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Federal Taxation of Gifts, Trusts and Estates

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FEDERAL TAXATION OF GIFTS, TRUSTS AND ESTATES. By *Douglas A. Kahn* and *Lawrence W. Waggoner*. Boston: Little, Brown. 1977. Pp. xvii, 848. \$21.95.

From the vast repertoire of anthems sung by the consumer choirs in the age of Nader, legal educators have heard the often loud, sometimes clear, usually dissonant chorus of law students lamenting the nature and quality of their legal education.¹ To the conservative ear, some of the calls for change, such as that for a two-year law school program,² have a radical tenor. Law schools tend to change slowly, however, and most students would probably oppose a true revolution in legal education. Nonetheless, major changes in the content and methods of legal education have occurred. Law schools have increased the number of clinical and interdisciplinary programs, offered courses in new subjects, instituted smaller classes, and tried new approaches to old subjects (*e.g.*, legal ethics) and basic skills (*e.g.*, research and writing). I will not try to evaluate these developments here, but I do sense some worthy achievements and applaud vigorously those institutions experimenting in legal education.

Unfortunately the inclination to change rarely extends to that staple of legal education, the well-subscribed, standard-subject course. Whatever the merits of the developments listed above, many law school faculties may have used them merely to appease a deeper dissatisfaction. Many faculty members support clinical education, for instance, to bolster the morale of second- or third-year students who are bored with standard legal materials that emphasize legal analysis and parade substantive rules.³ Many students believe that much of what they learn will benefit them directly only because it helps them pass their courses. Beyond that, it may give them a head start on the bar review and fitfully be useful in practice. Part of the problem may arise from an unrealistic notion about the pace of a lawyer's professional development.⁴ Legal educators should stress that such development proceeds slowly, is hard to measure, and continues long after graduation.

Nevertheless, there are reforms that will genuinely and directly meet the legitimate criticisms of the law school curriculum. Teachers can change their teaching methods, use more kinds of materials, em-

1. Like most forms of music, these contemporary anthems have antecedents. One writer has noted that student complaints about the third-year program were heard at Harvard as early as 1935. Stolz, *The Two-Year Law School: The Day the Music Died*, 25 J. LEGAL EDUC. 37, 41 (1971).

2. Stolz supplies a partial bibliography. *Id.* at 39.

3. For a study of contemporary student attitudes toward their legal education, see Carington & Conley, *The Alienation of Law Students*, 75 MICH. L. REV. 887 (1977).

4. A similar observation was recently made of the general attitude of students regarding career planning. Goodman, *The Anxiety Syndrome*, Washington Post, March 14, 1978, at 17, col. 1.

phasize some neglected legal skills, and show how related subjects interact. The scant attention given these matters is especially regrettable since student discontent flows largely from their experience in the staple courses.

At one time, many law students argued that law schools focused on what the legal rules are but not what they should be if we are to progress toward a just society. More recently, a preoccupation with their careers seems to have blunted that criticism. Indeed, I have observed at several law schools that most students respond to serious discussions of policy with vacant stares. Perhaps they fear any diversion from the "tell me what the law is" approach, which they consider essential to their immediate professional development. Nevertheless, I disagree with those who wish to expand the coverage of traditional, broad policy issues. Specific policy questions should be raised. For example, the merits of special tax treatment of capital gains income is a good classroom topic, but it can hardly be covered extensively in an introductory course in federal income taxation.⁵ On the other hand, tax students who deal with the conflict between fairness and the need for objective, workable rules should learn about the benefits of administrative convenience, for the taxpayer and the government, in the content and implementation of basic tax rules. A better understanding of this problem among lawyers would reduce unnecessary tax litigation; that understanding should not be dismissed as a matter to be learned in practice.

Although after Watergate few students need to be made more cynical about vested interests and the legal process, the dynamics of the legislative process and its potential for special-interest laws should be probed.⁶ Introducing law students to the social and moral complexities of legislation does as much to improve the integrity of the federal tax system as urging a deeper concern for equity by practicing specialists and their professional associations. Examining the realities of tax legislation may also alleviate student concerns about overly abstract education.⁷

5. The scope of the subject is illustrated by Blum, *A Handy Summary of the Capital Gains Arguments*, 35 TAXES 247 (1957).

6. S. SURREY, W. WARREN, P. MCDANIEL & H. AULT, *FEDERAL INCOME TAXATION, CASES & MATERIALS* 390 (1972), raises the suspicion that the old § 166(f) of the Internal Revenue Code of 1954, relating to preferred treatment of certain bad debts, was designed to meet the needs of a particular taxpayer. Not until the Tax Reform Act of 1976, Pub. L. No. 94-455, § 605(a), 90 Stat. 1575, was this special rule repealed.

7. Additionally, such an inquiry may illustrate the devious ways in which narrow statutory language can be used to implement special interests. For example, in 1966 Congress finally amended the old § 2056(d) of the Internal Revenue Code of 1954 to permit an increase in the marital deduction through a disclaimer by a person other than the decedent's surviving spouse. Act of Oct. 4, 1966, Pub. L. No. 89-621, 80 Stat. 872. Although § 1(b) applies the amendment to estates of decedents dying after enactment, § 1(c) reaches back to include certain prior disclaimers by reference to an estate tax return filing date occurring on or after January 1, 1965. Since the estate tax returns at that time were not due until fifteen months after death, the

Law schools are beginning to respond better to the call for instruction in professional responsibility, but the subject has usually been confined to single courses. These courses have been plagued by the difficulty of securing enthusiastic and long-term commitments from full-time faculty members, who fear a professional dead end; uninterested students, who see no relationship to "real" law; and the scarcity of modern teaching materials. I do not insist that such courses be abandoned, but that professional responsibility issues should more often be incorporated into substantive courses. Students may better appreciate the complexity of ethical problems that are presented as part of a substantive legal analysis. Furthermore, instructors experienced in a particular field can best identify the important problems and the uncertain line between the ethical and the expedient.

Scheduling and personnel demands inevitably divide the law school curriculum into courses imperfectly aligned with the practice of law. That fragmentation serves pedagogical purposes, particularly in the first year. However, the traditional second- and third-year curriculum may perpetuate unrealistic dividing lines. The ability to interweave principles from different areas of the law, or from different branches of a single area lies at the core of a successful legal career. Thus, the second- and third-year curriculum should stress analysis that embraces more than one traditional subject, and instructors should learn to teach that kind of analysis. Yet one can hardly expect revolution in the face of tradition, established specializations, and the fragmented state of teaching materials.

Some integration of substantive areas has occurred, but peculiar deficiencies persist. Federal estate and gift tax courses, for instance, generally ignore or skim the formidable income-tax rules that influence the planning of inter vivos gifts. For more than ten years, I have taught my federal estate and gift tax students the relevant income-tax rules, particularly by comparing the estate and gift tax provisions with the income tax provisions for incomplete lifetime gifts. Needless to say, I do not claim to have invented this scheme, but I am struck by the persistence of the old ways.

A broader integration of property and tax materials in an estate planning course raises serious issues on which reasonable people committed to innovation in legal education will disagree. An integrated property and estate tax planning course might overwhelm students who have had no prior exposure to the area. Although attractive because of its practical and "real life" appearance, the course might demand too much knowledge of basic property and tax

special provision could grant a marital deduction to the estate of a decedent who died during 1963. The provision does not openly favor a small class of taxpayers, but one may speculate that it benefited a limited number of taxpayers.

rules. Whether the property-tax integration should be reserved for advanced courses or seminars in estate planning seems to me an open question, but so little has been attempted in the large basic courses that property-tax teachers should be anxious to experiment.⁸

With tradition and inertia, the perennial shortage of time militates against integration. Surely an estate and gift tax course with substantial income tax coverage needs three hours rather than two. Moreover, the potential benefits of an integrated estate and gift tax course so impress me that I would sacrifice some "pure" estate and gift tax material to achieve it; a broad perspective far outweighs the harm of exploring fewer nooks and crannies in the substantive law. I am prepared to defend that idea to students whose curricular decisions are unduly influenced by the content of bar examinations. I would also delete from the basic income-tax course all but a general introduction to income taxation of trusts and estates,⁹ prune the course from four hours to three,¹⁰ and reduce the number of hours now offered in trusts, estates and future interests courses.¹¹ I recognize that these suggestions present problems for my colleagues in tax and property, but these colleagues may be placated by the compensating advantages of my proposals.

Questions remain about teaching methods. I am uninterested in joining the traditional debate over the merits of the case method,¹² problem approach and the combinations thereof. More basic questions must be confronted before legal materials can be selected for a course. I share the view of some teachers and, I sense, some thoughtful students, that second- and third-year courses focus too narrowly on litigation. That the American lawyer's training begins with a law school curriculum devoted to the analysis of court opinions certainly helps explain Americans' litigiousness.¹³ No one, of course, suggests locking the casebooks in a back room of the law library. The attitude and approach of the instructor, not just the materials he uses, are at issue. Law school courses traditionally give too little time to legal planning, to asking how to draft a document or

8. J. DUKEMINIER & S. JOHANSON, *FAMILY WEALTH TRANSACTIONS* (2d ed. 1978), though otherwise devoted to the nontax aspects of wealth transmission, contains a chapter on estate and gift tax provisions.

9. I have used with general satisfaction J. FREELAND, S. LIND & R. STEPHENS, *FUNDAMENTALS OF FEDERAL INCOME TAXATION, CASES AND MATERIALS* (2d ed. 1977). I have regularly deleted, however, the detailed materials on income taxation of trusts and estates (at 304-21).

10. From my limited experience in teaching a four-hour basic income tax course, I sense an inevitable pressure to fill the latter part of the course with specific materials of limited benefit to most law students.

11. Trusts and estates instructors will disagree as to whether to prune the basic wills and trusts rules or the more complicated but sometimes exotic future interests problems.

12. For a contemporary defense of the case method, see Dente, *A Century of Case Method: An Apologia*, 50 WASH. L. REV. 93 (1974).

13. See generally Ehrlich, *Legal Pollution*, N.Y. Times, Feb. 8, 1976, § 6 (Magazine), at 17.

statute to eliminate problems in advance. Classroom materials can facilitate either the planning or litigation approach; those who favor substantial use of problems as the basis for class discussion easily resist the overemphasis on litigation.

The focus on litigation in most courses may not foreclose, but does discourage, classroom consideration of other important skills. Students need to learn to collect and distill accurately the information needed to plan safely a transaction or to draft plainly a statute or regulation; to evaluate proposed transactions, statutes, and regulations from the perspectives of those affected; and to negotiate transactions and dispute settlements. Courses studying private transactions and their governmental regulation or taxation most clearly invite teaching these skills. Since the bulk of most practice, whether in a large or small city, in a firm or a government agency, involves private transactions regulated by the government, these skills deserve more attention than the neglect they receive in law schools.

Some have suggested that these skills are best developed after graduation.¹⁴ But why should skills so important to success in the profession not be nurtured as early as possible? Notwithstanding the size of the staple classes, an instructor with the right materials can convey the broad range of the lawyer's tasks.

No doubt a broader approach requires sacrificing some of what we now teach. The alternative, extending law school beyond three years, is infeasible given the cost of legal education and the discontent of students. As I remarked above, I would reduce the coverage of substantive law. Students retain much of the detail in courses only long enough to take the examination. Furthermore, a properly trained law student has the basic analytical skills and the acquaintance with legal materials to fill the gaps in course work. Indeed, I suspect that law teachers in good schools underestimate the speed with which students grasp the skills taught in the staple courses. If a beginning lawyer is prudent and supervised, there should be no increase in professional incompetence.

Finally, teachers' and practitioners' complaints about law students' research and writing ability have little to do with course content and perspective. Writing deficiencies stem from fundamental problems in our educational system and almost certainly will not be corrected in the large staple class. Similarly, complaints about the research of beginning lawyers simply reflect the likelihood that only law review and moot court participants will have done any research after the freshman year.

14. *E.g.*, Gorman, *Proposals for Reform of Legal Education*, 119 U. PA. L. REV. 845, 847 (1971).

This lengthy discussion of legal education was stimulated by a major new book, Kahn and Waggoner's *Federal Taxation of Gifts, Trusts and Estates*. The authors have integrated the study of federal transfer¹⁵ and income tax provisions relevant to the gratuitous transmission of wealth. Indeed, among contemporary volumes,¹⁶ the Kahn and Waggoner book has the most integrated approach to the subject. In the preface the authors comment:

[W]e have tried to integrate the material functionally, so that the income, estate, gift and generation-skipping tax consequences of a particular transaction are considered together. This not only enables us to look at the materials in the way a practicing lawyer must approach planning problems [reviewer's exclamation: hallelujah], but it also facilitates a more sophisticated probe of the underlying policies, or lack thereof, of our tax system as a whole. We do not, however, attempt to integrate an in-depth study of property law.¹⁷

For reasons discussed previously, I have no quarrel with the exclusion of property law,¹⁸ and enough property law is integrated where necessary for a broader perspective or for an understanding of specific tax problems.

A quick survey of the book reveals the authors' integrative technique. Part I (chapters 2-7) includes the income tax basis rules for property acquired from a decedent in its discussion of the basic estate tax rules for property owned by the decedent at his death and for property over which he has a power of appointment. Tax instructors will immediately detect an overlap with the traditional basic income tax course, but some repetition in the law school curriculum is hardly a major fault, particularly in a subject made so complex by the recent enactment of carryover basis rules for property acquired

15. The phrase "federal transfer tax" will increasingly be used as a shorthand for three federal taxes applicable to gratuitous transfers: gift, estate, and generation-skipping transfers.

16. The collaborators on *THE STUDY OF FEDERAL TAX LAW: ESTATE AND GIFT TAX VOLUME* (1977-1978) have finally added a chapter dealing with income taxation of trusts and estates. See also B. BITTKER & L. STONE, *FEDERAL INCOME, ESTATE, AND GIFT TAXATION* (4th ed. 1972). I find classroom use of the gigantic A. CASNER, *ESTATE PLANNING* (3d ed. 1961 & Supp. 1977) difficult. Less problematic is A. CASNER & R. STEIN, *ESTATE PLANNING UNDER THE TAX REFORM ACT OF 1976* (2d ed. 1978), a volume apparently prepared for use in continuing legal education.

Other recent books have retained isolated considerations of federal transfer taxes, e.g., S. SURREY, W. WARREN, P. MCDANIEL & H. GUTMAN, *FEDERAL WEALTH TRANSFER TAXATION, CASES AND MATERIALS* (1977). Professor David C. Johnson rather comfortably ignores that fact in Book Review, 1977 S. ILL. U. L.J. 470. The isolated treatment of the transfer taxes may be partially explained by the structure of the nonclassroom material. E.g., R. KRAMER & J. McCORD, *PROBLEMS FOR FEDERAL ESTATE AND GIFT TAXES* (1976), which is designed for use with their text, C. LOWNDES, R. KRAMER & J. McCORD, *FEDERAL ESTATE AND GIFT TAXES* (3d ed. 1974).

17. D. KAHN & L. WAGGONER, *FEDERAL TAXATION OF GIFTS, TRUSTS AND ESTATES* xvi (1977) [hereinafter cited as KAHN & WAGGONER].

18. See text at note 8 *supra*.

from a decedent.¹⁹ Moreover, the repetition allows the students to reconsider basic income tax rules in an estate planning context.

Part II (chapters 8-9) introduces the student to income taxation of trusts and estates, including the infamous throwback rules for distributions of accumulated trust income. Again, the basic income tax course may be duplicated to some extent.²⁰ I prefer to delete all but an introduction to this subject from the basic course. Unlike the income tax basis rules, which apply to a variety of transactions outside the estate planning area, these highly specialized and complex rules apply only to the income taxation of trusts and estates. Thus as long as students are introduced to the taxpayer entity subject in the basic income tax course, those who do not take the estate and gift tax course are unlikely to suffer from not having learned those trusts and estates rules in law school.

The most dramatic example of the book's integrated approach is to be found in Part III (chapters 10-17). Entitled "Inter Vivos Transfers," it is divided into three parts: (1) gift rules; (2) estate and income tax provisions applicable to lifetime gifts; and (3) federal taxation rules for jointly held property and significant special assets such as life insurance, annuities, and employee death benefits.²¹

Kahn and Waggoner's book may also help tax instructors answer some of the other criticisms of law school curriculum. Chapter 1, for example, includes ample and challenging materials on the policies underlying the basic transfer tax²² and the new generation-skipping transfer tax, though the reproduction of the entire House Ways and Means Committee Report on the latter provisions seems excessive.²³ Legislative materials and professional association reports on policy issues in more specific areas are included throughout the book.²⁴ The failure of the government and the courts to develop a workable policy regarding an estate tax deduction for selling expenses incurred by the executor is illustrated clearly but repetitively.²⁵

19. The authors are to be congratulated on their effective incorporation of the Tax Reform Act of 1976, which was enacted when they had already reached a very late stage in the preparation of their book.

20. See text at note 9 *supra*.

21. The authors raise the issue of the gratuitousness of property transfers for federal gift and estate tax purposes at appropriate points. See, e.g., the basic gift tax materials, KAHN & WAGGONER, *supra* note 17, at 399-428. The separate treatment of the consideration subject in Chapter 14 is of doubtful value.

22. See, e.g., *id.* at 12-15.

23. *Id.* at 160-78. It is doubtful that many students can profit from this item, but, in fairness to the authors, all the instructors in this area are still searching for an appropriate approach to this major new subject.

24. E.g., *id.* at 431-43, on the annual gift tax exclusion, and 407-09, on the new disclaimer rules.

25. *Id.* at 190-98.

Kahn and Waggoner integrate ethical issues through a recent California case holding an attorney liable for a tax planning mistake²⁶ and through some bar association opinions regarding solicitation of estate planning business. They also explore the draftsman's protection under a "savings clause" designed to assure qualification for complex and error-prone areas such as the marital deduction.²⁷ One of the more difficult practical problems facing the tax practitioner is the proper response to the question whether to disclose on tax returns items which the lawyer considers not taxable but which he knows that the government might consider taxable. An exercise in drafting language for a "rider" to a return might be added by an instructor.

Those primarily concerned with estate *planning* might find that this book shares the traditional casebook's preoccupation with litigated transactions. Some planning discussions and exercises are included,²⁸ but as I previously noted, the breadth of a course's perspective depends as much on the instructor as on the book. An instructor concerned with estate planning should be able to alert students to the planning problems inherent in even traditional materials. This book does not include a large, summary problem that invites the student to draft a complete estate plan.²⁹ I suspect the authors consider such exercises best developed by instructors for their advanced course or seminar.³⁰

Most teachers will need to be selective in their use of the book. The authors admit the difficulty of covering the entire book in a three semester-hour course.³¹ A syllabus that prunes the course to manageable proportions could relieve students of excessive detail.³² Indeed, some of the book is probably too detailed even for an advanced course. For example, I consider it essential to cover the simultaneous death problem in the marital deduction context. The basic problem is difficult enough, however, and applying it in the context of tenancy by the entirety as well may hinder, more than aid,

26. In the Teachers' Manual at 1, the authors openly discourage coverage of the malpractice case in class. Although the nontax principles in the California case are self-evident, classroom discussion may insure that students give at least some attention to an issue of growing importance to practitioners in the estate planning area.

27. KAHN & WAGGONER, *supra* note 17, at 275-78.

28. *E.g., id.* at 305-07, on marital deductions and 196-97, on executors' selling expenses.

29. *See generally* A. CASNER, *supra* note 16.

30. Neither do the authors devote any attention to the professional skills of interviewing, counselling, and negotiations. The difficulty of fact-gathering could have been illustrated in the Chapter 2 discussion of valuation, for instance, by including one or two cases rich in facts pertinent to the valuation of real estate or closely held stock.

A more direct approach to the development of these skills is taken in N. STEUBEN & W. TURNER, *PROBLEMS IN THE TAXATION OF INDIVIDUALS, PARTNERSHIPS AND CORPORATIONS* (1978).

31. KAHN & WAGGONER, *supra* note 17, at xv.

32. Each author reprints his own syllabus in the Teachers' Manual at 211-16.

the student.³³

On the other hand, most teachers will prefer too much to too little. Indeed, because of the abundance of materials,³⁴ this book can be used in advanced as well as beginning courses in estate planning, and even in the basic course detailed items may appeal to some. Few recipients of a general power of appointment, for example, are later disabled by mental incapacity,³⁵ but the situation presents an interesting conceptual problem. Importantly, the authors analyze that problem from the perspective of the estate planner.

Furthermore, I applaud the book's diversity; the authors include not only cases and rulings, but legislative materials, professional association reports, and excerpts from the IRS Audit Technique Handbook for Estate Tax Examiners.³⁶ A separate volume compiles portions of the Internal Revenue Code, treasury regulations, and certain uniform property laws. That volume will be useful to students and practitioners alike.

The book's format fails to differentiate adequately cases, problems, and the authors' textual discussion through titles or typography. The book's homogeneous appearance, which complicates reading, may be part of the authors' design of "a highly structured course . . . which assigns equal weight to cases, hypotheticals, and planning and policy questions."³⁷ This worthy goal, I fear, may be defeated by the students' tendency to read selectively, particularly in a book with such an abundance of materials. And as does that abundance of materials, the book's physical appearance suggests the importance of a detailed syllabus. Nevertheless, any author will admire the book's general technical qualities and freedom from typographical errors.

I am pleased to endorse a book that advances a broad perspective of tax instruction without sacrificing substantive content. Those who share some of the views expressed earlier in this review will also be grateful to the authors for assisting the movement toward that vision of legal education.

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33. KAHN & WAGGONER, *supra* note 17, at 228-30. The problem is made especially difficult by the authors' postponement until Chapter 15 of a detailed treatment of joint tenancy property for estate tax purposes.

34. For a "leaner" but quite satisfactory basic income tax book, *see* note 9 *supra*.

35. KAHN & WAGGONER, *supra* note 17, at pp. 132-35. In their Teachers' Manual at 25-25b, the authors report some reconsideration of this subject in Estate of Gilchrist, 69 T.C. 5 (1977).

36. KAHN & WAGGONER, *supra* note 17, at 49-50.

37. *Id.* at xvi.