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TAXATION - FEDERAL GIFT TAX - INTEGRATION WITH INCOME TAX

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TAXATION — FEDERAL GIFT TAX — INTEGRATION WITH INCOME TAX — Beck in 1935 created an irrevocable funded insurance trust of $172,000 in securities together with seven policies of insurance on his life. The income from the securities was to be applied to pay the premiums on the policies and any surplus was to be distributed to his wife and daughter. At grantor's death the proceeds of the policies were to be added to the corpus of the trust and all income was to go to the same beneficiaries for life with remainders over. There was no possibility of reverter in the grantor and no right to alter, modify or revoke the trust in any way, except to substitute a different trustee. Nor did the grantor reserve any power over the policies. In his gift tax return for 1935, Beck reported the value of the securities and of the policies and deducted therefrom $48,026.65, the capitalized value of the income necessary to pay the insurance premiums during his life expectancy. He argued that he was required to include that much of the trust income in his taxable income and that it would be inconsistent to tax the same payments as income and as a gift and therefore Congress must have intended to exempt this portion from the gift tax.[1] The Commissioner of Internal Revenue found a deficiency in the gift tax, but the Board of Tax Appeals expunged it.[2] *Held*, reversing the Board of Tax Appeals, the entire corpus of the trust is subject to gift tax. There was no Congressional intent completely to integrate the gift, estate, and income taxes. The same transaction may be a completed gift for one purpose and incomplete for another. *Commissioner v. Beck's Estate*, (C. C. A. 2d, 1942) 129 F. (2d) 243.

The income tax statute is explicit in taxing to the grantor of a trust the income used to pay premiums on insurance policies on his life.[3] On the other hand, the language of the gift tax is undoubtedly broad enough to include the full value of the securities and policies trans-

[1] The taxpayer did not contend that a double tax would be unconstitutional, thus conceding the power of Congress to levy it.

[2] Martin Beck, 43 B. T. A. 147 (1940), reasoning that "if those benefits [retained by grantor] are of sufficient importance to justify taxation to him of the income used to pay the premiums, then it is difficult to see why they are not of sufficient importance to prevent the imposition of a gift tax." Id. 150. Under the board's decision, the question whether the annual payments of premiums should be considered gifts was reserved. Id. 151, note 2.

[3] Revenue Act of 1934, § 167 (a) (3), 48 Stat. L. 729: "where any part of the income of a trust . . . is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor . . . then such part of the income of the trust shall be included in computing the net income of the grantor." This provision was held constitutional in Burnet v. Wells, 289 U. S. 670, 53 S. Ct. 761 (1933), noted 32 MICH. L. REV. 123 (1933).

ferred in trust by the taxpayer in the principal case.[4] The circuit court of appeals did not feel that it could go beyond the bare language of the statutes, relying in part upon a criticism by Randolph Paul of the Board of Tax Appeals decision.[5] However, the Congressional committee reports expressly stated that the gift tax was intended to supplement both the estate tax and the income tax.[6] In recent cases the Supreme Court has relied on the fact that the gift tax is supplementary to the estate tax in construing the revenue acts to avoid double taxation.[7] The Supreme Court has not yet had to pass on a case directly involving correlation of the gift and income taxes.[8] However, other recent cases do not show any tendency to correlate the income and

[4] Revenue Act of 1932, § 501 (b), 47 Stat. L. 245, taxing "the transfer of property by gift . . . whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. . . ." The original act of 1924, 43 Stat. L. 313 (1924), repealed in 1926, 44 Stat. L. 126 (1926), contained the same language and so have all the subsequent acts.

[5] 2 PAUL, FEDERAL ESTATE AND GIFT TAXATION, § 17.19, p. 1206 (1942).

[6] H. REP. 708, 72d Cong., 1st sess. (1932), p. 28; S. REP. 665, 72d Cong., 1st sess. (1932), p. 40. To the same effect as to the short-lived gift tax of 1924, see 65 CONG. REC. 3120, 3172, 8095, 8096 (1924).

[7] E. g., Estate of Sanford v. Commissioner, 308 U. S. 39, 60 S. Ct. 51 (1939), noted 38 MICH. L. REV. 566 (1940), in which it was held that a transfer by inter vivos trust became taxable as a gift not when the grantor relinquished his power to revoke but only upon relinquishment of his power to designate new beneficiaries. A previous case had held that a trust reserving powers to amend (except in favor of himself or his estate) but not to revoke must be included in the grantor's gross estate at his death. Porter v. Commissioner, 288 U. S. 436, 53 S. Ct. 451 (1932). A contrary decision in the Sanford case would have allowed the transfer to escape both gift and estate taxes, as the power to revoke had been relinquished prior to the enactment of the gift tax.

In Rasquin v. Humphreys, 308 U. S. 54, 60 S. Ct. 60 (1939), where an inter vivos trust created a life estate to the donor with remainders over and reserved power in the donor to designate new beneficiaries but not to increase his own beneficial interest, the gift of the remainders was held incomplete and not taxable. The Supreme Court refused to enforce, at least retroactively, TREAS. REG. 79 (1936 ed.), art. 3, providing that a gift is complete where "the donor has so parted with dominion and control as to leave in him no power to cause the beneficial title to be revested in himself." The regulations have now been modified to conform to the Rasquin and Sanford decisions. T. D. 5010, 1940-2 CUM. BULL. 293-295. See Higgins v. Commissioner, (C. C. A. 1st, 1942) 129 F. (2d) 237.

[8] It is not likely that the case will go to the Supreme Court, as the opinion states that respondents had agreed not to appeal if the commissioner did not attempt to tax the trust under the estate tax. (The grantor had died pending the appeal.) This he had threatened to do, although it would have required the reversal of existing decisions. The ground for including the trust in the gross estate probably would have been as insurance "taken out by the decedent on his own life." See discussions by Smith, "Federal Taxation of Insurance Trusts," 40 MICH. L. REV. 207 at 220 ff. (1941), and 40 MICH. L. REV. 1221 (1942).

estate taxes[9] and it is probably impossible under the present statutes to achieve complete integration of the three taxes.[10] The problem, however, is one which warrants serious attention by Congress.[11] It is not simply a matter of revenue, but involves questions of public policy, such as how far inter vivos gifts shall be encouraged to permit the training of the beneficiaries in property management and to prevent the accumulation of large properties in the control of one person or in the hands of aged persons.

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[9] Helvering v. Schweitzer, 296 U. S. 551, 56 S. Ct. 304 (1935), reversing per curiam Schweitzer v. Commissioner, (C. C. A. 7th, 1935) 75 F. (2d) 702 (trust for settlor's minor children); Helvering v. Stokes, 296 U. S. 551, 56 S. Ct. 308 (1935), reversing per curiam Commissioner v. Stokes, (C. C. A. 3d, 1935) 79 F. (2d) 256 (same); Commissioner v. Grosvenor, (C. C. A. 2d, 1936) 85 F. (2d) 2 (same); Helvering v. Blumenthal, 296 U. S. 552, 56 S. Ct. 305 (1935), reversing per curiam Blumenthal v. Commissioner, (C. C. A. 2d, 1935) 76 F. (2d) 507 (irrevocable trust to secure settlor's debt). See also the language in Estate of Sanford v. Commissioner, 308 U. S. 39 at 47-48, 60 S. Ct. 51 (1939); Helvering v. City Bank Farmers' Trust Co., 296 U. S. 85 at 88-89, 56 S. Ct. 70 (1935).

[10] For example, when property is transferred by a gift in contemplation of death, the donor is relieved of income tax thereon, but a gift tax is assessed and the value of the property is included in the donor's gross estate at his death for purposes of the estate tax (although a credit is allowed for the amount of the gift tax paid). Likewise, where the donor-settlor of a trust reserves the power of revocation in conjunction with a person having a substantial adverse interest, the transfer is subject to the gift tax and is also part of the gross estate. Commissioner v. Prouty, (C. C. A. 1st, 1940) 115 F. (2d) 331. See also Reinecke v. Northern Trust Co., 278 U. S. 339, 49 S. Ct. 123 (1929); Helvering v. City Bank Farmers' Trust Co., 296 U. S. 85, 56 S. Ct. 70 (1935). And where an inter vivos trust reserves the net income for life to the settlor with an irrevocable remainder to another, a gift tax must be paid on the completed transfer of the remainder, although the whole of the trust is included in the gross estate.

[11] The integration of gift, estate and income taxes is discussed by Knouff, "Death Taxes on Completed Transfers Inter Vivos," 36 MICH. L. REV. 1284 at 1311 (1938); Altman, "Combining the Gift and Estate Taxes," 16 TAX MAG. 259 (1938); Altman, "Integration of the Estate and Gift Taxes," 7 LAW & CONTEMP. PROB. 331 (1940); Magill, "The Federal Gift Tax," 40 COL. L. REV. 773 (1940); Merry, "Federal Estate and Gift Tax: Concept of a Transfer," 38 MICH. L. REV. 1032 (1940); Warren, "Correlation of Gift and Estate Taxes," 55 HARV. L. REV. 1 (1942).

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