provided she survives Don, but if Julia predeceases Don, then the farm shall revert to Paul or his heirs.

In the situations enumerated below, because Paul has given another donee an interest in the property which such donee may possess or enjoy upon the termination of the interest of Julia, Paul's wife, the marital deduction will not be allowed:

1. Paul gives his wife, Julia, a life estate or a leasehold for years in a farm or other property and makes a gift of the remainder to their son, Don. It is immaterial whether Don acquires his interest before or after or at the same time that Julia acquires hers.
2. Paul purchases an annuity providing for payments to his wife, Julia, for life, with payments to their son, Don, if the aggregate payments made to Julia are less than the contract cost.
3. Paul purchases an annuity payable to his wife, Julia, and their son, Don, for their joint lives and then to the survivor for life.
4. Paul transfers the farm to his son, Don, for life, with remainder to Paul's wife, Julia, provided she survives Don; but if Julia predeceases Don, the farm shall go to their daughter, Verna, and her heirs in fee.
5. Paul makes a gift to his wife, Julia, and their son, Don, of the farm as joint tenants with the right of survivorship or creates a joint tenancy between Julia, Don, and himself.[50]

Based upon the statute,[51] the gift by Paul to his wife, Julia, and their son, Don, of the farm as joint tenants will not qualify for the marital deduction since Don may acquire the fee if he survives his mother. However, this exception appears to be of dubious value. Julia has the right to sever the tenancy and convey her interest to a third person. Also upon Julia's death, one-half of the value of the property will be included in

[50] SEN.REP. NO. 1013, pt. 2, 80th Cong., 2d Sess. 32 (1948).
[51] INT. REV. CODE § 1004(a)(3)(B).

her estate. What is to prevent Julia and Don from creating their own joint tenancy although the conveyance by Paul is made to them as tenants in common so that Paul may have the gift to Julia qualify for the marital deduction? The subsequent creation by Julia and Don of their own joint tenancy would involve no gift tax payment by either of them since each is already an owner of one-half of the property. Would this double transfer be regarded as one conveyance so that the marital deduction would be disallowed to the husband, Paul?

The following gifts by Paul to his wife, Julia, will qualify for the marital deduction:

1. Paul transfers to his wife, Julia, a ten-year leasehold in the farm which constitutes the entire interest that he ever had in the property.
2. Paul sells the farm he owned in fee for full consideration in money's worth, reserving to himself an estate for years or for life. He makes a gift to his wife, Julia, of his reserved interest.
3. Paul conveys a life estate in the farm to his son, Don, and the remainder to Paul's wife, Julia, in fee.
4. Paul makes a gift to his wife, Julia, and their son, Don, of the farm in fee as tenants in common.
5. Paul purchases an annuity for Julia to terminate upon her death or with any remainder payable to her estate.

The annuity to Paul's wife, Julia, that secures the benefit of the marital deduction enables the donor to avoid the disqualifying effects of a transfer to the wife for life and remainder in fee to the children and at the same time, permits securing some similar economic benefits. Paul can now give his wife, Julia, her life estate in the form of an annuity and transfer other property to their children outright or in trust. The argument has been advanced that advantages exist in the use of a trust with only a life estate in the wife since she is protected from loss through her lack of business experience and the estate is preserved for the donor's children. An annuity will afford similar protection with the advantages or disadvantages that result from a fixed return. Gifts of annuities from a husband to a wife may become increasingly attractive. Also annuities may be used to secure a guaranteed return to spouses if either or both desire to make large transfers of property to their children.

Will Julia's interest in an annuity purchased by Paul, payable to himself for his life and then to his wife, Julia, for her life if she survives him, qualify for the marital deduction? The Senate Report [52] states that

[52] SEN. REP. NO. 1013, pt. 2, 80th Cong., 2d Sess. 30-31 (1948).

it will not qualify because the donor may, if he survives his spouse, possess or enjoy his retained interest after the failure of her interest. However, Julia can come into possession or enjoyment only after Paul's interest has terminated, and he does not come into possession or enjoyment as a result of her death. He acquires nothing as a result of the failure of her interest. In spite of the gift, upon his death the value of the annuity to her will be included in his gross estate and will qualify for the estate tax marital deduction in determining the federal estate tax.[53] While this gift is not taxable in her estate, neither is any annuity for her life. The gift to her actually does not differ from an annuity purchased by Paul payable to his wife alone for her life commencing with his death, which would be taxable in his gross estate as being in the nature of insurance. The cost to Paul would qualify for the gift tax marital deduction and the value upon his death would qualify for the estate tax marital deduction. Also by purchasing ordinary life insurance and retaining the incidents of ownership with the proceeds payable to his wife for life, Paul can avoid a gift tax entirely. In spite of this, the Senate Report construction appears to represent the law. As a result, neither will the interest of Paul's wife, Julia, in an annuity contract purchased by him, payable to his son, Don, for life and then to Paul's wife, Julia, for her life if she survives Don, qualify for the marital deduction.

The creation of joint tenancies between spouses will be discussed later. The gift to the spouse is expressly permitted to qualify for the marital deduction.[54]

The marital deduction is based upon the amount of the gift without any deduction for the annual exclusion. If Paul makes a gift to his wife, Julia, of $8,000—his sole gift during the year to her—the marital deduction is $4,000, even though the included amount of the gift is $5,000 ($8,000 less the annual exclusion of $3,000). The difference between $5,000 and $4,000 leaves $1,000 which is the amount subject to tax or applicable against Paul's specific exemption. To cover gifts under $6,000, a technical amendment [55] has been added which provides that the marital deduction is limited to the extent that the gifts as to which the deduction is taken are included in the amount of gifts against which the deduction is applied. If a husband makes total gifts to his wife during a calendar year of $5,000, after deduction of the annual exclusion, $2,000 remains. The amount of the marital deduction is limited to $2,000 instead of $2,500 because $2,000 is the amount that would be included in total gifts and nothing remains subject to tax. If the gift is of a future interest, or the annual exclusion is otherwise applied, then the marital deduction would be $2,500.

[53] SEN. REP. NO. 1013, pt. 2, 80th Cong., 2d Sess. 12-13 (1948).
[54] INT. REV. CODE § 1004(a)(3)(D).
[55] *Id.* § 1004(c).

Community property will not secure the benefit of the marital deduction where only one-half of the value is treated as the amount of the gift.[56]

Since transfers between spouses are no longer necessary to secure income tax savings, they will not be encouraged. However, where the spouses have no children or the wife has little or no property, it may be advisable for the husband to transfer some of his property to his wife so as to secure the benefit of his specific exemption and the annual exclusions. Where the husband has never used any portion of his exemption, he may give his wife up to $66,000 during the first year without incurring any gift tax. Further, if the wife predeceases her husband without having received any inter vivos gifts from him and, as a result, leaves little or nothing to their children, upon his death as a widower, his estate will carry a heavier estate tax burden.

To qualify for the marital deduction, the parties must be married to each other at the time of the gift. Thus gifts that might otherwise be made prior to the wedding or after the union has been dissolved should be timed to occur while the marriage is in existence. Payments made pursuant to an antenuptial agreement legally enforceable under Florida law have been held to be gifts.[57] The transfers were made after the wedding. Will these secure the benefit of the marital deduction? While they appear to qualify, a definite answer had better await further interpretation of the law.

If a husband and wife file a joint income tax return, the payment by one spouse of all or part of the income tax liability is not treated as a taxable gift.[58] The same rule would be applicable to payment of the gift tax by one spouse where consent has been signified to treat gifts made to third persons as coming one-half from each.[59] The tax-free gifts thus afforded may be used to advantage.

INCOME TAX BASIS TO DONEE ON SALE

When planning a gift of property, the donor should consider its basis for ascertaining income tax liability in the event of sale. If property is acquired by gift after December 31, 1920,[60] for the purpose of determining gain, the basis is the same as it would be in the hands of the donor or the last preceding owner who did not acquire it by gift. In

[56] *Id.* § 1004(a)(3)(F) (Also covers other provisions regarding community property).

[57] Merrill v. Fahs, 324 U.S. 308, 65 Sup. Ct. 655 (1945).

[58] E.T. 21, 1948 INT. REV. BULL. No. 20 at 10 (1948).

[59] SEN. REP. No. 1013, pt. 2, 80th Cong., 2d Sess. 35 (1948).

[60] INT. REV. CODE § 113(a)(2); U.S. Treas. Reg. 111, § 29.113(a)(2)-1 (b) (1943). Not followed as to gift pursuant to antenuptial agreement. Farid-Es-Sultaneh v. Commissioner, 160 F.2d 812 (C.C.A. 2d 1947).

the event of loss, the basis is the same, unless the fair market value of the property at the time of the gift is lower, in which event such fair market value constitutes the basis. For this reason property that has depreciated in value should not constitute the subject matter of a gift. Property which has enhanced in value may be used if the donee is in lower income tax brackets. If the recipient requires cash, he may sell the property and pay the income tax on the gain. If the donor sold the property and then made a gift of the proceeds, he would be required to pay the tax. However, if the donor keeps appreciated property until his death, the property will acquire as its income tax basis in the hands of the death beneficiary the increased estate tax value,[61] provided the property itself does not represent income.[62] From this point of view, there may be tax disadvantages in making gifts of property that have greatly enhanced in value. A wise choice for a gift is property that is expected to appreciate in worth in the future but after the donor's decease.

However, the Bureau made a recent ruling that where a livestock raiser made a bona fide gift to his son of cattle raised by the father for the production of income, the fair market value of such cattle at the time of the gift was taxable income to the father.[63] The son was permitted to use as his income tax basis on a subsequent sale of the cattle the fair market value at the time of the gift, but the gain to him was taxable as ordinary income. The ruling is based on the fact that the father raised the cattle for the production of income and for sale in his ordinary course of business. The Bureau has ruled similarly in connection with charitable gifts.[64] If this ruling is upheld, the making of gifts of such property will result in taxable income as well as gift tax liability to the donor. While the correctness of the ruling is open to question, until it is reversed, one should be wary of gifts of such property. But even if the ruling is sustained, no reason exists why it should be applicable to gifts of income producing property itself.

TRANSFERS IN CONTEMPLATION OF DEATH

Upon the death of a person who has made inter vivos gifts, there is a lurking danger that the government may contend that the transfers were made in contemplation of death and subject to federal estate tax in the donor's estate. That the gift is complete with no rights retained

[61] INT. REV. CODE § 113(a)(5).

[62] *Id.* § 126.

[63] I.T. 3932, 1948 INT. REV. BULL. NO. 26 at 2 (1948). *See* Helvering v. Horst, 311 U.S. 112, 61 Sup. Ct. 144 (1940) (collections on gifts of interest coupons remained taxable income to donor where donor retained the bonds).

[64] I.T. 3910, 1948 INT. REV. BULL. NO. 13 at 2 (1948). See subsequent discussion regarding charitable gifts.

by the donor and will be part of the donee's taxable estate, if still owned by him upon his death, is immaterial.

The Internal Revenue Code [65] provides for the inclusion in the decedent's gross estate of any transfers made by him at any time in contemplation of his death, except in the case of a bona fide sale for full consideration in money's worth.

The test hinges on the motive which induced the transfer. A leading case frequently cited is *United States v. Wells*.[66] The issue was whether certain gifts by the decedent to his children, with one gift also including his wife as donee, when he was past seventy years of age, should be included in his gross estate as having been made in contemplation of death. The decedent had been making large gifts to his children over a period of about twenty years. The court held that since the gifts in question were part of a long-range policy of making liberal gifts to his children and associated with life, the transfers were not made in contemplation of death. The court mentioned that the intent was to reach substitutes for testamenary dispositions and to prevent evasion of the estate tax. It added that it is the thought of death, as a controlling motive prompting the disposition of the property, that affords the test. The reference is not to the general expectation of death which all entertain.

The question may be raised whether gifts made as part of planning one's estate are necessarily in contemplation of death. As previously indicated, estate planning is considerably broader and much more inclusive than planning for one's death. It includes, as well, lifetime planning. Many gifts involve no intent to avoid estate taxes. Also if the motives behind the gifts are primarily those connected with life, the fact that the donor may realize that he also saves on estate taxes should not brand them as being in contemplation of death. The United States Supreme Court has stated that the mere purpose to make provision for children after a donor's death is not enough conclusively to establish that action to that end was "in contemplation of death." [67] But the Tax Court has held that where the dominant motive in creating a trust for an incompetent son was to supply funds for the son's needs after the donor's death, the gift was in contemplation of death.[68]

In *Allen v. Trust Company of Georgia*,[69] the decedent created trusts in 1925 for the benefit of his children to protect them against their own

[65] INT. REV. CODE § 811(c).

[66] 283 U.S. 102, 51 Sup. Ct. 446 (1931).

[67] Colorado National Bank v. Commissioner, 305 U.S. 23, 59 Sup. Ct. 48 (1938).

[68] Estate of James E. Frizzell, 9 TC 979 (1947), *aff'd on rehearing*, 11 TC No. 69 (1948). *But cf.* Estate of Ernest Hinds, 11 TC 314 (1948).

[69] 326 U.S. 630, 66 Sup. Ct. 389 (1946). In view of this as well as other decisions, U. S. Treas. Reg. 105 § 81.16 (1942), as amended in 1940, is too inclusive in describing gifts in contemplation of death. See Pavenstedt, *Taxation of Transfers in Contemplation of Death: A Proposal for Abolition*, 54 YALE L. J. 70 (1944).

business misadventures. In 1937 upon learning that a power retained by the grantor to amend with the consent of the trustee and beneficiaries would require the inclusion of such trusts in his gross estate at his death, he released the power to amend in order to carry out his original purpose of having the donated property freed from all claims, tax or otherwise. The court held the gifts not to have been made in contemplation of death. The court stated that a transfer is made in contemplation of death if the thought of death is the "impelling cause of the transfer" and that every man making a gift knows that what he gives away today will not be included in his estate when he dies and that all such gifts are not made in contemplation of death. His desire to make adequate provision for his children remained the dominant motive. What is the "dominant, controlling, or impelling motive" is a question of fact in each case.

The following motives have been held to be associated with life: to make children independent,[70] to save on income taxes,[71] to escape the burdens incident to the management of the properties transferred,[72] to enable the donor to speculate upon the stock market without fear that the part of his fortune transferred might be lost,[73] to insure a granddaughter's adequate care and make her more eligible for marriage,[74] to make Christmas gifts in accordance with long-established practice,[75] to rid donor of financial cares and worries,[76] to equalize gifts to children,[77] and to train sons and have them take over a business.[78] Since the passage of the Revenue Act of 1948, saving of income taxes may not be a persuasive argument regarding a gift to a spouse. A generous decedent who has been making gifts over a long period of time is more likely to have his gifts held to have been made with motives associated with life than a parsimonious decedent who hoarded his money until shortly before death.

Where the controlling and dominant purpose was to escape estate taxes, the gift was held to have been made in contemplation of death.[79] The fact that decedent made his will about the same time that he made his

[70] Becker v. St. Louis Union Trust Co., 296 U.S. 48, 56 Sup. Ct. 78 (1935).

[71] *Ibid.*

[72] Estate of Oliver Johnson, 10 TC 680 (1948).

[73] Colorado National Bank v. Commissioner, 305 U.S. 23, 59 Sup. Ct. 48 (1938). Similar holding as to gifts to compensate wife for stock market losses from following decedents' advice. Estate of Charles J. Rosebault, 12 TC No. 1 (1949).

[74] Estate of Augusta D. Moyse Schmucker, 10 TC 1209 (1948); Acq., 1948 INT. REV. BULL. No. 21 at 1 (1948).

[75] Black v. United States, 68 F. Supp. 74 (N.D. Ohio 1946) *aff'd.*, 164 F.2d 96 (C.C.A. 6th 1947).

[76] Estate of Frank F. Tillotson, 44 B.T.A. 644 (1941).

[77] Estate of Henry Monroe Springer, 45 B.T.A. 561 (1941).

[78] Estate of Herbert G. Lowe, 38 B.T.A. 117 (1938).

[79] Estate of Edwin W. Rickenberg, 11 TC 1 (1948). *See* also Farmers Loan & Trust Co. v. Bowers, 98 F.2d 794 (C.C.A. 2d 1938), *cert. denied*, 306 U.S. 648, 59 Sup. Ct. 589 (1939); *but cf.* Denniston v. Commissioner, 106 F.2d 925 (C.C.A. 3rd 1939).

gifts will tend to show that the transfers were made in contemplation of death.[80] They may be regarded as a single transaction in connection with the disposition of decedent's property. If the donor in making transfers had provisions of his will in mind, this will tend to show the transfers to have been in contemplation of death.[81] Where the donees receive interests in gifts in the same proportions and under substantially the same terms that they will take as beneficiaries under the donor's will, this will be regarded as a testamentary disposition.[82]

In order to determine the impelling motive, the age and physical condition of the decedent are relevant. The age of the decedent is not conclusive, although the younger he was at the time of the gift, the stronger is the taxpayer's case. A testator who was ninety years old when he made his gift but was in extraordinarily good health, was held not to have made a gift in contemplation of death.[83] In order to demonstrate his agility, on one occasion he jumped into the air and clicked his heels together two or three times before descending to the floor. The health and physical condition of the testator are very important.[84] However, if the testator believes he is in good health although actually fatally ill, then the fact of the illness is not conclusive.[85]

The size of the transfer is relevant but not always decisive. The larger the gift in relation to the decedent's estate, the more likely it will be questioned and possibly regarded as a substitute for testamentary disposition. However, the United States Supreme Court [86] has held that a transfer of $800,000 by an eighty-year old decedent in good health was not in contemplation of death. Upon his death he left an estate of $900,000.

The statute [87] provides that a transfer by the decedent of a material part of his property in the nature of a final disposition made within two years prior to his death shall, unless shown to the contrary, be deemed to have been made in contemplation of death. The two-year rebuttable presumption is not as significant as a reading of the statute might lead one to believe. After the matter has come to court, the obstacles to be overcome by the taxpayer are usually about the same as in the case of a gift over two years old. However, if a transfer is made within two years of death, the government will be more likely to raise an issue about such

[80] Igleheart v. Commissioner, 77 F.2d 704 (C.C.A. 5th 1935); O'Neal's Estate v. Commissioner, 170 F.2d 217 (C.C.A. 5th 1948); *cf.* Estate of Schmucker, see note 74 *supra.*

[81] Koch v. Commissioner, 146 F.2d 259 (C.C.A. 9th 1944).

[82] *See* Estate of Alice B. Davis, 1 TCM 476 (1943).

[83] Estate of Oliver Johnson, 10 TC 680 (1948).

[84] Flack v. Holtegel, 93 F.2d 512 (C.C.A. 7th 1937); Buckminster's Estate v. Commissioner, 147 F.2d 331 (C.C.A. 2d 1944).

[85] Blakeslee v. Smith, 110 F.2d 364 (C.C.A. 2d 1940).

[86] Colorado National Bank v. Commissioner, 305 U.S. 23, 59 Sup. Ct. 48 (1938).

[87] INT. REV. CODE § 811 (c).

transfer. Also closeness of the date of the gift to the date of death will be one of the factors in ascertaining the motive for the gift and in a close case may affect the decision.[88]

Since the question as to whether a gift is in contemplation of death is one of fact, each case must be considered individually, and a decision on the facts governs. This has resulted in considerable litigation with the government being a frequent loser.

The decedent who acts in good faith and gives no thought or consideration to death may leave little or no evidence to support his executor's position that the gift was not made in contemplation of death. Where a gift is made, not in contemplation of death, but under such circumstances that the government later might argue otherwise, all pertinent evidence concerning the donor's personal, social, and business activities, his state of health, his financial position, the donee's financial condition, and the donor's motives for the gift should be preserved. The donor's relevant correspondence and papers should be saved.

STATE DEATH TAX

Illinois subjects a gift made in contemplation of death to an inheritance tax based upon the value at the time of death and provides that every transfer within two years prior to death without an adequate valuable consideration in money or money's worth shall, prima facie, be deemed to have been made in contemplation of death.[89]

CONSEQUENCES OF GIFT BEING HELD IN CONTEMPLATION OF DEATH

Assume that a gift is held to be in contemplation of death and is subject to death taxes. When the gift was made, a federal gift tax was payable based upon the value of the property at the date of the gift which, subject to limitations, will be allowed as a credit against the estate tax.[90] If a husband makes a gift to his children in contemplation of death, even though he may pay a gift tax on only one-half because the gift is treated as having been made by both spouses, the entire value will be included in his gross estate in determining the amount of estate tax upon his death. His estate will receive credit, subject to limitations, for the gift tax paid by both spouses.

[88] *See* Bassett's Estate v. Commissioner, 170 F.2d 916 (C.C.A. 2d 1948), where numerous small gifts were involved.

[89] ILL. REV. STAT., c. 120, § 375 (3) (1947).

[90] INT. REV. CODE §§ 813(a) and 936(b).

When the property is included in the gross estate for purposes of the federal estate tax, the valuation date is the same as that of all other property included in the gross estate, which is the date of death or the subsequent optional valuation date.[91] The value at the time of the gift may not be the same as the valuation for the estate tax. The discrepancy conceivably could be very large. The consequence of changes in valuation should be borne in mind whenever a gift that might be held to be in contemplation of death is considered. Also what effect, if any, will subsequent transfers or exchanges by the donee have on the determination.[92]

Situations exist where the position of the estate may be improved even though the gift is held to be a transfer in contemplation of death. If the estate is very large, there may be definite tax savings. Suppose Paul, a widower, makes a large gift in contemplation of death. When he dies his taxable estate will be reduced by the amount of the gift tax on the transfer and the estate will receive a gift tax credit. Thus a gift made by an affluent person in poor health, shortly before his demise, may result in total tax savings. Because of the estate tax marital deduction and the limitations on the gift tax credit, such transfer by a married person to a spouse may not prove tax-wise.

Another advantage in making gifts, even though they are held to be in contemplation of death, is a division of the income immediately for income tax purposes. The income on the gift is not included in the gross estate; only the corpus is so included.[93]

Even though the gift is held to be in contemplation of death and an estate tax is paid, based upon the value of the property at the time of death, in the event of sale by the donee the basis for gain or loss for income tax purposes is the same as in the case of any other inter vivos gift.[94]

CHARITABLE GIFTS

In determining the gift tax, a deduction is allowed to a citizen or resident from the total gifts made during the year for the amount of all charitable, public, and similar tax free gifts, as defined by the statute.[95] For income tax purposes, an individual is permitted a deduction for charitable and like contributions in an amount not to exceed 15% of his adjusted gross income, provided the taxpayer does not elect to take the optional

[91] *Id.* § 811; U.S. Treas. Reg. 105, §§ 81.10 and 81.15 (1942); Estate of Frizzell, 9 TC 979 (1947); Milliken v. United States, 283 U.S. 15, 51 Sup. Ct. 324 (1931).

[92] See MONTGOMERY, FEDERAL TAXES ON ESTATES, TRUSTS AND GIFTS 1946-1947 530.

[93] Estate of Frizzell, 9 TC 979 (1947).

[94] Wurlitzer v. Helvering, 81 F.2d. 928 (C.C.A. 6th 1936); Rose M. Everett, 4 TCM 454 (1945).

[95] INT. REV. CODE § 1004(a)(2).

standard deduction.[96] Where a joint return is filed, this would be 15% of the aggregate adjusted gross income of both spouses based upon their return.[97] Donations of citizens or residents that qualify in connection with the income tax will also meet the gift tax deduction requirements, but the converse is not always true. For income tax purposes the charitable organization must be created or organized in the United States or its possessions. No such requisite exists regarding the gift tax.

If the contribution to charity is in property other than cash, the amount of the income tax deduction is its fair market value at the time of the gift.[98] Hence, a charitable donation in the form of property that has appreciated in value is preferable to cash. If the donor retained and sold the property and gave the proceeds to charity, he would be required to pay a tax on the gain. If he transfers the property itself to the charity, no income tax will be payable on the gain, provided such gain is not within the purview of the subsequent paragraph. Obviously he should avoid contributions of property which have decreased in value as there will be no opportunity to secure the benefit of the loss.

The Bureau has issued a ruling[99] that where a farmer contributed to charity agricultural products—here wheat—raised by him on his farm, he would be required to include their fair market value in his gross income. He was permitted a deduction for the value of the wheat as a charitable contribution and was allowed to show as expenses the cost of raising it. The Bureau stated that the products of a farm are, from the beginning, in the nature of income. It cited as an authority a United States Supreme Court holding[100] that where a father made a gift to his son of interest coupons shortly before their due date with the father retaining the bonds, the subsequent payment of such interest coupons was income to the parent. It argued also that it would not appear proper to allow a taxpayer a deduction for the expenses of producing income and permit him to exclude such income from gross income and at the same time, use it to secure the benefit of a charitable contribution. An answer to this is merely to disallow the expense deduction instead of requiring the income to be included. Suppose a businessman makes a gift of an item from his inventory sold by him in the ordinary course of business. Will there be an attempt to apply a similar rule? This is possible. Until the entire matter is clarified, the safest contribution of property will be income-producing property itself or other property not sold in the taxpayer's regular business or not produced or acquired by him for sale.

[96] INT. REV. CODE § 23 (o) and (aa). Regarding certain individuals securing full deduction, *see id.* § 120. Regarding corporations, *see id.* §§ 23(q) and 102(d) (1) (B) and 505(a) (2).

[97] U.S. Treas. Reg. 111, § 29.23(o)-1 (1943).

[98] *Ibid.*

[99] I.T. 3910, 1948 INT. REV. BULL. NO. 13 at 2 (1948).

[100] Helvering v. Horst, 311 U.S. 112, 61 Sup. Ct. 144 (1940).

A contribution to be deductible from income must actually be paid during the taxable year. Thus delivery of the taxpayer's uncertified check would not constitute payment.[101] The Bureau has ruled that where a taxpayer permitted a charitable organization to use certain property without payment of rent, the value of its use cannot be deducted as a contribution to charity.[102]

A form of charity that may appeal to certain donors is making contributions to a charitable organization and, in return, securing its promise to pay an annuity to the donor or to someone close to him. The commuted value of the annuity must be deducted in determining the amount of the exempted gift;[103] and if the annuity is in favor of a third person, its value will be subject to gift tax. The contribution may be in the form of appreciated property. If the charitable contribution exceeds the donor's allowable deduction for income tax purposes for the taxable year, the donor may arrange to make his contribution over two or more years by reducing the contribution for the first year through taking back a mortgage or serial notes of the charitable organization. As the notes are cancelled or the mortgage satisfied by the taxpayer, they will constitute charitable contributions.[104]

Charitable foundations, which may take the form of non-profit corporations or charitable trusts, are effective mechanisms for securing the maximum benefit of charitable donations. The directors or trustees may be the donor and his immediate family or others close to him. Although the donor may make his contributions annually to the extent of 15% of his adjusted gross income, the charity may postpone making disbursements to later years, with the beneficiaries being then determined. All members of a family may contribute to the same foundation. This mechanism may be used to avoid losing control of a closely-held corporation by avoiding a forced sale of its stock to pay heavy death taxes. Each donor may make annual contributions in the form of shares of stock. Additional shares may be bequeathed tax free.

The marital deduction allowed against the gross estate of a decedent in determining the estate tax, unfortunately, may result in discouraging inter vivos charitable gifts by married persons and encouraging testamentary gifts to charity, especially where they exceed the amount of the permissible deduction for income tax purposes. The marital deduction in determining the estate tax may not exceed one-half of the adjusted gross estate.[105] The larger the charitable gifts passing at death, the greater will be the adjusted gross estate, and, consequently, the larger will

[101] Estate of John F. Dodge, 13 B.T.A. 201 (1928).

[102] I.T. 3918, 1948 INT. REV. BULL. No. 17 at 4 (1948).

[103] Anna L. Raymond, 40 B.T.A. 244 (1939).

[104] Andrus v. Burnet, 50 F.2d 332 (App. D.C. 1931).

[105] INT. REV. CODE § 812(e) (1) (H).

be the amount of the allowable marital deduction. Also the executor may now take the unusual position that inter vivos charitable gifts were made in contemplation of death in an effort to increase the size of the gross estate.[106]

JOINT OWNERSHIPS WITH RIGHT OF SURVIVORSHIP [107]

The popularity of joint ownerships with the right of survivorship has increased during the last decade. Considerable real estate is held in joint tenancy. Bank deposits and United States savings bonds are often payable in the alternative, for example: to Julia or Paul. Before creating joint ownerships with the right of survivorship or continuing their use, the tax consequences—including income, gift, and estate tax—should be considered.

Under the traditional joint tenancy which may be used in holding title to real estate in Illinois, neither joint owner acting alone can convey away the entire property. The most that either can do individually by conveyance to a stranger is to sever the joint tenancy, thereby creating a tenancy in common.[108] Some states recognize tenancies by the entirety which can be created only between spouses, and under which neither spouse singly can sever the tenancy nor convey any interest.[109] Another type of joint ownership is exemplified by the joint bank account in which either party alone may withdraw any or all funds. United States savings bonds payable to Paul or Julia are in a similar category as either, acting individually, may cash these bonds.

If Paul pays the entire consideration for the purchase of a parcel of real estate for the benefit of his wife, Julia, and himself and has title placed in joint tenancy, he has made a reportable gift to Julia of one-half of the value of the property.[110] Although the interest received by his wife, Julia, is terminable and, as such, ordinarily would not qualify for the gift tax marital deduction, the 1948 Revenue Act specifically provides that if the interest transferred to the donee spouse is as sole joint tenant with the donor or as tenant by the entirety, it shall secure the benefit of the marital deduction.[111] Thus only one-fourth of the entire value of the property is subject to gift tax.[112] If the joint tenants consist of Paul,

[106] See SURREY, *Federal Taxation of the Family—The Revenue Act of 1948*, 61 HARV. L. REV. 1097, 1152 (July, 1948).

[107] For more detailed discussion, see EPSTEIN, *Joint Tenancies—Tax Saving or Spending Device*, PROCEEDINGS INSTITUTE ON TAXATION, COLLEGE OF LAW, UNIVERSITY OF ILLINOIS 12 (February, 1948).

[108] Kane v. Johnson, 397 Ill. 112, 73 N.E. 2d 321 (1947).

[109] Ades v. Caplin, 132 Md. 66, 103 Atl. 94 (1918).

[110] U.S. Treas. Reg. 108, § 86.2(a) (5) (1943).

[111] INT. REV. CODE § 1004(a) (3) (D).

[112] Regarding tenancies by the entirety, *see* U.S. Treas. Reg. 108, §§ 86.2(a) (6) and 86.19(h) (1943); Lilly v. Smith, 96 F.2d 341 (C.C.A. 7th 1938), *cert. denied*, 305 U.S. 604, 59 Sup. Ct. 64 (1939).

his wife, Julia, and their son, Don, Julia's interest will not qualify for the marital deduction in view of Don's interest.

In the case of a joint bank account created by Paul for himself and his wife, Julia—or a similar type of ownership where Paul can regain the entire fund without Julia's consent—there is a gift to Julia when she draws upon the account for her own benefit to the extent of the amount withdrawn.[113] A United States savings bond purchased by Paul, payable to Paul or Julia, would constitute no gift to Julia until she redeemed the bond.[114] These gifts would obviously qualify for the gift tax marital deduction as no terminable interest is involved.

Ordinarily no income tax problem will exist regarding property held in joint ownership between a husband and wife as they may now divide their total income on a joint return. Occasionally, however, joint ownerships exist between persons who are not spouses. If Paul purchases property in joint tenancy with his son, Don, even though Paul pays the entire consideration, each reports only one-half of the income and one-half of the gain or loss on sale.[115] The interest on a joint bank account or a United State savings bond payable to either would be reported by the contributor.[116]

If one joint tenant pays the taxes or the interest on the mortgage on property held in joint tenancy, he may deduct the entire payment in full on his income tax return where both are on a cash basis.[117]

Upon the death of a joint owner of property held under joint ownership, with the right of survivorship, there is included in the gross estate in determining the federal estate tax the entire value of the jointly held property, except such part as may be shown to have originally belonged to the survivor and never to have been received by the latter from the decedent for less than full consideration in money's worth.[118] It is the existence of the joint ownership at the time of death and not its creation at the earlier date that forms the basis for the tax. This rule applies to property held in joint tenancy or in tenancy by the entirety, as well as

[113] U.S. Treas. Reg. 108, § 86.2(a)(4) (1943).

[114] Mim. 5202, 1941-2 CUM. BULL. 241.

[115] William R. Tracy, 25 B.T.A. 1055 (1932); Frederick J. Haynes, 7 B.T.A. 465 (1927), Acq. VII-1, CUM. BULL. 14 (1928); I.T. 3825, 1946-2 CUM. BULL. 51; I.T. 3754, 1945 CUM. BULL. 143. As to tenancies by the entirety, Cooley v. Commissioner, 75 F.2d 188 (C.C.A. 1st 1935), *cert. denied*, 295 U.S. 747, 55 Sup. Ct. 825 (1935), *see* Commissioner v. Hart, 76 F.2d 864 (C.C.A. 6th 1935), *aff'g*, 27 B.T.A. 528 (1933); I.T. 3878, 1947 INT. REV. BULL. No. 24 at 4 (1947).

[116] I.T. 3301, 1939-2 CUM. BULL. 75.

[117] I.T. 3785, 1946-1 CUM. BULL. 98; F. C. Nicodemus, Jr., 26 B.T.A. 125 (1932); Acq. XIV-2 CUM. BULL. 16 (1935); I.T. 3304, 1939-2 CUM. BULL. 159.

[118] INT. REV. CODE § 811(e); United States v. Jacobs, 306 U.S. 363, 59 Sup. Ct. 551 (1939); Tyler v. United States, 281 U.S. 497, 50 Sup. Ct. 356 (1930); Mim. 5202, 1941-2 CUM. BULL. 241; Estate of Joseph A. Brudermann, 10 TC 560 (1948). Regarding gift tax credit, *see* INT. REV. CODE §§ 813(a) and 936(b).

joint bank accounts and savings bonds. The burden of proof rests upon the executor or survivor if he seeks to avoid taxation.[119]

If a gift of land from Paul to his wife, Julia, is later traded by her for another parcel of real estate and she has title to the second piece placed in joint tenancy, Paul will be regarded as the original donor; and upon his death, the entire value of the second piece will be included in his taxable gross estate.[120] The income on a gift from Paul to Julia used by her to purchase jointly-held property will not be regarded as originally belonging to him.[121]

Where property held in joint ownership with the right of survivorship is included in the decedent's gross estate and the other joint owner is his spouse, then the amount that is required to be so included will qualify for the estate tax marital deduction.[122] However, if a joint tenancy consists of Paul, his wife, Julia, and their son, Don; upon Paul's death, Julia's interest will not qualify for the marital deduction because she has a terminable interest as Don may become the sole owner upon her death.

The termination of existing joint tenancies by the creation of tenancies in common to save estate taxes by reducing the gross estate of the contributing joint owner upon his death, may result in still having the entire property included in his gross estate as being a transfer made in contemplation of death.[123]

In states similar to Illinois, upon the death of a joint owner the interest of the joint tenant is taxed as though the property had been held in equal shares as tenants in common and the share of the deceased tenant passed to the survivor or survivors by will.[124] When a husband and wife own real estate in joint tenancy or have a joint bank account or savings bonds payable to either, upon the death of either, one-half will be subject to the Illinois inheritance tax no matter who the contributor was.

Where property is acquired in joint tenancy or by the entirety and a joint owner dies, upon a subsequent sale of the property, even though all or part of the entire value of the property was previously included in the gross estate of the decedent in determining the federal estate tax, the survivor must take the basis of the joint owners in determining gain or loss for income tax purposes.[125] If the property had been inherited,

[119] McGrew's Estate v. Commissioner, 135 F.2d 158 (C.C.A. 6th 1943).

[120] Estate of Edward T. Kelley, 22 B.T.A. 421 (1931); Dimock v. Corwin, 306 U.S. 363,371, 59 Sup. Ct. 551, 555 (1939).

[121] Estate of Ralph Owen Howard, 9 TC 1192 (1947); Acq., 1948-1 CUM. BULL. 2 (1948).

[122] INT. REV. CODE §§ 812(e)(1) and (3) (D) and (E).

[123] Frank K. Sullivan Estate, 10 TC 961 (1948).

[124] ILL. REV. STAT., c. 120, § 375 (5) (1947).

[125] Lang v. Commissioner, 289 U.S. 109, 53 Sup. Ct. 534 (1933); Helen G. Carpenter, 27 B.T.A. 282 (1932), *pet for review dism'd for non-pros.*, 68 F.2d 995 (C.C.A. 7th 1934); I.T. 3754, 1945 CUM. BULL. 143; I.T. 3785, 1946-1 CUM. BULL. 98.

the basis for determining gain or loss would have been the value in the decedent's gross estate.[126]

JOINT OWNERSHIPS WITH SURVIVORSHIP—TAX SPENDING OR TAX SAVING?

Where tax considerations affect policy, the joint tenancy arrangement with the right of survivorship in holding title to property should be used with caution. No necessity exists for a husband or wife to create joint tenancies to secure income tax benefits. Although the contributing spouse pays a gift tax when the joint tenancy is created, if he predeceases his spouse, all of the property valued at the date of death is included in his gross estate (subject to a limited gift tax credit). While jointly-held property qualifies for the marital deduction in the decedent's taxable estate, it may prevent other property from securing the benefit of the estate tax marital deduction. Of course, if the non-contributing spouse had died first, no part of the property would be included in her gross estate. There would, however, be loss of any gift tax paid.

As previously indicated, when the surviving joint tenant sells the property formerly held in joint tenancy, even though the full value may have been included in the deceased spouse's gross estate, the basis for ascertaining gain for income tax purposes is the old basis of the joint owners. This is a definite tax disadvantage in a rising market.

If the surviving spouse had inherited an improved parcel of real estate from the deceased spouse, the value of the property at the time of the decedent's death would be its basis not only for gain or loss in the event of a sale, but also in setting up a new depreciation schedule in determining net income for income tax purposes. However, where the property was held in joint tenancy, the surviving tenant must continue with the original depreciation schedule, and this often results in a tax loss.

If a person desires to use joint ownerships with the right of survivorship, he should use them because of the conveniences they afford disregarding the tax donations that may follow. Joint tenancies may be advisable in small estates to avoid probate where tax problems are of little or no importance. The larger estate always has some property that requires the opening of an estate in the probate court, and adding a few parcels of real estate or some other property will not make any material difference.

Joint ownerships with the right of survivorship should be used with caution and only after the tax consequences have been carefully considered.

[126] INT. REV. CODE § 113(a)(5).

GIFT TAX RETURNS

A donor who is a citizen or resident of the United States is obligated to file a return covering any gift to any donee of a value in excess of the annual exclusion of $3,000 (or, regardless of value, in the case of a gift of a future interest) made during the calendar year.[127] A return may be required even though no tax is due. Although the specific exemption claimed covers the entire gift, a return must be filed if its value is in excess of the annual exclusion. If a gift to charity is made, the donor must report this gift—in excess of the exclusion—in a return even though no tax is payable. If the donor dies before filing his return, the executor or administrator should file the same. The return must be filed on or before March 15th after the close of the calendar year in question.[128]

If Paul, a married person, makes a gift to his son, Don, of $5,000 in cash, which is his sole gift for the year, and the gift is treated as one from both spouses, he must file a return even though no tax is payable. His wife, Julia, need not file a return but must signify her consent. If the gift to Don was over $6,000 or if she herself made any gifts to her son so that her share is over $3,000, a return from her would also be required. Must Paul report a gift to his wife of $5,000? Since the marital deduction is not an exclusion, a return would seem to be required.

In every case where the gift must be reported by the donor, an information return also due on or before March 15th of the following year must be filed by every donee or trustee [129] (excepting charitable organizations which have been held by the Commissioner to come within the meaning of the statute).

Where a gift is in trust, the information return may be filed by the trustee or the beneficiary. Even though the gift in trust is not complete because the donor retains one or more powers, the notice should be filed.

[127] INT. REV. CODE § 1006(a); U.S. Treas. Reg. 108, § 86.20 (1943).
[128] INT. REV. CODE § 1006(b); U.S. Treas. Reg. 108, § 86.22 (1943).
[129] *Id.* § 86.21.