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The Approaching Crisis in Federal Estate and Gift Taxation

Adrian W. DeWind*

For some thirty years the Federal Government has regularly obtained a portion of its revenue from the taxation of decedents' estates. In that time the propriety of Federal participation in death taxation has acquired almost undisputed recognition, although at the outset entrance into the field by the national government was widely challenged, primarily as an unwarranted invasion of the taxing jurisdiction of the states.1

It is remarkable evidence of the broad public acceptance of a Federal death tax that few persons seriously question the propriety of the existing law; for, on two interrelated scores, the Federal estate tax (and its companion gift tax) are subject to real criticism: the taxes are confused and difficult in their application and, considering the resulting wide area of dispute and litigation, they produce relatively very little revenue.2 Ordinarily the combination of these two conditions might be expected to lead to general demand for elimination of the taxes by those affected. That they have not is the result of a number of factors, but primarily, it would seem, of three: the existing structure combines relatively high exemptions and low rates with "loopholes" of major significance, resulting in a revenue system so weak that there is little cause for real disturbance;3 at the same time, the taxes symbolize a traditional and apparently deep-seated aversion in this country, on grounds both of social attitude and eco-

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1 Occasionally this viewpoint is still expressed. See, The Committee on Postwar Tax Policy, A Tax Program for a Solvent America 137 (1945). The explicit grounds for objection have, of course, often been a cover for antipathy to progressive-rate death taxation, with its "social motives." Cf. note 4, infra; Groves, supra p. 28.

2 At a high level of revenue collections in the fiscal year 1947 the total for the estate and gift taxes was only about $800 million, out of total collections of almost $40 billion. This was considerably less than the $1.2 billion in tobacco tax collections and somewhat less than the combined revenues from gasoline and admissions taxes. 1947 Annual Report of the Commissioner of Internal Revenue 119-120 (U.S. Treas. Dept.). The Revenue Act of 1948 has made substantial inroads on the estate and gift taxes which will be reflected in reduced collections. See note 7, infra.

3 In fiscal 1939 the taxes produced about $400 million, or 7% of total Federal revenues. Collections in fiscal 1949, despite war-born increases in property value, were less than $800 million, constituting less than 2% of total revenues. Only slightly more than 1% of all adult decedents leave taxable estates. Statement by Secretary of the Treasury Snyder before the House Ways and Means Committee, February 3, 1950.
nomic policy, to very large accumulations of inherited wealth; and, finally, since the taxes affect only a relatively few people in the upper economic levels, the difficulties and complexities of the two levies have elicited neither the quantitative administrative burdens nor widespread dissatisfaction among people unable to afford expensive counsel that would undoubtedly develop if the tax base were broader.

While few persons now undertake openly to attack Federal death taxation in principle, the present estate and gift taxes have not been without their vociferous critics. Some of the critics are, no doubt, motivated by antipathy to these progressive-rate Federal taxes. Indeed, recent major changes made by the Congress in the taxing structure reflect a calculated willingness, at least on the part of the well-informed among its sponsors and legislators, to see even the past strength of the system sapped to a substantial degree. It seems, however, that the more detached criticisms are not aimed at ultimate destruction of Federal death taxes, but are motivated by the desire to eliminate undoubtedly serious shortcomings. Nevertheless, these defects of structure have and will attract repeated proposals for piecemeal legislative onslaughts. These attacks, if continued at the pace of recent years, could quickly reduce the present estate and gift tax

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4 PAUL, FEDERAL ESTATE AND GIFT TAXATION §§ 1.02, 1.07 (1942), contains a discussion of the history of Federal death taxes revealing the widespread acceptance of their economic and social objectives as a "substantial, if not . . . primary, motive" (p. 31). Cf. COMMITTEE ON POSTWAR TAX POLICY, op. cit. supra note 1, 127-139.

5 The Tax Message of the President to the Congress of January 23, 1950 (H. R. Doc. No. 451, 81st Cong., 2nd Sess.) proposed increased revenues from estate and gift taxes. To the extent this may be done by broadening the tax base through reduced exemptions, the administrative problems will be accentuated.


7 The Treasury Department estimated and informed the Congress at the time of enactment that the 1948 amendments would ultimately result in an annual loss of close to one-third of the revenues from estate and gift taxes. H. R. Doc. No. 589, 80th Cong., 2nd. Sess. 4 (1948). The predicted loss is in course of being realized. Estimated collections in fiscal 1950 are off $100 million from 1949. Budget Message of the President, January 9, 1950 (96 Cong. Rec. 169, 172; H. R. Doc. No. 405, 81st Cong., 2nd Sess.). Very few persons, in or out of Congress, appear to have been fully aware of the nature or significance of the changes at the time of their enactment. Surrey, Federal Taxation of the Family—The Revenue Act of 1948, 61 HARV. L. REV. 1097, 1117 (1948).

8 Good examples are proposals to weaken further the contemplation of death rule (e.g., H. R. 6712, 80th Cong., 2d Sess., § 204); to exclude the estate tax from the tax base by giving a deduction for estate tax payment bonds (e.g., Report of Special Tax Study Committee to the Committee on Ways and Means, November 4, 1947, H. R. Doc. No. 523, 80th Cong., 2d Sess., pp. 32 (majority recommendation), 62 (minority dissent)); and to weaken the estate tax as it applies to life insurance (Ibid. at 30, 61). See Harris, Proposals to Exempt Life Insurance Used to Pay Estate Tax, 5 TAX L. REV. 119 (1950).
system to chaos productive of insignificant revenue. Unless the structure is rebuilt to eliminate the handholds for these attacks, the estate and gift taxes may shrink to the point at which their actual disappearance from the Federal revenue system will be but a formality.

The danger of this possibility represents a crisis in taxing policy, for the revenue lost would have to be raised somewhere else, by levies which almost certainly would be more painful to the economy than the estate and gift taxes. While this outcome should not appeal to any but the shortest-ranged visions, its possibility is great enough to merit serious efforts to improve and stabilize the existing structure.

Upon the assumption that a critical point is about to be reached in the history of Federal death taxation, it is the chief purpose of this article to explore some of the possibilities for improvement in the estate and gift taxes within the general framework of the existing structure. This is, in large part, a task of going over past ground, for most of the area has been explored before. However, it may be appropriate to take another overall look at the scene to determine whether present dissatisfactions with these taxes may permit combining and modifying past proposals into a practicable and more broadly appealing program for early revision than has heretofore appeared.

One line of inquiry is not intended for discussion or consideration here—namely, the matter of the amount of Federal revenue that should be sought from this source. It is my belief that the estate and gift taxes might be made to produce substantially more than they do now at less cost in decreased incentives and other adverse economic effects than would result from raising an equal amount of revenue from almost any of the other possible sources, particularly the income

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tax, to name the most likely alternative. But that question is one for analysis and discussion elsewhere. Except for the assumption that the taxes should make a significant contribution to Federal revenues, my concern here is only with the possibility of outlining a program for legislative revision which would constitute at least a good start toward a system having greater internal strength, consistency and simplicity. The inquiry also assumes adherence to the existing general framework and the continued use, so far as possible, of the thirty years of experience and precedent in estate and gift taxation. How much revenue such a system should be called on to raise may then be determined and reflected in any desired arrangement of rates and exemptions.

I. SUMMARY OF MAJOR DEFECTS OF THE EXISTING STRUCTURE

A. Dual Application of Taxes to the same Transfers

Among the most prominent objectionable features of today's estate and gift taxes is the lack of adequate coordination of incidence between the two levies. As is well known, some of the most common types of inter vivos transfers incur both a gift tax and, on the death of the donor, an estate tax. The gift tax credit provisions are aimed merely at avoiding double transfer taxation of the same transfers and are but an attempted and complicated cure for what may be an unnecessary structural ailment. In any event, the cure bears only incidentally on the problem of proper tax incidence because it deals not at all with the policy question of the propriety of the estate tax which gives rise to a credit. On the other hand, if the estate tax is the only tax which, as a matter of basic taxing policy, should apply, the credit for prior gift tax is only a partial remedy which takes no account of the loss of the use of the gift tax money and, in addition, is not designed to effect a refund of the gift tax but only to prevent double taxation.

It is not intended here to review in detail the whole area of poor tax coordination, but only briefly to summarize the problems.

10 See Statement of Secretary Snyder, supra note 3, at 22. "The changes I have outlined would increase the yield of estate and gift taxes on an annual basis by about $400 million. No other method of raising this additional revenue would have less serious effects on the economy."

11 §§ 813, 936. (All section references are to the Internal Revenue Code, unless otherwise specified.)

12 A much more complete exposition of the problems is to be found in Federal Estate and Gift Taxes, A Proposal for Integration and for Correlation with the Income Tax, op. cit. supra note 6.
In the field of trusts a few simple examples of the double application of the taxes will demonstrate the difficulties in the present structure. Suppose $A$ transfers property in trust to pay the income to himself for life, with vested remainders on his death to his children. A gift tax falls upon the present value of the remainder interests created and, on $A$'s death, the entire value of the corpus sustains an estate tax. This example typifies a group of cases in which the application of both taxes finds little necessity in basic policy. The tax at death is imposed because of obvious testamentary characteristics of the gifts in remainder, but consequently the tax at the time of transfer is unnecessary since its only real purpose would be to protect the estate tax which, in this instance, does not need it. Imposition of gift tax serves only to deprive the donor of the use of the gift tax money and thus to set the complicated credit provisions in operation, all without real reason in policy.

Let us take another example: $H$ transfers property in trust to pay the income to $S$, his son, during $S$'s life, remainders to $S$'s children unless $H$ should survive $S$, in which event the corpus shall revert to $H$. Again a gift tax attaches to the value at the date of transfer of the remainder interests and, on $H$'s death, the remainders which then vest indefeasibly are subjected to estate tax. Again, if $X$ transfers property in trust to pay the income to $Y$ for life, with remainders to $Y$'s children, and $X$ retains the right to terminate the trust and accelerate the remainders, but only with the consent of $Y$, a taxable gift of the entire present value of the corpus has occurred and, at $X$'s death, an estate tax on the whole value also attaches. These two examples


14 §1000 and Regs. 108, §86.2; §811(c) (1) and (3) and Regs. 105, §81.17. §811(c) (2) as amended by §7(a) of the Technical Changes Act of 1949 (Pub. L. No. 378, 81st Cong.), approved October 25, 1949, exempts certain transfers made prior to October 7, 1949, under which the grantor's reversionary interest arises by operation of law or has a "value" not in excess of 5% of the value of the property transferred measured at the moment before death by use of mortality experience tables and without regard to the actual death a moment later. (A unique method of valuation and a bizarre test of liability!)

15 Gift Tax: §1000 and Regs. 108, §86.3. Estate Tax: §811(d) and Regs. 105, §81.80; Comm'r v. Estate of Holmes, 326 U.S. 480 (1946); Pauline W. Tidemann, 1 T.C. 968 (1943).
raise more difficult problems than the first one above discussed. Protection of the estate tax is not any more in the picture, but protection of the income tax is. These transfers, unlike the first, shift the income tax on trust income from donor to life beneficiary. The gift tax is intended to protect both estate tax and income tax.\textsuperscript{16} Hence, while from the point of view of the estate tax, no exaction on the gift is called for, protection of the income tax calls for offsetting transfer taxation in respect of the property placed in trust. Correlation here demands an alignment of the three taxes.

If we leave the trust field and look at the treatment of life insurance, the picture is no happier. Suppose \(A\), an insured, makes a complete assignment to \(B\), the named beneficiary, of an ordinary level premium whole life policy \(A\) has purchased. A gift tax is imposed on the replacement value of the policy at the time of assignment and if \(A\) thereafter continues to pay the premiums, each payment is a taxable gift. On \(A\)'s death the entire proceeds of the policy will be taxed in his gross estate.\textsuperscript{17} If \(B\) pays the premiums after the assignment, the proceeds are allocated between taxable and non-taxable status in the proportion the premiums he paid bear to the total premiums paid.\textsuperscript{18} The lack of correlation here does not involve the income tax since the income increment in insurance is exempt from that tax so far as is relevant to the correlation problem.\textsuperscript{19} The imposition of two transfer taxes is not, however, lacking in rational basis. The assignee may readily convert his gift into cash or (under policy options) he may choose an annuity, deferred or immediate, and to that extent an immediate gift has occurred. On the other hand, the testamentary characteristics of life insurance are sufficiently prominent, despite the frequent argument that it is "just like other property," to support the propriety of taxation at death.\textsuperscript{20} The possibility that premature death of the

\textsuperscript{16} The joint purpose of the gift tax to supplement the estate tax and also to deter income tax avoidance has been recognized from the start. The short-lived 1924 tax was primarily inspired by income tax considerations and restoration of the tax in 1932 was motivated by considerations as to its effect on both the other taxes. For discussion of the legislative history and purpose, see 2 \textsc{Paul}, \textit{Federal Estate and Gift Taxation} §§15.01, 15.02, 17.03 (1942); \textsc{Harris}, \textit{Gift Taxation in the United States} (1940).

\textsuperscript{17} Gift Tax: §1000 and Regs. 108, §86.19. Estate Tax: §811(g) and Regs. 105, §§81.25, 81.27, 81.28.

\textsuperscript{18} §811(g); Regs. 105, §81.27.

\textsuperscript{19} The interest earned during the period a policy is in effect is not taxable income as it accrues. Proceeds paid by reason of the death of the insured are specifically exempt from income tax. §22(b)(1); Regs. 111, §29.22(b)(1)-1.

\textsuperscript{20} See 1 \textsc{Paul}, \textit{Federal Estate and Gift Taxation} §10.15 (1942).
insured will produce a substantial mortality gain to the assignee which would otherwise entirely escape transfer taxation is a persuasive reason for applying the estate tax. Satisfactory correlation here would seem to involve an appropriately divided application of both taxes. Another aspect to the disjointed relationship between the two taxes lies in the contemplation of death provision of the estate tax.\textsuperscript{21} Since this taxing provision depends for its application on a determination of a subjective state of mind, it is productive of endless disputes in which the objective "evidence" of subjective motive frequently becomes absurdly artificial.\textsuperscript{22}

Here again the double application of transfer taxes on the same transfer sets off the complicated operation of the gift tax credit provisions. It precipitates valuation, tracing and income tax basis difficulties. The provision also fails, in any event, properly to protect the estate tax since the gift tax paid is excluded from the estate tax base, or, if it has not been paid prior to death, it is an allowable deduction in computing the net estate. Thus, a transfer deliberately made in contemplation of death may, nevertheless, produce significant tax savings.

The imposition of estate tax on gifts made in contemplation of death is, under the present law, a defective but necessary safeguard against what would otherwise be a most obvious device for estate tax avoidance. At the same time, no practicable means exists for preventing such transfers from also incurring a gift tax, so long as we have two separate and unrelated taxes. Pretty clearly, the present provision could be improved by tinkering with it. A conclusive application of the estate tax to all transfers made within a specific period, say five years, before death, and exemption of all transfers falling outside the period would probably be as effective as the present provision and much simpler. At the same time it would subject to tax only transfers which, regardless of motive, come reasonably close in point of time to being testamentary.\textsuperscript{23} Nevertheless, a scheme of revision which would resolve any need for either subjective inquiry or arbitrary classification would represent a substantial advance.

\textsuperscript{21} §811(c).

\textsuperscript{22} An outstanding example of the variety of trivia which may be deemed to have a bearing on the decedent's mental state is to be found in Estate of Oliver Johnson, 10 T.C. 689 (1948).

\textsuperscript{23} The British have adopted a fixed number of years as the sole criterion governing taxability. \textit{Cf.} the provision in H.R. 6712, 80th Cong., 2d Sess.: §204, as one example of several alternative proposals which would not eliminate the necessity for exploring
B. Inequalities and Defects Attributable to the Marital Deduction Provisions

The estate and gift tax provisions of the Revenue Act of 1948 have imposed upon the two taxes new inequalities of treatment as between taxpayers in community property and common law states and added defects in technical structure which will harass both taxpayer and government if allowed to stand as they are.

The marital deduction was evolved as a vehicle whereby the community property states could be restored to the favorable tax position which they enjoyed prior to the enactment of the Revenue Act of 1942 without, at the same time, restoring the large measure of discrimination against the common law states which also existed before the 1942 amendments. The marital deduction, in turn, was the political lever which induced the community property states to accede to loss of their long-enjoyed income tax edge over the common law states, through the painless device of universal splitting of income by spouses.

The income tax solution, with unimportant exceptions, solved the problem of unequal geographical application of the income tax, without introducing new complexities, chiefly because it cut across the fine points of diverse systems and methods of holding property. In contrast, the accompanying marital deduction provisions paid homage to the technicalities of property ownership in the family group, thus producing no increased equality of treatment and creating more complexities than the few resolved. Moreover, it can fairly be said that in many instances they have created new inducements for taxpayers to make unwise property dispositions for tax saving purposes.

1. Inequality of treatment

It is readily apparent that the repeal of the 1942 community property amendments and the adoption of the marital deduction have not produced geographical equality of tax treatment. Numerous cases of subjective motive, but would restrict the application of the section. As tending to support the view that under present law restriction on the scope of the section is hardly necessary and the taxpayer's case never hopeless, see Dierks v. United States, 86 F. Supp. 832 (1949).

24 §§351-374 (Pub. L. No. 471, 80th Cong., 2d Sess.).

25 For a full discussion and analysis of the income “splitting” provisions of the 1948 Act, see Surrey, supra note 7.

26 For the same reason it also made an important contribution to the equalization of the tax burden on earned incomes and investment incomes.

27 A detailed discussion and analysis of the marital deduction provisions of the 1948 Act is to be found in Surrey, supra note 7, and in Sugarman, Estate and Gift Tax Equalization—The Marital Deduction, 36 Calif. L. Rev. 223 (1948).
significant inequality can be stated. Fundamentally, the disparity of burden between common law and community property states is traceable to a basic difference in tax incidence as between, on the one hand, treating community property as though it involved separate ownership of half the property by each spouse, and, on the other, permitting the marital deduction for non-community property. Under the marital deduction system, an inter vivos gift from one spouse to another is taxable as to half. But, in community property states one spouse’s half interest in community property produced by the other arises by operation of law without attracting any gift tax.

Out of this critical difference arise various situations in which the tax burden will fall with different impact on transfers having substantially identical economic effects. Two of the most simple examples will show how substantial the differential may be. H and W, residing in California, acquire through H’s efforts $500,000 in community property during H’s life. At his death, leaving W surviving, H bequeathes his share of $250,000 to his children. No gift tax is imposed during H’s life on W’s acquisition of her community interest. On death $250,000 is included in H’s gross estate. In contrast, consider the case of X, a husband residing in New York, who also earns $500,000 during his life. He gives half of it to Y, his wife, as he earns it, $125,000 thus being included in taxable transfers for gift tax purposes. At death he leaves the remaining $250,000 (less the gift tax on the $125,000) to his children. It is apparent that H will incur substantially smaller total transfer taxes than X and, in addition, will have the use during life of an amount equal to the tax money X paid in the form of gift tax. On the other hand, if we change the foregoing examples to suppose that H and X have no children and leave all their properties to their wives, we then find that H will pay an estate tax on a gross estate of $250,000, while X will pay gift tax on gross gifts of $125,000 and estate tax on $125,000 of gross estate after marital deduction. In this instance, X will incur a smaller total tax than H, offset to some extent by losing the use of the gift tax money.

Further examples of disparity of treatment based upon the same basic cause can easily be thought of. The present rules probably favor the community property states, for the “normal” disposition of property involves passing it along to succeeding generations. The

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28 In this connection, see the statement of Secretary of the Treasury Snyder in Hearings before the Senate Committee on Finance on H.R. 4790, 80th Cong., 2d Sess. 25-28 (1948). Further examples and discussion appear in Surrey, supra note 7.
inter vivos preparation for this process is favored tax-wise by the community property rules since, unlike the common law state spouses, the community property husband and wife can "split" the estate between them for estate tax purposes without one incurring any gift tax for the privilege. Nor is it even a partial answer to say that the common law state spouses can wait until death and avoid the gift tax penalty, for the surviving spouse loses opportunity for splitting with the other. It is clear that substantial geographical equality in estate taxation has not been achieved.

In addition to the fundamental disparities, other quirks of inequality arise. One is of some interest because of its somewhat ironic quality. In common law states a husband may not leave a life estate in trust to his wife with remainders to his children without forfeiting the marital deduction as to the property passing under the testamentary trust. In some or all community property states, however, it is apparently possible to achieve most of this result, without losing the community property tax benefits, by giving the wife a life estate in the whole of the community property on condition that she accept a provision that the entire property pass in remainder to the children on her death. If this can be done, then the common law states have incurred, in the 1948 Act, a new tax penalty against this usual and frequently desirable type of testamentary disposition which is native to and typical of the common law system, while community property state residents may still enjoy, to a considerable degree, a comparable disposition unfettered by additional tax cost.29

2. Defects of structure

In addition to problems of geographical uniformity, the marital deduction provisions have presented a number of major technical difficulties. The tax saving possibilities for decedents who leave a surviving spouse and for donors who exercise their generosity in favor of their spouses have been so marked that they have temporarily stilled protests against the technique whereby they have been accomplished. Defects in that technique, nevertheless, are fairly imposing and will be protested as time goes on and taxpayers and their estates become involved deeper and deeper in them.30

29 Surrey, supra note 7.

30 Some of these are already making themselves apparent. See, for example, a number of technical proposals approved by the Section of Taxation of the American Bar Association, p. 139, in 1949, submitted by the Committee on Equalization of Taxes in Community Property and Common Law States.
Perhaps the most serious structural disharmony is the one already briefly mentioned in connection with geographical inequality, namely, the restrictions on the use of the life estate and remainder pattern of property distribution. To enjoy the marital deduction, property passing to a surviving spouse must pass absolutely or, in the case of certain trusts and life insurance, in such manner that the survivor will have absolute dominion over its disposition, either inter vivos or at death. To place a large tax saving reward on transfers to spouses under which the transferee obtains either outright ownership or the unlimited right of disposition during life or at death, is frequently to force a choice between wise property dispositions and tax saving. The trust device was developed in response to social and economic needs which have not yet disappeared. In many instances, to throw responsibility for management or disposition of complicated business or investment properties on a spouse completely inexperienced in such matters is to invite disaster, soon or late. To deter more sensible arrangements in such instances by a tax penalty seems a peculiar departure from wise tax policy.

The origins of this aspect of the marital deduction were two-pronged. In the first place, justification for the marital deduction was founded entirely, for argument purposes, upon creating a supposed similarity of treatment with community property, under which the surviving spouse’s interest is absolute. Clearly a disposition consisting of a life estate in a wife followed by remainders to children or other descendants creates an interest in the wife which is unlike the survivor’s interest in community property. Furthermore, since no transfer tax at present attaches to the falling in of the remainders, it would be patently unacceptable to make such transfers exempt at the husband’s death without abandoning the present exemption at the wife’s death when the remainder interests in the children come into possession and enjoyment. This the sponsors of the legislation apparently were not ready to do. Hence, the poor middle ground compromise, which avoids taxing the falling in of remainders but penalizes transfers of less than either a complete ownership in fee, or a transfer giving to the wife a full power of lifetime or testamentary disposition.

Another fundamental and troublesome structural defect is the 50% limitation on the deduction. Here, again, the inspiration for the limitation lay in trying to copy the tax results of community prop-

31 §812(e) (1) (B), (F) and (G).
32 §§812(e) (1) (H), 812(e) (2).
erty ownership. In the case of the estate tax the similarity of treatment is fairly substantial. The gift tax marital deduction, however, involves a wholly different principle because the 50% limitation is applied to each inter-spouse transfer. The result is to create some new and difficult planning and tax choice problems which must frequently be resolved before all pertinent information is known. Inter vivos inter-spouse transfers which incur gift tax may turn out to be expensive taxwise if they result in a failure fully to use the marital deduction at death. Since property holdings and their values can fluctuate greatly over the period of a few years, the ultimate tax desirability of a transfer by gift to a spouse of a substantial portion of the donor’s holdings may be very difficult to predict.

The 50% limitation has also drawn with it into the estate tax structure another defect of some significance in connection with the deduction for property previously taxed. Unable, at least within the time available for drafting the 1948 amendments, to prepare a workable adjustment to this already overly-complicated provision, which would prevent its operation as to marital deduction property, the draftsmen and the Congress were forced to a blanket exclusion from the deduction of all property acquired from a spouse of the decedent.33 The effect is that where a deceased spouse has received property by gift or inheritance from the other spouse within five years of death, an estate tax will be applied to the entire value of the property received even though, despite the marital deduction, part of it was previously taxed. To take the simplest case, if \( H \) bequeaths his entire estate outright to \( W \) and then \( W \) dies a year later, \( H' \)’s gross estate will include one-half the value of the property passing and \( W' \)'s estate will include the entire balance remaining at her death. Prior to the 1948 law the “double tax” on roughly one-half the estate would not have occurred.

It would be possible to correct this discriminatory effect by extremely complicated deduction provisions. The sufficiently initiated may also, to some extent, forestall the present danger of double tax by seeing to it that a surviving spouse receives no more than the maximum deductible interest in a form that will be taxed again at the second death, e.g., a surviving spouse can be given one-half the estate outright and one-half in a trust which does not qualify for the marital deduction. However, this latter type of solution will not infrequently violate the first decedent’s real wishes as to disposing of his estate

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33 §812(c).
and, moreover, will not avoid the problem in all instances. In the case of an inter vivos gift to a spouse who dies shortly thereafter, estate tax will attach to the whole value at her death, despite the prior gift tax on one-half. It would be, at best, a poor solution to this problem to add substantial complications to the already obfuscated provisions.

Another probable source of much difficulty is the so-called terminable interest rule, designed to prevent the marital deduction from applying to inter-spouse transfers of interests less than a fee which have been carved out by the transferor from property in which other persons have acquired from him successor interests for less than full and adequate consideration.\(^4\) Here, again, the genesis of the limitation was the effort to impose on the deduction a community property likeness. The community property interest acquired by a surviving wife from her husband is not subject to being cut down to terminable interests by the husband. Accordingly, the marital deduction was not intended to extend to such interests created under common law dispositions.

This line of policy, even if it were basically more sensible, is not one which can be sharply drawn and the difficulties are readily apparent. For example, under the terminable interest rule, a husband cannot benefit from a deduction by giving a fund to his wife in the form of a legal or equitable life estate, with remainders to his children. Nor, as a protection to this rule, can he adopt such alternatives as directing his executor to use the fund to purchase a life annuity for his wife and hold the balance in an accumulation trust for distribution to the children at the wife's death.\(^5\) But nothing prevents him, for example, from buying such an annuity for his wife during his life to take effect at his death and providing for the children in his will through a testamentary trust.\(^6\) Thus, in theory at least, the policy reflected in the terminable interest rule easily breaks down. If the break is not almost equally a practical one it is in large part because of the fact that annuity policies today are not generally an attractive purchase on present conservative interest and mortality assumptions. Almost equally responsible is the fact that it is frequently a substantial inconvenience or worse to have to convert a large proportion of one's assets into cash during life.\(^7\)

\(^4\) §812(e) (1) (B).
\(^5\) §812(e) (1) (B) (iii); Regs. 105, §81.47b(e).\(^1\)
\(^6\) Regs. 105, §81.47b(d), example iv.
\(^7\) The foregoing analysis sets forth only the prime sources of trouble. For a more
II. A PROPOSAL FOR REVISION

Faced with the numerous and serious shortcomings of the existing estate and gift tax structure, what can be done, within the limits of political practicality, promptly to eliminate at least the most fundamental difficulties? Are there legislative steps which interested representative groups could unite in urging and on which the Congress might fairly readily agree, that would thus establish the estate and gift taxes on a simpler and more satisfactory basis? To have any hope of early attainment, revision would have to avoid, it seems, raising issues of policy which are too basic and controversial for any chance of prompt agreement. Presumably, too, we would have to avoid any further overall weakening of the present taxing structure. Within

detailed discussion of the defects of technique in the present marital deduction, see Surrey, supra note 7, 1147-1159.

An area of major difficulty that is not dealt with here involves the tax treatment of settled property. This is at least as much a broad problem of taxing policy as it is of technical structure. Under existing law no transfer tax attaches upon the termination of a life estate of any one of a series of successive life estates. This situation (coupled with the flexibility made possible by generous exemption of most powers of appointment under §511(f)) makes possible an attractive method of estate disposition through successive life estates in trust, covering two, three or, occasionally, even four generations, at the cost of a tax only upon the creation of the trust and no further tax until the deaths of the ultimate remaindermen. The broad resort by testators having large estates to testamentary dispositions involving successive life estates in trust is evidence of the powerful tax saving motivation provided by this major "loophole." (See, Characteristics of Property Transfers During Life and at Death, Exhibit 5 accompanying Statement of Secretary Snyder before the Committee on Ways and Means, House of Representatives, February 3, 1950.) It is probably true that the estate and gift taxes cannot be made to produce very great amounts of revenue or to be very efficient instruments of a policy against excessive accumulations of inherited wealth so long as the settled property exemptions continues. The problem is not dealt with here for a number of reasons. Primarily, it is not because it seems to me that it will probably take a good deal longer to work out acceptable solutions to this broad policy issue than it will to reach agreement on methods for curing the more purely technical defects that are the subject matter of this article. It seems to me somewhat unlikely that the 81st Congress will find the time in its remaining session to deal with so basic and controversial a problem.

As this article was being completed, the problem of settled property came into public prominence. The President's Tax Message of January 23, 1950 (H. R. Doc. No. 451, 81st Cong., 2d Sess.) dealt with the question and urged action to eliminate this method of tax escape through which large amounts of wealth pass tax free from one generation to another. This is all to the good and the work should be started. However, in terms of priority, the working out of a method for bringing this broad area within the scope of the tax law should not be permitted to cause delay in the correction of the most important technical defects which plague the present taxing area. In terms of what may reasonably be expected to be accomplished promptly, the technical defects dealt with here seem to me to take precedence over solving the settled property problem.
these limitations, can a balanced program be advanced which might have a broad appeal?

The problems involved seem to boil down to these:

1. Can the estate and gift taxes be made to work together so that without drastic changes in present concepts, each transfer will, so far as possible, involve no more than a single taxable event to which only one or the other tax will apply and still promote a proper relationship between income and transfer taxes?

2. Can the marital deduction system be modified so that it will cut across property systems and establish a geographically uniform and more simple and equitable basis for taxing the property dispositions of spouses?

A. Integration and Correlation: The Basis for a Single Taxable Event for Most Transfers

In any effort to limit estate and gift taxation so far as possible to a single tax on each property transfer, one is faced at the outset with the problem already adverted to: the gift tax serves two masters. It must not only perform its more obvious task of protecting the estate tax by weakening the tax impetus to inter vivos dispositions; it must also, by its impact on inter vivos transfers, protect the income tax from being debilitated through various forms of property dispositions designed to split taxable income from the transferred property advantageously among a number of taxpayers. Any choice of the taxable amount or event in respect of a particular transfer for transfer tax purposes must be made with the function of protecting the income tax also in mind. Stated differently, in the process of making the choice of taxable event one must correlate income, estate and gift taxes if both functions of the inter vivos tax are properly to be carried out.

One of the chief reasons for difficulty in correcting the relationship between income, gift and estates taxes is that the present gift tax, whatever its efficacy in protecting the income tax, generally imposes a so much lighter burden than the estate tax that it cannot, in the case of inter vivos transfers which are really substitutes for testamentary dispositions, serve as a substitute for estate taxation. The first and, to me, the only practicable solution for this problem yet advanced is to neutralize the estate and gift taxes as completely as possible by combining the two into a single transfer tax applicable alike to inter vivos and death transfers. To be neutral the tax burden on all transfers must become closely uniform regardless of when made. Then,
when elimination of the existing disparity of burdens has made the imposition of transfer tax primarily a problem of timing, this timing problem can in most instances readily be solved by selecting as the taxable event that which also shifts to the donee liability for income tax on income from the transferred property.

The process of combining the two transfer taxes has come to be known as "integration" and the selection of a single taxable event for each transfer under all three taxes as "correlation." A joint study on income, estate and gift taxes issued in 1947 by the Treasury Department and an Advisory Committee of well-known attorneys embraced a comprehensive revision of the three taxes to present an integrated and correlated system.\(^9\) Briefly, under the Treasury-Advisory Committee plan, integration would be achieved by establishing a single transfer tax imposed upon a cumulative base similar to the present gift tax, the transfers taxed at death being treated merely as the last of the taxpayer's transfers, to be cumulated with those made inter vivos. Thus a single set of rates, exemptions and transfer tax concepts would apply to all taxable dispositions of property. For administrative and taxpayer convenience, inter vivos transfers would be made subject to an annual exclusion of some specific amount for each donor and, in addition, a small annual exclusion for each donee. In order to protect decedents' estates from too great depletion at death, the single exemption for both taxes would be usable only in part against inter vivos transfers, any unused balance being reserved to apply to transfers taxed at death. Transfers made within the year of death would be included in the final transfers at death.

The system of correlation proposed in the Treasury-Advisory Committee report envisaged that, in general, a transfer of property which would cause a shift of taxability from one person to another for income tax purposes was the event which was necessary and alone sufficient to set off the imposition of the cumulative tax. If, after a taxable transfer, the transferor retained an interest in the property, no tax would thereafter be imposed on any diminishment of the retained interest, whether during life or at or after death.

In arriving at a choice of taxable events in respect to various classes of transfers the Treasury-Advisory Committee study did not select as controlling the whole body of existing rules governing any one of the three taxes involved, but rather picked and chose, in some places making existing income tax concepts yield to conflicting estate

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or gift tax rules, in others subordinating present estate tax rules to the income tax situation, in others, creating new rules, and so on. In doing this, the authors of the study cut new paths of basic tax policy and made deliberate and often difficult choices. Their decisions seem to me to have involved no unacceptably radical innovations and their adoption would result in many distinct improvements in structure which less far-reaching revisions may not achieve. I would not personally be disposed to find much fault with the conclusions reached. It must be admitted, however, that because their decisions involved departure from a good many existing rules, particularly in the crucial income tax field, the recommendations had to encounter not only the usual initial measure of opposition to significant changes in long-established concepts, but also the delay incident to the process of informing and acquainting busy Congressional committees and other interested groups with the nature of the proposals and the reasons supporting them. These factors and, no doubt, others, have contributed to only a slow dispersion of knowledge, let alone acceptance, of the integration and correlation recommendations of the Treasury study.

At this stage it would seem that any hope for prompt agreement on a program for correlation would lie in making as little change as possible in existing concepts and particularly in the present income tax rules. This objective would seem measurably nearer if satisfactory correlation can be achieved upon the basis of applying existing income tax rules as the criteria for the taxable event. If this could be agreed upon, the other major question would be whether, under this transfer concept, there are any serious grounds for objection to the integrated transfer tax which are not susceptible either to correction or acceptable compromise in the light of other provisions of the overall revision plan.

1. *Correlation on the Basis of Existing Income Tax Rules*

The proposition that an interest sufficient to support the propriety of taxing the income from property to the transferee will support also a transfer tax on the transferor is not troublesome in concept. In fact, existing law produces this result in the common situations. Likewise, if a grantor retains sufficient interest in property transferred to make the income from it appropriately taxable to him, it would seem for the most part acceptable to defer the imposition of a transfer tax until a more definitive transfer occurs. But these generalities will not suffice.
The real task is to determine the specific areas, if any, in which correlation based on existing income tax rules might lead to unacceptable difficulties.

Fortunately, the transfer concepts of the income tax are usually more refined and flexible than those of the estate tax and, hence, provide, with some exceptions, a better theoretical basis for correlation. At the outset, however, it should be recognized that adoption of the income tax rules would involve perpetuation of some significant shortcomings. At least one very unfortunate effect would be the continuance (and to some extent, perhaps, a broadening) of the uncertainties and unrealities of the "substantial adverse interest" concept, which is expressly carried into the income tax by the present sections 166 and 167 of the Code and, by implication derived from history, into the gift tax. This effect the Treasury-Advisory Committee plan would have avoided by providing for the same tax result in the case of any power conferred on a third person, either alone or in conjunction with the grantor, as would follow if the same power were retained by the grantor alone. While this would produce a result greatly to be desired, its attainment does not rank in general importance with correction of the more fundamental structural defects and its continuance, at least for the time being, is not too great a price to pay to avoid the controversy and inevitable delay incident to any fundamental revision of existing income tax concepts.

Greater facility in isolating the detailed problems of correlation based on income tax concepts may result if the discussion classifies various inter vivos transfers into types producing similar or comparable problems, in an effort to characterize the principal problem areas.

(1) Transfers Correlated under Present Law.

First and easily disposed of are those transfers as to which existing income, estate and gift tax laws are already correlated. Here no change in present rules would have to be made, since the estate and gift taxes already in effect, follow the applicable income tax treatment. There are included here such transfers as the following:

a. Transfers over which the grantor has retained a power either to alter, amend or revoke, exercisable either alone or in conjunction with a person having no interest substantially adverse to the exercise

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40 See Revenue Act of 1934, §511; H. R. Rep. No. 704, 73rd Cong., 2d Sess. 40; Regs. 108, §86.3.

41 Federal Estate and Gift Taxes, op. cit. supra note 9, 19-20.
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of the power. Present law treats these transfers as incomplete for all purposes.42

b. Transfers under which power to alter, amend or revoke or apply income or corpus for the benefit of the grantor is given to a third person who has a substantial interest adverse to exercise of the power, or is given to any third person if the power be exercisable only by will. These at present are deemed completed transfers for purposes of all three taxes.43

c. Transfers subject to a power in an independent trustee or other person to accumulate, distribute or apportion income or invade corpus for the benefit of beneficiaries other than the grantor, or a power in any third person to distribute or accumulate income for such beneficiaries or, where the beneficiaries are not closely related to the grantor, to apportion income among them. These are considered completed transfers for all purposes.44

d. Transfers for the benefit of third persons measured by the life of the grantor, with remainders over to others, under which the grantor retains no beneficial interest. These are completed transfers.45

e. Transfers under which the grantor retains no more than a possibility of reverter not dependent on the grantor surviving other beneficiaries. These are completed transfers for purposes of all three taxes.46

42 Income Tax: §166; Regs. 111, §29.166, 29.22(a)-21(d); Comm'r v. Buck, 120 F. 2d 775 (2d Cir. 1941); Arthur H. Ingle, T.C. Mem., Aug. 26, 1949, CCH TAX COURT REP., Dec. #17,169(M).

Gift Tax: §1000; Regs. 108, §86.3; Burnet v. Guggenheim, 288 U.S. 280 (1933); Estate of Sanford v. Comm'r, 308 U.S. 39 (1939). Cf. §1000(c) and Regs. 108, §86.3, last par., as to certain transfers prior to January 1, 1939. Cf. also §1000(g), added by §6 of the Technical Changes Act of 1949, as to certain transfers made prior to January 1, 1939. Estate Tax: §811(d); Regs. 105, §81.20; Porter v. Comm'r, 288 U.S. 436 (1933).

43 This is a counterpart of the rule referred to in note 38, supra. The income tax treatment of a testamentary power in a third person lacking a substantial adverse interest is perhaps open to question, and the doubt, it is contemplated, should be resolved in favor of the rule as stated in the text.

44 Regs. 111, §29.22(a)-21(d). Cf. §167; Regs. 108, §86.3; Regs. 105, §81.20.

45 Note 44 supra. Correlation has been the rule and continues to be for all transfers made prior to October 8, 1949. Reinecke v. Northern Trust Co., 278 U.S. 339 (1929). §7 of the Technical Changes Act of 1949 (Pub. L. No. 378, 81st Cong.), approved October 25, 1949, added §811(c)(3) changing the estate tax rule as to transfers made after October 7, 1940, and making the transfer incomplete. While this seems eminently sensible under existing law, the proposal here would contemplate reverting to the rule applicable to preexisting transfers, in the light of the proposed neutral transfer tax. It seems likely that few transfers or none at all have been made under the new rule.

46 Gift Tax: Regs. 108, §86.3. Estate Tax: Regs. 105, §81.17; Frances Biddle Trust, 3 T.C. 832 (1944). There is, of course, the "remote" reversion, the value of which might
f. Transfers under which the grantor retains a power to invade corpus for beneficiaries other than himself under an enforceable standard (such as a power to provide for education, support and maintenance). These are also completed transfers.47

(2) Completed Transfers for Income Tax Purposes which Incur Both Gift and Estate Taxes.

The second class of transfers, which presents few problems,48 is that in which a gift tax now applies on the full value of the property when the income tax shifts to the transferee, but an estate tax also applies at the grantor’s death. Here the solution is simply to apply the transfer tax only at the time the gift tax now applies and eliminate any tax upon the grantor’s death. These cases include such as the following:

a. Transfers under which the grantor and a person having a substantial adverse interest have the power to alter, amend or revoke.49

b. Transfers under which the grantor alone or in conjunction with any person may accumulate income for, or distribute to, an income beneficiary other than the grantor.50

c. Transfers under which the grantor retains in himself or his estate a remote reversionary interest if all named remaindermen fail to survive him.51

(3) Incomplete Transfers for Income Tax Purposes Which Incur a Gift Tax.

be exempt from gift tax and subject to estate tax if determinable under acceptable actuarial methods. These are generally insignificant and it is contemplated that no exclusion would be made for such interests at the time of transfer or inclusion at the time of death under an integrated transfer tax.

47 Note 40 supra; Jennings v. Smith, 161 F. 2d 74 (2d Cir. 1947).

48 Few problems only on the assumption of very complete neutrality of transfer taxation, for we are here dealing largely with what are clearly “testamentary substitutes.”


50 See note 44, supra. It is open to dispute whether the estate tax now applies in this situation, but the question should be clarified as part of the correlation revision. Cf. note 62, infra.

51 It is assumed here that the reversion is so remote as to be either incapable of valuation or of only nominal value. In either event there seems to be no difficulty with proposed treatment, which would ignore the “reverter” interest. Robinette v. Helvering, 318 U.S. 184 (1943). Cf. discussion under part (5), infra. §7 of the Technical Changes Act of 1949 (Pub. L. No. 378, 81st Cong.), approved October 25, 1949, has effectively correlated certain past transfers of this class by adding §811(c)(2) to the Code, eliminating the estate tax. Cf. Estate of Spiegel v. Comm'r, 335 U.S. 701 (1949).
The third class of case, substantially more difficult to deal with, includes those instances where, under present law, a gift tax is or may be imposed on a transfer which, for income tax purposes, is incomplete and results in the grantor continuing to be taxed on the annual income. This class of case includes:

a. Assignments of income or transfers in trust for a short period with a reversion to the grantor or his estate.\(^5\)

b. Transfers under which income from the property may be applied by the grantor or by a person having no substantial adverse interest, to discharge obligations of the grantor (other than a power in the grantor as trustee or in such other person to support the grantor’s dependents)\(^5\) or may be applied to the payment or premiums on insurance on the grantor’s life.\(^5\)

c. Transfers under which the grantor retains such broad administrative powers over the trust corpus as to subject him to continued income tax liability.\(^5\)

d. Transfers under which persons having no substantial adverse interest and closely related or subordinate to the grantor have the power to apply income or corpus for close members of the grantor’s family in such manner as to make the income taxable to the grantor.\(^5\)


\(^{53}\)§167(c). See note 58, infra.

\(^{54}\)§167(a) and (b); Regs. 111, §§29.167-1, 29.167-2; Regs. 108, §86.3; Helvering v. McCormack, 135 F. 2d 294 (2nd Cir. 1943); Comm’r v. Beck’s Estate, 129 F. 2d 243 (2nd Cir. 1942). Doubts persist as to the gift tax rules all through the area of “Stuart” type and other “Clifford” trusts. See 2 Paul, Federal Estate and Gift Taxation §§17.17, 17.18, 17.19 (1942) and Supplement (1946). See Smith v. Shaughnessy, 318 U.S. 176 (1943); Comm’r v. Hogle, 165 F. 2d 352 (10th Cir. 1947); Lockard v. Comm’r, 166 F. 2d 409 (1st Cir. 1948). Cf. Helvering v. Stuart, 317 U.S. 154 (1942), rehearing 2 T.C. 1103 (1943).

\(^{55}\)Regs. 111, §29.22(a)-21(c) and notes 52 and 54, supra. This type of transfer is also to be compared with the family partnership problem. Generally speaking, in the partnership problem comparable taxing criteria are at work. Even if “incomplete” for income tax purposes, the transfer of a valuable interest in a business is probably a taxable gift. Fred Reilley, ....... T.C.M. ......... See also William H. Gross, 7 T.C. 837 (1946). Cf. Overton v. Comm’r, 162 F. 2d 155 (2nd Cir. 1947); Comm’r v. Hogle, 165 F. 2d 352 (10th Cir. 1947).

\(^{56}\)Regs. 111, §29.22(a)-21(d) and notes 52 and 54, supra. Estate Tax: Comm’r v. Irving Trust Co., 147 F. 2d 946 (2nd Cir. 1945). Gift Tax: Herzog v. Comm’r, 116 F. 2d 591 (2d Cir. 1941).
e. Transfers in trust under which a third person lacking a substantial adverse interest is given the power to alter, amend or revoke the trust or to pay over income or corpus to the grantor.\textsuperscript{57}

In these cases if the transfer tax were to be correlated with the income tax rule, no transfer tax would apply at the time of the transfer, but a tax would apply to each completed payment of income to the donee or beneficiary. In contrast, as indicated above, present law in many cases imposes a gift tax on the initial transfer, but not on each income payment. In some cases, as again already indicated, the correlated result may be the rule. This is one of the areas where the governing rules of law are most in flux.

Correlation with the income tax in these cases presupposes that the government will in all cases of this type agree to relinquish any transfer tax collection on present values of future payments when the transfers are made, tax on the value of the corpus being deferred until a later more complete disposition. While some deferment of revenue will result as compared with present law, it would be consistent with the basic notion of correlation. In view of the annual exclusion for inter vivos transfers there would also be some permanent loss of revenue due to splitting up the transfers of income into annual pieces. Nevertheless, this appears to be a proper price to pay for the correlation principle. Indeed, the only alternative would seem to be to abandon correlation in this area, for continued income taxability of the grantor seems necessary both in terms of uniformity of structure and protection of the surtax. There is certainly nothing sacred about the principle of determining and taxing immediately the present value of future interests, although it is the general rule. The correlated rule already applies to some indeterminate extent in this area and also clearly applies to such commonplace arrangements as trusts revocable by the grantor or under which he retains the right to change beneficiaries. The extension of this rule to the broader area here involved should cause no extensive disagreement by either government or taxpayer. Finally, in view of the continued liability of the grantor for income tax the number of trusts of this kind must be relatively very small.

The adoption of the suggested rule of correlation here would appear logically to call for the same result in family partnership situations, which are quite comparable.

One further aspect of the correlation problem in this area should

\textsuperscript{57} See Paul, Supplement to Federal Estate and Gift Taxation §17.18 (1946).
be considered. In a few instances it is impossible to tell when a transfer is made whether the income tax liability will or will not shift, this determination being subject to later conduct on the part of the grantor or trustee. Examples of this problem are the following:

a. Transfers under which income from the property may be appear by the grantor as trustee or by a person having no substantial adverse interest to discharge the legal obligation of the grantor to support his minor children or other dependents.\footnote{\textsuperscript{58}}

b. Transfers in trust under which the grantor has the power to borrow corpus or income.\footnote{\textsuperscript{50}}

In cases of this kind, income taxability of the grantor will depend on whether or not the power by which he may be benefited is in fact exercised. This income taxability may vary from year to year. To permit the grantor to shift income tax liability and still avoid any transfer tax on the value of the corpus at the time of transfer, merely by the insertion of powers which may never be exercised, would constitute a tax avoidance loophole which seems to be of sufficient significance to warrant a rule to prevent it.\footnote{\textsuperscript{60}} Accordingly here the recommendation should be that the transfer be deemed complete for transfer tax purposes when made. Correlation would be achieved, subject only to the possibility that the grantor might from time to time in the future have income tax liability drawn to himself again by reason of later conduct of the trust. However, no second transfer tax would result from reacquisition and later reshifting of income tax liability.


In a few instances, a transfer may be incomplete for income tax purposes because of a retained interest in the grantor and to that extent also incomplete for gift tax, and yet incur a gift tax and estate tax in respect of succeeding interests taking effect in possession and enjoyment after the grantor's interest terminates. These include such as the following:

a. A transfer in trust under which the grantor retains the right to income from the property during his life or for some other period,

\footnote{\textsuperscript{58} §167(c); Regs. 111, §29.167-2.}
\footnote{\textsuperscript{50} Regs. 111, §29.22(a)-21(e)(3).}
\footnote{\textsuperscript{60} Some loophole may already exist since it is not, for example, entirely clear under existing law how the gift tax applies in the case of a transfer in trust of the section 167(c) type under which the grantor is a trustee or co-trustee. See Paul, Supplement to Federal Estate and Gift Taxation §17.18 (1946).}
with remainders over, the grantor retaining no powers over, or interest in, the remainder interests.\textsuperscript{61}

b. A transfer in trust under which the income is to be distributed to beneficiaries named by the grantor or apportioned among named beneficiaries in the grantor's uncontrolled discretion, with vested remainders over to third persons.\textsuperscript{62}

Correlation in this type of case can be achieved by abandoning the gift tax on the initial transfer. While this would defer the transfer tax on the completed transfer of the future interests, the imposition of the tax at death or other termination of the grantor's interest is the appropriate timing of the taxable event in view of the income tax effects and the frequent testamentary aspects of such transfers. The policy considerations are much the same as in the preceding section. Here, too, completed income payments to beneficiaries other than the grantor would incur transfer tax.


Another class of case presenting the most difficult set of problems consists of those instances in which the grantor makes a transfer complete in part under present law for purposes of all three taxes, but retains an interest following the taxable portion of the transfer which renders the remainder of the transfer incomplete for estate and gift tax purposes. These include such transfers as the following:

a. Transfers in trust under which the grantor, alone or in conjunction with a person lacking a substantial adverse interest, retains an absolute power (or in some cases contingent power) to alter or amend the disposition of the corpus following a vested grant to another of a life estate or other prior interest.\textsuperscript{63}

b. Transfers under which the grantor retains a vested reversionary interest following a life estate or other long-term prior interest in another person.\textsuperscript{64}


\textsuperscript{62} Gift Tax: §1000, Regs. 106, §86.3. Income Tax: Regs. 111, §29.22(a)-21(d). Estate Tax: §811(c) and perhaps (d); Industrial Trust Co. v. Comm'r, 165 F. 2d 142 (1st Cir. 1947). There may be included here also powers in the grantor to accumulate or distribute income where the choice will or may affect the identity of the ultimate recipient. Industrial Trust Co. v. Comm'r, supra.

\textsuperscript{63} §§811(c) and (d); Regs. 105, §§81.17, 81.20; Estate of Dravo, 40 B.T.A. 309 (1939). The extent to which contingent powers may produce estate tax or avoid gift tax is a still unanswered problem to a large extent. See 2 Paul, Federal Estate and Gift Taxation (and Suppl., 1946) §§17.10, 17.16.

\textsuperscript{64} Regs. 108, §86.3 (gift tax). §811(a); Regs. 105, §81.13 (estate tax).
c. Transfers in trust under which the grantor retains a substantial contingent reversionary interest, whether of the Hallock type, or of the type where the grantor's death does not affect the interest, or of the type which consists of a right to have the trustee invade corpus for the grantor's benefit pursuant to an enforceable standard.

In these cases imposition of a transfer tax only at the time of initial transfer will not be satisfactory if the tax on the transfer is to be measured solely by the value of the vested interest. The question, therefore, arises whether the imposition of a tax at the time of transfer on the entire value of the transferred property may be acceptable. This is a basic inquiry, since the fundamental policy requires that the shift of the income tax incur a protective transfer tax.

In the case of retained powers, whether absolute or contingent, merely to change beneficial enjoyment among third persons, imposition of an immediate transfer tax on the entire value seems neither inappropriate nor productive of controversy. The grantor should not object if a transfer which saves him from future income tax liability incurs also a gift tax. Nor is he faced in such instances with the prospect of a second transfer tax at some later date, since he has no future beneficial interest, contingent or vested, which may result in the property returning to him.

When we consider transfers of the type described in paragraphs (b) and (c) above, the matter is more difficult precisely because the grantor or his estate has an interest which will or may result in return of the possession and enjoyment of the property to him and a second transfer tax. Nevertheless, on balance, the imposition upon the initial transfer of a tax measured by the entire value of the property in such cases may not be an inappropriate or excessive price for shift of income tax liability. Under present law where the retained interest will take effect in possession and enjoyment only upon occurrence of a contingency not susceptible to valuation for actuarial measurement, the gift tax now applies to the entire value of the property upon the initial transfer. Moreover, in many such cases under present law the estate tax will, in any event, attach to the entire value of the property.


66 Frances Biddle Trust, 3 T.C. 832 (dismissal of appeal authorized 1945 P.H., ¶71.095; cf. Dominick v. Comm'r, 152 F.2d 843 (2d Cir. 1946) cert. denied per stip. 329 U.S. 693.

67 Blunt v. Kelly, 131 F.2d 632 (3d Cir. 1942).
at death of the grantor. If a grantor is to have the benefit of a shift of income tax liability, even though at the same time he retains an interest which may return the property to his possession, the imposition of a transfer tax on the entire value of the property does not seem to present substantial inequality or hardship. Moreover, there seems to be no available alternative which would achieve correlation since it would seem impracticable and undesirable to impose income tax liability on the grantor in these cases. All in all, the recommendation to measure the transfer at the time of initial disposition by the entire value of the property appears acceptable, even though it may assure a double transfer in those rare dispositions in which the grantor retains a vested reversion. Transfers under which the grantor retains contingent reversionary interests are probably even fewer in number and, in any event, the possibility of double tax is of less importance.

(6) Joint Interests.

Correlation based on income tax rules is a relatively simple matter in the case of joint interests. The Treasury-Advisory Committee plan envisaged conforming to existing income tax concepts by treating transfers in joint tenancy or by the entirety, with the grantor as joint tenant, as complete to the extent of the share of income to which the transferee becomes entitled, usually half. This proposal appears entirely acceptable.68

In summary of the correlation discussion, it seems feasible to correlate the three taxes sensibly on the basis of governing income tax criteria. The classification made of the problems by types of transfer is, of course, far from exhaustive, but is believed to be sufficiently complete as to types of transfer to make possible a satisfactory appraisal of the proposed treatment. Correlation on the basis of existing income tax rules should raise no insurmountable controversies or policy disputes if we assume even a reasonable modicum of will to accommodate divergent views. The system would not be above criticism, but that is unavoidable. The important thing is not the lack of perfection but the possibility of agreement by many interests.

2. A Single Transfer Tax: Integration of Estate and Gift Tax

The correlation proposal based upon following existing income tax rules presupposes that no disparities of burden will exist as between taxing a transfer inter vivos or at death. This consideration is crucial, for frequently correlation involves inter vivos application of the tax,

68 Federal Estate and Gift Taxes, op. cit. supra note 6, at 44-47.
as against taxation at death, even though the "testamentary substitute" aspect of the transfer may be substantial. It therefore becomes important that the combining of the two taxes into a single transfer tax will achieve substantially complete neutrality.

The Treasury-Advisory Committee study recommended substantial integration of the estate and gift taxes for most purposes. In its principal outlines this plan seems equally satisfactory for purposes of the correlation plan here proposed. In some respects, however, integration was not to be complete under that proposal. Thus, except in the case of taxable inter vivos transfers within a year of death, the amount of the tax itself on lifetime transfers was to be excluded from the taxing base. In addition, a small annual exclusion was to be maintained and only a portion of the total exemption was to be permitted to be used for inter vivos gifts. These recommendations do not seem to be any less appropriate here with the exception of the proposal to continue the exclusion of the tax on inter vivos gifts from the tax base. This exclusion would maintain one significant item of non-neutrality in the transfer tax system, which seems particularly inappropriate if a number of "testamentary substitute" transfers are to be taxed only at the time of inter vivos transfer because of the policy of correlation on the basis of income tax rules. It would be a relatively simple matter substantially to eliminate it by one of several methods: (1) either add the amount of the tax to each taxable inter vivos transfer, or (2) treat the tax on each transfer when it is paid in the following year, as itself a taxable transfer, or (3) perhaps most simple of all, collect the gift tax from the donee out of the donated property. This would have the effect of modifying the Treasury-Advisory Committee plan by extending the rule it proposed for transfer made within a year of death to all transfers, i.e., the transfer tax would always come out of the property which measures the tax and not out of the retained property of the donor. In view of greater reliance here on income tax concepts of transfer than the Treasury-Advisory Committee plan envisaged, this modification seems unavoidable if real tax neutrality is to result.

Under the integrated transfer tax, special provision has to be made for life insurance. Income tax incidence not being involved, a split application of the transfer tax is possible within the framework of correlation. The plan proposed in the Treasury-Advisory Committee

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69 Id. at 14.
70 Id. at 14-16.
study appears to be satisfactory. Under it a complete assignment of life insurance by the insured would incur transfer tax measured by the value of the policy at the date of assignment. Premium payments thereafter paid by the insured would also be taxed as transfers. On the death of the insured, tax would apply only to the amount, if any, by which the proceeds exceeded the value at the time of assignment plus the amount of the premiums thereafter paid by the insured. This would seem a practicable and fair solution to the insurance problem, at least so long as the income increment in insurance continues to be entirely exempted from income tax in the hands of the beneficiary.

Rules for the creation of joint interests are also necessary. Here again the Treasury-Advisory Committee plan, which suggested following existing income tax rules, appears satisfactory. That plan also dealt with creation of tenancies by the entirety, but the treatment of all joint interests between husband and wife through the marital deduction proposal which follows this discussion of integration and correlation would render this part of the plan superfluous here.

The integration proposal has elicited little real criticism at the level of basic policy. The objections that have been advanced against the plan have been few. They seem to boil down really to a single one. Since adopting the gift tax, so the argument runs, Congress has continued to favor inter vivos transfers of property by extending bargain transfer tax rates. This policy would not be subsidized by an integrated tax. The proposal is, therefore, unacceptable.

One suspects that this argument comes, for the most part, from those who are fundamentally opposed to substantial federal transfer taxation. Viewing the argument entirely on its merits, it is difficult to find much substance in it. The policy, if it exists at all, is certainly served in a haphazard fashion by the present gift tax, for the bargain gift tax rates begin to disappear if the inter vivos transfers total a large proportion of the total estate and ultimately the point is reached where further transfers during life are penalized by higher rates. Even in small estates the point is quickly reached where a penalty attaches to further gifts. Thus, if a single person has a net estate of $90,000, it becomes disadvantageous to make taxable gifts of more than $30,000, since gift tax will fall on any gifts above $30,000 and no estate tax would be due on the remaining $60,000.

On the broad policy level, no recognized national policy seems to

\[\text{Id. at 48-50.}\]

\[\text{Id. at 44-47.}\]
be served by favoring, through special tax treatment, inter vivos gifts by a limited number of wealthy people. Those who object to integration do not undertake to elucidate on the rationale of the alleged national interest involved. In fact, there is evidence that the present differential between estate and gift tax rates was primarily motivated by the view that the gift tax, at least in one light, was merely an advance payment of estate tax and thus should be to some extent discounted for prepayment. Such a rationalization never was particularly persuasive and seems much less so in the context of a tax on transfers under which the time of the tax would frequently be motivated by income tax considerations rather than by the presence or absence of testamentary attributes. In any event, the history of the tax differential hardly rises to the dignity of a major policy against attaining the simplicity of tax neutrality. In truth, the existing favors to inter vivos gifts, including lower rates, separate exemptions, separate tax base and exclusion of the tax itself from the base, have been no more than the accidental or badly conceived results of the taxes being separately enacted, rather than of any considered or conscious policy favoring gifts.

Even if we assume that some types of gifts by the wealthy might be deemed desirable enough to be encouraged by special tax inducements (although no such selective policy has even been seriously presented), it seems clear that the present indiscriminate, disappearing subsidy is difficult to defend. Gifts which tie up property in trust for two or three generations do not break up large inherited fortunes. In fact, quite the contrary. These hardly merit tax advantage even if outright gifts by fathers to ambitious and enterprising offspring for investment in new enterprises might. Yet the present tax law favors the extension of the "dead hand" just as fully as it does the relinquishment of wealth to younger and more adventurous hands. If this situation reflects a considered "policy" of the Congress, which seems more than doubtful, it is time it were re-examined. A policy of transfer tax neutrality, which would leave wealthy persons free to make property dispositions relatively uncoerced by thoughts of tax incidents, appears much more susceptible of rational defense.

In addition to making possible the whole correlation plan, other advantages in technical simplicity would arise from a neutral, integrated tax. The complete elimination of the entire contemplation of death concept would be the most important technical gain; one which would be hard to surpass from the viewpoint of the government and
taxpayer. The equalization of burden between inter vivos and death transfers would remove the need for any distinction between death motivated transfers and others and with this removal would go the most unrewarding and difficult factual disputes in the whole transfer tax area.

Even more widespread a benefit would result to the taxpayer-clients of the average lawyer with a general practice who prepares their wills and trusts. This lawyer today, who is not primarily a tax expert, runs a very great risk that his possible ignorance of complicated refinements and variations of tax incidence cost his clients a big estate tax bill. The present rules are just too difficult for many a practitioner to learn and keep abreast of. The reduction of most of the problems to a single set of more simple rules would materially assist him in serving his clients.

3. Transition to the Integrated and Correlated Tax

One of the most difficult problems faced in the Treasury-Advisory Committee plan for integration and correlation was the method of transition to the new rules. In the matter of correlation, compromise was achieved between the extremes of applying the new rules to all pre-existing transfers and confining them entirely to transfers occurring after their adoption. Although the compromise reached was workable, it was not simple. Moreover, the most compelling motivation for the complex compromise plan apparently stemmed from the fact that in many instances the proposals made involved shifts in existing income tax incidence. By contrast, the proposal for correlation on the basis of existing income tax rules seems to present fewer problems of comparable difficulty in connection with pre-existing transfers, since no question would arise of subjecting a grantor of a pre-existing trust to an unanticipated annual income tax burden. The principal problem would seem to relate to tax adjustments in the case of transfers previously incomplete for estate tax purposes which would be rendered complete by the proposed revision. In general, it would seem best to cover pre-existing transfers by the new rules as completely as possible. However, the problem of the full extent to which this could properly be accomplished or of how tax liabilities should be adjusted where pre-existing transfers are involved, has little bearing upon the question of adopting the basic plan and could be left to exploration in connection with working out details of the basic scheme.

73 Id. at 57-60.
Transition to the cumulation rule of the integrated transfer tax presents a different although related problem. The Treasury-Advisory Committee proposed that cumulation for purposes of the tax on inter vivos transfers should include all transfers after June 6, 1932, as does the present gift tax. This should cause no difficulty. But it was also recommended that cumulation at death should include only taxable transfers made after the adoption of the integrated tax. The policy reasons for this limitation on cumulation at death were not clearly enunciated. Whatever they may have been, no persuasive reason seems to exist for not making a full cumulation from June 6, 1932, for all purposes under the proposal here advanced. It would have the merit of advancing the realization of the full advantages of simplicity of the single transfer tax. So far as possible in conformity with equity the old system should give way to the new in its entirety and avoid the coexistence of old and new rules side by side over any considerable period of time. The only argument against full cumulation in the future of all transfers since June 6, 1932, would seem to be that taxpayers in the past have not anticipated or considered such a taxing method and may have expected in a general way that inter vivos transfers would produce greater estate tax savings than they might in the light of the new rules. The expectations or speculations of taxpayers at any time as to what may be the state of the federal death tax system and the degree of its burden on transfers occurring in some uncertain future are not so sacred that they cannot properly be disappointed in the interests of a simplified and improved tax structure.

B. Total Exemption for Inter-Spouse Transfers

As has been indicated, the principal difficulties with the present marital deduction provisions stem from the fact that they originated in an attempt to extend the equivalent of community property tax treatment to comparable situations (in the economic sense) under common law concepts. The resulting structure has not been conducive either to geographical equality of treatment or neutrality of tax burden between various types of property dispositions. If any real improvement is to be effected, it seems apparent that it will have to be based upon a treatment of inter-spouse transfers which ignores the technicalities of various forms of property ownership as between husbands and wives.

74 Id. at 54.
75 Id. at 54-55.
It is also largely indisputable that the principle of some sort of exemption for transfers between spouses is now fairly firmly established in the estate and gift taxes, at least for any reasonably foreseeable future. Although the origins of the present marital deduction provisions contained more of political maneuvering and tax reduction than of tax principle, a case may certainly be made in terms of basic policy for exemption of transfers between spouses. The estate tax is designed in part to prevent excessive concentrations of wealth by taxing the devolution of property. But it may be argued that in the interest of protecting surviving spouses, particularly wives, and to promote equitable tax incidence, no taxable devolution of property should arise except in the case of transfers from one generation to another or from one husband-wife family unit to another person. A husband and wife may be said to be, in socio-economic terms, basically an integrated unit. Transfers between the two partners in this unit can be viewed as having little economic significance within the purview of the objectives of transfer taxation. Moreover, in any future consideration of the proper relative place of transfer taxes in the federal system high progressive-rate death taxation with relatively small exemptions may be much more justifiable in terms of taxing property devolutions only between generations or, in the rarer case, from one family unit to another in the same generation. Avoidance of a heavy impact of taxation on the surviving member of a husband-wife team, and particularly on a surviving wife, finds much justification in our existing social pattern.

Justifiable in principle or not, the marital deduction idea appears to have enough political vitality to assure its continued presence in the taxing structure for a good many years. Accordingly, whatever one may feel about its desirability as an original principle, it seems only good sense to try to make the adopted principle function as simply and equitably as possible.

The marital deduction principle should be made to cut across all or most of the technicalities of various forms of property ownership. Its application should not become enmeshed in the rules of property law or in tax law complexities such as now surround it. The easiest, and probably the only practicable device which would come close to this objective would be an "unlimited" marital deduction or exclusion.\footnote{Proposals of this kind are not new, e.g., Surrey, supra note 7, at 1161.}

The unlimited marital deduction or exclusion which I propose
The approaching crisis would be combined with the integrated and correlated transfer tax already discussed. Its main characteristics would be the following:

1. **Transfers in fee**

   No transfer tax would be applicable to any transfer in fee of property between husband and wife, including testamentary transfers made to a surviving spouse by a decedent. Thus, a husband could transfer all or any part of the property owned by him outright to his wife inter vivos or at death without incurring any tax on account of such transfers. The principal difference between this aspect of the plan and the present marital deduction would be the elimination of

   (1) the adjusted gross estate concept under the estate tax law\(^\text{77}\) and of the limitation of the marital deduction to 50% of the adjusted gross estate,\(^\text{78}\) and

   (2) the limitation on the gift tax marital deduction to one-half of the value of the property transferred between spouses.\(^\text{79}\)

   The mechanics for carrying out these changes could be to continue the use of a deduction as at present, or perhaps, with the elimination of the 50% rules, it would be considerably simpler as a matter of draftsmanship to convert the deduction to an exclusion from the gross estate.

2. **Transfers of interests less than a fee**

   The second major aspect of the plan would extend the complete deduction or exclusion to interests of less than a fee transferred from one spouse to another. Here the proposal would be to exclude from taxability all property in which one spouse receives from the other an interest which confers on the recipient, alone or jointly with the donor, the possession or enjoyment of the property or of the income from it.

   The proposal would contemplate exclusion of not only the value of the donee's interest but of the entire property, even if successor interests are transferred to third persons. It would make no difference whether or not the donee spouse's interest was terminable upon the occurrence of any event or contingency or whether or not the donee spouse had any power to take the corpus of the property or any power, general or limited, to dispose of the property inter vivos or at death. So long as possession and enjoyment of the property or the income from it was lodged in one or both the spouses no transfer tax would attach to the property or to any interest in it, the possession or enjoyment

\(^{77}\) §812(e)(2).

\(^{78}\) §812(e)(1)(H).

\(^{79}\) §1004(a)(3)(A).
of which must await upon some future event depriving the spouses of possession and enjoyment, such as death of the donee spouse or of both spouses, a lapse of years, remarriage of one spouse, and so forth.

To exemplify the rule on interests of less than a fee:

(1) A transfer by will of securities in trust to pay the income to the testator’s spouse during her life or until remarriage with remainders to the testator’s children or their heirs would be an excluded transfer and no part of the value of the securities would be subjected to transfer tax at the testator’s death.

(2) A transfer by gift inter vivos of Blackacre under which the donor’s spouse is to receive all the rents and income during the period of a 20-year lease, upon the termination of which the property is to pass in fee to the donor’s children or their heirs, would be an excluded transfer to the extent of the entire value of Blackacre.

The basis upon which tax on the entire property would be deferred would be that husband and wife are a socio-economic unit and so long as possession or enjoyment of property does not pass outside the unit no tax should attach to transfer of any other interest in the property possessed and enjoyed by either or both spouses.

A problem would arise with respect to transfers in which possession or enjoyment passes outside the unit but may return. An argument might be made that the basic theory in such a case requires that the transfer tax apply only to the value of the interests which precede the right of the donee spouse to recover possession and enjoyment. On the other hand, such a rule would appear to lend itself readily to tax avoidance and accordingly it would seem to be a better rule and one which observes the fundamental policy that any transfer which shifts possession and enjoyment out of the spouse unit results in transfer tax on all granted interests except that of the donee spouse. To take an example:

A transfer by gift of securities in trust to pay the income to the donor’s mother during her life, corpus to the donor’s spouse if living at the mother’s death, otherwise to the donor’s children or their heirs, would be an excluded transfer only to the extent of the value of the spouse’s remainder interest. The value of the prior interest of the mother and of the subsequent interest of the children would be taxable. A contrary rule taxing only the mother’s interest could be argued for, but it would provide a simple method whereby a remote contingent interest in a spouse could be made to cause delay in the transfer tax on much more valuable contingent interests transferred to third
persons. Moreover, there seems to be no very strong argument for protecting from transfer tax any interest in third persons once the spouse's possession and enjoyment is broken.

On a somewhat related score another limitation might be necessary to prevent tax avoidance. The present requirement in the case of marital deduction trusts that the donee spouse must have full and unlimited enjoyment at least of all the income should, perhaps, be continued to the extent of requiring that at least the full right to possession and enjoyment of the excluded property must remain within the husband-wife unit. Thus, for example, the marital exclusion might be denied in the case of a transfer of property in trust under which a trustee other than one of the spouses has the power to pay over income or corpus to third persons. Lacking such a limitation the transfer tax on the corpus of property transferred might be deferred over a long period without the husband-wife unit having more than a contingent right to possession or enjoyment of corpus or income.

This second part of the proposed plan would serve to eliminate most of the complicated provisions of the present marital deduction sections. The rule as to life estates and other terminable interests would go; so would the rule as to reducing the deduction when unidentified assets available to satisfy a spouse's interest include terminable interests; the common disaster provisions; and, of course, the whole structure built around trusts and insurance coupled with a broad general power of appointment in the spouse.

3. Termination of interest of spouse

The second part of the full marital exclusion requires as a corollary a third. Whenever the possession and enjoyment of property transferred passes from the transferee spouse and for the first time leaves the husband-wife unit, a transfer tax would have to attach to the entire value of the property. This, of course, would be necessary to prevent the complete escape from transfer tax of succeeding interests created by the transferor spouse. Thus, in the examples given in the discussion of the exclusion in case of transfers of less than a

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81 §§812(e)(1)(C), 1004(a)(3)(C).
82 §§812(e)(1)(D).
83 §§812(e)(1)(F) and (G), 1004(a)(3)(E).
84 When the transferee spouse has had an interest in fee, a power of appointment taxable under §811(f), or other taxable interest, the transfer tax would apply upon death or transfer of all or part of her interest, under the general provisions of the statute.
fee, a transfer tax would attach to the entire value of the property upon the death or remarriage of the spouse, or upon the termination of the leasehold interest. So also in the case of any other interest less than a fee conferring possession and enjoyment of corpus or income on one or both spouses; the termination of such interest in all or part of the corpus would result in a transfer tax being applied on the value of the corpus freed from the interest.

The transfer tax on termination of possession and enjoyment by the spouse unit would be imposed on the member of the unit from whom the interest conferring possession and enjoyment passed. Thus, in the case of a trust set up by a husband to pay the income to his wife for life, remainders to their children in fee, the termination of the wife's life estate would be the occasion for treating the transfer of the corpus to the remaindermen as a taxable transfer by the wife. If the husband had created a joint tenancy in property between himself and his wife and thereafter they conveyed the jointly held property to a third person, each would be deemed to have made a taxable transfer to the extent of his or her joint interest.

It is clear that this brief discussion of the proposal for a full marital exclusion has not taken into account many problems of detail which would arise in the course of drafting the plan. I have no illusions that the plan does not have its complexities which would emerge as it was developed. The utopia of tax simplicity in a complicated social and economic structure is a delusion. However, while absolute simplicity is not attainable, substantial relative improvement is. It seems clear that the proposed treatment would be much simpler and more comprehensible than the marital deduction monstrosity we now have; the average lawyer in general practice would have some chance of grasping it sufficiently well to avoid most of the hazards of seriously misadvising his clients.

The principal question of policy which this proposal appears to raise is whether its adoption would seriously weaken the taxing structure. The Treasury Department has estimated that the marital deduction provisions of the 1948 Revenue Act will lose in the neighborhood of a third of the total revenues otherwise collectible from estate and gift taxes. If anything even approaching a similar loss should result from an extension of the deduction to the entire value of the inter-spouse transfers, it would seem to be a near fatal objection to

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85 Part B. 2, supra.
86 Notes 3 and 7, supra.
the plan. However, it seems apparent that the revenue loss would not be of the same magnitude. In the first place, most decedents with taxable estates, and particularly larger estates, will not desire to leave their entire property for the benefit of a surviving spouse to the exclusion of children and all other objects of their bounty. In the second place, in most instances, and again particularly in the larger estates, the price for complete deferment of tax would be an ultimately larger total estate tax burden on the death of the surviving spouse. A split of the taxable transfers between husband's and wife's estate will generally produce a smaller total tax, even taking into account the substantial benefits which may arise from tax deferment.

On the other hand, it must be recognized that a complete exemption for inter-spouse transfers would offer a frequently substantial inducement in the case of wholly or substantially "non-liquid" estates to postpone the problems of cash realization for transfer tax purposes. In addition, many husbands (or wives) now unwilling to entrust sufficient powers of management or disposition of property to their spouses in order to obtain the present marital deduction would take advantage of the proposed unlimited deduction. To this might be added the substantial number of situations in which unwritten understandings would be reached that the surviving spouse would make property dispositions to children and others after the other spouse's death, where such indirect arrangements would result in significant tax savings. Finally, when the surviving spouse is much younger than the decedent the value of tax deferment can often much more than offset an ultimately higher total transfer tax. The possible use of tax money for 15 or 20 years, particularly in a family business, may far outweigh any offsetting ultimate liability. Various combinations of these factors would often result in taking full advantage of the complete deduction or at least making more use of it than is possible under the present limitations.

Nevertheless, it would appear that a full marital deduction would not involve an additional revenue loss comparable to that involved in the adoption of the present deduction. Moreover, in considering the proposal, there is to be offset against any such loss the gain that might inhere in the strengthened structure which would result from simultaneous adoption of the accompanying proposal for integration and correlation of the estate and gift taxes. The two proposals are designed not only to deal with the present main structural defects, but to balance each other in terms of the strength of the taxing system. Thus,
even if the marital deduction significantly reduced collections, a proper coordination of the two revision plans and adjustment of rates and exemptions in the light of their mutual action on revenues could avoid, in over-all effect, any further revenue losses. This is not to say that rates would be higher or exemptions lower than in the present estate tax, since the structural improvements through integration and correlation would themselves tend to increase revenue.

If, despite the grounds for believing that the revenue losses would not be great, significant losses should eventuate due to a full marital deduction, there are more directly related offsetting steps which might then be considered to restore a balance. Some measure of cumulation of transfers of both spouses to prevent too great splitting of brackets and exemptions would be a possible source of increasing revenue without losing either the benefits of tax deferment for surviving spouses or the increased basic equality of treatment and simplicity of the full marital deduction. To the extent that revenue losses appeared to be attributable to the combined effect of a shift to inter vivos application of the transfer tax rather than a tax at death and the general trend to increasing property values over a period of years, consideration might be given to making the new income tax basis at death the occasion for a taxable gain or loss. However, for the present time and until a significant period of experience with the full deduction could be obtained it would seem unnecessary to explore such sources of tax increase.

CONCLUSION

With a general willingness to seek accommodation between divergent views and interests, agreement could probably be reached on a balanced and inter-adjusted program for integration and correlation of the estate, gift and income taxes and for the broadening of the marital deduction to a complete allowance for all inter-spouse transfers. The present discussion is clearly not a complete analysis of all the details of the plan. That is not its purpose. It is intended only to present what appears to me to be a basis upon which to seek agreement in principle between the Treasury and various representative groups, which would permit going forward with the task of implementing the proposal here set forth only in outline.