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Taxation - Federal Estate Tax - Interpretation of "In Fact" Clause of Section 2036 and Deductibility of Support Rights of Wife

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TAXATION—FEDERAL ESTATE TAX—INTERPRETATION OF "IN FACT" CLAUSE OF SECTION 2036 AND DEDUCTIBILITY OF SUPPORT RIGHTS OF WIFE—Having decided to separate, but desiring to avoid the publicity of a judicial proceeding, decedent and his wife executed an agreement which called for the transfer of securities to a trust, the income of which was to be paid to the wife for her life or until her remarriage, with a reversionary interest in the decedent. In consideration for the transfer, the wife relinquished her right to support by the decedent. Both parties were represented by attorneys in the arms-length negotiations leading to the agreement. About six years after the separation, during which time neither party took steps to procure judicial sanction for the arrangement, the decedent died unexpectedly. The Commissioner included the trust corpus in the gross estate of the decedent under section 811 (c) (1) (B) of the 1939 code[1] and denied a deduction from the gross estate for the value of the

[1] "The value of the gross estate shall include . . . any interest . . . [in property] of which decedent has . . . made a transfer under which he has retained . . . for any period which does not in fact end before his death—. . . the right to the income from the property. . . ." Now I.R.C., §2036.

support rights of the wife under authority of section 811 (i)[2] and section 812 (b).[3] The Tax Court sustained the Commissioner's position. Section 811 (c) (1) (B) applies despite the fact that the decedent did not intend to retain possession and enjoyment of the property for a period which would extend beyond his death. Also, support rights of a wife are embraced within the meaning of "other marital rights" in section 812 (b). *Estate of Robert M. McKeon v. Commissioner,* 25 T.C. 697 (1956).

In seeking to impose tax liability on the taxpayer in the principal suit, the Commissioner refused to follow both a treasury regulation,[4] which would have excluded the property from the taxpayer's gross estate, and an Internal Revenue Service ruling,[5] which would have allowed a deduction from the gross estate for the amount of wife's support rights. In the wake of such action by the Commissioner, a taxpayer can hardly be certain as to how much he can safely rely upon these materials in the future. The regulation mentioned interprets the "in fact" clause of section 811 (c) (1) (B) of the 1939 code to mean that the decedent must *intend* for the retention of income to extend at least for the duration of his life and that such intention may be evidenced by the period of retention itself.[6] Support for this position of the Treasury is found in pre-enactment materials in which Congress gives, as one example of the intended thrust of the clause, the case of a decedent, seventy years old, who reserves the income from transferred property for an extended term and who then dies before the term ends.[7] A literal reading of the statute, however, requires a finding of the mere fact that there actually was a retention of a right to the income from transferred property for a period which does not end before his death.[8] While a literal interpretation of the "in fact" clause clearly sweeps the trust property of the principal case into the gross estate, a reading in of a requirement of intention would allow the property to be excluded since the taxpayer here did not expect to die before his wife's remarriage or death. Unfortunately, the Tax Court does not discuss the issue of whether a transfer under the circumstances

2 Now I.R.C., §2053 (c) (1).

3 ". . . [A] relinquishment . . . of dower . . . or of other marital rights in the decedent's property or estate, shall not be . . . a consideration 'in money or money's worth.'" Now I.R.C., §2043 (b).

4 Treas. Reg. 105, §81.18.

5 1946-2 Cum. Bul. 166.

6 A suggestion that it may be significant whether the decedent intended the transfer of property to extend beyond his own life is found in Estate of Donnelly v. Commissioner, 38 B.T.A. 1234, 1240 (1938), revd. on other grounds by Helvering v. Mercantile-Commerce Bank & Trust Co., (8th Cir. 1940) 111 F. (2d) 224.

7 See 1939-1 Cum. Bul. 491, 532. The "in fact" clause was intended to clarify certain problems arising under the Joint Resolution of March 31, 1931, 46 Stat. 1516, which was passed in an effort to reach transfers under which the decedent reserved the income for his life. For a discussion of the ambiguity of the pre-enactment materials themselves, see Marks v. Higgins, (2d Cir. 1954) 213 F. (2d) 884.

8 On the question of balancing the literal words of the statute with the history of the legislation, see Wright, "Transfer of Joint Property in Contemplation of Death," 55 MICH. L. REV. 1 (1956).

of the present case, which was made with no intention of avoiding the estate tax, should be dealt with in the same manner as a transfer with the principal purpose of avoiding tax liability, although the effect of the decision is clearly that both shall be treated alike. By adopting a literal interpretation of the statute, the court has at least eliminated the administrative problem of ascertaining the intention of the decedent, as well as eliminating a possible avenue for tax evasion.

In 1946, the Internal Revenue Service issued E.T. 19,[9] which stated that for both estate and gift tax purposes, a release of support rights by a wife may, if computed reasonably, constitute consideration in money or money's worth. The basis of the ruling is that the husband normally has a legal duty to support his wife at least for the period of their joint lives,[10] and that, therefore, a transfer of property to meet this obligation is not such a transfer as would deplete the estate of the decedent to any greater extent than would have occurred had periodic payments been made by decedent for the period of his expected life. A transfer by a decedent to meet the obligation of supporting his children, which is comparable to a transfer to support a wife, has unanimously been regarded as a deductible claim from the decedent's estate.[11] Moreover, had the transfer in the present case not been founded upon an agreement but upon a court decree,[12] then the requirement of "consideration in money or money's worth" would not apply and the value of the wife's support rights would clearly have been deductible from the estate.[13] Policy-wise, it therefore appears anomalous to impose a tax here because of the absence of a judicial decree. While the court's holding that support rights of the wife are embraced in the phrase "other marital rights in the decedent's property or estate" does accord with several judicial pronouncements on the point,[14] it is not so venerable a conclusion as to be beyond question.[15] The claim of a wife to support from her husband is not literally an interest "in decedent's property or estate," any more than a contract or tort claim against the estate is an interest in his property.[16] Neither policy considerations

[9] See note 5 supra.

[10] 2 VERNIER, AMERICAN FAMILY LAWS §104 (1932).

[11] Estate of Phillips, 36 B.T.A. 752 (1937); Commissioner v. Weiser, (10th Cir. 1940) 113 F. (2d) 486; Helvering v. United States Trust Co., (2d Cir. 1940) 111 F. (2d) 576.

[12] The phrase "when founded upon a promise or agreement" in §2053 was intended to insure the deductibility of tort claims and other obligations imposed by law. S. Rep. 655, 72d Cong., 1st sess., p. 51 (1932).

[13] Estate of Silas Mason v. Commissioner, 43 B.T.A. 813 (1941); Harris v. Commissioner, 340 U.S. 106 (1950); Helvering v. United States Trust Co., note 11 supra. This decretal obligation test is strongly criticized by Taylor and Schwartz, "Tax Aspects of Marital Property Settlements," 7 TAX L. REV. 19 at 38 (1951).

[14] Commissioner v. Maresi, (2d Cir. 1946) 156 F. (2d) 929; Meyer's Estate v. Commissioner, (2d Cir. 1940) 110 F. (2d) 367; Helvering v. United States Trust Co., note 11 supra.

[15] Edythe Young v. Commissioner, 39 B.T.A. 230 (1939); Estate of Brokaw, 39 B.T.A. 783 (1939).

[16] See dissent of Judge Learned Hand in Meyer's Estate v. Commissioner, note 14 supra.

nor a literal reading of the statute dictate the result reached by the Tax Court, which has, in effect, silently overruled E.T. 19.

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