

NOTES

THE GENERIC ESTATE TAXATION OF EMPLOYEE DEATH BENEFITS BEYOND THE AMBIT OF SECTION 2039.

I. INTRODUCTION

Although the government has concerned itself with the estate taxation of employee death benefits for several decades, recent developments in this field have accentuated the problems encountered when attempting to include such benefits in the gross estate. The two factors making the estate taxation of such benefits difficult are based upon creativity. First, both employers and employees have become more economically sophisticated and the diverse types of benefit plans formulated reflect their creativity.¹ Secondly, Congress, in an attempt to eliminate some of the earlier difficulties in taxing such benefits, lacked creativity and foresight in its statutory treatment of employee benefits under § 2039 of the 1954 Internal Revenue Code.²

Specifically, the estate taxation of a particular type of employee benefit plan exemplifies the acuteness of the general difficulty and gives credence to the criticisms of § 2039. This problematic benefit is designated

1. Such benefit plans may vary extensively as to amount, the type of compensation (i.e. stock, cash, insurance, etc.), the beneficiary and the time at which compensation commences or terminates. Annuities, life insurance, stock option plans, profit sharing plans and other benefits are often included in employment contracts. See generally S. FOOSANER, *TAXATION OF LIFE INSURANCE AND ANNUITIES* (1960) (detailed discussion of the income, estate and gift tax consequences of both life insurance and annuities); Groll, *Some Federal Tax Aspects of Life Insurance*, 15 DEPAUL L. REV. 48 (1965) (life insurance plans); Pyle, *Income Estate and Gift Taxation of Life, Accident and Sickness Insurance and Annuities Under the 1954 Code*, 1956 TUL. TAX INST. 467.

2. INT. REV. CODE OF 1954, § 2039(a)-(b):

(a) General.—The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

(b) Amount Includible.—Subsection (a) shall apply to only such part of the value of the annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust or fund forming part of a pension annuity, retirement, bonus or profit sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

as a "pure death benefit" and refers to those payments which are payable only to a beneficiary upon the death of an employee-decedent who could receive nothing during his lifetime. This note while concerned with the estate taxation of employee benefits in general, emphasizes the specific problem presented by the attempts to tax "pure death benefits."

II. HISTORICAL DEVELOPMENT³

Estate taxation under the generic sections (2033, 2035, 2036, 2037 and 2038) has been summarized as a tax, imposed at the time of death, upon the transfer of property.⁴ As a result of this classification, federal estate taxation since its inception, has focused upon the concepts of *property* and *transfer*. These two notions are heavily imbued with property law implications which have endured and caused courts great difficulty.⁵

With regard to employee benefit plans, it is apparent that prior to the enactment of § 2039, most cases involved a determination of the nature of the employee's interest and an inquiry into its disposition. These cases were inconsistent in their holdings and demonstrated the difficulty which resulted from the adoption and application of property law concepts. An example of the difficulty in applying these property concepts is found in *Dimock v. Corwin*,⁶ a case of importance decided just prior to the adoption of the 1939 Code. There, the District Court found that under the terms of a benefit plan, the decedent lacked the requisite property interest for inclusion under § 302(a) of the 1926 Code. The court examined the rights retained by the *employer* and concluded that the right of the company to "withdraw or modify this plan" together with a caveat to the employee that the benefits were "voluntary grants,"⁷ precluded the

3. For an excellent historical discussion of estate taxation which was presented before a Congressional committee see Eisenstein, *The Rise and Decline of the Estate Tax*, FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY, in JOINT COMMITTEE ON THE ECONOMIC REPORT, 84th Cong., 1st Sess., THE IMPACT OF FEDERAL ESTATE GIFT TAXATION 819, 819-31 (1955).

4. See, e.g., *United States Trust v. Helvering*, 307 U.S. 57, 60 (1939); *Knowlton v. Moore*, 178 U.S. 41, 56 (1900). See also C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES § 1.1 (2d ed. 1962) [hereinafter cited as LOWNDES & KRAMER]; 1 J. MERTENS, THE LAW OF FEDERAL GIFT AND ESTATE TAXATION § 1.02 (1959, Supp. 1970) [hereinafter cited as MERTENS].

5. Although the concepts *property* and *transfer* may be difficult to apply to an employee "pure death benefit plan", such concepts may properly be utilized to tax other types of interests. Despite the conceptual problems, the constitutionality of the imposition of an estate tax has clearly been established. See *New York Trust Co. v. Eisner*, 256 U.S. 345 (1921); *Knowlton v. Moore*, 178 U.S. 41 (1900); LOWNDES & KRAMER §§ 3.1-3.

6. 19 F. Supp. 56 (E.D.N.Y. 1937), *aff'd on other grounds*, 99 F.2d 799 (2d Cir. 1938), *aff'd sub nom.*, *United States v. Jacobs*, 306 U.S. 363 (1939). The 1954 provisions similar to § 302(a) of the 1926 Code are INT. REV. CODE OF 1954 §§ 2031(a) and 2033.

7. *Id.* at 58.

employee's interest from amounting to property.⁸ The interest was therefore characterized as an "expectancy."⁹ The court reached this decision despite the contention of the government that the employee's right to designate the beneficiary justified inclusion.¹⁰

This early precedent established the methodology for subsequent judicial inquiry into the exact nature of an employee's property interest in the benefit. The procedure focuses upon the express terms of the benefit agreement in what is essentially a two step process. First, the court examines the contract to decide exactly what rights are conferred upon both the employee and the employer. Next, the two are balanced. By making this interest comparison, the court is able to distinguish between unenforceable plans (expectancies, gratuitous, or voluntary plans) and those which are enforceable.¹¹

As in *Dimock*, this comparative procedure may give much weight to the powers retained by the employer. Under the 1939 Code,¹² an expect-

8. Many other cases have reached the same conclusion. See *Charleston Nat'l Bank v. United States*, 221 F. Supp. 271 (S.D.W.Va. 1963) (plan terminable at the will of the employer); *Molter v. United States*, 146 F. Supp. 497 (E.D. N.Y. 1956) (plan terminable or modifiable in whole or in part by a board); *Estate of Albert L. Salt*, 17 T.C. 92 (1951) (payments made at the discretion of a committee); *Estate of William S. Miller*, 14 T.C. 657 (1950), *non-acquiesced in*, 1950-2 CUM. BULL. 6, *non-acquiescence withdrawn in*, 1955-2 CUM. BULL. 7 (benefits modifiable at the will of the employer); *Estate of Jack Messing*, 1948 P-H Tax Ct. Mem. 474 (payment of bonuses at the complete discretion of the corporation president); *Illinois Merchant Trust Co.*, 12 B.T.A. 818 (1928) (distribution of benefits at the will of the company).

9. The court quoted directly from G.C.M. 17817, 1937-1 CUM. BULL. 281, which defeats the Commissioner's contention that the benefits are includible.

10. *Dimock v. Corwin*, 19 F. Supp. 56, 59 (E.D.N.Y. 1937), See note 26 *infra*.

11. See note 9 *supra*. While this distinction received much attention prior to the enactment of § 2039, it still persists to be a key determination in the estate taxation of employee death benefits. See LOWNDES & KRAMER 207 n. 19; see also Beck, *Family Benefits and Family Security: Employee Death Payments*, N.Y.U. 13TH INST. ON FED. TAX. 471, 490-98 (1955) (discusses the leading cases decided under the 1939 Code); Kramer, *Employee Benefits and Federal Estate and Gift Taxes*, 1959 DUKE L.J. 341, 348 (discusses and criticizes the taxpayers' "expectancy" argument); Mc Dowell, *Estate and Income Tax Aspects of Employee Death Benefits Including Corporate Payments to Executive's Widows*, N.Y.U. 25TH INST. ON FED. TAX. 985, 1011 (1967) (mentions the present importance of making the "expectancy" distinction between enforceable and non-enforceable plans); Murphy, *The Survivor Annuity: Estate Tax Kaleidoscope*, 1 HOW. L.J. 1, 3-6 (1955) (nature of property interest owned at death); Nelson, *The New \$5,000 Death Benefit*, 31 TAXES 629, 632-36 (1953) (brief summary of cases decided under the 1939 Code); Zissman, *Problem Areas in the Estate Tax*, 41 TAXES 875, 884 (1963) (brief treatment of pre-§ 2039 case law); Note, *Estate Taxation of Employee Death Benefits*, 66 YALE L.J. 1217, 1231 (1957) (discusses "expectancies" in regard to the 1954 Code).

12. The section most often resorted to for the taxation of employee benefits was § 811(c) TRANSFERS IN CONTEMPLATION OF, OR TAKING EFFECT AT DEATH:

To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoy-

ancy or its legal and terminological equivalent was found in plans where payment was discretionary,¹³ terminable,¹⁴ not legally obligatory,¹⁵ made prior to the contractually prescribed date,¹⁶ or where the plan itself specifically disclaimed the conferring of any right upon the employee.¹⁷ The government consequently accepted the exclusion of gratuitous benefits from estate taxation in G.C.M. 17817.¹⁸

Several taxpayers have contended that the property interest necessary for inclusion was lacking in their particular situations because of conditions precedent or subsequent which were imposed upon the actual receipt of the benefits.¹⁹ If the employee has complied with the conditions,²⁰

ment at or after his death or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from the property, of (2) the right either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in the case of a bona fide sale for an adequate and full consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this subchapter;

13. *Molter v. United States*, 146 F. Supp. 497 (E.D.N.Y. 1956); *Estate of Jack Messing*, 1948 P-H Tax Ct. Mem. 474.

14. *Chase Nat'l Bank v. United States*, 278 U.S. 327 (1929); *Estate of Albert L. Salt*, 17 T.C. 92 (1951); *Estate of William S. Miller*, 14 T.C. 657 (1950); *Estate of Emil A. Stake*, 11 T.C. 817 (1948), *acquiesced in*, 1949-1 CUM. BULL. 3. *But see* *Estate of Nevin*, 11 T.C. 59 (1948), *acquiesced in*, 1949-1 CUM. BULL. 3; *Estate of Paul G. Leoni*, 11 T.C. 1140 (1948); *Estate of Adeline S. Davis*, 27 T.C. 378 (1956).

15. *Hanner v. Glenn*, 111 F. Supp. 52 (W.D.Ky. 1953), *aff'd*, 212 F.2d 483 (6th Cir. 1954); *Estate of Eugene F. Saxton*, 12 T.C. 569 (1949), *acquiesced in*, 1949-1 CUM. BULL. 3, *acquiescence withdrawn in*, 1950-1 CUM. BULL. 8; *Estate of Jack Messing*, 1948 P-H Tax Ct. Mem. 474.

16. *Estate of M. Hadden Howell*, 15 T.C. 92 (1951), *acquiesced in*, 1953-1 CUM. BULL. 4 (1951).

17. *Charleston Nat'l Bank v. United States*, 221 F. Supp. 271 (S.D. W.Va. 1963); *Dimock v. Corwin*, 19 F. Supp. 56 (E.D.N.Y. 1937); *Illinois Merchant Trust Co.*, 12 B.T.A. 818 (1928); 2 MERTENS 499.

18. G.C.M. 17817, 1937-1 CUM. BULL. 281, *modified by* G.C.M. 27242, 1952-1 CUM. BULL. 160, *revoked by* Rev. Rul. 97, 1967-1 CUM. BULL. 380. *See also* notes 6-11 *supra* and accompanying text.

19. *See generally* 2 MERTENS § 14.21; Kramer, *Employee Benefits and Federal Estate and Gift Taxes*, 1959 DUKE L.J. 341, 349; Tannenwald, *Payments to Widows of Executives as an Element in Estate Planning*, N.Y.U. 18TH INST. ON FED. TAX. 1131, 1147 (1960) (continued employment as a condition of payment); Young, *Deferred Pay Plans—Qualified and Non-Qualified Plans*, N.Y.U. 13TH INST. ON FED. TAX. 457, 465-67 (1955); Comment, *Estate Taxation of Contractual Rights Subject to Condition Precedent*, 67 YALE L.J. 467 (1958). *See* notes 20-22 *infra* for appropriate cases.

20. *See, e.g.*, *Goodman v. Granger*, 243 F.2d 264 (3d Cir.), *cert. denied*, 355 U.S. 835 (1957) (payment conditioned upon employee rendering required services and not competing with employer after termination); *Estate of Albert B. King*, 20 T.C. 930 (1953) (employee required to remain with employer); Comment, *Estate Taxation of Contractual Rights Subject to Condition Precedent*, 67 YALE L.J. 467 (1958).

or if they are within his control,²¹ the existence of restrictions has not altogether precluded taxation. Similarly, benefits earned prior to death, although payable only afterwards, have been held includible.²² Such benefits have been labeled "deferred compensation" and although that phrase has not been judicially defined,²³ it refers to the employee's enforceable claim to payments *in futuro* for services previously rendered. In practice, this label is used most frequently to refer to post-mortem payments by the employer to a beneficiary, in consideration of the employee's previously rendered services.²⁴

As estate taxation under the generic sections²⁵ is conceptually contingent upon both the presence of *property* and its *transfer*,²⁶ neither alone is an adequate basis for inclusion. A transfer is easily found if the employee designates the beneficiary,²⁷ but when the employee has not designated the beneficiary, courts have examined the plan for evidence of a contractual exchange of consideration²⁸ between the employee and

21. See, e.g., *Estate of Charles B. Wolf*, 29 T.C. 441 (1957) *rev'd on other grounds*, 264 F.2d 82 (3d Cir. 1959) (quitting voluntarily or being released for intoxication etc.); *Estate of Albert B. King*, 20 T.C. 930 (1953) (leaving or being fired).

22. *Estate of Leonard B. McKitterick*, 42 B.T.A. 130 (1940) (bonus); *Estate of Albert B. King*, 20 T.C. 930 (1953) (cash and stock); Rev. Rul. 217, 1965-2 CUM. BULL. 214 (taxation of bonuses contingent upon whether or not they were awarded prior to death). The court's classification of a condition as either precedent or subsequent may be significant in determining taxability. See Comment, *Estate Taxation of Contractual Rights Subject to Condition Precedent*, 67 YALE L.J. 467 (1958).

23. *Worthen v. United States*, 192 F. Supp. 727, 733 (D. Mass. 1961).

24. *Garber's Estate v. Commissioner*, 271 F.2d 97 (3d Cir. 1959); *Worthen v. United States*, 192 F. Supp. 727 (D. Mass. 1961); *Beaver Trust Co. v. United States*, 184 F. Supp. 553 (W.D. Pa. 1960). See also Childs, *Deferred Compensation Plans for Executives*, 31 TAXES 1007 (1953).

25. See note 83 *infra*.

26. See note 4 *supra*. For a valuable discussion of the transfer concept as it relates to estate taxation see Merry, *Federal Estate and Gift Tax: Concept of a Transfer*, 38 MICH. L. REV. 1032 (1940).

27. *Altshuler v. United States*, 169 F. Supp. 456 (W.D. Mo. 1958); *Kernochian v. United States*, 29 F. Supp. 860 (Ct. Cl. 1939), *cert. denied*, 309 U.S. 675 (1940); *Estate of Raphael A. Casilear*, 1945 P-H Tax Ct. Mem. 1084; G.C.M. 27242, 1952-1 CUM. BULL. 160, *modifying* G.C.M. 17817, 1937-1 CUM. BULL. 281, *revoked* by Rev. Rul. 97, 1967-1 CUM. BULL. 380. See also Bilder, *Death Benefits Paid Under an Express Contract*, 34 TAXES 529 (1956). *But see* *Charleston Nat'l Bank v. United States*, 221 F. Supp. 271 (S.D. W. Va. 1963); Bittker, *Estate and Gift Taxation under the 1954 Code: The Principal Changes*, 29 TUL. L. REV. 453, 470 (1955); note 10 *supra* and accompanying text.

28. The concept of consideration is not foreign to estate taxation; transfers made for "adequate and full consideration in money or money's worth" are not subject to the estate tax. The concept of consideration in relation to the transfer sections of the estate and gift tax provisions is extensively treated in Lowndes, *Consideration and the Federal Estate and Gift Taxes; Transfer for Partial Consideration, Relinquishment of Marital Rights, Family Annuities, the Widow's Election, and Reciprocal Trusts*, 35 GEO. WASH. L. REV. 50 (1966).

the employer.²⁹ Such an exchange is presumed to make the agreement bilateral and hence obligatory upon the employer who has designated the beneficiary. Consideration is therefore related to the concept of transfer in that it has been presumed that post-mortem payments by an employer, to a beneficiary, actually represent salary payments which would otherwise have been made to the decedent absent a benefit plan.³⁰ The resulting inclusion of the benefits in the decedent's gross estate is consistent with the established principle in estate taxation that the recipient or beneficiary of an interest need not receive the benefit directly from the decedent in order for it to be included in the decedent's gross estate.³¹

It is difficult to determine whether a transfer has occurred if the employee has an option to convert his single annuity into a joint and survivorship annuity.³² Courts are divided on whether the employee's exercise of a pre-existing option amounts in substance³³ to a transfer of property.³⁴ However, when the option exists but has not been exercised

29. *Lehman v. Commissioner*, 39 B.T.A. 17 (1939), *aff'd*, 109 F.2d 99 (2d Cir.), *cert. denied*, 310 U.S. 637 (1940); *Worthen v. United States*, 192 F. Supp. 727 (D. Mass. 1961); *Provident Trust Co. v. United States*, 170 F. Supp. 74 (E.D. Pa. 1959); *Estate of Paul G. Leoni*, 11 T.C. 1140 (1948); see Childs, *Deferred Compensation Plans for Executives*, 31 TAXES 1007, 1012 (1953).

30. *Garber's Estate v. Commissioner*, 271 F.2d 97, 101 (3d Cir. 1959); *Beaver Trust Co. v. United States*, 184 F. Supp. 553, 556 (W.D. Pa. 1960); *Estate of Paul G. Leoni*, 1948 P-H Tax Ct. Mem. 678; 2 MERTENS § 14.21.

31. *Helvering v. Hallock*, 309 U.S. 106 (1940), *overruling*, *Helvering v. St. Louis Union Trust*, 296 U.S. 39 (1935); *Chase Nat'l Bank v. United States*, 278 U.S. 327, 337-38 (1929); *Bahen's Estate v. United States*, 305 F. 2d 827 (Ct. Cl. 1962); *O'Daniel's Estate v. Commissioner*, 173 F.2d 966 (2d Cir. 1949); *Commissioner v. Wilder's Estate*, 118 F.2d 281 (5th Cir.), *cert. denied*, 314 U.S. 281 (1941); *Lehman v. Commissioner*, 109 F.2d 99 (2d Cir. 1940); *Worthen v. United States*, 192 F. Supp. 727 (E.D. Pa. 1954); *Estate of William L. Nevin*, 11 T.C. 59 (1948); *Estate of Paul G. Leoni*, 1948 P-H Tax Ct. Mem. 678. *But see Hanner v. Glenn*, 111 F. Supp. 52 (W.D. Ky. 1953), *acquiesced in*, 1949-1 CUM. BULL. 3; *Estate of Charles F. Clise v. Commissioner*, 41 B.T.A. 820 (1940), *rev'd*, 122 F.2d 998 (9th Cir.), *cert. denied*, 315 U.S. 821 (1941); *Rev. Rul. 682*, 1955-2 CUM. BULL. 601; *Rev. Rul. 302*, 1955-1 CUM. BULL. 447; *Rev. Rul. 158*, 1953-2 CUM. BULL. 259. See notes 4, 25 *supra*.

32. As to the various specific types of annuities see S. FOOSANDER, *TAXATION OF LIFE INSURANCE AND ANNUITIES* §§ 3.01-.08 (1966).

33. Courts often determine tax consequences upon the substance rather than the form of the transaction involved. See, e.g., *Chase Nat'l Bank v. United States*, 278 U.S. 327, 338 (1929); *Worthen v. United States*, 192 F. Supp. 727, 734 (D. Mass. 1961); Lowndes, *An Introduction to the Federal Estate and Gift Taxes*, 44 N.C. L. REV. 1, 4 (1965).

34. Compare *Estate of Adeline S. Davis*, 27 T.C. 378 (1956) (exercise of option held to be a transfer); *Rev. Rul. 158*, 1953-2 CUM. BULL. 259; with *Estate of Fredrick J. Twogood*, 15 T.C. 989 (1950) (exercise of option not a transfer of property), *aff'd*, 194 F.2d 627 (2d Cir. 1952), *non-acquiescence in*, 1951-52 CUM. BULL. 6, *non-acquiescence withdrawn in*, 1953-1 CUM. BULL. 6, and *Herrick v. United States*, 108 F. Supp. 20 (E.D.N.Y. 1952). See also Bittker, *Estate and Gift Taxation Under the 1954 Code; The Principal Changes*, 29 TUL. L. REV. 453, 470 (1955); Bliss, *Widow's Pension Plans and the Higgs Case*, N.Y.U. 8TH INST. ON FED. TAX. 376 (1950); Colgan, *How to Provide Death Benefits Before and After Retirement*, N.Y.U. 12TH INST. ON FED. TAX.

it is particularly difficult to determine that a transfer occurred.³⁵ Although the concepts of *property* and *transfer* may be analytically divorced, most courts have realized the relationship between the two and have concluded that when an enforceable property interest is lacking there can obviously be no transfer.³⁶

As the pre-section 2039 case law demonstrates, the estate taxation of employee benefit plans was accomplished by straining property law concepts³⁷ and applying them to diverse, if not unique, types of interests. The inconsistency in the holdings, the absence of any general guidelines or principles, and the strained applicability of many code sections to employee benefit plans provided a poor foundation for both estate planners and the government. The generic sections of the 1939 Code were ill-suited to the specialized types of interests present in employee benefit plans.³⁸

III. ENACTMENT OF § 2039

Against this historical background, Congress enacted § 2039 as a part of the 1954 Internal Revenue Code.³⁹ The legislative history of the

391, 398 (1954); Murphy, *The Survivor Annuity: Estate Tax Kaleidoscope*, 1 How. L.J. 12, 25 (1955); Murphy, *Federal Tax Treatment of Annuities*, 16 U. PITT. L. REV. 311, 322 (1955); 64 HARV. L. REV. 675 (1951); 51 MICH. L. REV. 1246 (1953); 99 U. PA. L. REV. 552 (1951).

35. See, e.g., *Libbey v. United States*, 147 F. Supp. 383 (N.D. Cal. 1956).

36. Cf. *Hanner v. Glenn*, 111 F. Supp. 52, 58 (W.D. Ky. 1953); *Estate of M. Hadden Howell*, 15 T.C. 224 (1950), *Estate of William S. Miller*, 14 T.C. 657, 664 (1950), *acquiesced in*, 1955-2 CUM. BULL. 7; *Estate of William J. Higgs*, 12 T.C. 280 (1949); *Estate of Emil A. Stake*, 11 T.C. 817 (1948), *acquiesced in*, 1949-1 CUM. BULL. 3.

37. See, e.g., *Helvering v. Hallock*, 309 U.S. 106, 118 (1940).

38. Many courts and commentators have realized the difficulties encountered when attempting to tax employee death benefits under the generic sections of the 1939 Code. This problem has provoked criticism as well as suggestions for reform. See, e.g., *Estate of Eugene F. Saxton*, 12 T.C. 569, 576 (1949); Bittker, *Estate and Gift Taxation Under the 1954 Code: The Principal Changes*, 29 TUL. L. REV. 453, 469 (1955); Murphy, *The Federal Tax Treatment of Annuities*, 16 U. PITT. L. REV. 311, 320 (1955); Note, *Employee Death Benefits*, 26 TAX L. REV. 329, 330 (1971); Comment, *The Baptism of Section 2039—A New Look at the Estate Taxation of Death Benefits Under Nonqualified Plans*, 10 U.C.L.A. L. REV. 619 (1963). See also note 43 *infra*.

39. INT. REV. CODE OF 1954, § 2039(a)-(b):

(a) General.—The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

(b) Amount Includible.—Subsection (a) shall apply to only such part of the value of the

section is not extensively revealing, and most Congressional intent has been deduced from the examples set out in the legislative reports.⁴⁰

Courts and commentators have interpreted the new section, with its accompanying legislative history, as an attempt to divorce estate taxation from the interpretation of property law concepts.⁴¹ Others interpret the section as an attempt to tax uniformly annuities within one section, regardless of the source of the annuity.⁴² While it may have clearly been Congress' intent that § 2039 should not be the exclusive statutory provision for taxing employee benefit plans,⁴³ the limited inclusiveness of the section has been criticized.⁴⁴

annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust or fund forming part of a pension annuity, retirement, bonus or profit sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

40. S. REP. NO. 1622, 83d Cong., 2d Sess. 469 (1954); H. R. REP. NO. 8300, 83d Cong., 2d Sess. A314 (1954).

41. See Murphy, *The Survivor Annuity: Estate Tax Kaleidoscope*, 1 HOW. L.J. 1, 36 (1955); Weinberg, *Taxation of Non-Qualified Deferred Compensation Plans*, 52 KY. L.J. 750, 759 (1964); Note, *Estate Taxation of Survivor Annuities: Section 811(c) and the Proposed IRC of 1954*, 6 STAN. L. REV. 473 (1954); Note, *Employee Death Benefits*, 26 TAX L. REV. 329, 331 (1971); Comment, *The Baptism of Section 2039—A New Look at Estate Taxation of Employee Death Benefits Under Nonqualified Plans*, 10 U.C.L.A. L. REV. 619, 620 (1963).

42. LOWNDES & KRAMER §§ 10.2, 10.3, 10.5; Joseph, *The Estate Tax Impact on Survivor Annuities; How Far Can Section 2039 Reach?*, 25 J. TAX. 214, 215 (1966).

43. S. REP. NO. 1622, 83d Cong., 2d Sess. 469, 472 (1954); H. R. REP. NO. 8300, 83d Cong., 2d Sess. A314, A316 (1954) states:

The provisions of this section shall not prevent the application of any other provision of law relating to the estate tax. For example, if a contract provides for a refund of a portion of the cost thereof, in the event of the decedent's premature death payable to the decedent's estate the amount thereof shall be treated as any other property of the decedent. This section does not, however, apply to insurance under policies on the life of the decedent to which section 2042 is applicable.

See generally 2 MERTENS § 18.16.

44. For a general criticism of the estate and gift sections of the 1954 Code see Bittker, *Estate and Gift Taxation Under the 1954 Code: The Principal Changes*, 29 TUL. L. REV. 453 (1955); Kramer, *Federal Estate and Gift Tax*, 33 N.Y.U. L. REV. 113, 119 (1958); Lowndes, *An Introduction to the Federal Estate and Gift Taxes*, 44 N.C. L. REV. 1, 24 (1965); Lowndes, *A Practical Program for Reforming the Federal Estate Tax*, 5 VILL. L. REV. 1, 25 (1959); McDowell, *Estate and Income Tax Aspects of Employee Death Benefits Including Corporate Payments to Executive's Widows*, N.Y.U. 25TH INST. ON FED. TAX. 985, 1011 (1967); Tannenwald, *Payments to Widows of Executives as an Element in Estate Planning*, N.Y.U. 18TH INST. ON FED. TAX. 1131 (1960). The exclusion for qualified plans under § 2039(c) has been especially criticized. Many commentators feel that a reasonable policy justification for the exception is lacking and that it is inequitable in the favorable treatment accorded to particular plans. See Bittker, *Estate and Gift Taxation Under the 1954 Code: The Principal Changes*, 29 TUL. L. REV. 453, 471 (1971); Kramer, *Employee Benefits and Federal Estate and Gift Taxes*, 1959 DUKE L.J. 341, 374-77; Note, *Employee Death*

The case law since the enactment of the section is sparse.⁴⁵ However, the delineation of the scope of the section and the explication of its intricacies has nevertheless been primarily a judicial product. Although Congress did not necessarily assume that § 2039 would be the only provision to deal with the estate taxation of employee benefits,⁴⁶ it is presently the primary basis for inclusion.

IV. DEVELOPMENT OF § 2039⁴⁷

In a case of first impression, *Bahen's Estate v. United States*,⁴⁸ the court delineated the three general requirements of § 2039.⁴⁹ First, there must be some form of contract or agreement. Secondly, the contract or agreement must pertain to an annuity or other payment. Thirdly, the annuity or other payment must have been payable to the decedent or he must have possessed the right to receive it. While not specifically requiring the decedent's possession of *property*, the case demonstrates that the possession of some type of interest is required. Thus, if the employee's interest is not an "annuity or other payment," it is not includible under § 2039.⁵⁰ The form of payment is irrelevant in determining whether the benefit amounts to an "annuity or other payment" and, hence, both lump sum and periodic payments are includible.⁵¹ Periodic payments need not be uniform with reference to the amount, or interval

Benefits, 26 TAX. L. REV. 329, 353 (1971); *Estate Taxation of Employee Death Benefits*, 66 YALE L.J. 1217, 1219-22 (1957). The exclusionary provision was characterized as "an unexcusable loop-hole" in testimony before a Congressional committee. *Hearings Before the Subcomm. of the Joint Comm. on the Economic Report*, 84th Cong., 1st Sess. at 700 (Dec. 5-9, 12-16, 1955).

45. There have been fewer than twenty cases involving determinations made under § 2039 and no cases concerning this section have been before the Supreme Court (See P-H 1971 Fed. Taxes, Estate & Gift ¶ 120.392.1).

46. See note 42 *supra*.

47. As the concern of this note is with the inclusiveness and requirements for inclusion of an employee benefit plan under § 2039, the valuation of the interest is not of direct concern. Furthermore, as the problem of the includibility of "pure death benefits" is unaffected by the exclusionary subsection (§ 2039(c)), an analysis of its scope is not helpful in resolving the difficulties.

48. 305 F.2d 827 (Ct. Cl. 1962).

49. See also Estate of William E. Barr, 40 T.C. 227, 235 (1963), *acquiesced in*, 1964-1 CUM. BULL. 4; for a thorough discussion of *Bahen* see, Comment, *The Baptism of Section 2039—A New Look at the Estate Taxation of Employee Death Benefits Under Nonqualified Plans*, 10 U.C.L.A. L. REV. 619 (1963).

50. Treas. Reg. § 20.2039-1(b)(ii) (1958); LOWNDES & KRAMER § 10.8; 2 MERTENS § 18.05.

51. Treas. Reg. § 20.2039-1(b)(ii) (Ex. 1) (1958); S. REP. NO. 1622, 83d Cong., 2d Sess., 469, 470 (1954); H. R. REP. NO. 8300, 83d Cong., 2d Sess. A314, A315 (1954); LOWNDES & KRAMER § 10.6; Comment, *The Baptism of Section 2039—A New Look at Estate Taxation of Employee Death Benefits Under Nonqualified Plans*, 10 U.C.L.A. L. REV. 619, 624 (1963).

between payment. The outward boundary as to what is includible as an "other payment" was established in a test case, *Estate of Firmin D Fusz*.⁵²

In that case the decedent's employment contract provided for post-mortem payments of \$200 per month to his wife until her death. There were no provisions providing any retirement benefits to the employee and he was *only* entitled to his salary. The Commissioner contended that "[t]he salary to which the decedent was entitled by reason of his employment contract is to be considered the 'other payment' payable to the decedent within the meaning of § 2039 of the Internal Revenue Code of 1954."⁵³ He further argued that example four in the Senate Report,⁵⁴ which was includible under § 2039, was identical with the facts in *Fusz*. He contended that as in the example, nothing other than salary was payable to the decedent and that it was obviously intended by Congress that a salary be considered as an "other payment."⁵⁵ The Tax Court firmly rejected this contention and held "that the phrase 'other payment' is qualitatively limited to post-employment benefits which, at the very least, are paid or payable during the decedent's lifetime."⁵⁶ The court did not consider whether the payments would be includible under a section other than § 2039.⁵⁷ Since the *Fusz* decision it is accepted that a pure death benefit plan, standing alone, is not includible under § 2039.

52. 46 T.C. 214 (1966), *acquiesced in*, 1967-2 CUM. BULL. 2; *accord*, *Bahen's Estate v. United States*, 305 F.2d 827, 834 (Ct. Cl. 1962); *Insert*, 24 J. TAX. 217 (1966) (where it is suggested that *Fusz* was a test case).

53. Brief for Respondent at 10, *Estate of Firmin D. Fusz*, 46 T.C. 214 (1966).

54. S. REP. No. 1622, 83d Cong., 2d Sess. 469, 470 (1954):

The following are examples of contracts, but are not necessarily the only forms of contracts, to which this section applies:

(4) A contract or agreement entered into by the decedent and his employer under which at decedent's death, prior to retirement or prior to the expiration of a stated period of time, an annuity or other payment was payable to a designated beneficiary if surviving the decedent.

55. The ambiguity of the example has been recognized by many commentators. See Pincus, *Estate Taxation of Annuities and Other Payments*, 44 VA. L. REV. 857, 866 (1958); Note, *The Baptism of Section 2039—A New Look at Estate Taxation of Employee Death Benefits Under Non-qualified Plans*, 10 U.C.L.A. L. REV. 619, 627 (1963); Note, *Estate Tax-Annuities-Agreement to Serve as Advisor Not a Post-Employment Contract and Therefore Survivor Annuity Not Includible in Decedent's Gross Estate*, 55 VA. L. REV. 1128, 1134 (1969); Note, *Estate Taxation of Employee Death Benefits*, 66 YALE L.J. 1217, 1244 n. 114 (1957).

56. *Estate of Firmin D. Fusz*, 46 T.C. 214, 218 (1966), *accord*, *Kramer v. United States*, 406 F.2d 1363 (Ct. Cl. 1969).

57. *Estate of Firmin D. Fusz*, 46 T.C. 214, 218 n. 4 (1966); *cf.*, 65 MICH. L. REV. 577 (1967); 18 SYRACUSE L. REV. 655 (1967).

58. See notes 6-18 *supra* and accompanying text.

As in *Dimock*,⁵⁸ a determination of the enforceability of an interest persists to be significant despite the terminological change from “property” to “contract or other agreement.”⁵⁹ Some courts⁶⁰ have interpreted the requirement of a contract or agreement to be the substantive equivalent of an enforceable interest and have therefore considered voluntary payments to be beyond the reach of § 2039.⁶¹ On the other hand, the “contract or agreement” requirement may be fulfilled by any “arrangement, understanding or plan, or any combination of arrangements, understandings or plans arising by reason of the decedent’s employment.”⁶² By including “any combination of arrangements,” the section is able to bring within its ambit certain plans which otherwise would not be within the section’s coverage but for a connection with another benefit plan.⁶³ Therefore, with the exception of life insurance contracts,⁶⁴ or other specifically exempted benefits,⁶⁵ § 2039 could encompass virtually any type of benefit through this combination treatment.⁶⁶

59. Estate of William E. Barr, 40 T.C. 227, 232 (1963); INT. REV. CODE OF 1954, § 2039(a); 2 MERTENS § 18.06. See also notes 6-26 *supra* and accompanying text.

60. *McCobb v. All*, 206 F. Supp. 901, 905 (D. Conn. 1962), *rev'd*, 321 F.2d 633 (2d Cir. 1963); Estate of Raymond W. Albright, 42 T.C. 643 (1964), *rev'd*, 356 F.2d 319 (2d Cir. 1966); Estate of William E. Barr, 40 T.C. 227, 235 (1963).

61. See also Treas. Reg. § 20.2039-1(b)(1)(ii) (1958); Joseph, *Estate Tax Impact on Survivor Annuities; How Far Can Section 2039 Reach?*, 25 J. TAX. 214 (1966); Pincus, *Estate Taxation of Annuities and Other Payments*, 44 VA. L. REV. 857, 864 (1958); Note, *Employee Death Benefits*, 26 TAX L. REV. 329, 333 (1971); Comment, *The Baptism of Section 2039—A New Look at Estate Taxation of Employee Death Benefits Under Nonqualified Plans*, 10 U.C.L.A. L. REV. 619, 624 (1963).

62. Treas. Reg. § 20.2039-1(b)(ii) (1958); Treas. Reg. § 20.2039-1(b) (ii) (Ex. 4) (1958).

63. *Gray v. United States*, 410 F.2d 1094 (3d Cir. 1969); *McCobb v. All*, 321 F.2d 633 (2d Cir. 1963); *Bahen’s Estate v. United States*, 305 F.2d 827 (Ct. Cl. 1962); Estate of Henry C. Beal, 47 T.C. 269 (1966); Treas. Reg. § 20.2039-1(b)(ii) (1958); Treas. Reg. § 20.2039-1(b)(ii) (Ex. 6) (1958); Sporn, *Tax Planning for Employee Death Benefits*, N.Y.U. 26TH INST. ON FED. TAX. 1229, 1240 (1968); Comment, *The Baptism of Section 2039—A New Look at Estate Taxation of Employee Death Benefit Plans Under Nonqualified Plans*, 10 U.C.L.A. L. REV. 619, 623 (1963).

64. INT. REV. CODE OF 1954, § 2039(a); Treas. Reg. § 20.2039-1(d) (1958); LOWNDES & KRAMER § 10.7. See also note 42 *supra*.

65. See, e.g., Rev. Rul. 70, 1960-1 CUM. BULL. 372 (Railroad Retirement Act benefits); Rev. Rul. 637, 1956-2 CUM. BULL. 600 (statutory recovery for death due to occupational hazard); Rev. Rul. 609, 1955-2 CUM. BULL. 34 (any statutorily conferred death benefit); Rev. Rul. 581, 1955-2 CUM. BULL. 381 (Air Force death payments); Rev. Rul. 87, 1955-1 CUM. BULL. 112 (social security payments not payable to decedent’s estate); Rev. Rul. 89, 1954-1 CUM. BULL. 179 (recovery under wrongful death statute); Rev. Rul. 19, 1954-1 CUM. BULL. 79 (recovery under N.J. wrongful death statute).

66. Although the section stipulates that “any beneficiary” may be the recipient of the benefit to make it includible, such is apparently not the case. In Estate of Wilmar Mason Allen, 39 T.C. 817, 824 (1963), the Tax Court held that where the employer is the recipient of the benefit, “it can [not] be considered a beneficiary within the intentment of section 2039(a) . . .”

The section's requirement that the benefit "was payable" to the decedent or that he "possessed the right to receive" it, is a substitution for the former property concepts which defined the quantum and disposition of the employee's interest.⁶⁷ Although the two phrases are closely related, there exists an interpretative distinction.⁶⁸

The Commissioner has interpreted the phrase "was payable" as encompassing payments which the decedent was in fact receiving even if the decedent had no enforceable right to receive them.⁶⁹ His interpretation is verified by the legislative history⁷⁰ and the regulations.⁷¹ If a benefit "was payable" and actually being received by the decedent, the existence of any conditions of forfeiture would not preclude inclusion.⁷² Furthermore, the decedent's right to the receipt of the benefits *paid* need not be enforceable.⁷³ The "expectancy" benefits excluded under the 1939 Code⁷⁴ would therefore be includible under § 2039 if the decedent actually received any payments.

If the decedent-employee was not actually receiving any payments but was entitled to payments in the future, his interest is includible under § 2039 if he "possessed the right to receive such annuity or payment."⁷⁵ A contingent future interest is similarly includible⁷⁶ if the con-

67. See notes 6-29 *supra* and accompanying text; 2 MERTENS § 18.09.

68. See, e.g., Estate of William E. Barr, 40 T.C. 227, 235 (1963).

69. LOWNDES & KRAMER § 10.8; 2 MERTENS § 18.10; Joseph, *The Estate Tax Impact on Survivor Annuities; How Far Can § 2039 Reach?*, 25 J. TAX. 214, 216 (1966); Kramer, *Employee Benefits and Federal Estate and Gift Taxes*, 1959 DUKE L.J. 341, 355; Note, *Employee Death Benefits*, 26 TAX L. REV. 329, 346 (1970); Comment, *The Baptism of Section 2039—A New Look at Estate Taxation of Employee Death Benefits Under Nonqualified Plans*, 10 U.C.L.A. L. REV. 619, 624 (1963).

70. S. REP. NO. 1622, 83d Cong., 2d Sess. 469, 470 (1954):

(3) A contract or agreement entered into by the decedent and his employer under which the decedent immediately before his death and following retirement *was receiving* or was entitled to receive an annuity or other payment, payable to the decedent for the duration of his life and thereafter to a designated beneficiary, if surviving the decedent, whether the payments after the decedent's death are fixed by the contract or subject to an option or election exercised or exercisable by the decedent. (emphasis added)

The utilization of the phrase "was receiving" seems to give emphasis to the present possessory nature of the decedent's interest in the payments. LOWNDES & KRAMER 216 n.48 and accompanying text.

71. Treas. Reg. § 20.2039-2(b)(ii) (1958); Treas. Reg. § 20.2039-1(b) (ii) (Ex. 2) (1958).

72. Treas. Reg. § 20.2039-1(b)(ii) (Ex. 2) (1958); Tannenwald, *Payments to Widows as an Element in Estate Planning*, N.Y.U. 18TH INST. ON FED. TAX. 1131, 1135 (1960).

73. Treas. Reg. § 20.2039-1(b)(ii) (1958).

74. See note 9 *supra*.

75. INT. REV. CODE OF 1954, § 2039(a); Treas. Reg. § 20.2039-1(b)(ii) (1958); LOWNDES & KRAMER § 10.8; 2 MERTENS § 18.11.

76. See *Bahen's Estate v. United States*, 305 F.2d 827, 831 (Ct. Cl. 1962). It is established that the possibility of forfeiture does not prevent taxation. See, e.g., Estate of Edward H. Wadewitz, 39

tendency is either fulfilled upon death,⁷⁷ or is within the employee's control.⁷⁸ However, an unenforceable right⁷⁹ to future payments is not includible.

The final requirement for inclusion under § 2039 concerns the period during which the "decedent possessed the right to receive" the payment.⁸⁰ This temporal requirement, which is identical to the requirement under § 2036,⁸¹ states that the period be "for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death."⁸² This requirement for inclusion under § 2039 has been criticized because it leads to an absurd result under an example in the regulations.⁸³

T.C. 925, 937 (1963); Treas. Reg. § 20.2039-1(b)(ii) (Ex. 3) (1958); Joseph, *The Estate Tax Impact on Survivor Annuities, How Far Can § 2039 Reach?*, 25 J. TAX. 214, 216 (1966); Kramer, *Employee Benefits and Federal Estate and Gift Taxes*, 1959 DUKE L.J. 341, 357.

77. Treas. Reg. § 20.2039-1(b)(ii) (1958).

78. See Note, *Employee Death Benefits*, 26 TAX L. REV. 329, 342 (1971); Comment, *The Baptism of Section 2039—A New Look at Estate Taxation of Employee Death Benefits Under Nonqualified Plans*, 10 U.C.L.A. L. REV. 619, 625 (1963); Note, *Estate Taxation of Employee Death Benefits*, 66 YALE L.J. 1217, 1223 (1957).

79. Although it might seem to be a self-contradiction to speak of "unenforceable rights," both courts and commentators use this phrase to refer to those interests of the employee-decedent which are unenforceable at law.

80. INT. REV. CODE OF 1954, § 2039(a); Note, *Employee Death Benefits*, 26 TAX L. REV. 329, 343 (1971).

81. Treas. Reg. § 20.2039-1(b)(ii) (1958). See generally Kramer, *Employee Benefits and Federal Estate and Gift Taxes*, 1959 DUKE L.J. 341, 359.

82. The similarity between § 2039 and § 2036 has been criticized since the latter section (Transfers with Retained Life Estate) is specifically concerned with "property." See Joseph, *The Estate Tax Impact on Survivor Annuities; How Far Can § 2039 Reach?*, 25 J. TAX. 214 at 214 (1966); Kramer, *Employee Benefits and Federal Estate and Gift Taxes*, 1959 DUKE L.J. 341, 355. The interpretation of this requirement under § 2036 controls for purposes of § 2039.

83. Treas. Reg. § 20.2039-1(b)(ii)(Ex. 5) (1958):

Example (5). The employer made contributions to a retirement fund which were credited to the employee's individual account. Under the plan, the employee was to receive one-half the amount credited to his account upon his retirement at age 60, and his designated beneficiary was to receive the other one-half upon the employee's death after retirement. If the employee should die before reaching the retirement age, the entire amount credited to his account at such time was to be paid to the designated beneficiary. The retirement plan at no time met the requirements of section 401(a) (relating to qualified plans). Assume that the employee received one-half the amount credited to his account upon reaching the retirement age and that he died shortly thereafter. Since the employee received all that he was entitled to receive under the plan before his death, no amount was payable to him for his life or for any period not ascertainable without reference to his death, or for any period which did not in fact end before his death. Thus, the amount of the payment to the designated beneficiary is not includible in the decedent's gross estate under section 2039(a) and (b). If, in this example, the employee died before reaching the retirement age, the amount of the payment to the designated beneficiary would be includible in the decedent's gross estate

V. TAXATION OF PLANS BEYOND THE AMBIT OF § 2039

One commentator accurately stated the problem of taxing employee benefits under sections other than § 2039 when he wrote:

Once it has been determined that Section 2039 is inapplicable, recourse must be had to the 'vagaries and varieties' which are so characteristic of 'prior law', and which remain so characteristic of the other sections of the Internal Revenue Code . . .⁸⁴

Resorting to other estate tax sections of the Code⁸⁵ results in the judicial restoration of pre-section 2039 case law with its accompanying property law concepts which are ill-suited for the taxation of employee death benefits.⁸⁶ The estate taxation of "pure death benefits,"⁸⁷ which have their origin in the employment relationship, is a glaring example of the problems encountered.

It is evident that unless a "pure death benefit" plan exists in conjunction with another plan under which the decedent "possessed the right to receive" or was receiving payments, the benefit will not be within the ambit of § 2039.⁸⁸ This was the conclusion of the Tax Court in *Estate of Firmin D. Fusz*,⁸⁹ but as the decision reached was limited exclusively to § 2039, the possibility of taxation under the other estate tax sections was not considered.⁹⁰ In a recent case the issue of inclusion under other sections was unavoidably before the Tax Court.

under section 2039(a) and (b). In this latter case, the decedent possessed the right to receive a lump sum payment for a period which did not in fact end before his death.

See LOWNDES & KRAMER § 10.8, at 219-20; Garner, *Income and Estate Taxation of Annuities*, N.Y.U. 13TH INST. ON FED. TAX. 265, 283 (1955); Joseph, *The Estate Tax Impact on Survivor Annuities; How Far Can § 2039 Reach?*, 25 J. TAX. 214, 216 (1966).

84. Tannenwald, *Payments to Widows of Executives as an Element in Estate Planning*, N.Y.U. 18TH INST. ON FED. TAX. 1131, 1135 (1960) (Tannenwald is presently a judge on the Tax Court).

85. If § 2039 is inapplicable to the particular benefit plan, the Commissioner's "entire quiver" may be unleashed. However, resorting to the generic sections of the estate tax code restores to prominence the concepts of *property* and *transfer*. If the decedent, until his death, is deemed to have had an enforceable property interest § 2033 (Property in which the Decedent Had an Interest) may be applicable. If the decedent transferred his entire interest within three years prior to his death, then resorting to § 2035 (Transfers in Contemplation of Death) would be appropriate. If the decedent made a partial transfer of his property, retaining some interest then § 2036 (Transfers With a Retained Life Estate), or § 2037 (Transfers Taking Effect at Death), or § 2038 (Revocable Transfers) may be utilized depending upon the type of retained interest. The applicability of any particular transfer section(s) will depend upon when, if at all, a transfer occurred, and upon the nature of the employee-decedent's interest.

86. As to the similar problems encountered under the provisions of the 1939 Code see notes 36-37 *supra* and accompanying text.

87. See p. 2-3 *supra*.

88. See notes 51-56 *supra* and accompanying text.

89. 46 T.C. 214 (1966).

90. *Id.* at 215 n.2, 218 n.4.

In *Estate of Bernard L. Porter*,⁹¹ the decedent, an employee and partial owner of three closely held corporations, simultaneously executed identical agreements with each company, whereby his widow or issue would receive post-mortem payments. Payment was conditioned upon the decedent remaining in the employ of the respective companies, and the stated purpose of the contract was to induce the decedent to continue rendering his services. It was further stipulated that “[These] agreement[s] shall be binding upon and inure to the benefit of the parties, their successors, heirs, executors, administrators or other legal representatives.”⁹² Seventeen days after executing the agreements, Porter died testate following a gall bladder operation. An estate tax return which excluded the value of the agreements was filed and the Commissioner determined a deficiency. The Commissioner, recognizing that § 2039 was inapplicable, argued alternatively for inclusion under §§ 2033, 2035, 2036 or 2038.⁹³ On these facts the majority of the Tax Court held that the value of these agreements was includible in the decedent’s gross estate under § 2035.⁹⁴ This section utilizes the terms “property” and “transfer” and therefore, the court’s decision is an example of the current problems encountered under the generic estate tax sections.⁹⁵

The statutory elements required for inclusion under § 2035 are three-

91. 54 T.C. 1066 (1970), *aff'd*, 442 F.2d 915 (1st Cir. 1971).

92. 54 T.C. 1066, 1068 (1970).

93. *Id.* at 1067; Appellate Brief for Respondent at 14-18, *Estate of Bernard L. Porter*, 442 F.2d 915 (1st Cir. 1971) (on appeal the respondent did not argue for inclusion under § 2033); furthermore, the Tax Court did not consider the applicability of §§ 2036 and 2038, as the decision was predicated upon § 2035. The Court of Appeals stated in its opinion that § 2039 was inapplicable to the plan in question. That court also concluded: “In order to determine the appropriate estate tax treatment of such benefits, it is relevant to consider the treatment of employee death benefits generally under pre-1954 law.” 442 F.2d 915, 916 (1971). This substantiates the conclusion that the limited inclusiveness of § 2039 results in reliance upon earlier precedents and statutes. The applicability of cases decided under the 1939 Code is questionable. *See, e.g., Note, Employee Death Benefits*, 26 TAX L. REV. 329, 330 (1971).

94. INT. REV. CODE OF 1954, § 2035:

(a) General Rule.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money’s worth), by trust or otherwise, in contemplation of his death.

(b) Application of General Rule.—If the decedent within a period of 3 years ending with the date of his death (except in case of a bona fide sale for an adequate and full consideration in money or money’s worth) transferred an interest in property, relinquished a power of appointment, such transfer, relinquishment, exercise, or release shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this section and sections 2038 and 2041 (relating to revocable transfers and powers of appointment); but no such transfer, relinquishment, exercise, or release made before such 3-year period shall be treated as having been made in contemplation of death.

95. The Commissioner’s “shot gun” approach as well as the differing views of the judges of the Tax Court may be reflective of the uncertainty of the exact holding. One concurrence held the benefits to be includible under § 2033, while the dissenters, in a terse opinion, argued that the payments should escape estate taxation altogether.

threefold:⁹⁶ first, the decedent must have possessed a property interest capable of transfer;⁹⁷ secondly, there must have been a complete *inter vivos* transfer of such an interest;⁹⁸ and finally, the transfer must have been made in contemplation of death. The last of these requirements, while of importance, is primarily a factual determination⁹⁹ to be made in consideration of the presumption of the section and the taxpayer's proffered evidence in rebuttal of that presumption.¹⁰⁰

The judicial inquiry as to whether the statutory requirements of § 2035 were fulfilled failed to distinguish the concepts of *property* and *transfer*.¹⁰¹ Furthermore, the court's emphasis upon the exchange of consideration¹⁰² between the employer and the decedent hopelessly enmeshed the issues as to whether Porter's interest constituted *property* and whether a *transfer* was effectuated by him.¹⁰³ Despite the petitioner's arguments concerning the non-enforceability of the agreement,¹⁰⁴ the

96. See, e.g., *United States v. Wells*, 283 U.S. 102 (1931); LOWNDES & KRAMER ch. 10; 2 MERTENS § 20.10-11; 3 MERTENS § 22.04-.05; Barry, *The Taxation of Transfers in Contemplation of Death*, 10 HAST. L. J. 370 (1959); Reicker, *A Pragmatic View of Transfers in Contemplation of Death*, 53 MINN. L. REV. 265 (1968).

97. *Helvering v. Hallock*, 309 U.S. 106, 118 (1940). See generally Merry, *Federal Estate and Gift Tax: Concept of a Transfer*, 38 MICH. L. REV. 1032 (1940). See notes 6-24 *supra* and accompanying text.

98. LOWNDES & KRAMER § 5.3; 2 MERTENS § 20.03, 20.06, 20.14-.17. See also notes 25-35 *supra* and accompanying text.

99. As to the numerous factors possibly to be considered, see LOWNDES & KRAMER 5.11; 3 MERTENS § 22.63-.73.

100. The exact nature of the three year presumption is detailed in Treas. Reg. § 20.2035-1(d) (1958). As the agreements in question were executed within weeks of the decedent's death, the presumption of the transactions being made in contemplation of death was raised. On this point the petitioner unsuccessfully argued that the executed agreements were merely a continuation of the earlier existing agreements between the parties. 54 T.C. 1066, 1076-77 (1970).

101. Regretfully, the court did not clearly separate its determination of the nature of Porter's property interest from whether or not he had made a transfer. The court's phrasing of the issue as ". . . whether in fact decedent made a transfer of property when he entered into the contracts. . .", evidences this problem. 54 T.C. 1066, 1070 (1970).

102. See notes 27-30 *supra* and accompanying text.

103. The court stated:

While the principal that a decedent who furnishes the consideration for the payment by another upon his death to the beneficiary designated by him has made a *transfer of property* as that term is used in the estate tax law has long been accepted, there has been much litigation concerning whether various arrangements came within the concept of a transfer procured by the consideration furnished by a decedent. (emphasis added)

Estate of Bernard L. Porter, 54 T.C. 1066, 1070 (1970). See note 98 *supra*.

104. The petitioner's argument was essentially two-fold: first, it was argued that the conditions precedent and the decedent's status as an employee at will precluded inclusion; secondly, it was argued that the contract was not enforceable after the decedent's death. The court disagreed on both points and in refuting the former argument the court determined that the conditions of forfeiture did not preclude the vesting of the interest, and that the decedent could not be dismissed by the

court held that upon the execution of the contracts, “a right to have payments made to decedent’s widow and issue was vested in the beneficiaries. . . .”¹⁰⁵ Arguably, this exchange of consideration in *Porter* sufficiently qualifies under pre-1954 law as creating a property interest.¹⁰⁶ Similarly, since the employer was a closely-held corporation it is arguable that the owner-employee was able to designate the beneficiary, thus fulfilling the pre-1954 “transfer” requirement.¹⁰⁷ The fact still remains, however, that since no litigated case with facts similar to those presented in *Porter* arose under pre-section 2039 law a death benefit plan similar to the plan in *Porter* was never held to be taxable to the decedent’s estate. There are several conjectural explanations for the absence of any litigation involving such a plan.¹⁰⁸

One concurring opinion differed substantially from the majority’s conclusion.¹⁰⁹ Rather than agreeing that a transfer of property occurred upon the *execution* of the contracts, these justices felt that no transfer could occur prior to death because:

[u]ntil those conditions [the survivorship of the beneficiary and the death of the decedent while in the companies’ employ] were fulfilled—which could not occur up until the date of the death of the decedent—all that the beneficiaries had was a mere expectancy or hope that the decedent would perform his part of the agreement, thereby making unconditional the obligation of the employer to pay the benefit.¹¹⁰

However, the concurring judges, upon the sole authority of *Goodman*

company in order to avoid the obligation to make payment. As to the latter argument the court held that Massachusetts law permits the administrator or executor of the estate to sue upon the contract which specifically states that it inures to the benefit of the decedent’s “successors, heirs, administrators. . . .”

105. Estate of Bernard L. Porter, 54 T.C. 1066, 1073 (1970).

106. See notes 27-29 *supra* and accompanying text.

107. See notes 25-26 *supra* and accompanying text.

108. It is possible that an administrative decision was made by the Commissioner not to tax such benefits. Another alternative is that such plans were virtually non-existent because both employees and employers lacked sophistication (see note 1 *supra* and accompanying text). Finally, it is possible that whenever such a plan was included in the decedent-employee’s estate by the Commissioner, this determination was not challenged by the taxpayer. Only one case involving a plan similar to the one in *Porter* seems to have reached the litigation stage. In *Flarsheim v. United States*, 156 F.2d 105 (8th Cir. 1946), the issue before the court was whether or not payments made to the beneficiary were includible as income.

109. Estate of Bernard L. Porter, 54 T.C. 1066, 1079-83 (1970).

110. *Id.* at 1079-80.

v. *Granger*,¹¹¹ determined that the contract was the decedent's property. They concluded that § 2033 was therefore applicable since a transfer was not effectuated upon the execution of the contract because "there was nothing to transfer in this case until the death of the decedent."¹¹²

Apart from whether one agrees with any of the opinions expressed in *Porter*, the decision is significant. *Porter* has taken the estate taxation of employee death benefits one step beyond the holding of the *Fusz* court.¹¹³ *Porter* is the first case since the adoption of the 1954 Code involving solely a pure death benefit which has determined such a benefit to be taxable to the estate under a provision other than § 2039. Despite the conceptual and historical problems which result, the concepts of *property* and *transfer* remain the only basis for the taxation of benefits outside the ambit of § 2039. It is obviously illogical to reintroduce into the estate taxation of employee death benefits the two concepts which Congress sought to eliminate¹¹⁴ from § 2039. The fact remains that as with the 1939 Code, they are ill-suited to the task.¹¹⁵ The limited inclusiveness of § 2039 can not be effectively remedied by resorting to the generic sections of the estate tax code in order to fill the legislative interstices. Far more is required.

VII. CONCLUSION

Commentators foreseeing these difficulties in the present statutory treatment have suggested that any death benefit payments having their origin in the decedent's employment relationship should be held taxable to the decedent's estate.¹¹⁶ This suggestion is based upon the conclusion

111. 243 F.2d 264, 266 (3d Cir. 1957). The *Goodman* case focused upon the valuation of the employee-decedent's rights to annual post-employment benefits conditioned upon his performance of the required services and non-competition with the employer after ceasing to work for him. The taxpayer argued that as the interests had no market value during the decedent's lifetime, they were not taxable. The taxpayer did not argue that the interests were not property. The court held that the value of the interest was to be measured "as of the time of death." A concurring judge in *Porter* relied upon this decision and stated, "the fact remains that unless the contracts [in *Granger*] were held to constitute 'property' in which the decedent had an 'interest' under § 811(a), I.R.C. 1939, there was nothing to value for estate tax purposes." Estate of Bernard L. Porter, 54 T.C. 1066, 1080 n.3 (1970).

112. Estate of Bernard L. Porter, 54 T.C. 1066, 1082 (1970).

113. See notes 85-87 *supra* and accompanying text.

114. See notes 40-43 *supra* and accompanying text.

115. See notes 82-84 *supra* and accompanying text.

116. See Kramer, *Employee Benefits and Federal Estate and Gift Taxes*, 1959 DUKE L. J. 341, 350; Note, *Estate Taxation-Annuities-Agreement to Serve as Advisor Not a Post-Employment Contract and Therefore Annuity Not Includible in Decedent's Estate*, 55 VA. L. REV. 1128, 1139 (1969); Note, *Estate Taxation of Employee Death Benefits*, 66 YALE L.J. 1217, 1250 (1956).

that the deferred aspect of the employee's compensation should not preclude estate taxation.

The American Law Institute's¹¹⁷ unified transfer tax system § X11g,¹¹⁸ while eliminating the favorable treatment accorded to qualified plans,¹¹⁹ would tax all enforceable benefit agreements arising out of

117. ALI, FEDERAL ESTATE AND GIFT TAXATION (1969). The ALI has put forth three proposals with different systems—a dual tax system, a unified transfer tax system and a system of accession taxes. See generally Casner, *ALI Federal Estate and Gift Tax Project*, 22 TAX. L. REV. 515 (1967); Williams, *The ALI's Federal Estate and Gift Tax Project*, N.Y.U. 25TH INST. ON FED. TAX. 1395 (1967); Young, *Proposed Revisions of the Federal Estate and Gift Tax Laws: The ALI Revisited*, 5 GA. L. REV. 75 (1970). As to the ALI's treatment of the estate taxation of employee death benefits, Casner states:

The proposal of *Study Draft No. 2* with respect to employee benefits is to sweep all benefits payable by an employer under an enforceable arrangement as a result of the death of the employee into the category of a deathtime transfer by the employee that is subject to the transfer tax. Voluntary payments made by the employer, as distinguished from those made under an enforceable arrangement, will continue to be treated as not transferred by the employee. When an employer regularly makes payments on the death of an employee to selected persons, however, it may be found that such payments are made pursuant to an enforceable agreement or understanding with the employees.

It is proposed that it be impossible to make a lifetime transfer of employee death benefits. Even an irrevocable designation by the employee in his lifetime of the recipients of any employee death benefit (not including life insurance which, of course, is subject to the life insurance rules) will not produce a lifetime transfer. Casner, *ALI Federal Estate and Gift Tax Project*, 22 TAX L. REV. 515, 567 (1967).

See also Note, *Employee Death Benefits*, 26 TAX L. REV. 329, 357-61 (1971) (detailed discussion of the ALI proposals in relation to the estate taxation of employee benefits).

118. ALI, FEDERAL ESTATE AND GIFT TAXATION § X 11g, 115-16 (1967):

g. Employee as transferor of employee benefits.

Death benefits may be payable on the death of an employee as a result of an agreement or understanding between an employer and employee. Regardless of the form of such agreement or understanding, the employee is treated as the owner of such death benefits and is treated as making a transfer of them at the time of his death to the persons entitled to receive such benefits. Voluntary payments made by an employer on the death of an employee to selected persons are not treated as beneficially owned by the employee, and thus no transfer is made by the employee on his death with respect to such payments. When an employer regularly makes payments on the death of an employee to selected persons, however, it may be found that such payments are made pursuant to an agreement or understanding with his employees. A transfer by an employee on his death of employee death benefits will be an included transfer unless it is an excluded one under Title III. . . .

An irrevocable inter vivos designation by the employee of the beneficiaries to receive employee death benefits will not result in any inter vivos transfer for the purposes of the Subchapter A. The transfer will be regarded as taking place on the employee's death.

Amounts payable on the death of a person under social security are employee death benefits for the purposes of this Subsection g.

Section X7 at page 92, *supra*, provides for a delay in the payment of the transfer tax attributable to employee death benefits payable in installments over a period of years.

119. Recommendation number 3:

There should be no exclusion from transfer taxation, under either a dual tax system or a unified tax, on the death of an employee on the ground that the transferred asset is an employee death benefit (*Id.* at 16)

the decedent's employment. The employee is regarded as the holder of a property interest which is transferred at the time of his death. The ALI section, like § 2039, does not make taxation contingent upon the form of the agreement and similarly an agreement may be inferred from the previous conduct of the employer. This unified transfer tax proposal is an improvement upon the present statutory scheme because the estate taxation of the death benefit is not dependent upon the finding of property or its transfer. Furthermore, the emphasis is not upon the specific type of enforceable plan or interest but upon the generating source of the benefit.

If Congress should re-draft the entire system of estate and gift taxation, a section similar to § X11g should be adopted. This would permit the inclusion of all enforceable benefits while eliminating the present historical and conceptual problems which are encountered with the concepts of *property* and *transfer*. Finally, the estate taxation of pure death benefits, presently beyond the ambit of § 2039, would be simplified and certainly preferable to resorting to generic taxation.