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Voluntary Payments to Widows of Corporate Executives: Gifts or Income?

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VOLUNTARY PAYMENTS TO WIDOWS OF CORPORATE EXECUTIVES: GIFTS OR INCOME?

The solicitude of hardhearted corporations for the widows of corporate executives has given rise to an abundance of cases involving the question whether payments to these widows constitute gifts or income. In the cases to be considered in this comment, payments are made by the corporation to the decedent's widow on a purely voluntary basis. In the typical situation, the board of directors adopts a resolution eulogizing the decedent and authorizing payments to his widow in recognition of his long and faithful service.[1] In most cases, these payments are measured by the decedent's salary and continue for periods ranging from a few months to a few years. The Commissioner of Internal Revenue relies upon section 61(a)[2] and claims that the widow's receipts constitute taxable income. The widow insists that she has received a gift which may be excluded from gross income under section 102(a).[3]

Prior to the Supreme Court's decision in *Commissioner v. Duberstein*,[4] the Commissioner met with little success in his attempts to tax these payments. Since *Duberstein*, however, the courts have widely disagreed. By tracing the development of the widow payment phase of the gift-income controversy and by delineating possible solutions to the problems which presently exist, it is hoped that guidelines will be provided for remedial action by either Congress or the courts.

I. THE PRE-DUBERSTEIN ERA

The first case of major significance in the gift-income area did not arise until 1937, when the Supreme Court handed down its decision in *Bogardus v. Commissioner*.[5] Although not dealing with payments to widows of corporate executives, this case has had a significant influence on the development of the tax treatment of such payments. The *Bogardus* case involved payments made by Corporation *A* to petitioner and others who had rendered services to Corporation *B*. In January 1931, all of *B*'s stock was sold, but prior to the sale, *A* was organized and purchased some of *B*'s assets. All of *B*'s former stockholders became stockholders of *A* with the same proportionate holdings. A few days after the sale, the stockholders of *A* proposed that they show their appreciation for the loyalty and support of some of the employees of *B* by making a "gift or honorarium." A resolution to that

1 For examples of typical resolutions, see Reed v. United States, 177 F. Supp. 205, 206 (W.D. Ky. 1959), *aff'd mem.*, 277 F.2d 456 (6th Cir. 1960); Roy I. Martin, 36 T.C. 556, 557-58 (1961), *aff'd*, 305 F.2d 290 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962); Estate of John A. Maycann, Sr., 29 T.C. 81, 83 (1957), *appeal dismissed per stipulation*, (6th Cir. 1958).

2 INT. REV. CODE OF 1954, § 61(a). "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived . . . ."

3 INT. REV. CODE OF 1954, § 102(a). "Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance."

4 363 U.S. 278 (1960).

5 302 U.S. 34 (1937).

effect was adopted by *A*'s board of directors and ratified by its stockholders. Pursuant to the resolution, payments were made to present and former employees, attorneys, and experts of *B*, none of whom had ever been in the employ of *A*. The Commissioner held that the payments were part of petitioner's gross income. The Board of Tax Appeals sustained this determination and the Court of Appeals for the Second Circuit affirmed.[6]

The Supreme Court, four Justices dissenting,[7] reversed the decision of the Second Circuit and held that the payment to petitioner was a gift. Both the majority and the dissenters agreed as to the determinative factor which distinguishes gifts from income. In the language of the dissent: "What controls is not the presence or absence of consideration. What controls is the intention with which payment, however voluntary, has been made."[8] Indicative of the reasoning of the Court are the following excerpts from the majority opinion:

> "Neither the Unopco company [corporation *A*] nor anyone else was under any obligation, legal or otherwise, to pay any of the recipients, including petitioner, any salary, compensation or consideration of any kind. . . . [T]he disbursements were *not made or intended to be made* for any services rendered or to be rendered or for any consideration given or to be given . . . . There is entirely lacking the constraining force of any moral or legal duty as well as the incentive of anticipated benefit of any kind beyond the satisfaction which flows from the performance of a generous act. . . ."[9]

> "A gift is none the less a gift because inspired by gratitude for the past faithful service of the recipient."[10]

Agreeing that the intent of the transferor is the crucial element in distinguishing gifts from income, the members of the Court disagreed as to whether they were reviewing a question of law or of fact. The majority held that the question is one of law, or at least a mixed question of law and fact,[11] and that as a result, the determination of the Board was subject to a broad review. The decision was reversed because, as a matter of law, the inferences drawn by the lower court were incorrect because of failure to find the intent to make a gift. The four dissenters felt that the question was purely factual and that reversal was precluded because the inferences drawn by the Board were not clearly erroneous.[12]

Prior to the decision in *Bogardus*, the Commissioner had issued two rulings dealing with payments to widows.[13] These provided that in in-

6 Bogardus v. Helvering, 88 F.2d 646 (2d Cir. 1937).
7 Justices Brandeis, Stone, Cardozo, and Black.
8 Bogardus v. Commissioner, 302 U.S. 34, 45 (1937).
9 *Id.* at 41.
10 *Id.* at 44.
11 *Id.* at 38-39.
12 *Id.* at 45.
13 O.D. 1017, 5 CUM. BULL. 101 (1921); T.D. 2090, 16 TREAS. DEC. INT. REV. 259, 267-68 (1914).

stances in which the monthly salary of an officer or employee was paid for a limited period after his death to his widow in recognition of services rendered by him, the payments would not be treated as taxable income to the widow if she had rendered no services to the corporation. These rulings also provided that the payments were not a deductible business expense to the corporation. In 1939, two years after the *Bogardus* decision, the Commissioner issued I.T. 3329.[14] In accordance with his prior rulings, he stated that the payments were gifts excludable from the recipient's gross income, but for the first time he ruled that the payments were deductible by the corporation as a business expense.

The tax saving possibilities inherent in I.T. 3329 and in the broad language used in *Bogardus* probably brought forth an increasing number of voluntary payments to widows of corporate executives. In any event, the number of litigated cases involving these payments increased, and the Commissioner felt obliged to change his position. In 1950, he issued I.T. 4027, applicable to payments received on or after January 1, 1951:

> "[T]he essential factor is *whether services were rendered to the employer, not . . . whether services were rendered by the recipient. . . .* It is the position of the Bureau that irrespective of a 'plan,' voluntary or involuntary, definite or indefinite, payments of the type herein considered constitute taxable income, and it is held that payments made by an employer to the widow of a deceased officer or employee, in consideration of services rendered by the officer or employee, are includible in the gross income of the widow for Federal income tax purposes."[15]

The strict position taken by the Commissioner in I.T. 4027 did not gain the acceptance of the courts. Initially, the Tax Court chose to ignore the ruling. In the first three cases before it which involved payments made after January 1, 1951, it found nontaxable gifts without even mentioning the Commissioner's ruling.[16] In *Estate of Arthur W. Hellstrom*,[17] the Tax Court finally acknowledged the existence of I.T. 4027, but expressly rejected the position the Commissioner had taken. Mr. Hellstrom had been a minority stockholder, director, and president of Hellstrom Corporation. After his death on February 20, 1952, in recognition of services rendered by him, the corporation, though under no obligation to do so, paid his widow his monthly salary to the end of the year. The Tax Court, in holding that the payments were gifts, disposed of I.T. 4027 in one short sentence: "The respondent, obviously, cannot by administrative ruling tax as ordinary income a payment which the payor made and intended as a gift."[18] The

[14] I.T. 3329, 1939-2 CUM. BULL. 153.

[15] I.T. 4027, 1950-2 CUM. BULL. 9, 10-11, *revoking* O.D. 1017, 5 CUM. BULL. 101 (1921), *revoking* T.D. 2090, 16 TREAS. DEC. INT. REV. 259, 267-68 (1914), *modifying* I.T. 3329, 1939-2 CUM. BULL. 153. (Emphasis added.)

[16] Marie G. Haskell, 24 P-H Tax Ct. Mem. 661 (1955); Estate of Ralph W. Reardon, 24 P-H Tax Ct. Mem. 482 (1955); Ruth Hahn, 23 P-H Tax Ct. Mem. 366 (1954).

[17] 24 T.C. 916 (1955).

[18] *Id.* at 919.

court attached no particular significance to the fact that the amount paid to the widow was deducted by the corporation on its tax return or to the fact that the payments were in effect a continuation of the decedent's salary. However, the court did cite the following as "controlling facts" in establishing the intent to make a gift:

1. The payment was made to the widow rather than to her husband's estate.
2. The corporation was under no obligation to pay additional compensation to the husband.
3. The corporation derived no benefit from the payments.
4. The widow performed no services for the corporation.
5. The services of the husband had been fully compensated.[19]

In the years between the Tax Court's decision in *Hellstrom* and the Supreme Court's decision in *Duberstein,* both the district courts and the Tax Court employed the same criteria in deciding the many widow payment cases that came before them. Heavy reliance was placed upon the five factors set forth in *Hellstrom* and upon recent decisions in factually similar cases. In addition to being heavily weighted in favor of a finding of gift, the five-factor test was interpreted quite liberally in favor of the widow.[20] For example, in considering the question of whether the corporation derived any benefit from the payments, the courts consistently ignored the possibility of indirect benefits such as the creation of good will or the development of a sense of loyalty and security in officers and executives. The result was a great number of Tax Court[21] and district court[22] cases which, in the absence of unusual circumstances, were decided in the widow's favor.[23]

Before considering the *Duberstein* case and the ensuing confusion, one statutory development must be noted. Prior to the adoption of the Revenue Act of 1951, there were no statutory provisions in the Code dealing directly with death benefits paid by employers. Decisions in cases which excluded from gross income payments made upon the death of an employee were based solely upon the provisions of the Code pertaining to gifts.[24] In 1951,

19 *Id.* at 920.

20 See Florence E. Carr, 28 T.C. 779 (1957) (nontaxable gift despite contractual obligation to pay); Estate of Frank J. Foote, 28 T.C. 547 (1957) (nontaxable gift despite payment to husband's estate).

21 See cases collected in Note, 49 VA. L. REV. 74, 86-87 n.58. *Contra,* Ruth T. Lengsfield, 24 P-H Tax Ct. Mem. 860 (1955), *aff'd,* 241 F.2d 508 (5th Cir. 1957) (closely held corporation; payments were dividends).

22 See cases collected in Note, 49 VA. L. REV. 74, 87 n.59.

23 Due to these adverse court decisions, the Commissioner issued a ruling holding that the Internal Revenue Service would no longer litigate cases arising under the 1939 Code involving the taxability of voluntary payments to widows by their deceased husbands' employers unless there was clear evidence that the payments were intended as compensation or could be considered as dividends. Rev. Rul. 58-613, 1958-2 CUM. BULL. 914.

24 Int. Rev. Code of 1939, § 22(b)(3) (now INT. REV. CODE OF 1954, § 102(a)): "The following items shall not be included in gross income and shall be exempt from taxation under this chapter: . . . The value of property acquired by gift, bequest, devise, or inheritance."

section 22(b)(1), which related to the taxation of the proceeds of life insurance, was amended to provide a 5,000-dollar exclusion for payments by an employer to the beneficiaries of a deceased employee, if made pursuant to a contract and paid by reason of the death of the employee.[25] Section 101(b) of the 1954 Code eliminated the requirement that the payments be made pursuant to a contract.[26] The Commissioner later seized upon this provision as a solution to the problem of determining the tax treatment of widow payments. He took the position that since payments to widows are employee death benefits, they are fully controlled by section 101(b) and, in considering their tax treatment, the gift exclusion provisions of section 102(a) are completely irrelevant.[27] It was his contention that congressional intent was to compromise the extremes of complete taxation and complete exclusion by excluding up to 5,000 dollars of such payments and including in gross income all amounts received above 5,000 dollars.

Those opposing the Commissioner's position argued that the 5,000-dollar limitation applies only to payments which can not be classified as gifts subject to full exclusion from gross income under section 102(a). They pointed out that under the 1939 Code, death benefits pursuant to contract qualified for the 5,000-dollar exclusion, gifts were fully excluded from gross income, and non-contractual obligations which did not qualify as gifts were fully taxed. It was their contention that the changes in the law were designed to extend the exclusion to non-contractual, non-gift payments rather than to encroach upon the tax-free status of gifts. In support of this position, they cited the legislative history, which indicated that Congress intended to liberalize, rather than to restrict, the benefits of the 5,000-dollar exclusion provision.[28]

25 Int. Rev. Code of 1939, § 22(b)(1). The purpose of the amendment was to equalize the tax treatment of the proceeds of a life insurance contract paid upon the death of an employee and payments directly from the employer under the same circumstances. Pelisek, *Tax Treatment of Payments to the Widows of Corporate Officers and Employees*, 44 MARQ. L. REV. 16 (1960).

26 INT. REV. CODE of 1954, § 101(b):

"(b) EMPLOYEES' DEATH BENEFITS.—

(1) GENERAL RULE.—Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee.

(2) SPECIAL RULES FOR PARAGRAPH (1).—

(A) $5,000 LIMITATION.—The aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed $5,000. . . ."

27 Rev. Rul. 60-326, 1960-2 CUM. BULL. 32.

28 H.R. REP. No. 1337, 83d Cong., 2d Sess. 14 (1954). "Present law provides a special exclusion of up to $5,000 for payments by an employer to beneficiaries of a deceased employee. Under existing law, however, this exclusion is available only where the employer is under a contractual obligation to pay the death benefits. . . . Restricting the exemption to benefits paid under a contract discriminates against those who receive benefits where this contractual obligation does not exist. To avoid this problem your committee's bill extends this exclusion to death benefits whether or not paid under a contract." See generally Crown, *Payments to Corporate Executives' Widows*, N.Y.U. 19th INST. ON FED. TAX. 815, 828-36 (1961); Diehl, *Payments to Widows of Corporate Employees: Recent Cases and Rulings*, U. So. CAL. 1960 TAX INST. 491, 504-09; Pelisek, *supra* note 25, at 28-32.

Dicta in two cases decided under the 1939 Code supported the Commissioner's interpretation.[29] However, in cases in which the question was squarely in issue, his position was consistently rejected.[30] Consequently, in 1962, the Commissioner announced that he would no longer contend that section 101(b) controls the taxability of payments to the widow of a deceased executive when the payment otherwise qualifies as a gift fully excludable under section 102(a).[31] In other words, section 101(b) has settled the conflict over the tax treatment of voluntary payments to widows up to 5,000 dollars, but, above that amount, the gift-income controversy still rages.

II. THE DUBERSTEIN TRILOGY

On June 13, 1960, decisions were handed down in three cases that had been argued together before the Supreme Court.[32] In issue, in each of these cases, was the question whether certain payments made to the taxpayers were excludable from gross income as gifts. Despite the fact that none of these cases involved corporate payments to executives' widows, the Supreme Court's decisions in these cases have had a profound effect upon later decisions involving payments to widows. Prior to June 13, 1960, the Commissioner had rarely succeeded in his attempts to tax these payments. Since that date, the courts have disagreed and the Commissioner has tasted victory on numerous occasions.

In *Duberstein*, the taxpayer supplied the names of potential customers to the president of a corporation whom he had known personally for a number of years. The information proved valuable and, despite the taxpayer's protests that he had not intended to be compensated, he was presented with a Cadillac. In *Stanton v. United States*, the taxpayer resigned as comptroller of a church corporation and as president of its wholly owned subsidiary, created to manage its extensive real estate holdings. Shortly thereafter, he was given a gratuity of 20,000 dollars in appreciation of his past services. In *United States v. Kaiser*, a labor union furnished strike assistance in the form of room rent and food vouchers to the taxpayer,

29 Bounds v. United States, 262 F.2d 876, 878-79 n.2 (4th Cir. 1958); Rodner v. United States, 149 F. Supp. 233, 237 (S.D.N.Y. 1957). "In the complete revision effected by the 1954 Code the general language exempting gifts is controlled by the particular language of section 101(b) limiting the exemption of death benefits to $5,000. Gifts in general are exempt but gifts in the form of death benefits are taxable insofar as they exceed $5,000." *Id.* at 237.

30 Rice v. United States, 197 F. Supp. 223, 227 (E.D. Wis. 1961); Wilner v. United States, 195 F. Supp. 786, 788-89 (S.D.N.Y. 1961); Frankel v. United States, 192 F. Supp. 776, 777-78 (D. Minn. 1961), *aff'd*, 302 F.2d 666 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962); Cowan v. United States, 191 F. Supp. 703, 705 (N.D. Ga. 1960); Reed v. United States, 177 F. Supp. 205, 209 (W.D. Ky. 1959), *aff'd mem.*, 277 F.2d 456 (6th Cir. 1960).

31 Rev. Rul. 62-102, 1962-2 CUM. BULL. 37, *modifying* Rev. Rul. 60-326, 1960-2 CUM. BULL. 32.

32 Commissioner v. Duberstein, 363 U.S. 278 (1960) (also deciding Stanton v. United States); United States v. Kaiser, 363 U.S. 299 (1960).

a striking employee who was not a member of the union. The payments were made to strikers on a need basis without regard to union membership or participation in picketing or other activity in furtherance of the strike.

In each of these cases, the taxpayer did not include the payment in his gross income and the Commissioner assessed a deficiency. The Supreme Court reversed the decision of the Sixth Circuit in *Duberstein*,[33] thus sustaining the Tax Court's holding that the Cadillac was not a gift. In *Stanton*,[34] the Supreme Court considered the findings of fact inadequate. Therefore, the Second Circuit's judgment reversing the district court's finding in favor of the church executive was vacated and the case was remanded. In *Kaiser*,[35] the Court affirmed, thus sustaining the jury's finding that the strike benefits were not taxable.

The *Duberstein* trilogy was decided by a divided Court with only four Justices joining in the opinion of the Court.[36] Yet, despite the lack of majority support, the *Duberstein* opinion has been heavily relied upon in subsequent cases because of its extensive discussion of the meaning of the term "gift" as used in the federal income tax statute and because of its holding that the distinction beween gift and income is a question of fact.

In the *Duberstein* trilogy, the Government proposed a new test to distinguish gifts from income. The proposal defined gifts as "transfers of property made for personal as distinguished from business reasons,"[37] and its major corollary was that there could be no such thing as a corporate payment which could qualify both as an ordinary and necessary business expense to the corporation and as a gift to the recipient.[38] In expressly rejecting both this test and its corollary, the Court pointed out that general principles for distinguishing gifts from income had already been established by its prior decisions and that the statutory framework does not lend itself to more definitive rules.[39] The Court further indicated that rephrasing the test in terms of "motive" rather than "intention" would be a change with no practical significance.[40]

While citing a number of its previous opinions, the Court established a number of general principles. Since the federal income tax statute does not use the term "gift" in the common-law sense, voluntary transfers without consideration and transfers made in the absence of any legal or moral ob-

33 363 U.S. 278 (1960), *reversing* 265 F.2d 28 (6th Cir. 1959), *reversing* 27 P-H Tax Ct. Mem. 13 (1958).

34 363 U.S. 278 (1960), *vacating and remanding* 268 F.2d 727 (2d Cir. 1959), *reversing* an unreported district court judgment in which the findings of fact and conclusions of law were made orally.

35 363 U.S. 299 (1960), *affirming* 262 F.2d 367 (7th Cir. 1958), *reversing* 158 F. Supp. 865 (E.D. Wis. 1957) (judgment n.o.v.).

36 Justices Brennan, Black, and Clark and Chief Justice Warren. *Duberstein* was decided by an eight-to-one vote, *Stanton* by a five-to-four vote and *Kaiser* by a six-to-three vote.

37 Commissioner v. Duberstein, 363 U.S. 278, 284 n.6 (1960).

38 *Id.* at 288.

39 *Id.* at 284-85.

40 *Id.* at 286.

ligation are not necessarily gifts.[41] However, "if the payment proceeds primarily from 'the constraining force of any moral or legal duty,' or from 'the incentive of anticipated benefit' of an economic nature, . . . it is not a gift,"[42] and if the payment is in return for services rendered, it is not a gift, even if the donor derives no economic benefit from the payment.[43] "A gift in the statutory sense, on the other hand, proceeds from a 'detached and disinterested generosity,'[44] . . . 'out of affection, respect, admiration, charity or like impulses.' "[45] What controls is the intention with which payment is made. "[T]he proper criterion . . . is one that inquires what the basic reason for his conduct was in fact—the dominant reason that explains his action in making the transfer."[46]

With respect to the scope of appellate review, the opinion of the Court accepted the position of the dissent in *Bogardus*, holding that the gift-income question is basically one of fact to be determined on a case-by-case basis.[47] The Court's opinion pointed out that in cases decided by a properly instructed jury, appellate review is limited to determining whether or not reasonable men could differ, and in cases tried by a judge without a jury, the judge's findings must stand unless "clearly erroneous."[48]

III. THE POST-DUBERSTEIN PERIOD

In widow payment cases decided since the Supreme Court's decision in *Duberstein*, the district courts have continued to rule in favor of the taxpayer widow.[49] The Tax Court, on the other hand, has changed its position and has ruled in favor of the Commissioner in every one of the fourteen post-*Duberstein* cases it has heard.[50]

41 *Id.* at 285.

42 *Id* at 285, quoting Bogardus v. Commissioner, 302 U.S. 34, 41 (1937).

43 *Id.* at 285.

44 *Id.* at 285, quoting Commissioner v. LoBue, 351 U.S. 243, 246 (1956).

45 *Id.* at 285, quoting Robertson v. United States, 343 U.S. 711, 714 (1952).

46 *Id.* at 286.

47 *Id.* at 289-90.

48 *Id.* at 290-91. FED. R. CIV. P. 52(a). "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

49 Schleyer v. United States, 12 Am. Fed. Tax R.2d 5005 (E.D. Mo. 1963); Peters v. United States, 11 Am. Fed. Tax. R.2d 1694 (D. Minn. 1963); Corasaniti v. United States, 212 F. Supp. 229 (D. Md. 1962); Hine v. Tomlinson, 11 Am. Fed. Tax. R.2d 315 (M.D. Fla. 1962); Taylor v. United States, 10 Am. Fed. Tax R.2d 6059 (E.D. Tenn. 1962); Pixton v. United States, 10 Am. Fed. Tax R.2d 5578 (S.D. Ala. 1962); Canning v. United States, 10 Am. Fed. Tax R.2d 5068 (N.D. Tex. 1962); Palmer v. Mathis, 10 Am. Fed. Tax R.2d 5248 (E.D. Ark. 1962); Schwarz v. United States, 10 Am. Fed. Tax R.2d 5429 (N.D. Tex. 1962); Vaughn v. United States, 10 Am. Fed. Tax R.2d 5551 (S.D. Ga. 1962); Rice v. United States, 197 F. Supp. 223 (E.D. Wis. 1961); Wilner v. United States, 195 F. Supp. 786 (S.D.N.Y. 1961) (cross-motions for summary judgment denied); Frankel v. United States, 192 F. Supp. 776 (D. Minn. 1961), *aff'd*, 302 F.2d 666 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962); Cowan v. United States, 191 F. Supp. 703 (N.D. Ga. 1960). *Contra*, Froehlinger v. United States, 217 F. Supp. 13 (D. Md. 1963); Browne v. United States, 63-2 U.S. Tax Cas. ¶ 9696 (D. Mass. 1963); Hein v. United States, 9 Am. Fed. Tax R.2d 1749 (E.D. Wis. 1962); Gaugler v. United States, 204 F. Supp. 493 (S.D.N.Y. 1962), *aff'd*, 312 F.2d 681 (2d Cir. 1963).

50 Estate of James Doumakes, 32 P-H Tax Ct. Mem. 1416 (1963); Lucile McCrea Evans,

The Tax Court's radical change of position is based upon its interpretation of *Duberstein*. Despite the express rejection of the Government's new test, the Tax Court has felt that the *Duberstein* opinion represents a new development in gift-income law rather than a mere restatement of existing law.[51] Prior to *Duberstein*, all the lower courts had decided widow payment cases by considering the five factors which the Tax Court had cited as controlling in *Hellstrom*[52] and by relying upon decisions in cases that were factually similar. Since *Duberstein*, the Tax Court has felt that lower court opinions handed down prior to *Duberstein* are no longer of value as authority. Instead, the Tax Court considers each case as it arises by examining its particular facts in light of the general principles laid down in *Duberstein*.[53] In doing so, the court has tightened its interpretation of the original five-factor test and has broadened its factual inquiry to include such factors as the wording of the resolution, the widow's financial situation, and the transferor's knowledge thereof.[54]

Typical of the Tax Court's new approach was its decision in the case of *Mildred W. Smith*.[55] In that case, the petitioner's husband had been a director and employee of a corporation for thirty-five years and had served as its vice-president and treasurer for twenty-three years. Shortly after his death, the corporation's board of directors adopted a memorial resolution and authorized the payment of certain sums to his widow. The Tax Court classified the payments as additional compensation in recognition of past services and entered judgment for the Commissioner. The court's opinion indicated that it did not find an intent to make a gift because the board of directors did not give consideration to the widow's financial situation. The board knew that the widow's income had been reduced by the death of her husband but, evidently, the Tax Court was reluctant to find a gift in a

39 T.C. 570 (1962); Estate of Louis Rosen, 31 P-H Tax Ct. Mem. 359 (1962); Margaret H. D. Penick, 37 T.C. 999 (1962); Mary C. Westphal, 37 T.C. 340 (1961); Estate of Julius B. Cronheim, 30 P-H Tax Ct. Mem. 1249 (1961); Roy I. Martin, 35 T.C. 556 (1961), *aff'd*, 305 F.2d 290 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962); Estate of W. R. Olsen, 30 P-H Tax Ct. Mem. 882 (1961), *rev'd*, 302 F.2d 671 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962); Mildred W. Smith, 30 P-H Tax Ct. Mem. 848 (1961), *aff'd*, 305 F.2d 778 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962); Estate of Irving B. Cooper, 30 P-H Tax Ct. Mem. 847 (1961); Mary Fischer, 30 P-H Tax Ct. Mem. 340 (1961); Estate of Rose A. Russek, 30 P-H Tax Ct. Mem. 131 (1961); Estate of Martin Kuntz, Sr., 29 P-H Tax Ct. Mem. 1531 (1960), *rev'd*, 300 F.2d 849 (6th Cir.), *cert. denied*, 371 U.S. 903 (1962); Estate of Mervin G. Pierpont, 35 T.C. 65 (1960), *vacated and remanded sub nom.* Poyner v. Commissioner, 301 F.2d 287 (4th Cir. 1962). The Court of Claims has heard one case. Carson v. United States, 317 F.2d 370 (Ct. Cl. 1963) (income).

51 Estate of Mervin G. Pierpont, *supra* note 50, at 67.

52 See text accompanying note 19 *supra*.

53 Estate of Mervin G. Pierpont, 35 T.C. 65, 69 (1960), *vacated and remanded sub nom.* Poyner v. Commissioner, 301 F.2d 287 (4th Cir. 1962).

54 See Mildred W. Smith, 30 P-H Tax Ct. Mem. 848 (1961), *aff'd*, 305 F.2d 778 (3d Cir.), *cert denied*, 371 U.S. 904 (1962); Estate of Rose A. Russek, 30 P-H Tax Ct. Mem. 131 (1961); Estate of Mervin G. Pierpont, *supra* note 53 (heavy reliance upon wording of resolution).

55 Mildred W. Smith, *supra* note 54.

case in which the transferor was not aware of the widow's capital resources and independent sources of income.[56]

If the *Smith* case had arisen in one of the district courts which had heard a widow payment case, it is quite likely that the result would have been different. Factually, the case was similar to numerous pre-*Duberstein* cases which had been decided in the taxpayer's favor. Since the district courts have interpreted *Duberstein* as reaffirming rather than changing gift-income law,[57] there is no reason to believe that any of these district courts would have decided this case in the Commissioner's favor.

Since the Tax Court has changed its position and since it has not found a gift in any of the fourteen post-*Duberstein* cases before it, it is not possible to determine the facts that the court would require in order to establish a gift. The *Smith* case indicates that the transferor must be aware of the widow's financial situation. Several other recent cases indicate that, in addition, the court may require a showing of actual financial need on the part of the widow.[58] If in fact the Tax Court does require such a showing, it would be even more difficult for the widow to prevail.

With the district courts and the Tax Court reaching different results in factually similar cases, the crucial element in most widow payment cases is the choice of forum. If the widow pays the deficiency assessed by the Commissioner, she may sue for a refund in a district court,[59] and a judgment in her favor is quite likely. If, on the other hand, the widow does not pay the deficiency, the case is heard in the Tax Court[60] and the widow's chances of success virtually disappear. It would seem that the circuit courts should remedy this unsatisfactory situation. However, as a result of the Supreme Court's ruling that the determination of gift or income is a factual determination subject to limited review,[61] the circuit courts are placed in a position in which they can resolve the conflict only by holding that the factual inferences drawn by the Tax Court or the district courts are clearly erroneous.

Since the *Duberstein* decision, eight widow payment cases have been decided by the circuit courts.[62] Unfortunately, instead of resolving the con-

56 *Id.* at 853.

57 See Frankel v. United States, 192 F. Supp. 776, 778 (D. Minn. 1961), *aff'd*, 302 F.2d 666 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962).

58 See Lucile McCrea Evans, 39 T.C. 570, 579 (1962); Estate of Louis Rosen, 31 P-H Tax Ct. Mem. 359, 363 (1962); Margaret H. D. Penick, 37 T.C. 999, 1005 (1962). This test would add another element of uncertainty by requiring the court to define the term "needy." Would a widow accustomed to living on an income of $100,000 a year be considered "needy" if her income were reduced to $20,000 a year due to her husband's death?

59 28 U.S.C. § 1346(a)(1) (1958).

60 INT. REV. CODE OF 1954, § 7442; see Int. Rev. Code of 1939, § 272(a).

61 Commissioner v. Duberstein, 363 U.S. 278, 290 (1960).

62 Gaugler v. United States, 312 F.2d 681 (2d Cir. 1963); Martin v. Commissioner, 305 F.2d 290 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962); Smith v. Commissioner, 305 F.2d 778 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962); United States v. Frankel, 302 F.2d 666 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962); Estate of Olsen v. Commissioner, 302 F.2d 671 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962); Estate of Kuntz v. Commissioner, 300 F.2d 849 (6th Cir.), *cert. denied*, 371 U.S. 903 (1962); Poyner v. Commissioner, 301 F.2d 287 (4th Cir. 1962); United States v. Kasynski, 284 F.2d 143 (10th Cir. 1960).

flict, these cases have resulted in a split among the circuits.[63] As the situation stands today, six circuits seem uncommitted,[64] two have resolved the conflict in favor of the district courts' approach,[65] and two seem to feel that it is not within their power to resolve the conflict because they feel that in most cases conflicting inferences are possible and that lower court decisions should be affirmed.[66]

Of the six uncommitted circuits, only two have actually heard a case. In *Poyner v. Commissioner*,[67] the Fourth Circuit vacated a Tax Court judgment in favor of the Commissioner and remanded. However, the opinion indicated neither approval nor disapproval of the Tax Court's new position.[68] The stipulation of facts was made prior to the Supreme Court's decision in *Duberstein*, and, recognizing that the Tax Court had broadened its factual inquiry after *Duberstein*, the court decided that the widow should be given an opportunity to amplify the record. In *United States v. Kasynski*,[69] the Tenth Circuit affirmed a Colorado district court judgment in favor of the widow. Although the court held that the finding of an intent to make a gift was a reasonable inference from the facts, it did not indicate whether a lower court finding of taxable income would have been clearly erroneous and subject to reversal.[70]

In cases heard on appeal in the Eighth Circuit, the conflict between the Tax Court's approach and that of the district courts has been resolved in favor of the district courts' position. A Tax Court decision for the Commissioner was reversed in *Estate of Olsen v. Commissioner*,[71] and a judgment for a taxpayer rendered by a district court in Minnesota was affirmed in *United States v. Frankel*.[72] In the *Olsen* case, the Eighth Circuit found that the Tax Court's decision was clearly erroneous even though the factual setting was quite typical.

The Sixth Circuit has also resolved the conflict in favor of the district courts' position. In *Estate of Kuntz v. Commissioner*,[73] it reversed a Tax Court judgment for the Commissioner, holding that the judgment was

63 In cases involving a purely factual determination, one hesitates to suggest that there is a "conflict" or a "split" among the courts. However, in the situation under consideration use of the terms "conflict" and "split" seems proper because the same evidence is being treated differently by different courts.

64 The First, Fourth, Fifth, Seventh, Ninth, and Tenth Circuits.

65 The Sixth and Eighth Circuits.

66 The Second and Third Circuits.

67 301 F.2d 287 (4th Cir. 1962).

68 See *id.* at 292: "The Supreme Court in Duberstein did not destroy the authority of the earlier Tax Court cases and the guides enunciated in them for discovering motivation. The plea addressed by the Government to the Supreme Court in Duberstein to establish a new test defining 'gift' was expressly rejected. . . . On the other hand, Duberstein cannot be read as limiting inquiry by the trier of fact solely to the factors recognized by the earlier decisions."

69 284 F.2d 143 (10th Cir. 1960).

70 See *id.* at 146.

71 302 F.2d 671 (8th Cir.), *cert. denied,* 371 U.S. 903 (1962).

72 302 F.2d 666 (8th Cir.), *cert. denied,* 371 U.S. 903 (1962).

73 300 F.2d 849 (6th Cir.), *cert. denied,* 371 U.S. 903 (1962).

clearly erroneous because a finding of gift was the only reasonable inference that could be drawn from the facts.[74] The *Kuntz* case clearly indicated that the Sixth Circuit did not approve of the post-*Duberstein* decisions of the Tax Court. In *Kuntz,* the facts seemed to indicate income rather than gift: (1) the payments to the widow were deducted as a *salary* expense by the corporation, (2) the resolution authorizing the payments was phrased in terms of additional compensation in consideration of services rendered, and (3) the resolution indicated that the payments were being made in the best interests of and to benefit the corporation.[75] Despite the testimony of two directors that a gift was intended, the case for the Commissioner remained a very strong one. The Sixth Circuit's reversal indicates that it probably would reverse every post-*Duberstein* Tax Court decision. This position seems stronger than that taken by the Eight Circuit. The latter would find most post-*Duberstein* Tax Court findings clearly erroneous, but it might not reverse in cases with facts strongly favoring a finding of income.

The Second and Third Circuits, in deciding *Gaugler v. United States,*[76] *Martin v. Commissioner,*[77] and *Smith v. Commissioner,*[78] have taken the position that in the typical widow payment case, conflicting factual inferences are possible and lower court decisions of either gift or income should be affirmed. In each of the cases, a lower court decision in favor of the Commissioner was affirmed, but in none of them was there any indication that the court agreed with the inferences drawn by the trier of fact. However, each of the opinions did make it clear that the appellate court's function was quite limited and that it could not reverse simply because there was room for reasonable difference of opinion. In addition, both the Second and the Third Circuits intimated that the Sixth and Eighth Circuits had exceeded their powers in reversing *Olsen* and *Kuntz.*[79]

IV. THE PROBLEM AND ITS SOLUTION

Despite the welter of cases, two basic problems remain. The first of these is the determinative role played by the choice of forum. In factually similar cases, the widow's success or lack thereof depends almost entirely upon whether the action is brought in a district court or the Tax Court. Thus far, there is little indication that the circuit courts can or will resolve this situation. The second problem is one that has plagued the Commissioner for decades. With a good deal of justification, he has sought to tax these transactions at one end or the other. As the law stands today, however, it is quite possible that the corporation will be allowed to deduct

[74] *Id.* at 852.

[75] Estate of Martin Kuntz, Sr., 29 P-H Tax Ct. Mem. 1531-32 (1960), *rev'd,* 300 F.2d 849 (6th Cir.), *cert. denied,* 371 U.S. 903 (1962).

[76] 312 F.2d 681 (2d Cir. 1963).

[77] 305 F.2d 290 (3d Cir.), *cert. denied,* 371 U.S. 904 (1962).

[78] 305 F.2d 778 (3d Cir.), *cert. denied,* 371 U.S. 904 (1962).

[79] See Gaugler v. United States, 312 F.2d 681, 686 (2d Cir. 1963); Smith v. Commissioner, 305 F.2d 778, 782 (3d Cir.), *cert. denied,* 371 U.S. 904 (1962).

the payment and the widow will not have to include it in her gross income. On the other hand, it is conceivable, though less likely, that in two separate actions, one court would disallow the corporation's deduction and another would hold that the payment was income to the widow. While taxation at both ends would be less disturbing to the Commissioner, it seems just as unreasonable as failure to tax either the widow or the corporation.

Prior to *Duberstein,* there was always the hope that the Supreme Court would help resolve the first of these problems. It could have granted certiorari in a widow payment case and established a workable definition of the term "gift," one that would have provided a formula based upon specific factual elements rather than intent. Such a formula would have served as a clear guide for the lower courts. Instead, in *Duberstein,* the Court made it quite clear that promulgation of such a formula is within the province of the legislative rather than the judicial function.[80] It pointed out that under the present statutory framework, the gift-income problem does not lend itself to a definitive statement that can be mechanically applied to resolve a variety of cases.[81] Instead, the Court felt that the question was basically one of fact which had to be determined on a case-by-case basis. It realized that such an approach would lead to uncertainty and litigation, but it apparently did not realize that such a wide divergence would develop between the Tax Court on the one hand and the district courts on the other.[82] However, denial of certiorari in five cases[83] involving payments to widows indicates that the Court still feels that if the lower courts are to be given more definite guidance, it must come from Congress.

Three recent district court decisions[84] indicate that the district courts may be gradually adopting the Tax Court's view. Prior to *Duberstein,* it was immaterial whether reference was made to the *Hellstrom* five-factor test, precedent, or both, because all led to the same result, inasmuch as both Tax Court and district court precedents were based upon the five-factor test. After *Duberstein,* the Tax Court approach differed from that of the district courts, with the result that post-*Duberstein* lower court cases offered conflicting precedents. The three district court cases, described below, indicate

80 Commissioner v. Duberstein, 363 U.S. 278, 290 (1960).

81 *Id.* at 284-85.

82 *Id.* at 290: "Doubtless diversity of result will tend to be lessened somewhat since federal income tax decisions, even those in tribunals of first instance turning on issues of fact, tend to be reported, and since there may be a natural tendency of professional triers of fact to follow one another's determinations, even as to factual matters."

83 Commissioner v. Estate of Olsen, 371 U.S. 903 (1962); Commissioner v. Kuntz, 371 U.S. 903 (1962); Martin v. Commissioner, 371 U.S. 904 (1962); Smith v. Commissioner, 371 U.S. 904 (1962); United States v. Frankel, 371 U.S. 903 (1962).

84 Froehlinger v. United States, 217 F. Supp. 13 (D. Md. 1963); Browne v. United States, 63-2 U.S. Tax Cas. ¶ 9696 (D. Mass. 1963); Gaugler v. United States, 204 F. Supp. 493 (S.D.N.Y. 1962), *aff'd,* 312 F.2d 681 (2d Cir. 1963). In Hein v. United States, 9 Am. Fed. Tax R.2d 1749 (E.D. Wis. 1962), the only other post-*Duberstein* district court case to be decided against the widow, the opinion did not indicate that the court was departing from the pre-*Duberstein* district court approach.

a willingness to accept Tax Court precedent and to rely upon the additional factors which the Tax Court has been considering since *Duberstein*.

In *Browne v. United States*,[85] which was decided in the Commissioner's favor, the charge to the jury indicated that the Massachusetts District Court had been influenced by recent Tax Court opinions. Included in the factors which the jury was instructed to consider were the wording of the resolution, the accounting and tax treatment of the payments by the corporation, the failure of the corporation to investigate the widow's financial circumstances, and the actual financial status of the widow at the time of her husband's death.[86] In *Froehlinger v. United States*[87] and *Gaugler v. United States*,[88] also decided in favor of the Commissioner, the evidence indicated that the payments were motivated by anticipated economic benefit to the corporation and by a moral obligation arising from similar payments to other widows. However, despite the fact that the decisions might have been the same if the courts' inquiry had been limited to the five factors cited in *Hellstrom*, both opinions indicate that their factual inquiries were not so limited. In support of their conclusions, these courts referred to, among other things, the wording of the resolution, the way the payments were treated on the books of the corporation, and the failure to investigate the financial circumstances and needs of the widow.[89]

If these three cases mark the beginning of a trend, the district courts may gradually adopt the Tax Court's position, thus both the problem of "forum shopping" and that of possible tax-free treatment at both ends of the transaction will be eliminated. Such a trend would appear to be little more than a remote possibility and even if it were to develop, it would require an appreciable period of time.

Since the Supreme Court will not resolve the problem and since solution by the lower courts is unlikely, the only recourse seems to be Congress. Legislative action could take any of several forms. Congress could amend the Code to provide substantially as follows:

1. The transferor may deduct the payment at his option.
2. At the time of the transfer, the transferor must inform the recipient as to whether it is deducting the payment.
3. Payments not deducted by the transferor are excludable by the recipient. Payments deducted by the transferor are to be included in the recipient's gross income.

Such an amendment would eliminate the problems of "forum shopping" and tax-free treatment at both ends of the transaction, but it would create a situation in which some widows would receive more favorable tax treat-

85 Note 84 *supra*.
86 Browne v. United States, 63-2 U.S. Tax Cas. ¶ 9696, at 89782-83 (D. Mass. 1963).
87 217 F. Supp. 13 (D. Md. 1963).
88 204 F. Supp. 493 (S.D.N.Y. 1962), *aff'd*, 312 F.2d 681 (2d Cir. 1963).
89 Froehlinger v. United States, 217 F. Supp. 13, 17 (D. Md. 1963); Gaugler v. United States, 204 F. Supp. 493, 500-01 (S.D.N.Y. 1962), *aff'd*, 312 F.2d 681 (2d Cir. 1963).

ment than others. In cases in which the corporation and the widow deal at arm's length, it does not seem objectionable to permit the corporation to determine the extent of its generosity by having the option of making a taxable or non-taxable payment. However, in cases in which a closely held corporation and a widow do not deal at arm's length, legislation of this type would tend to establish the corporate tax rate as the maximum rate applicable to these transactions because closely held corporations would be likely to forego a deduction if the marginal rate applicable to the widow's income is greater than the rate applicable to the corporation's earnings. Thus, in the setting of a closely held corporation, the desirability of this type of legislation seems questionable because it would provide widows in the higher tax brackets with disproportionate tax savings.

A second possibility would be promulgation of a set of specific factual elements similar to those now considered by the lower courts, with the requirement that the widow include the payments in her gross income unless these elements are present. Legislation of this type would undoubtedly resolve the differences among the lower courts and would eliminate the "forum shopping" problem. However, since such legislation would be directed only at the widow, it would not eliminate the possibility, in any given case, of tax-free treatment at both ends of the transaction. Even if the congressional test is so framed as to provide additional impetus to a finding of income, such a test would be particularly amenable to circumvention and would not significantly reduce a corporation's ability to make a tax-free gift. Tax-free treatment at both ends could be avoided by allowing the corporation to deduct only in cases in which the widow is taxed, but by so limiting the corporation's deduction, this legislative possibility would be reduced to a mere variation of the option plan discussed in the preceding paragraph.

A third possibility would be to amend section 101(b)'s exclusion of a stated amount, now 5,000 dollars, to require also the inclusion of payments received above the stated amount. Such an approach would eliminate uncertainty and litigation but, standing alone, would not remove the possibility of taxation at both ends of the transaction. To eliminate this possibility, Congress could link deductibility and excludability by limiting the corporation's deduction to that part of the payment which the widow must include in her gross income.

In the opinion of this writer, the last proposal seems best. Permitting the corporation to deduct when the widow is not required to include the payment in her gross income creates an unnecessary loophole. If the payment is motivated by business reasons and is in reality a continuation of the decedent's salary, the corporation should be allowed to deduct, but the payment should be included in the widow's gross income. On the other hand, if the payment is motivated by generosity, affection, charity, or like impulses, the recipient should not be taxed and the corporation should not be permitted to take a deduction. Originally, gifts were excluded from gross income because it was felt that it would be more appropriate to tax them separately by means of a gift tax and to tax the donor rather than the recipient. Thus, as originally conceived, the gift exclusion was not designed to immunize gift transactions from all forms of taxation. Since the gift tax is not applicable to corporations, if complete immunity is to be avoided, the corporation must not be permitted a deduction in cases in which payments are motivated by generosity and are not included in the widow's gross income. In most widow payment cases, it is difficult to characterize the payment. Some factors indicate that it is made for business purposes and is analogous to a salary payment which should be included in gross income. Other factors indicate that the payment is motivated by generosity or like impulses and that it is analogous to an excludable gift. Therefore, it seems best to compromise by permitting the widow to exclude only those payments received up to a stated amount and by allowing the corporation to take a deduction for those payments which the widow must include in her gross income.

As presently interpreted, the Code provides a possible loophole for both corporations and widows of corporate executives. The different approaches taken by the courts and the subjective tests used to distinguish gifts from income lead to confusion, uncertainty, and a great deal of litigation. The absence of any significant propensity on the part of the courts to even as much as acknowledge a duty to resolve these difficulties would seem to belie the possibility of a judicial solution. If a solution is to be found in the near future, it would seem that the initiative must be taken by Congress. Several legislative solutions are available. Each has its drawbacks, but each seems preferable to the current confusion and uncertainty.

Paul A. Rothman