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even less desirable, and though the husband is said to be taxed, she feels it as if she were taxed.

Finally the *Davis* position complicates divorce negotiations and frustrates domestic relations purposes for what is probably an insufficient revenue return. In the interests of fairness and consistency Congress should overrule *Davis*.

INEQUITIES IN CORPORATE PAYMENTS TO WIDOWS

One of the present problem areas in income tax law is the taxability of voluntary payments by a corporate employer to a widow or other survivors of a deceased employee. This situation usually arises in closely held corporations or with executive employees. The Internal Revenue Code allows an exclusion of \$5,000 to the beneficiaries or the estate of the employee if the payments are made by reason of the death of the employee.¹ However, if the employee is entitled to receive the payments while living, the beneficiaries or the estate of the employee do not qualify for the exclusion.² The problem area concerns whether the amount in excess of \$5,000 is to be treated as income or a gift. If the payment can qualify as a gift, it is wholly excludable from the gross income of the recipient,³ and the corporation is able to treat the payment as an expense.⁴ Recent cases in the United States Courts of Appeals have held that amounts in excess of \$5,000 are gifts,⁵ while other cases have held them to be taxable income.⁶ The cases that have classified the payments as

1. INT. REV. CODE OF 1954, § 101(b).

2. Treas. Reg. § 1.101-2 (1957), provides that the exclusion does not apply to amounts which constituted income payable to the employee during his life as compensation for services, such as bonuses, unused leave, or uncollected salary, plus other amounts to which the employee possessed a nonforfeitable right. A nonforfeitable right includes amounts to which the employee was entitled while living if he had made an election or demand, or upon termination of employment, such as under a pension or profit-sharing plan.

3. INT. REV. CODE OF 1954, § 102(a).

4. See, e.g., *Fifth Avenue Coach Lines, Inc.*, 31 T.C. 1080 (1959); *I. Putnam, Inc.*, 15 T.C. 86 (1950), *acq.*, 1950-2 CUM. BULL. 4.

5. *Kuntz v. Commissioner*, 300 F.2d 849 (6th Cir. 1962), *reversing* 19 CCH Tax Ct. Mem. 1379 (1960), *cert. denied*, 371 U.S. 903 (1962); *Olsen v. Commissioner*, 302 F.2d 671 (8th Cir. 1962), *reversing* 20 CCH Tax Ct. Mem. 807 (1961), *cert. denied*, 371 U.S. 903 (1962); *United States v. Frankel*, 302 F.2d 666 (8th Cir. 1962), *affirming* 192 F. Supp. 776 (D. Minn. 1961), *cert. denied*, 371 U.S. 903 (1962); *United States v. Kasynski*, 284 F.2d 143 (10th Cir. 1960).

6. *Martin v. Commissioner*, 305 F.2d 290 (3d Cir. 1962), *affirming* 35 T.C. 556 (1961), *cert. denied*, 371 U.S. 904 (1962); *Smith v. United States*, 305 F.2d 778 (3d Cir. 1962), *affirming* 20 CCH Tax Ct. Mem. 775 (1961), *cert. denied*, 371 U.S. 904 (1962).

gifts have resulted in certain inequities and have created a potential abuse of the tax law. A review of the law preceding the conflicting interpretations will serve to place the problem in its proper legal context and provide a basis for an analysis of the tax consequences of such voluntary payments.

The Bureau of Internal Revenue ruled in 1939 that voluntary payments by an employer to the widow of an officer-stockholder were gifts and not taxable income, so long as she did not render services to the payer.⁷ This ruling was in effect until 1950, when the Commissioner held such payments, if in consideration for services rendered by the deceased officer or employee, includable in the gross income of the widow.⁸ The Commissioner's contention in I.T. 4027 was that failure to perform services by the widow was irrelevant in determining the taxability of the payments, so long as the payments were for services rendered. The reversal of the Commissioner's position appears to have been prompted by the case of *Louise K. Aprill*,⁹ where the Tax Court held that the voluntary payments were gifts, since in conformity with I.T. 3329, no services had been rendered by the widow. Prior to the *Aprill* case, the disputes that arose concerning the taxability of payments to a widow by an employer were few, and generally the payments were not of a voluntary nature as in I.T. 3329.¹⁰ It is apparent that the Commissioner issued I.T. 4027 to restrain an increase in the use of these payments as a tax avoidance device.

The courts were not sympathetic to the position taken by the Commissioner in I.T. 4027. The Government suffered losses in virtually every case that immediately followed the announcement.¹¹ In *Estate of Arthur W. Hellstrom*,¹² the Tax Court came into direct contact with I.T. 4027 and rejected the ruling. Prior cases merely ignored it.¹³ In the cases which followed the ruling, the widows continued to receive favor-

7. I.T. 3329, 1939-2 CUM. BULL. 153.

8. I.T. 4027, 1950-2 CUM. BULL. 9.

9. 13 T.C. 707 (1949).

10. For a summary of these early cases, see 39 Ky. L.J. 363 (1951).

11. Marie G. Haskell, 14 CCH Tax Ct. Mem. 788 (7955); Estate of Arthur W. Hellstrom, 24 T.C. 916 (1955); Estate of Ralph W. Reardon, 14 CCH Tax Ct. Mem. 577 (1955); Ruth Hahn, 13 CCH Tax Ct. Mem. 308 (1954); Alice M. Macfarlane, 19 T.C. 9 (1952). *Contra*, Bausch's Estate v. Commissioner, 186 F.2d 313 (2d Cir. 1951), affirming 14 T.C. 1433 (1950); Fisher v. United States, 129 F. Supp. 757 (D. Mass. 1955).

12. 24 T.C. 916 (1955).

13. Marie G. Haskell, 14 CCH Tax Ct. Mem. 788 (1955); Estate of Ralph W. Reardon, 14 CCH Tax Ct. Mem. 577 (1955); Ruth Hahn, 13 CCH Tax Ct. Mem. 308 (1954); Alice M. Macfarlane, 19 T.C. 9 (1952).

able treatment from the courts.¹⁴ These adverse decisions forced the Commissioner to modify his position with respect to the Internal Revenue Code of 1939.¹⁵

The Internal Revenue Code of 1939 contained no statutory provisions dealing with death payments received from an employer until the enactment of Section 302 of the Revenue Act of 1951.¹⁶ This section of the Revenue Act permitted the beneficiaries and the estate of the employee to exclude from taxable income \$5,000 of payments received under a pre-existing contract with the employer. The object of the new provision was to equalize the tax consequences of the contractual payments with the exclusion provided recipients under group life insurance plans.¹⁷ The regulations promulgated by the Commissioner under section 302 stressed the requirement of a pre-existing contract to qualify for the exemption. Therefore, the amendment had no effect on the voluntary payment to widows since the prior cases had classified the payments as gifts and within that exemption provision of the Code.¹⁸

The requirement of a pre-existing contractual obligation for the \$5,000 exclusion was deleted from the Internal Revenue Code of 1954. The Government then took the position that section 101(b) of the 1954 Code limited the widow's exemption to \$5,000.¹⁹ A few cases contained dicta in support of this contention.²⁰ The courts, however, refused to accept this construction and continued to hold the payments to widows free from taxation.²¹ The basis for the decision was that Congress intended to equalize the tax consequences of contractual and voluntary payments, since under the Revenue Act of 1951 the voluntary payments

14. For a collection of cases and discussion of decisions rendered in favor of the taxpayer see Pelisek, *Tax Treatment of Payments to the Widows of Corporate Officers and Employees*, 44 MARQ. L. REV. 16 (1960).

15. The Internal Revenue Service ruled that it would not litigate, under the 1939 CODE, cases involving the taxability of voluntary payments to widows unless there was clear evidence that they were intended as compensation. The Service stated that its position with respect to the 1954 CODE involved other considerations. Rev. Rul. 58-613, 1958-2 CUM. BULL. 914.

16. INT. REV. CODE OF 1939, § 22(b)(1), added by ch. 521, 65 Stat. 483 (1951).

17. For a discussion of this point see Crown, *Payments to Corporate Executives' Widows*, N.Y.U. 19TH INST. ON FED. TAX 815, 831 (1961).

18. *Ibid.*

19. Rev. Rul. 60-326, 1960-2 CUM. BULL. 32.

20. *Bounds v. United States*, 262 F.2d 876, 878 (4th Cir. 1958); *Rodner v. United States*, 149 F. Supp. 233, 237 (S.D.N.Y. 1957).

21. *Frankel v. United States*, 192 F. Supp. 776 (D. Minn. 1961), *aff'd*, 302 F.2d 666 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962); *Rice v. United States*, 197 F. Supp. 223 (E.D. Wis. 1961); *Wilner v. United States*, 195 F. Supp. 786 (S.D.N.Y. 1961); *Cowan v. United States*, 191 F. Supp. 703 (N.D. Ga. 1960); *Read v. United States*, 177 F. Supp. 205 (W.D. Ky. 1960), *aff'd mem.*, 277 F.2d 456 (6th Cir. 1960).

had been covered.²² Because of the adverse decisions as to this construction, the Internal Revenue Service abandoned its position that the voluntary payments to widows were limited to \$5,000.²³ However, the Commissioner still refused to relinquish the position taken in I.T. 4027.²⁴

The courts during this period recognized certain criteria for determining whether the payments constituted gifts. The following factors, established in the *Hellstrom* case²⁵ and affirmed in other cases,²⁶ were considered to be controlling: (1) the voluntary nature of the payments, (2) made directly to the widow, (3) who performed no services for the corporation, (4) which received no benefit from the payment, and (5) which were not in lieu of compensation to her husband for services rendered during his lifetime.²⁷ While these standards were generally adhered to by the courts, occasional deviations appeared. The existence of a plan or established pattern for such payments, which rendered an economic benefit to the corporation, has been held sufficient to prevent an exclusion of the payment as a gift.²⁸ Also, payments by a family owned corporation were held to be dividends and thus taxable as income.²⁹

The Commissioner in *Duberstein v. Commissioner*³⁰ proposed a test for determining whether a gratuitous transfer was a gift or income based

22. The requirement that there be a pre-existing contract to qualify for the \$5,000 was eliminated through the suggestion of public utility associations at Congressional Hearings. These utility companies were not bound to pay fixed death benefits, and such payments were therefore taxable to the recipient since there was no pre-existing contract. The utilities sought to eliminate this inequity where in substance their payments were similar to a firm contract. Crown, *supra* note 17, at 832. District Judge Weinfeld in *Wilner v. United States*, 195 F. Supp. 786, 789 (1961), stated that

[T]he legislative history . . . abundantly demonstrates that it had no relationship to the 'gift-compensation' controversy—on the contrary, it was enacted to eliminate discriminatory treatment against those recipients of payments from employers which were made on a voluntary basis, but which did not qualify as gifts. . . .

23. Rev. Rul. 62-102, 1962 INT. REV. BULL. No. 28, at 7.

24. *Ibid.*

25. *Estate of Arthur W. Hellstrom*, 24 T.C. 916 (1955).

26. *Bounds v. United States*, 262 F.2d 876 (4th Cir. 1959); *Florence S. Luntz*, 29 T.C. 647 (1958).

27. For a discussion of these criteria with respect to application in given cases see *Pelisek*, *supra* note 14.

28. *Simpson v. United States*, 261 F.2d 479 (7th Cir. 1958).

29. *Ginsberg's Estate v. Commissioner*, 271 F.2d 511 (5th Cir. 1959); *Lengsfeld v. Commissioner*, 241 F.2d 508 (5th Cir. 1957). *Contra*, *Bounds v. United States*, 262 F.2d 876 (4th Cir. 1958); *Estate of Albert W. Morse*, 17 CCH Tax Ct. Mem. 261 (1958); *Marie G. Haskell*, 14 CCH Tax Ct. Mem. 788 (1955).

30. 363 U.S. 278 (1960). *Duberstein* furnished a list of potential customers to a corporation with which he had previously done business. The corporation was able to take advantage of the information and gave *Duberstein* a Cadillac automobile as a present, although he had not expected remuneration. The Court held the transfer of the automobile to be compensation for services rendered and not a gift.

upon a set of "principles" derived from prior cases.³¹ This proposal was rejected by the Supreme Court and the Court stated that because of the nature of the problem, the principles that govern must be general and confined to those which have been spelled out in the past.³² The Court, however, did declare that "a gift in the statutory sense . . . proceeds from a 'detached and disinterested generosity' . . . 'out of affection, respect, admiration, charity or like impulses.'"³³ The controlling element is the intention with which the payment is made, and the proper criterion to determine intention is the "basic reason" for the conduct—the "dominant reason" that explains the making of the transfer.³⁴ The Court also recognized that each case must be decided by the fact-finding tribunal and appellate review of the decision must be quite restricted with reversal being limited to cases where the trier of fact was "clearly erroneous."³⁵

While the *Duberstein* case did not specifically concern voluntary payments to widows, it has had an effect in the area. The Tax Court took the position that *Duberstein* "clarified" and "developed" the law governing voluntary transfers, which included payments to widows,³⁶ and it has held against the widows in every case since.³⁷ The district courts, on the other hand, have generally held that *Duberstein* did not change the law but merely reaffirmed prior principles established in the *Hellstrom* case.³⁸ The courts of appeal have affirmed the district court cases which have held in favor of the widow.³⁹ However, the circuits

31. The Government proposed that "Gifts should be defined as transfers of property made for personal as distinguished from business reasons." *Id.* at 284 n. 6. The proposed test was derived from the following propositions: (1) payments by an employer to an employee, even though voluntary, should generally be taxable, (2) the concept of a gift is inconsistent with a payment being a deductible business expense, (3) a gift involves personal elements, and (4) a business corporation cannot properly make a gift of its assets. *Id.* at 287.

32. *Id.* at 284.

33. *Id.* at 285.

34. *Id.* at 286.

35. *Id.* at 290.

36. Estate of Mervin G. Pierpont, 35 T.C. 65 (1960), *rev'd sub nom.* Poyner v. Commissioner, 301 F.2d 287 (4th Cir. 1962).

37. Lucile McCrea Evans, 39 T.C. No. 56 (1962); Margaret H. D. Penick, 37 T.C. No. 98 (1962); Estate of Julius B. Cronheim, 20 CCH Tax Ct. Mem. 1144 (1961); Roy I. Martin, 36 T.C. 556 (1961), *aff'd*, 305 F.2d 290 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962); Estate of Rose A. Russek, 20 CCH Tax Ct. Mem. 123 (1961); Mildred W. Smith, 20 CCH Tax Ct. Mem. 775 (1961), *aff'd*, 305 F.2d 778 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962); Mary Westphal, 37 T.C. No. 36 (1961); Estate of Martin Kuntz, Sr., 19 CCH Tax Ct. Mem. 1379 (1960), *rev'd*, 300 F.2d 849 (6th Cir.), *cert. denied*, 371 U.S. 903 (1962); Ivan Y. Nickerson, 19 CCH Tax Ct. Mem. 1508 (1960).

38. Frankel v. United States, 192 F. Supp. 776 (D. Minn. 1961), *aff'd*, 302 F.2d 666 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962); Rice v. United States, 197 F. Supp. 223 (E.D. Wis. 1961).

39. United States v. Frankel, 302 F.2d 666 (8th Cir. 1962), *affirming* 192 F. Supp. 766 (D. Minn. 1961), *cert. denied*, 371 U.S. 903 (1962); United States v. Kasynski, 284

have produced divergent results in appeals from the Tax Court cases holding against the widow.⁴⁰

The first appellate decision after *Duberstein* that upheld a district court's determination that payments to a widow were gifts was *United States v. Kasynski*.⁴¹ There, the requirements established in the *Hellstrom* case⁴² were satisfied. As was typical in earlier cases, the deceased and his family controlled the payer corporation. In similar fact situations, district courts, in *Rice v. United States*⁴³ and *Frankel v. United States*,⁴⁴ also found that the payments were exempt from taxation. These precedents have been generally observed by district courts in later cases.⁴⁵

The first case decided by the Tax Court concerning payments to widows, subsequent to *Duberstein*, was *Estate of Mervin G. Pierpont*.⁴⁶ There, the deceased, who had owned two-thirds of the payer corporation, had been fully compensated, and the payments were made to the widow. The corporate resolution which authorized the expenditures declared that recognition of the deceased's past services had given rise to the payments. In addition, the corporation treated the payments as an expense. On these facts, the Tax Court concluded that the payments were remuneration because the record did not satisfy the *Duberstein* requirement that a gift proceed from a "detached and disinterested generosity." On review, the Court of Appeals for the Fourth Circuit expressed in its opinion that on essentially identical facts in prior cases the Tax Court had held for the widow, and a contrary determination was unwarranted. The decision was vacated and remanded for additional findings, in as much as other recent cases suggested that additional factors, *i.e.*, the widow's corporate holdings and needs, were necessary criteria in determining the

F.2d 143 (10th Cir. 1960). The appellate courts followed the principle laid down in *Duberstein* that their review was limited and primary consideration must be given to the findings of the trier of fact.

40. In *Martin v. Commissioner*, 305 F.2d 290 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962), and *Smith v. Commissioner*, 305 F.2d 778 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962), the Court of Appeals for the Third Circuit affirmed the determination of the Tax Court. On the other hand, the Court of Appeals for the Sixth and Eighth Circuits reversed the Tax Court in *Kuntz v. Commissioner*, 300 F.2d 849 (6th Cir.), *cert. denied*, 371 U.S. 903 (1962), and *Olsen v. Commissioner*, 302 F.2d 671 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962). The Fourth Circuit, in *Poyner v. Commissioner*, 301 F.2d 287 (4th Cir. 1962), vacated and remanded the decision of the Tax Court for additional findings.

41. 284 F.2d 143 (10th Cir. 1960).

42. *Estate of Arthur W. Hellstrom*, 24 T.C. 916 (1955).

43. 197 F. Supp. 223 (E.D. Wis. 1961).

44. 192 F. Supp. 766 (D. Minn. 1961), *aff'd*, 302 F.2d 666 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962).

45. For a discussion of other district court cases since *Duberstein* see Note, *Payments to Widows of Corporate Executives and Employees—Gifts or Income?*, 49 VA. L. REV. 74 (1963).

46. 35 T.C. 65 (1960), *rev'd*, 301 F.2d 287 (4th Cir. 1962).

“dominant reason” and none of the stipulated facts in the case embraced such criteria.

In *Estate of Martin Kuntz, Sr.*,⁴⁷ a widow received payments from a family corporation pursuant to a resolution which declared the payments to be additional compensation for past services. Likewise, the corporation treated the payments as a salary expense. The deceased had been fully compensated, but the Tax Court emphasized the wording of the resolution and held the payments taxable. The Court of Appeals for the Sixth Circuit rejected the contention that the resolution controlled and reversed the decision.

The Court of Appeals for the Eighth Circuit also reversed the decision of the Tax Court in *Estate of W. R. Olsen*⁴⁸ where similar payments were involved. However, there was no significant ownership in the corporation by either the deceased, the widow, or their families. The inference drawn by the Tax Court, based upon a study of the corporate resolution, that the payments proceeded from the constraining force of a moral duty was rejected by the reviewing court.

Payments were made to a widow by a family corporation in *Mildred W. Smith*.⁴⁹ Although, as in the earlier Tax Court cases, the requirements established before *Duberstein* had been met, the Tax Court held the payments taxable. The court pointed out that while weight was given to a decrease in the widow's income, the other sources of income, which were substantial, were not considered. The Court of Appeals for the Third Circuit in affirming expressed the opinion that the conclusion of the Tax Court was permissive and under the *Duberstein* case its review was narrow.

The facts in *Roy I. Martin*⁵⁰ also resembled those in the earlier cases with the payer corporation being closely held by the deceased and his family. Again, the Court of Appeals for the Third Circuit held the determination of the Tax Court not clearly erroneous and supported the court's conclusion that the payments were taxable income. Both courts stressed the failure of the board of directors to adequately consider the needs of the widow and the omission of dividends by the corporation in the past.

47. 19 CCH Tax Ct. Mem. 1379 (1960), *rev'd*, 300 F.2d 849 (6th Cir.), *cert. denied*, 371 U.S. 903 (1962).

48. 20 CCH Tax Ct. Mem. 807 (1961), *rev'd*, 302 F.2d 671 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962).

49. 20 CCH Tax Ct. Mem. 775 (1961), *aff'd*, 305 F.2d 778 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962).

50. 36 T.C. 556 (1961), *aff'd*, 305 F.2d 290 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962).

As a result of these decisions, there now exists a split among the circuits whether the voluntary payments are income or gifts. The Courts of Appeal for the Sixth, Eighth, and Tenth Circuits have either affirmed district court determinations or reversed Tax Court cases which have not allowed the gift.⁵¹ The Fourth Circuit also appears to favor the gift category.⁵² On the other hand, the Third Circuit has upheld Tax Court conclusions classifying the payments as income.⁵³

While the courts which have held the payments to be income have justified their decisions on the language contained in *Duberstein*, the facts in the cases are so similar that an intelligible reconciliation is impossible. The more cases decided, the more pronounced the disagreement becomes.⁵⁴ Ironically, the Court in *Duberstein* stated that factual differences in gift cases will serve as precedent and uncertainty will be somewhat eliminated.⁵⁵ Yet in the face of this conflict, the Supreme Court has denied certiorari.⁵⁶

The facts in the cases recently decided by the Tax Court are typical of the cases before *Duberstein*. The prevalent characteristics are (1) control of the corporation by the widow or her family and (2) the corporation charging the payments against income. In consideration of these circumstances, the present approach of the Tax Court that payments are taxable is sound and reflects good judgment and insight. The court's decisions should be upheld and accepted by the other courts to effect a fair and impartial administration of the tax law.

In reversing its prior position, the court eliminated a gross defect in the tax laws which permitted the corporation to treat the payment as a tax deduction and the widow to treat it as a gift and exclude it from income. If the payment is treated in such a manner, especially in the

51. *Kuntz v. Commissioner*, 300 F.2d 849 (6th Cir. 1962), *reversing* 19 CCH Tax Ct. Mem. 1379 (1960), *cert. denied*, 371 U.S. 903 (1962); *Olsen v. Commissioner*, 302 F.2d 671 (8th Cir. 1962), *reversing* 20 CCH Tax Ct. Mem. 807 (1961), *cert. denied*, 371 U.S. 903 (1962); *United States v. Frankel*, 302 F.2d 666 (8th Cir. 1962), *affirming* 192 F. Supp. 776 (D. Minn. 1961), *cert. denied*, 371 U.S. 903 (1962); *United States v. Kasynski*, 284 F.2d 143 (10th Cir. 1960).

52. *Poyner v. Commissioner*, 301 F.2d 287 (4th Cir. 1962).

53. *Martin v. Commissioner*, 305 F.2d 290 (3d Cir. 1962), *affirming* 35 T.C. 556 (1961), *cert. denied*, 371 U.S. 904 (1962); *Smith v. United States*, 305 F.2d 778 (3d Cir. 1962), *affirming* 20 CCH Tax Ct. Mem. 775 (1961), *cert. denied*, 371 U.S. 904 (1962).

54. For a detailed discussion of the cases that followed in both the Tax Court and district courts see Note, *supra* note 45.

55. 363 U.S. 278, 290 (1960).

56. *Kuntz v. Commissioner*, 300 F.2d 849 (6th Cir.), *cert. denied*, 371 U.S. 903 (1962); *Martin v. Commissioner*, 305 F.2d 290 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962); *Olsen v. Commissioner*, 302 F.2d 671 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962); *Smith v. Commissioner*, 305 F.2d 778 (3d Cir.), *cert. denied*, 371 U.S. 904 (1962); *United States v. Frankel*, 302 F.2d 666 (8th Cir.), *cert. denied*, 371 U.S. 903 (1962).

context of the closely held corporation, a tax avoidance is possible that challenges the integrity of the tax system. The large number of cases litigated during the last decade indicates the increased use of corporate payments to widows.⁵⁷ The practice would inevitably have caused Congress to enact corrective legislation. The enlightened treatment by the Tax Court somewhat reduces the need for this remedy.

Where transactions between related persons have occurred in other situations, they have been subjected to close examination. This is especially so with controlled corporations.⁵⁸ The courts and Congress have already expressed their aversion to such transactions. The courts have utilized the doctrines of anticipatory assignment of income⁵⁹ and constructive dividends⁶⁰ to thwart taxpayers who deal with closely held corporations from avoiding taxation. Congress, on the other hand, has enacted legislation that disallows losses and certain expenses between corporations and those who control them.⁶¹ This disallowance applies not only to those who maintain direct control, but also to someone whose family controls it.⁶² Based upon these pronouncements, there is inherent in the tax system a policy that transactions between corporations and related taxpayers are to receive close scrutiny, and if questionable, are to be denied the treatment accorded those engaged in arm's length transactions. The reasons for such a policy justify its existence. Often, nothing more than tax saving motives underly these transactions,⁶³ and no real change in the economic interests of the parties occurs.⁶⁴

This policy should be applied to the payments to widows. Because of the control that prevails, the payment can be made at the whim of the recipient, if a tax saving motive exists. The absence of an arm's length transfer denies the assurance that a "detached and disinterested generosity"⁶⁵ gave rise to the payment. Moreover, the close ownership does not change the total economic interests of the widow, her family, and the corporation.

57. For a collection and discussion of those cases see Pelisek, *supra* note 14.

58. Higgins v. Smith, 308 U.S. 473 (1940) (loss on sale to controlled corporation); Gregory v. Helvering, 293 U.S. 465 (1935) (corporate reorganization).

59. Griffiths v. Commissioner, 308 U.S. 355 (1939), *affirming* 103 F.2d 110 (7th Cir.).

60. Smith v. Manning, 189 F.2d 345 (3d Cir. 1951) (salaries); United States v. E. Regensburg & Sons, 144 F.2d 41 (2d Cir. 1944) (loans); Timberlake v. Commissioner, 132 F.2d 259 (4th Cir. 1942) (sale of property at less than fair market value).

61. INT. REV. CODE OF 1954, § 267(a)(1).

62. INT. REV. CODE OF 1954, § 267(c)(2).

63. P.G. Lake, Inc. v. Commissioner, 148 F.2d 898, 900 (5th Cir.), *cert. denied*, 326 U.S. 732 (1945).

64. McWilliams v. Commissioner, 331 U.S. 694, 699 (1947).

65. Commissioner v. Duberstein, 363 U.S. 278, 285 (1960).

With the widow or her family controlling the payer corporation, any factual determination concerning the transfer and the intent of the parties becomes difficult.⁶⁶ Under such circumstances, the opportunity to remove corporate income from taxation exists and is inviting. The conduct and the testimony of the family directors becomes inconsistent when the interests of the corporation and the widow are presented alternatively.⁶⁷ The controlling criteria articulated by the Court in *Dubersstein* to determine intent are elusive enough without the further complexity of a controlled corporation. When that type of corporation is injected into the problem, a determination becomes impossible.

To permit the widow to exclude the payment from gross income presents an opportunity to use her as a conduit to funnel corporate profits to other members of the family. Also, the payments can be used in an informal manner to buy out the widow by the other family members or to keep her out of the business. These possible abuses in themselves may be sufficient to justify the position of the Tax Court. However, there are other reasons to require the inclusion of the payment in gross income.

Where the widow, directly or indirectly, controls the corporation, the existence of the corporate entity in effect enables her to make a gift to herself. Had the business been organized as a proprietorship, rather than a corporation, the ability to exclude a portion of business income from taxation would be removed. If the widow is permitted to exclude business income from all taxation, she obtains preferential treatment over those who have selected other types of business organizations. No such preferred treatment has been provided in the Code. To the contrary, the Code requires that the income of the corporation be taxed initially⁶⁸ and that the same income is taxed again when distributed.⁶⁹

In other cases where a shareholder receives payments or property from a corporation in other than a bona fide transaction, the courts have held the transfer to be constructive dividends and taxable to the recipients.⁷⁰ The payments to widows, which may reasonably be classified as dividends since no services were performed, results in a denial of equal treatment to shareholders in other corporations if they are excluded

66. *McWilliams v. Commissioner*, 331 U.S. 694, 698 (1947).

67. An example of equivocation is *Estate of Albert W. Morse*, 17 CCH Tax Ct. Mem. 261 (1958). There the officers of the controlled corporation claimed that the payments were salary when the return of the corporation was examined. However, in testifying before the Tax Court, they stated that a gift was intended.

68. INT. REV. CODE OF 1954, § 11(a).

69. INT. REV. CODE OF 1954, § 62(a)(7).

70. *Smith v. Manning*, 189 F.2d 345 (3d Cir. 1951) (salaries); *United States v. E. Regensburg & Sons*, 144 F.2d 41 (2d Cir. 1944) (loans); *Timberlake v. Commissioner*, 132 F.2d 259 (4th Cir. 1942) (sale of property at less than fair market value).

from gross income. For a fair and impartial administration of the tax law to be effected, the widow should be placed in the same position as other shareholders who transact business with corporations they control.

While recognition of the corporate entity is found in the Code,⁷¹ corporate transactions have been disregarded where used primarily to avoid taxes.⁷² The courts have looked to the substance of the transaction and not merely its form. In the present case, the niceties or form of a common law gift should be disregarded, and the substantive nature of the transfer should be recognized for what it is, *i.e.*, an attempt to eliminate profits from taxation. Where the corporation is permitted to charge the payments against income, the widow should be required at least to include them in gross income so that the income is taxed somewhere.

Even where control of the corporation does not exist in the widow or her family tax inequality may prevail. One such area is the taxation of voluntary pensions.⁷³ The facts in both situations are somewhat similar. Neither of the recipients perform services while receiving the voluntary payments and the payments originate from past employment. The only significant difference is that in one case the former employee is paid directly while in the other payment is made to the deceased employee's wife. If the employee retires and his salary is continued it is taxed, but if he dies and his widow receives the same amount, it is exempt. To exempt the payments to the widow from taxation discriminates against the pensioner. Moreover, the wife of the retired employee should be considered as she enjoys indirectly as much benefit from the payments received by her husband as does the widow from payments received directly. This point is more apparent in states which have community property laws where the wife obtains a legal interest in the payments.⁷⁴ Therefore, taxation of retirement pay while exempting payments made to a widow also discriminates against the pensioner's wife.

The courts have held that where a well established plan or pattern exists in making the payments to widows by an employer, exclusion is not permitted.⁷⁵ The reason for the distinction is that the company obtains an economic benefit by retaining valuable employees when they are assured their widows will be provided for. The payment appears to be classified as additional compensation under such circumstances. While

71. INT. REV. CODE OF 1954, § 11.

72. *Higgins v. Smith*, 308 U.S. 437 (1940) (loss on sale to controlled corporation); *Gregory v. Helvering*, 293 U.S. 465 (1935) (corporate reorganization).

73. INT. REV. CODE OF 1954, § 62(a)(11).

74. *Poe v. Seaborn*, 282 U.S. 101 (1930).

75. *Simpson v. United States*, 261 F.2d 479 (7th Cir. 1958).

the reasoning of the courts is plausible, from the point of view of the widow being taxed the distinction appears to be unfair and discriminatory. Neither of the widows performed services nor have they done anything to give rise to the payments. However, because one widow's husband happened to be employed by a corporation that had a plan, she must be taxed on the payments.

It is apparent that underlying the decisions that hold the payments to be gifts is sympathy for the widow. This sentiment is manifested in the statement of Chief Judge Sobeloff of the Court of Appeals for the Fourth Circuit:

Not the least of the difficulties often faced by a recently widowed woman is the loss of her husband's financial support. However, for many widows of ranking employees in companies, the cause for worry has been alleviated by the practice of the employer making payments to the widow for limited periods following the husband's death. . . .⁷⁶

While the plight of the widow is readily perceived, and may be recognized to a limited extent in the Internal Revenue Code,⁷⁷ it is questionable whether the tax law should be interpreted in a manner that converts income to exempt life insurance proceeds. Even if there is sentiment for the position of the widow, the considerations of other taxpayers should be weighed. They are burdened as well as the widow by taxation. It is well established that equitable considerations have no place in the laws of taxation.⁷⁸ A fair and impartial administration of the tax laws is more fundamental.

In summary, the present position of the Tax Court is correct and represents a full understanding of the problem. The inequities that existed in the law prior to *Duberstein* are eliminated by its approach. The other taxpayers who are engaged in business or receive voluntary payments are afforded equal tax treatment as a result. The present conflict that exists among the circuits concerning the taxability of the payments should be resolved in favor of the Government to affirm the integrity of the tax law in this area. If the other courts do not reverse their position, the Supreme Court or Congress will have to remedy the situation.

76. *Poyner v. Commissioner*, 301 F.2d 287, 289 (4th Cir. 1962), *reversing sub nom.* Estate of Mervin G. Pierpont, 35 T.C. 65 (1960).

77. INT. REV. CODE OF 1954, § 2, provides some tax relief to a surviving spouse by computing the tax liability on the split income provision for two years after the death of the spouse.

78. *Lewyt Corp. v. Commissioner*, 349 U.S. 237 (1955).