Summer 1967

Federal Estate Tax--Inter Vivios--Transfers Under Sections 2035-38--Taxation of Income Earned Between Transfer and Death

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Under the federal estate tax certain inter vivos transfers of property result in the inclusion of the property in the transferor's gross estate. The included property is valued as of the date of his death. Where the property transferred is income producing, the amount included in gross estate could be: (1) the property originally transferred, (2) the property originally transferred and all income earned by it between the transfer and death, or (3) the property originally transferred and part of the income earned by it between the transfer and death. The Internal Revenue Code of 1954 does not explicitly designate the property includable, but a few cases and a Treasury regulation have decided the question in particular fact situations. This note reviews these decisions and analyzes their rationale. The note also considers whether the present law is consistent with sound tax policy and constitutes a proper interpretation of the Code.

I. Review of the Present Law and Consideration of Its Probable Application

The federal estate tax requires inclusion in gross estate of property subject to two types of inter vivos transfers: transfers in contemplation of death and transfers with retention of a string by the transferor.

1. INT. REV. CODE OF 1954, §§ 2035-38, quoted in notes 4 and 5 infra.
2. INT. REV. CODE OF 1954, § 2031(a):
   (a) General.—The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.
3. In order to isolate the interim income problem, it is assumed that the property originally transferred is intact in the hands of the transferee at the transferor's death. It is realized that when the property has been sold or otherwise disposed of, there are numerous other valuation problems.
4. 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, or exercised or released a general 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
The present law on taxation of income earned between the date of the transfer and the transferor's death distinguishes between these two types of transfers.

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.

5. **INT. REV. CODE OF 1954, § 2036:**
   (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, 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,
   (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.

   (b) **LIMITATION ON APPLICATION OF GENERAL RULE.**—This section shall not apply to a transfer made before March 4, 1931; nor to a transfer made after March 3, 1931, and before June 7, 1932, unless the property transferred would have been includible in the decedent's gross estate by reason of the amendatory language of the joint resolution of March 3, 1931 (46 Stat. 1516).

**INT. REV. CODE OF 1954, § 2037:**
   (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 after September 7, 1916, 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, if—
   (1) the possession or enjoyment of, or the right to the income from, the such interest, be obtained only by surviving the decedent, and
   (2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property. [Section (b) on Special Rules omitted.]

**INT. REV. CODE OF 1954, § 2038:**
   (a) **IN GENERAL.**—The value of the gross estate shall include the value of all property—
   (1) **TRANSFERS AFTER JUNE 22, 1936.**—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, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death.
   (2) **TRANSFERS ON OR BEFORE JUNE 22, 1936.**—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, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in
Section 2035: Transfers in Contemplation of Death

Commissioner v. Gidwitz' Estate and Burns v. Commissioner held that income earned between the inter vivos transfer in contemplation of death and the transferor's death is not includable in the transferor's gross estate. That position is also taken in a Treasury regulation. The cases advanced several reasons for this exclusion. One was that a transfer in contemplation of death is completed when made, and therefore only the property originally transferred should be included. Another was that the Code does not explicitly provide for the inclusion of income earned by the transferred property and should be strictly construed in favor of the taxpayer. A third reason was that the transferor does not make a transfer of the income. The argument was that since section 2035 requires a transfer, that transfer releases all the transferor's interest in the property, including his interest in the income subsequently earned by it.

The recent Supreme Court decision in United States v. O'Malley may indicate how interim income will be treated in future section 2035 cases. The case dealt with a transfer of property with a retained life estate and held the income accumulated in a trust includable in the transferor's gross estate, but the Court commented on transfers in contemplation of death. In discussing Gidwitz and Burns, the Court said:

The courts in those cases considered the taxable event to be a completed inter vivos transfer, not a transfer at death, and the property includable to be only the property subject to that transfer. The value of that property, whatever the valuation date, was apparently deemed an adequate reflection of any income rights included in the transfer since the grantor retained no interest in the property and no power over income which

conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph. [Section (b) on Date of Existence of Power and section (c) on Effect of Disability in Certain Cases omitted.]

6. 196 F.2d 813 (7th Cir. 1952), aqg., 1966-1 CUM BULL. 2.
7. 177 F.2d 739 (5th Cir. 1949), aqg., 1966-1 CUM BULL. 2.
10. Burns v. Commissioner, 177 F.2d 739, 741 (5th Cir. 1949).

Thus, the Court recognized that income rights were transferred with the original transfer of the property, but deemed that the valuation of the property at death reflected these income rights. The Court imputed rationale to the courts in Burns and Gidwitz. In recasting these two decisions, the Court reached an interpretation that might conflict with prior law in contemplation of death cases. While the two prior cases did not find a transfer of interim income, O'Malley found a transfer of the income with the original transfer of the property. The argument can be made that both the income and the property were transferred in contemplation of death and therefore should be included in gross estate.

This interpretation of the dicta in O'Malley is weakened by the Court's citation of Maass v. Higgins. 14 Maass held that income accrued between the date of death and the alternate valuation date was excluded from the alternate valuation. The Court reasoned that the valuation of the property alone at the alternate date included the value of the income because property is generally valued by considering its anticipated income. If O'Malley requires the application of the Maass reasoning to contemplation of death cases, 15 the valuation of the property at death would include the value of any income rights included in the original transfer.

The O'Malley opinion, by the phrase, "the courts . . . considered the taxable event to be a completed inter vivos transfer, not a transfer at

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14. 312 U.S. 443 (1941).
15. Gidwitz applied Maass to reject the Commissioner's argument that the interim income should be included in gross estate. Burns does not explicitly discuss Maass but cites it as support for excluding interim income. The tax court has rejected using Maass in contemplation of death cases, reasoning that the case lacks sufficient closeness. Estate of James E. Frizzell, 9 T.C. 979 (1947), aff'd sub nom. Burns v. Commissioner, 177 F.2d 739 (5th Cir. 1949).
16. It seems doubtful that the reasoning in Maass is correct. In rationalizing why income earned subsequent to the date of death should be excluded from the alternate valuation, a conclusion which seems correct when reached by different reasoning, the court maintained that the promise to pay income does not have any market value apart from the asset and that property is not separately valued for the right to receive interest and the other ownership elements. This argument is correct for the valuation of property at one point in time; but the argument seems invalid when the valuation is of the economic benefit which passed from the transferor to the transferee over a period of time. For example, assume the transferor transfers property worth $10,000 at the date of transfer, the property earns $600 between the transfer and death, and the property is still worth $10,000 at the date of death. The value of the property at death is $10,000; but the value of the economic benefit received by the transferee, measured at the transferor's death, is $10,600.
death . . . ," also hints that the Court may believe that the transfer in contemplation of death should be considered a transfer at death rather than a transfer inter vivos. Under this interpretation, gross estate would include both the property and the interim income since both would have been in the transferor's gross estate had there been no transfer.18

Sections 2036-38: Transfers With a String Attached

In order to include in gross estate property transferred by inter vivos transfers that do not take effect until the death of the transferor, the Code has three sections that reach the different varieties of these transfers.19 All three require a transfer of property with the retention of a string by the transferor. The sections differ only in the nature of the interest retained and the identity of the property required to be included in the transferor's gross estate.20 For purposes of this discussion the sections can be considered together since there are no significant differences.

It is difficult to generalize concerning the treatment of interim income from property transferred with retention of an interest. While the cases are consistent on the amount of property included in gross estate, their reasoning is generally unclear, inconsistent with the result, or based on an inadequate consideration of the problem.

The cases hold that the income accumulated in a trust at death is includable in gross estate in several situations.21 In all of the cases except one,22 the transferor transferred property to a trust of which he was a co-trustee with a party or parties not having a substantial adverse interest23 and retained the discretionary power as trustee to accumulate or distribute current income until his death. In these cases the transferor also retained the discretionary power to distribute corpus,24 the discre-

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18. Since the cases have dealt only with transfers to a trust, another possible difficulty is the treatment of interim income when there is a non-trust transfer in contemplation of death. However, there seems to be no reason why non-trust transfers should be treated differently. The regulation does not distinguish between trust and non-trust transfers. Treas. Reg. § 20.2035-1(e) (1958).
21. United States v. O'Malley, 383 U.S. 627 (1966); Round v. Commissioner, 332 F.2d 590 (1st Cir. 1964); Estate of E. A. Showers, 14 T.C. 902 (1950), remanded by stipulation P-H 1952 FED. TAX SERV. ¶ 71027 (5th Cir. 1951); Estate of Cyrus C. Yawkey, 12 T.C. 1164 (1949).
23. Under §§ 2036 and 2038, it would seem that even if the transferor were co-trustee with a person who had a substantial adverse interest, the accumulated income would be includable in this instance. Treas. Reg. § 20.2036-1(b)(3) (1958); Treas. Reg. § 20.2038-1(a) (1958). There is an exception for § 2038 transfers before June 2, 1924. Treas. Reg. § 20.2038-1(d) (1958).
tionary power to distribute accumulated income, the power to distribute corpus subject to an ascertainable standard, or no power to distribute corpus. Despite these variations, in all cases the entire corpus (and thus accumulated income) was included in gross estate under either section 2036(a)(2) or both section 2036(a)(2) and section 2038.

In one other case, the transferor did not retain the discretionary power to accumulate or distribute current income. He transferred property to himself as sole trustee, and the trust agreement required him to accumulate income and add it to corpus, but gave him as trustee the discretionary power to distribute corpus. The entire trust corpus, including accumulated income, was included in gross estate under section 2038. Since the transferor had no control over the accumulation of the income, the case seems to hold that accumulated income will be taxed as a part of the corpus at the transferor's death whether or not the transferor himself decided to accumulate it if the transferor had a string attached to the accumulated income as a part of corpus at the time of his death.

While it is possible to draw some general conclusions from the factual situations in the cases litigated, it is difficult to extend them to other factual situations because of the imprecise reasoning in the cases. One line of reasoning is that if the retention of a string on the property itself causes its inclusion in gross estate, the retention of the same string on the income from the property should cause its inclusion. This reasoning is imprecise because it is concerned only with finding a string attached to the income; it is not concerned with finding a transfer of the income. To some extent, the other line of reasoning does recognize the transfer of income problem, and the cases do find transfers of the income. In those cases, however, transfers are found by various methods, each capable of producing a different result.

28. Ibid. The case was decided under the predecessor to § 2036, Int. Rev. Code of 1939, § 811(c)(1)(B).
29. Round v. Commissioner, 332 F.2d 590 (1st Cir. 1964); Estate of Cyrus C. Yawkey, 12 T.C. 1164 (1949). The latter case was decided under the predecessors to the current Code sections, Int. Rev. Code of 1939, §§ 811(c)(1)(B), (d)(1).
33. See note 39 infra and accompanying text for the method whereby transfers were found by Round v. Commissioner, 332 F.2d 590 (1st Cir. 1964), and Estate of E. A. Showers, 14 T.C. 902 (1950), remanded by stipulation P-H 1952 Fed. Tax Serv. ¶ 71027 (5th Cir. 1951), and the inclusion it might produce. The interpretation of the methods whereby
In predicting the treatment of interim income in future section 2036-38 cases, the major obstacle is the *O'Malley* decision. As already noted, the dicta in the case on contemplation of death transfers is confusing. The holding, which concerns a transfer with a retained life estate but is also applicable to the other incomplete transfer sections, is equally perplexing. As one authority points out, the reasoning is subject to three interpretations, each of which would produce a different result. In *O'Malley*, however, the Court at least attacked the main problem in the treatment of interim income: whether there has been a transfer of the income when income producing property is transferred with retention of a string by the transferor until death.

One interpretation of *O'Malley* is that the income is transferred when the property is originally transferred. If this event is the transfer, it is arguable, as in the contemplation of death transfers, that *Maass* applies and requires the valuation of the property alone including the value a transfer was found by *O'Malley* and the inclusion they might produce are in the text immediately following.

34. In predicting the treatment of interim income in future §§ 2036-38 cases, there may be difficulty with non-trust transfers since the litigated cases have all been trust cases. However, there seems to be no reason why non-trust transfers should be treated differently. Moreover, a non-trust transfer of property with a string attached is unlikely. Prediction might also be made difficult by the absence of cases dealing with § 2036(a)(1) (transfer of property with retention of possession, enjoyment, or income in the transferor) or with § 2037 (transfer with a retained reversionary interest). However, because of the similarity of §§ 2036-38, the cases arising under § 2036(a)(1) and § 2037 should be governed by the reasoning of the cases litigated under §§ 2036(a)(2) and 2038.

35. The Court’s transfer language, 383 U.S. 627, 632 (1966):

The dispute in this case relates to . . . whether Fabrice had ever “transferred” the income additions to the trust principal . . . . [W]e are sure that he had. At the time Fabrice established these trusts, he owned all of the rights to the property transferred, a major aspect of which was his right to the present and future income produced by that property. With the creation of the trusts, he relinquished all of his rights to income except the power to distribute that income to the income beneficiaries or to accumulate it and hold it for the remainder-men of the trusts. He no longer had, for example, the right to income for his own benefit or to have it distributed to any other than the trust beneficiaries. Moreover, with respect to the very additions to principal now at issue, he exercised his retained power to distribute or accumulate income, choosing to do the latter and thereby adding to the principal of the trusts. All income increments to trust principal are therefore traceable to Fabrice himself, by virtue of the original transfer and the exercise of the power to accumulate. Before the creation of the trusts, Fabrice owned all rights to the property and to its income. By the time of his death he had divested himself of all power and control over accumulated income which had been added to the principal, except the power to deal with the income from such additions. With respect to each addition to trust principal from accumulated income, Fabrice had clearly made a transfer . . . . [Citations omitted.]


uation of income rights. Or, if Maass does not apply, it is arguable that all income earned between the transfer and death, whether or not subject to a string at the transferor's death, is includable in the transferor's gross estate since it was part of the original transfer of the property. Both arguments result in an inclusion of property different from that in O'Malley wherein the income accumulated in the trust at the transferor's death was included.

Another interpretation of O'Malley is that the income is transferred when the transferor-trustee exercises his discretionary power to accumulate it. Under this interpretation, future cases might hold that there is no transfer unless the transferor exercises a power over the income as it is received. Thus, if the trust agreement required that income be accumulated or gave a discretionary power to accumulate income to a trustee who was not the transferor and the transferor retained only the discretionary power to terminate the trust or a reversionary interest in the trust, the court would not find a transfer of income by the transferor, and the income would be excluded from gross estate. Also, this theory of transfer might require the inclusion of distributed as well as accumulated income since both are transferred by the transferor's exercise of his retained power. This is unlikely, however, because the transfer must be one with a string attached to the property transferred. There is no string attached to the distributed income. Also, O'Malley included only accumulated income, not distributed income.

A third interpretation of O'Malley is that the income is transferred at the transferor's death when the transfer is completed. The income includable is the income subject to a string at the transferor's death. Inclusion of this amount is in accordance with the amounts included in the previous section 2036-38 and in the O'Malley case. The theory does not find an inter vivos transfer of property which sections 2036-38 require. However, it is arguable that section 2033, which requires the inclusion of property in which the decedent had an interest at death,
requires the inclusion in gross estate of the income subject to a string as of the transferor's death.

II. Consideration of Tax Policy

The review of the present law and consideration of its probable application indicate an uncertainty concerning how interim income will be taxed. In general, interim income has been excluded from gross estate where there has been a section 2035 transfer and has been included where there has been a section 2036-38 transfer with retention of a string on the income at the date of the transferor's death. The natural question is whether there are overriding tax policy considerations that cause a different inclusion depending on the type of transfer. The cases lack discussion of tax policy, but various writers have discussed the policy reasons for including or excluding interim income.

Section 2035: Transfers in Contemplation of Death

There are several arguments for including interim income in gross estate when there has been a transfer of income-producing property in contemplation of death. The first is that exclusion of interim income creates a tax loophole. For example, a transferor who controlled a closely-held corporation could transfer his stock in contemplation of death and immediately thereafter declare a substantial extraordinary dividend. If the stock were includable in the transferor's gross estate, it would be valued as of the date of his death. Since the dividend would probably cause the value of the stock to decline, the estate tax would be computed on a reduced value of the property if the dividend were not also included in gross estate. This tax loophole could be closed by two methods other than including all interim corporate distributions in gross estate. One method would be valuing the property transferred in contemplation of death as of the date of the original transfer. However, this solution is impossible without statutory amendment since the Code requires the valuation of property as of the date of death. The other method would be including the amount of extraordinary dividends in gross estate. This would require the court to determine whether dividends were ordinary dividends from current income or extraordinary dividends from the retained income of the corporation, a difficult task.

43. 61 Harv. L. Rev. 891 (1948); 54 Mich. L. Rev. 577 (1956); 51 Nw. U.L. Rev. 149 (1956); 58 Yale L.J. 313 (1949).
44. 54 Mich. L. Rev. 577, 579 (1956); 51 Nw. U.L. Rev. 149, 151 (1956).
in most situations. Therefore, including all interim corporate distributions in gross estate seems the best method of closing the tax loophole.

Another argument for including interim income in gross estate when there has been a transfer in contemplation of death is that one who transfers income-producing property in contemplation of death has the motive of keeping the interim income as well as the property itself out of his gross estate. Therefore, in order to avoid a tax loophole, both the property and the interim income should be included in the gross estate of the transferor. This argument seems valid; taxpayers should not be prevented from keeping property out of gross estate by a transfer in contemplation of death but allowed to succeed in keeping its future income out of gross estate by the same transfer.

Another argument asserts that for administrative simplicity, only the property originally transferred, and not subsequent income, should be included in gross estate. To evaluate this expediency argument, it must be remembered that there are further complications if the original property transferred has been sold or exchanged by the transferee. When that is the case, the original property is traced to the property acquired by the transferee, and the substituted property is valued as of the date of the transferor's death. This tracing is difficult in cases involving both trust and non-trust transfers. In non-trust transfers, it is difficult because the transferee usually does not have adequate records. In trust transfers, if there have been distributions of corpus to beneficiaries, there are the same difficulties of tracing because the beneficiary usually does not keep adequate records. The intricacies of tracing the original property through several dispositions are compounded if income earned by the original property and by its substitutions must be traced. However, it is arguable that the tracing of the income earned does not involve much additional difficulty once the property itself has been traced. Also, the cases have traced the property even though tracing is intricate. The statutory limit of three years for transfers in contemplation of death offers some relief.

Another expediency argument, which assumes that some interim

47. See note 53 infra and accompanying text.
49. 61 HARV. L. REV. 891, 892 (1948).
50. Increases in the value of the original property transferred through sales of that property and reinvestment of the proceeds in other property have been held includible in the gross estate. In re Kroger's Estate, 145 F.2d 901 (6th Cir. 1944); Holderness v. Commissioner, 86 F.2d 157 (4th Cir. 1936); Igleheart v. Commissioner, 77 F.2d 704 (5th Cir. 1935); Estate of Daniel Guggenheim, 40 B.T.A. 181 (1939). But cf., Humphrey's Estate v. Commissioner, 162 F.2d 1 (5th Cir. 1947).
51. Ibid.
52. INT. REV. CODE OF 1954, § 2035, quoted in note 4 supra.
receipts are includable in gross estate, is that including all receipts is
easier than distinguishing between receipts of income and receipts of
principal in order to include only receipts of principal. Separating
principal from income in the law of trusts when there are separate in-
come and principal beneficiaries creates the same problem. Statutes
have been passed to solve the problem for trusts; it is evident from the
statutes that the legislatures found equity impossible in some instances.

When the property transferred is corporate stock, the inclusion of
dividends in gross estate is necessary for consistency with the indirect in-
cclusion of interim income in gross estate when dividends are not paid. If
the corporation retains current earnings, the value of the stock generally in-
creases proportionally, and the earnings are included in gross estate
as a part of the property valuation. But when the corporation distributes
current earnings, the income is excluded from gross estate if only the
value of the stock is included. As an alternative to including dividends,
dividends and increases in stock value resulting from retention of earnings
could be excluded in order to have consistency. However, the latter
alternative is not feasible since determining what effect the retained earn-
ings had on stock value would be difficult.

An argument for exclusion of interim income earned by property
transferred in contemplation of death is that the transferor should not
be taxed on what he could not control. However, the transferor is
taxed on the increase in value of the property or the substituted property
between the transfer and death, which he could not control. The estate
tax subjects the transferor to certain risks irrespective of his control.

It might be argued that excluding income earned between transfer and
the date of death is consistent with excluding income earned by property
included in gross estate between the date of death and the alternate valua-
tion date. The regulations under section 2032 define included and ex-
cluded property and value only included property at the alternate valuation
date. In general, the regulations exclude income received between the

53. For example, are the following income or a return of principal: stock dividends,
liquidating dividends, stock rights, income from wasting assets where no provision is made
for depletion, and discount bond increments?
54. 3 Scott, Trusts §§ 232-41 (2d ed. 1956).
55. E.g., Uniform Principal and Income Act; Revised Uniform Principal and Income Act.
56. The problem of treatment of dividends when paid out of earnings retained by
the corporation before the creation of the trust has been solved by a rule which is simple
rather than equitable. The Revised Uniform Principal and Income Act § 6(b) adopts the
general rule that cash dividends are income and stock dividends are principal.
57. 51 Nw. U.L. Rev. 149, 151 (1956).
58. 58 Yale L.J. 313, 316 (1949).
59. See cases cited in note 50 supra.
60. 61 Harv. L. Rev. 891 (1948).
date of death and the alternate valuation date if the income is earned during that period. The rationale is that only the property existing at death is valued one year later by this method.

To evaluate this argument it must be determined if consistency is desirable. Section 2032, which values property includable in gross estate one year after the date of death, was enacted to prevent an estate's being confiscated by estate taxes computed on high values of property when the values decline rapidly soon after the decedent’s death. Section 2035 was enacted to prevent avoidance of the estate tax by transfers of property when the transferor contemplates death. The latter purpose is achieved by including what would have been in the transferor's gross estate had there been no transfer, that is, the property and its interim income.

This evaluation of tax policy reveals several valid arguments for inclusion of the interim income when income-producing property is transferred in contemplation of death, the strongest being that exclusion from gross estate creates a tax loophole. The only valid argument for exclusion is that it is difficult to determine the income earned between the transfer and death. In balancing the two arguments, it would seem that if at all possible, the tax loophole should be closed even if administrative convenience is sacrificed. Since the present law excludes all interim income from property transferred in contemplation of death, it is not consistent with sound tax policy.

Sections 2036-38: Transfers With a String Attached

The tax policy arguments for inclusion or exclusion in gross estate of interim income when property is transferred with a string attached are similar to the arguments already presented for transfers in contemplation of death, with the qualification that only interim income to which a string is attached is includable. Some contemplation of death arguments for inclusion and their evaluation are equally applicable to transfers with a string attached: exclusion may create a tax loophole if a controlling shareholder transfers closely held corporation stock, including all in-

62. For example, the following are excluded if earned between death and the alternate valuation date: interest, rent, and amortization of discount on interest-bearing obligations. Ordinary dividends declared to stockholders of record after death are excluded, but liquidating dividends or stock dividends are included if paid from income earned prior to death. Treas. Reg. § 20.2032-1(d) (1958).
64. United States v. Wells, 283 U.S. 102, 116 (1931). The definition of “in contemplation of death” in the regulations is (1) for the purpose of avoiding death taxes, (2) as a substitute for a testamentary disposition of the property, or (3) for any other motive associated with death. Treas. Reg. § 20.2035-1(c) (1958).
65. See note 44 supra and accompanying text.
terim receipts is administratively easier;\textsuperscript{66} and if corporation stock is transferred, including dividends paid in gross estate is necessary for consistency.\textsuperscript{67} The rejection of the exclusion argument that the transferor should only be taxed on what he controls also applies to transfers with a string attached.\textsuperscript{68} The following arguments are different.

The argument that income earned between the transfer and the date of death should be excluded to be consistent with excluding income earned by property included in gross estate between the date of death and the alternate valuation date is also made for transfers with a string attached. However, consistency again does not seem desirable. Sections 2036-38 were enacted to prevent avoidance of the estate tax by transfers of property with the retention of such a string on it that it is not completely transferred until the transferor's death.\textsuperscript{69} This purpose is achieved by including in the transferor's gross estate that property which is not completely transferred until his death, that is, the property and the interim income to which he has a string attached as of the date of his death.

To avoid a tax loophole one who transfers income-producing property with the retention of a string on the interim income and the property should be taxed on all the property which is not effectively transferred until his death. Therefore, both the property and the income subject to the transferor's retained string at his death (but not necessarily all the original property or all the interim income) should be included in gross estate.

The argument for administrative convenience is also different for section 2036-38 transfers. First, practically all transfers with a string attached are in trust.\textsuperscript{70} Second, since only property subject to a string at the transferor's death in includable, there is no need to trace property after it has been distributed to a beneficiary with no further strings attached. Therefore, the gross estate would generally include only the trust corpus at the transferor's death. This inclusion is expedient for tax administration because it requires no tracing.

In summary, all tax policy considerations require the inclusion in gross estate of income accumulated in a trust at the death of the transferor if the property was transferred with a string attached to the interim income as well as to the property and if the string were still

\textsuperscript{66}. See note 53 \textit{supra} and accompanying text.
\textsuperscript{67}. See note 57 \textit{supra} and accompanying text.
\textsuperscript{68}. See note 58 \textit{supra} and accompanying text.
\textsuperscript{69}. This can be concluded from the earlier statutory wording that transfers "intended to take effect in possession or enjoyment at or after his death" are included. Revenue Act of 1916, ch. 463, § 202(b), 39 Stat. 777. This section was the predecessor of §§ 2036-38.
\textsuperscript{70}. To have an effective string attached to the property, the transfer is generally made by a formal trust arrangement.
attached as of the date of his death. The present law on including accumulated income where there is a string attached seems to be carrying out this sound tax policy.

III. Consideration of Present Statutory Requirements

As noted earlier the review of the present law and consideration of its probable application indicate an uncertainty concerning how interim income will be taxed. Also, the consideration of tax policy reveals that the present law is contrary to sound policy in contemplation of death cases. The natural question is whether the Code is deficient in these respects or has simply been misinterpreted.

Sections 2035-38 require inclusion in gross estate of "the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer." Cases and regulations have also stated that the estate tax is on transfers of property. The critical words for interpretation in applying the statute are, of course, "property" and "transfer."

The word "property" has several definitions in property law. Property can be defined as that to which a person has legal title. Applying this definition to interim income, a court would have to conclude that it is not property if the transferor never held title to it. Another definition of property is that which a person possesses or has the right to possess. Applying this definition, a court would have to conclude that interim income is not property unless the transferor had possession or the right to possession. Property can also be defined as a bundle of rights. Under this definition, a court would have to conclude that interim income is property if the transferor had an interest in it.

Sections 2035-38 all contain the wording "the value of all property to the extent of any interest therein." This language seems to militate

72. E.g., United States Trust Co. v. Helvering, 307 U.S. 57, 60 (1939); Treas. Reg. § 20.0-2(a) (1958). The estate tax was held constitutional in New York Trust Co. v. Eisner, 256 U.S. 345 (1921), which made reference to Knowlton v. Moore, 178 U.S. 41 (1900). The latter case emphasizes that the tax is on a transfer of property.
73. While the Restatement of Property rejects use of "title," Restatement, Property § 10 (1936), the comments point out that in common speech "title" signifies ownership or facts that result in ownership. Id. comment c.
74. The Restatement of Property, while discussing interests in land, points out a distinction between possessory and nonpossessory interests. Restatement, Property § 7 (1936).
75. This is the property theory used in O'Malley. The Restatement of Property defines an interest "to include varying aggregates of rights, privileges, powers and immunities and distributively to mean any one of them." Restatement, Property § 5 (1936). It then defines an owner as a "person who has one or more interests." Restatement, Property § 10 (1936).
76. Emphasis added.
against the first two theories which require title or possession. Also, several decisions have disclaimed finding these particular types of property for federal estate tax inclusion. Therefore, the definition of property as any interest seems to be correct.

The real difficulty has been interpreting the word "transfer." If it is assumed that "transfer" means an act which passes an interest from the transferor to the transferee, three interpretations of when the transfer of interim income occurs are possible. These three interpretations and their possible resulting differences in amounts includable in gross estate were noted earlier in connection with the effect of O'Malley on the law of transfers with a string attached. If income were transferred when the property was originally transferred, arguments could be made to exclude or include the interim income depending on whether the Maass reasoning applies. If the income were transferred when the transferor-trustee, as the income was received, exercised his discretionary power to accumulate it, then there would be no transfer of income where the transferor had no discretionary power to exercise, for example, transfers in contemplation of death, revocable transfers, or transfers with a reversionary interest. If the income were transferred at the transferor's death when the transfer was completed, then there would be no transfer of income in contemplation of death cases where the transfer is generally completed inter vivos.

It is difficult to determine which interpretation of transfer is correct, since the statutory language does not exclude any of the three. Since the three result in such different inclusions, statutory amendment might be necessary. However, if the legislative intent concerning what property should be included by sections 2035-38 is clear, statutory amendment is unnecessary.

The legislative intent of all four sections was to reach substitutes for testamentary dispositions, either transfers in contemplation of death or transfers with a string attached until death. The interim income as well as the property is such a substitute. Therefore, a definition of transfer that includes interim income earned by property transferred in contemplation of death and accumulated income earned by property transferred with a string attached would be the correct one. However, none of the three transfer theories produce this inclusion of property.

A sound theory can be achieved by modifying the theory that the income is transferred at the transferor's death when the transfer is com-

77. Commissioner v. Estate of Holmes, 326 U.S. 480 (1946); Porter v. Commissioner, 288 U.S. 436 (1933); Commissioner v. Chase Nat'l Bank, 82 F.2d 157 (2d Cir. 1936).
78. See note 34 supra and accompanying text.
79. See discussion in note 16 supra.
completed. The modification is to deem transfers in contemplation of death also incomplete until the transferor’s death. Some contemplation of death cases have held that the property should be treated as remaining in the ownership of the transferor until his death. With the modification, the income earned by property transferred in contemplation of death between the transfer and death would be transferred at death and includable in gross estate.

At the beginning of the discussion of the transfer theories, it was assumed that finding an act that passes an item from the transferor to the transferee was necessary. There are, however, cases involving other estate tax issues which have dispensed with the requirement of a technical transfer and have concentrated on whether an economic benefit passed from the transferor to the transferee. Using this theory, it is arguable that retention by the transferor of a string on income until his death postpones the passing of full economic benefit until the transferor’s death. And transferring income-producing property in contemplation of death gives the transferee the benefit of the income as well as the property, whether or not the income was strictly transferred by the transferor. Thus, under this theory there would be inclusion of income earned between the transfer and death in contemplation of death cases and of accumulated income in a trust in those section 2036-38 cases where the transferor re-

80. An interesting effect of deeming the transfer incomplete until death arises in cases dealing with severance of a joint tenancy in contemplation of death. Section 2040 requires inclusion of property held in joint tenancy in the estate of the joint tenant to the extent the value of the property is attributable to consideration furnished by him. It would seem that if a joint tenant severs the joint tenancy in contemplation of death, that value which would have been included in his gross estate without the severance should be included. This result would be achieved by deeming the transfer incomplete until death and therefore taking place at death. Yet cases have held that only the joint tenant’s one-half interest in the property was transferred in contemplation of death, and therefore only that interest is included in his gross estate. E.g., Sullivan’s Estate v. Commissioner, 175 F.2d 657 (9th Cir. 1949); Estate of Brockton, 18 T.C. 488 (1952).

An even more complicated situation was presented in United States v. Allen, 293 F.2d 916 (10th Cir. 1961). A transfer had been made with the retention of a life estate subject to inclusion in the gross estate under § 2036. Then the transferor sold her life interest in contemplation of death. It was argued for the estate: (1) that the transfer of the life interest was for adequate consideration and therefore not subject to § 2035, and (2) that there could be no inclusion under § 2036 because there was not an interest in the property retained for life. The court overcame the first argument by saying the consideration was inadequate because not paid for the property subject to the original transfer but only for the life interest. The court could have refuted the second argument by saying the transfer in contemplation of death should be deemed incomplete until death. Therefore, the property which would have been included had there been no transfer (the original property transferred with the retained life estate) would have been included under § 2036. The court ultimately reached this result by cumbersome reasoning.

81. E.g., Igleheart v. Commissioner, 77 F.2d 704 (5th Cir. 1935).

82. See cases cited in note 77 supra. The argument that economic benefit should be taxed was advanced in 51 Nw. U.L. Rev. 149, 154 (1956).
tained a string on the income until his death. This theory seems logical and results in sound tax policy.

IV. CONCLUSION

The inclusion of income earned between the date of the transfer in contemplation of death and the transferor's death and of income accumulated in a trust subject to strings is sound tax policy. However, the present law excludes all income earned subsequent to the transfer in contemplation of death, but includes income accumulated in a trust when the transfer is one with a string attached. The difficulty in carrying out sound tax policy has been interpreting the word "transfer" in the four inter vivos transfer sections. This note suggests that there are two approaches that would alleviate this difficulty and assure proper inclusion of the income. One is to deem transfers in contemplation of death incomplete until death, with the consequence that interim income would be included in gross estate. The other approach is to dispense with the requirement of a technical transfer of the income and instead determine the economic benefit passing from the transferor to the transferee either at death or in contemplation of death.