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## TAXATION-FEDERAL ESTATE TAX-CONSTITUTIONALITY OF COMMUNITY PROPERTY PROVISIONS OF REVENUE ACT OF 1942

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TAXATION—FEDERAL ESTATE TAX—CONSTITUTIONALITY OF COMMUNITY PROPERTY PROVISIONS OF REVENUE ACT OF 1942—Under Section 811(e)(2), (g)(4) of the Internal Revenue Code, as amended by sections 402 and 404 of the Revenue Act of 1942,<sup>1</sup> the Commissioner, in assessing an estate tax deficiency, included in decedent's gross estate all community property and insurance proceeds paid for with community funds. The decedent's estate filed claim for refund and the district court found for the petitioner. *Held*, the tax does not violate the due process clause of the Fifth Amendment nor does the taxing statute contravene Article I, Section 8 of the Constitution which requires that, "Excises shall be uniform throughout the United States." The decision below was accordingly reversed. *Fernandez v. Weiner*, (U.S. 1945) 66 S. Ct. 178.<sup>2</sup>

The primary objective of the amendments to the 1942 Revenue Act dealing with community property, was to put a taxpayer in a community state, on the same tax-footing, for estate and gift tax purposes, as a taxpayer in a non-community state.<sup>3</sup> This objective of Congress was given considerable weight in the principal case.<sup>4</sup> In holding that the tax did not violate the due process clause of the Fifth Amendment, heavy reliance was placed on the reasoning of the *Tyler*<sup>5</sup> and *Jacobs*<sup>6</sup> cases. The theory is that a change in the condition of ownership

<sup>1</sup> 26 U.S.C. (1940, Supp. IV) § 811(e)(2), (g)(4).

<sup>2</sup> On the authority of the principal case, on the same day, decision was rendered in favor of the government in the case of *United States v. Rompel*, (U.S. 1945) 66 S. Ct. 191, involving community property in the state of Texas.

<sup>3</sup> See H.R. Rep. 2333 on H.R. 7378, 77 Cong. 2d sess., pp. 35, 160 (1942); S. Rep. 1631 on H.R. 7378, 77 Cong. 2d sess., p. 231 (1942).

<sup>4</sup> *Fernandez v. Weiner*, (U.S. 1945) 66 S. Ct. 178, and see concurring opinion of Justice Douglas at 190.

<sup>5</sup> *Tyler v. United States*, 281 U.S. 497, 50 S. Ct. 356 (1930), upholding the constitutionality of the estate tax when applied to property held as a tenancy by the entireties, measured by the full value of the property.

<sup>6</sup> *United States v. Jacobs*, 306 U.S. 363, 59 S. Ct. 551 (1939), upholding the constitutionality of the estate tax when applied to a joint tenancy, measured by the full value of the property.

occurs, on the death of a spouse, in such a manner as to create a taxable incident.<sup>7</sup> Many changes in the husband's control over the wife's share of community property do occur when the husband predeceases the wife.<sup>8</sup> This also follows, though to a considerably lesser extent, when the wife predeceases her husband.<sup>9</sup> The court held further that section 402(b) of the Revenue Act of 1942 does not violate the constitutional requirement of uniformity. The uniformity required is geographical and this requirement is satisfied by section 402(b) for the tax is upon community property wherever found.<sup>10</sup> As regards the applicability of the principal case<sup>11</sup> to future constitutional problems arising with respect to community property, it suggests that Congress has the power to eliminate the preference in favor of residents of community states in the field of income taxation. In *Poe v. Seaborn*,<sup>12</sup> the Supreme Court held that the earnings of husband and wife, in a community property state, were taxable half to each, regardless of who earned them. This decision was followed by *Commissioner v. Harmon*<sup>13</sup> where the majority of the Court refused the opportunity to overrule *Poe v. Seaborn*<sup>14</sup> and, instead, distinguished the community property law of Oklahoma from that of other community property states.<sup>15</sup> Neither of these decisions involved the question of Congressional power to deal with the problem by appropriate legislation. It is submitted that the desirability of having a uniform application of the revenue laws unhampered by variations of local property law will go a long way with the Supreme Court should Congress decide to abolish the preference now shown residents of community property states in the field of income taxation.

<sup>7</sup> In the Tyler case, 281 U.S. 497, 50 S. Ct. 356 (1930), the court, at 503 says, "Taxation, as it many times has been said, is eminently practical, and a practical mind, considering results, would have some difficulty in accepting the conclusion that the death of one of the tenants in each of these cases did not have the effect of passing to the survivor substantial rights, in respect of the property, theretofore never enjoyed by such survivor."

<sup>8</sup> Principal case at 182; "The Estate and Gift Tax Amendments: Revenue Act of 1942," 31 CAL. L. REV. 60 at 65 (1942); 1 PAUL, FEDERAL ESTATE AND GIFT TAXATION, § 1.09, p. 54 (1942).

<sup>9</sup> Principal case at 186.

<sup>10</sup> Principal case at 188; *Poe v. Seaborn*, 282 U.S. 101, 51 S. Ct. 58(1930).

<sup>11</sup> Note 4, supra.

<sup>12</sup> The ability to distribute income earned by the husband between himself and his wife for income tax purposes is a marked advantage in view of the graduated rates of the income tax. See note 10, supra. Paul, "The Background of the Revenue Act of 1937," 5 UNIV. CHI. L. REV. 41 at 84 (1937), where the writer states, "The loss of revenue to the government from the community property method of reporting income has been variously estimated at figures ranging from \$20,000,000 to \$80,000,000 annually."

<sup>13</sup> 323 U.S. 44, 65 S. Ct. 103 (1944).

<sup>14</sup> 282 U.S. 101, 51 S. Ct. 58(1930).

<sup>15</sup> The Oklahoma statute gave the husband and wife the option of converting their separate property into community property. In spite of this option being exercised, the Supreme Court ruled that all income earned by the husband was taxable to him even though under local law one half of this income belonged to his wife. Justice Douglas, in his dissenting opinion, maintained that *Poe v. Seaborn* should either be overruled or applied to Oklahoma. For a thorough discussion of this and allied phases of the problem see MAGILL, TAXABLE INCOME 305-313 (1945).

Section 402(b) of the Revenue Act of 1942, as it stands today, may, in some cases, discriminate against community property states in favor of common law states when the wife predeceases her husband.<sup>16</sup> However, this discrimination is offset by the advantage retained by the community property states under the income tax laws.<sup>17</sup> Further, the Treasury Regulations provide that no gift tax results from a transfer of separate property to community property by either spouse<sup>18</sup> and that a wife may transfer her share of community property to her husband without payment of a gift tax,<sup>19</sup> even if the gift is made in contemplation of death.<sup>20</sup> Hence, the Revenue Act of 1942, as administered, does not place the residents of community property states in a disadvantageous tax position as compared with residents of other states.<sup>21</sup>

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<sup>16</sup> Under the second sentence of § 811 (e) (2) of the Internal Revenue Code, if the wife dies first, half of the community property is includible in her gross estate by virtue of her power of testamentary disposition. Should this part of the community pass to the deceased's husband, the entire property will be included in his gross estate upon his death. Hence, in this situation, the tax paid on the community property will be one and one half times as great as the tax paid on a similar estate in a non-community state. Jackson, "The New Federal Estate and Gift Taxes on Community Property," 21 TAXES. 535 (1943).

<sup>17</sup> See note 12, supra.

<sup>18</sup> Treasury Regulation 108, § 86.2 (c).

<sup>19</sup> Treasury Regulation 108, § 86.2(c).

<sup>20</sup> Treasury Regulation 108, § 81.15.

<sup>21</sup> Taylor, "Comments on The Federal Estate and Gift Tax Provisions Re Community Property," 19 CAL. S. B. J. 106 (1944).