Taxation—Contingent Remainder Subject to the Federal Gift Tax—[Federal].—A taxpayer created by gift two identical irrevocable trusts. The income of each was to be paid to a life tenant, upon whose death the principal was to be distributed to the taxpayer, if she were living, and to her children and their issue, if she were dead. The taxpayer paid a gift tax on the life estate as it was valued by actuarial estimates of life expectancy. She protested an assessment of deficiency based on the actuarial value of the contingent remainder in the children. The Board of Tax Appeals sustained her objection.[1] On appeal to the circuit court of appeals, *held*, reversed. The gift tax applies to all present transfers of property or property interests. Although the remainder in the children was contingent, and hence it might be argued that under property law it was not a gift, it is taxable as a gift of an interest in property, since property law distinctions between vested and contingent remainders are not controlling in the tax field. Since all estimates of value are at best mere "educated guesses" the fact that the children's remainder may not be worth the actuarial estimate or may not come into being at all is immaterial. *Com'r v. Marshall.*[2]

The court based its decision on the ground that ". . . . there was generosity here; the taxpayer lost, and the children gained, property interests of substantial value."[3] The gift tax, according to the Regulations, applies to ". . . . all transactions whereby property or property rights or interests are donatively passed . . . . regardless of the means . . . . employed."[4] Frank, J., further stated that since the Supreme Court in *Helvering v. Hallock*[5] considered mere formal distinctions of conveyancing irrelevant for the purposes of tax law, the tax applies to the children's interest regardless of the nature of that interest. The only feasible valuation of that interest is one based on actuarial tables. Hence, as the court pointed out, the tax must be based on that valuation regardless of potential or probable injustice; any other valuation would involve too many capricious and inevitable differences between cases.[6] The principal alternative open to the court was to ignore the Regulations[7] and hold that a contingent re-

[1] Margaret White Marshall, 43 B.T.A. 99 (1940).

[2] 125 F. (2d) 943 (C.C.A. 2d 1942).

[3] Com'r v. Marshall, 125 F. (2d) 943, 945 (C.C.A. 2d 1942).

[4] Treas. Reg. 79, art. 2 (1936).

[5] 309 U.S. 106 (1940). The Hallock trust was of the same kind as that used in the instant case. The Court there held that the vesting of the remaindermen was a transfer (from the settlor) taking effect at death, and hence was includible in the taxable estate under the federal estate tax.

[6] The federal tax law does not allow health or ancestral longevity (of the persons whose expectancies are being estimated) to be taken into account. 2 Bonbright, Valuation of Property 741 (1937). Since the evidence to be considered for such allowances would be highly speculative, it would involve the tax authorities in constant and costly litigation. It should be realized, however, that there are many sorts of actuarial tables, and their usefulness varies with the purposes to which they are applied. The Treasury Regulations use the Combined Experience Table, Treas. Reg. 79, art. 19 (7), (8) (1936). For a discussion of other tables, see 2 Bonbright, Valuation of Property 738–44 (1937).

[7] Note 4 supra. As for how much judicial respect should be given the Regulations, see Brown, Regulations, Reenactment, and the Revenue Acts, 54 Harv. L. Rev. 377 (1941); Griswold, A Summary of the Regulations Problem, 54 Harv. L. Rev. 398 (1941); Surrey, The Scope and Effect of Treasury Regulations under the Income, Estate, and Gift Taxes, 88 U. of Pa. L. Rev. 556 (1940).

mainder was not "property" or a "gift" as those words are used in the Revenue Act of 1932.[8] To have done so in the face of *Helvering v. Hallock*[9] would have required unusual judicial arrogance.

Nevertheless, the taxpayer argued that the reversionary interests in the trust instruments would make the reversions and the remainders includible in the taxable estate of the taxpayer at her death,[10] and hence the gift tax should not apply. The court questioned the premise[11] and denied the conclusion. Although the gift tax and the estate tax are to be construed together,[12] they are not mutually exclusive.[13] Moreover, the *Hallock* case is a questionable precedent for the proposition that the reversions and remainders were subject to the estate tax,[14] since the gift tax and the estate tax are in pari materia, and hence a decision concerning a trust created before the gift tax became operative is not a proper precedent for the construction of the Internal Revenue Code at present.[15]

The *Hallock* case is properly a precedent for the proposition that technical distinctions of property law will not be allowed to defeat the imposition of the federal estate tax. The limits of this proposition are not yet clear.[16] It is a cliché that tax law looks

[8] Revenue Act of 1932, § 501 (a), 47 Stat. 169 (1932), 26 U.S.C.A. Int. Rev. Acts 580 (1940), substantially re-enacted in Int. Rev. Code § 1000 (1939), 53 Stat. 144 (1939), 26 U.S.C.A. § 1000 (1940). Such a construction of the words would also ignore legislative intent, on which the Regulations are based. See S. Rep. 665, 72d Cong., 1st Sess., at 39 (1932); 1939-1 Cum. Bull. 496, 524.

[9] 309 U.S. 106 (1940). If, on the facts of the particular case, the contingent remainder was not substantial, it might be argued that the Hallock case excludes taxability. See note 18 infra.

[10] Note 5 supra.

[11] Com'r v. Marshall, 125 F. (2d) 943, 947 (C.C.A. 2d 1942). The Supreme Court has not passed on this question since the gift tax went into effect. It may soon do so, however, for a number of similar cases are now in the lower federal courts. See Helvering v. Robinette, C.C.H. Inheritance, Estate, and Gift Tax Serv. ¶ 10,157 (C.C.A. 3d 1942) (remainders taxable under gift tax); Marrs McLean, 41 B.T.A. 1266 (1940).

[12] Estate of Sanford v. Com'r, 308 U.S. 39, 44 (1939).

[13] Some of the language in the Sanford case would lead one to this conclusion. But on the whole the Sanford case must be regarded as merely confusing on this point. See Estate of Sanford v. Com'r, 308 U.S. 39, 45 (1939); Magill, The Federal Gift Tax, 40 Col. L. Rev. 773, 782 (1940). Moreover, since the Sanford case involved trusts with a power in the settlor to change beneficiaries, it is not strictly in point in the instant case. The estate tax credit for gift taxes paid, note 19 infra, seems to indicate a legislative intent that the two taxes are not mutually exclusive.

[14] It is not clear from the Hallock case, note 5 supra, what part of the trust is includible in the taxable estate. Probably the life estate is excluded, since the settlor's death does not add anything to it. See Magill, Federal Taxation in the Pre-War Decade, 42 Col. L. Rev. 356, 368 (1942).

[15] It should be noted that the exact relation of the gift tax to the estate tax is a matter of dispute. The Sanford case states that the former is supplementary to the latter. Estate of Sanford v. Com'r, 308 U.S. 39, 44 (1939). The legislative history is set forth in Magill, op. cit. supra note 13. For a general discussion of the problem, see 1 Paul, Federal Estate and Gift Taxation § 7.02 (1942).

[16] Magill, op. cit. supra note 14, at 368.

to the substance and not the form of the transaction;[17] but it may be questioned whether in practice this argument will be heard from the taxpayer as well as from the government.[18] It is a difficult proposition to apply both ways. According to the *Hallock* case, the substance of the transaction was a transfer at death; the court in the instant case holds that the substance was a transfer inter vivos. To a certain extent and in a limited sense both the transfer inter vivos and the transfer at death can be substantial, since a present generosity exists, and a substantial certainty is added by death. But both decisions insist that they are rejecting the form for the reality. In most of the litigated cases, the distinction will be one of degree, and, like all distinctions of degree, will be capable of two different applications on two different occasions. The apparent injustice of the resultant double taxation is partially mitigated in the estate tax by the credit for gift taxes paid on the same items.[19] But the complete solution of the problem lies outside the field of judicial interpretation and can be reached only by the much advocated legislative integration of all federal taxation.[20]

The court in the instant case held that the taxable gift was the actuarially estimated life estate and remainder, reduced to a present value by the tables of the Treasury Regulations.[21] It was objected that under the Code[22] the remaindermen would be presently personally liable for unpaid gift taxes on a gift they might never receive. Even if the taxpayer's contention as to secondary liability were sound, the objection was of dubious relevance, since the remaindermen could elect to refuse the gifts when made. The court dismissed the taxpayer's argument without meeting it, implying that the objections, based on the uncertainty of the children's interest, were merely attempts to revive the concept-juggling of vested and contingent interests rejected in *Helvering v.*

[17] Estate of Sanford v. Com'r, 308 U.S. 39, 43 (1939); 2 Paul, op. cit. supra note 15, at § 16.01.

[18] But see Com'r v. Kellogg, 119 F. (2d) 54 (C.C.A. 3d 1941); Smith v. Shaughnessy, 40 F. Supp. 19 (N.Y. 1941). One factor in this question is the strong judicial hostility to tax avoidance; thus a trust might find it impossible to escape the gift tax, only to find that, being in substance clearly a transfer taking effect at death, it was subject to the estate tax. For a discussion of this attitude of the courts in tax cases, see Rudick, The Problem of Personal Income Tax Avoidance, 7 Law and Contemp. Prob. 243 (1940); Lowndes, Tax Avoidance and the Federal Estate Tax, ibid., at 309; 1 Paul, op. cit. supra note 15, at 42.

[19] The credit is not complete, however. Int. Rev. Code § 813 (a)(2) (1939), 53 Stat. 125 (1939), amended by H. R. J. Res. 60, 77th Cong., 1st Sess. (Pub. L. No. 18, March 17, 1941), 26 U.S.C.A. § 813 (a) (2) (Supp. 1941). A similar provision exists in regard to the additional estate tax. Int. Rev. Code § 936 (b) (1939), 53 Stat. 142 (1939), amended by H. R. J. Res. 60, 77th Cong., 1st Sess. (Pub. L. No. 18, March 17, 1941), 26 U.S.C.A. § 936 (b) (Supp. 1941).

[20] Although legislative reform is the tiresome keynote of most law review case notes, the experts seem agreed on the need for it in this field. See Magill, op. cit. supra note 14, at 375; Warren, Correlation of Gift and Estate Taxes, 55 Harv. L. Rev. 1, 42 (1941); Altman, Integration of the Estate and Gift Taxes, 7 Law and Contemp. Prob. 331 (1940). However, no two experts are agreed as to what program will effectuate the reform.

[21] Note 6 supra.

[22] Revenue Act of 1932, § 510, 47 Stat. 249 (1932), 26 U.S.C.A. Int. Rev. Acts 589 (1940). The section is now Int. Rev. Code § 1009 (1939), 53 Stat. 149 (1939), 26 U.S.C.A. § 1009 (1940). This secondary liability of the donee was also considered in the Sanford case. For a criticism of the treatment there, see Warren, op. cit. supra note 20, at 18.

Hallock.[23] In view of the revenue statutes the court reached the logical result, but a more complete discussion of the largely undecided question of secondary liability could have made a valuable addition to the case law of taxation.

In a lengthy dictum the court indicated that many of the valuations which courts are constantly forced to make prove to be utterly false; hence, a tax on the actuarial valuation of a remainder which may never come into being is no worse than a tax on the valuation of city real estate, whose "market value" may turn out to be a "mirage."[24] But there is a difference, if only in degree, between property valuations based on past earnings, or present or past cost, and actuarial valuations which are estimates of mathematical probabilities. The former valuation is intended to be a unique appraisal of the individual property surveyed; the latter is not intended to be more than a mathematical statement of a group phenomenon.[25] The actuarial system of valuation is a legal *deus ex machina*, too well established to be attacked in principle. But its inherent limitations are so great that its use should be avoided where feasible, although in the instant case the court could not properly escape it.

The instant case leaves the taxpayer faced with the probability of double taxation and the certainty of taxation of arbitrarily valued uncertainties. It might be argued that double taxation is a valid means of enforcing a legislative policy against trusts with reversionary interests. No direct evidence of such congressional intent exists. And if the double taxation created by the instant case may be taken to represent a social policy against trusts in general,[26] it effectuates it in an inefficient and somewhat accidental manner.

[23] 309 U.S. 106 (1940). "It may well be that the Supreme Court has succeeded in ridding the law of estate taxation of the 'casuistries of conveyancing' only to find that it has removed them over into the field of gift tax. For a decision intended to dispel confusion and uncertainty, the majority opinion in the Hallock case leaves a great deal unanswered." Nash, Implications of Developments in the Taxation of Trusts, 18 Taxes 267, 324 (1940).

[24] Com'r v. Marshall, 125 F. (2d) 943, 946 (C.C.A. 2d 1942), citing Abrams, Revolution in Land 81–89, 132–33, 198–200 (1939). The court here is talking about extreme possibilities, a rather defeatist approach. A better attitude is to compare the *usual* results of land valuation with the *usual* results of actuarial valuation. Bonbright states that death-tax valuation (including actuarial estimates) ". . . . presents American legal valuation at its best . . . ." and that property valuation and rate making are the worst. 2 Bonbright, op. cit. supra note 6, at 745. But land valuation is extremely difficult, while the actuarial system is comparatively simple, once the proper tables have been chosen. For a discussion of the virtues and drawbacks of taxing by actuarial estimates, see Some Statutory Provisions for the Taxation of Contingent Remainders and Defeasible Estates, 29 Col. L. Rev. 180 (1929).

[25] The larger the experiential data on which the actuarial system is based, the more nearly will the total estimates of remainder values equal the total actually realized values. Hence it is a desirable system from the standpoint of the government. But the equality of the sums involved may not make for even a maximum probability of accuracy in the particular case, as statisticians realize. Land is not capable of statistical analysis, and hence the experiential data on which land valuation is based are apt to be more complex and less precise. But precision and mechanical ease in application should not be mistaken for fairness.

[26] Such a policy might be advocated. Compare the common law hostility to restraints on alienation.