

ilarly, interpretation of the constructive notice provision of the Federal Register Act should accord with the objectives Congress had in mind not only when it provided generally for publication of regulations but also when it established a crop insurance corporation.<sup>30</sup> If there is explicit awareness that it is a new and ever more important government-citizen relationship that is being adjudicated there may well be less homage paid such symbols as "estoppel," "immunity," and "notice."

## TAXATION

### GIFT TAXABILITY OF DIVORCE SETTLEMENTS

An increasing tendency to change spouses<sup>1</sup> has had marked effect on federal tax administration.<sup>2</sup> Particularly

---

39. Relaxing the rigidity of the "constructive notice" phrase for purposes of the *Merrill* decision need not introduce uncertainty and confusion with respect to that phrase and other material published in the Federal Register. When the Court is again called upon to consider the legal effect of publication of other regulations, it should frame its decision by correlating the pertinent statute, its history and purpose, the regulations issued and the objectives which the Federal Register was established to achieve. Congressional action would be appropriate too, in that by classifying federal administrative activities distinctions could be established in regard to the legal effect of publication of their regulations.

---

1. The trend is indicated by the estimated divorce rates compiled by the National Office of Vital Statistics. The divorce rate per 1000 (of population) increased from 1.9 in 1937 to 3.6 in 1945. 23 VITAL STATISTICS, Special Reports, No. 9, at 203 (1946).

2. Another tax problem in the divorce settlement area is the income taxability of payments by the husband to the wife. Section 22(k), INT. REV. CODE, in general, requires the wife to include in her income periodic alimony payments. The wife must also include installment payments under a lump-sum settlement if the payments are to be made over a period of ten years or longer, to the extent that the installment for any tax year does not exceed 10% of the total obligation of the husband. Section 23(u) allows the husband a deduction corresponding to § 22(k). See U. S. Treas. Reg. 111, §§ 29.22(k)-1, 29.23(u)-1 (1949). If the husband establishes a trust for his spouse to discharge his marital obligations, the income from the trust likewise is taxable to the wife. INT. REV. CODE § 171(a). Thus, the marital settlement agreement must be drafted with regard to both the income and gift taxes. That the settlement in the *McLean* case was made with due regard to the income taxability of the payments is evidenced by the provision that the husband's payments would be reduced if they were not deductible. *McLean* case at p. 545.

Recent Indiana legislation allows the divorce or tax attorney greater latitude than formerly in framing the settlement so as to take advantage of tax-saving opportunities under both tax statutes. Ind. Acts 1949, H.B. 401, provides that a divorce court may decree either periodic alimony payments or a sum in gross. Prior statutes allowed

is this true in the field of gift taxation where large divorce settlements reduce the estates of husbands. With respect to such settlements, the Commissioner of Internal Revenue has insisted that a gift tax must be imposed if the primary purposes of the federal tax scheme are to be effected. In the light of a congressional policy to tax large estates,<sup>3</sup> the gift tax has as its primary purpose the supplementation of the estate tax by taxing *inter vivos* transactions which tend to reduce the taxpayer's estate.<sup>4</sup> Despite numerous rebuffs from the courts, the Commissioner has made another attempt to secure recognition of his position by the Tax Court—and again has been rebuffed.

In 1943 Edward B. McLean, the taxpayer, entered into protracted negotiations for a settlement with his wife in contemplation of divorce. The parties agreed on a lump-sum settlement of \$100,000 payable in installments over a twelve-year period plus yearly payments of \$16,000, all of which was reduced to a monthly payment formula. The agreement, which was incorporated in a subsequent divorce decree, provided that payments to the wife should continue even though she should remarry, and that in the event that either the taxpayer or the wife died all obligations on the part of the taxpayer should cease. McLean returned no part of the money paid to his wife in his 1943 gift tax return. The Commissioner, by the use of actuarial tables, assessed a gift tax deficiency for that part of the settlement which represented the present value of McLean's obligation to pay his wife if she should remarry. The Commissioner reasoned that that portion of the obligation was subject to gift tax because made without adequate and full consideration in money or money's worth, since McLean would be under no duty to support his wife should she remarry. The Tax Court refused to accept the contentions of the Commissioner and held that the transfer was in consideration of the re-

---

a court to grant only a sum in gross. IND. STAT. ANN. (Burns 1933) § 3-1218.

3. There is a specific exemption of \$60,000. Thus, in effect, the estate tax is imposed on estates of the value of \$60,000 or more. INT. REV. CODE § 935(c). The purpose of the tax is twofold: (1) to produce revenue and (2) to discourage excessive accumulation of wealth. See 1 PAUL, FEDERAL ESTATE AND GIFT TAXATION § 1.07 (1942).

4. See Commissioner v. Wemyss, 324 U. S. 303, 307 (1945). See also H. R. REP. NO. 708, 72d Cong., 1st Sess. 28 (1932); SEN. REP. NO. 665, 72d Cong., 1st Sess. 40 (1932); 2 PAUL, FEDERAL ESTATE AND GIFT TAXATION 963 (1942).

linquishment of a presently enforceable claim, and therefore was not a gift subject to the tax. *Edward B. McLean v. Comm'r*, 11 T. C. 543 (1948).<sup>5</sup>

Section 1002 of the Internal Revenue Code provides that the transfer of property for less than adequate and full consideration in money or money's worth<sup>6</sup> is a gift subject to the gift tax.<sup>7</sup> The Commissioner in dealing with transfers incident to marriage and divorce originally interpreted this section to mean that the relinquishment of none of the rights which the wife by law acquires by virtue of the marital relation<sup>8</sup> was such consideration for a husband's transfer as would relieve him of the obligation to pay a gift tax.<sup>9</sup> In *Commissioner v. Weymss*<sup>10</sup> and *Merrill v. Fahs*,<sup>11</sup> the only Supreme Court pronouncements on the subject,<sup>12</sup> the Court

---

5. Two judges dissented. The case has been appealed to the Court of Appeals for the Second Circuit.

6. The term "consideration" in this note will connote adequate consideration for purposes of § 1002, INT. REV. CODE, *i.e.*, "money or money's worth."

7. This or similar language has been in the gift tax statutes since the original enactment in 1924. Revenue Act of 1924, § 320, 43 STAT. 253, 305 (1924). The section reached its exact present form in the Revenue Act of 1932, § 503, 47 STAT. 247 (1932), when the phrase "adequate and full consideration" was added. This phrase was first used in the comparable sections [now §§ 811, 812] of the estate tax statute in the Revenue Act of 1926, §§ 300-303, 44 STAT. 69-72 (1926).

8. Generally the wife acquires by marriage the right to a share of the husband's estate at his death, and the right to support and maintenance during the marriage. These rights are defined by statute in most states. See III VERNIER, AMERICAN FAMILY LAWS §§ 161, 188 (1932).

9. For the Commissioner's position, see *Commissioner v. Bristol*, 121 F.2d 129, (1st Cir. 1941) (an antenuptial agreement); *Herbert Jones*, 1 T. C. 1207, 1209 (1943), *aff'd* 129 F.2d 243 (7th Cir. 1943) (an agreement incidental to divorce proceedings). The courts, however, generally did not accept the Commissioner's position. *Commissioner v. Mesta*, 123 F.2d 986 (3rd Cir. 1941); *Lasker v. Commissioner*, 138 F.2d 889 (7th Cir. 1943); *Herbert Jones*, *supra*. *Contra*: *Commissioner v. Bristol*, *supra*.

10. 324 U. S. 303 (1945).

11. 324 U. S. 308 (1945).

12. In the *Wemyss* and *Merrill* cases, decided conjunctively, the Court, construing the gift and estate taxes in *pari materia*, read § 812(b) of the estate tax statute into § 1002 of the gift tax statute. Section 812(b) defines claims against the decedent's estate which are deductible in computing the taxable estate. It expressly provides that the relinquishment of marital property rights is not such consideration "in money or money's worth" as will make a claim founded upon the relinquishment deductible from the gross estate. The Court concluded that since "money or money's worth" should have the same meaning in the estate and gift taxes, the relinquishment of marital property rights was not such consideration as required by § 1002.

accepted the Commissioner's position, at least in so far as it dealt with the relinquishment of marital property rights, *i.e.*, rights other than support rights,<sup>13</sup> in consideration of an antenuptial transfer of property by the husband. Subsequent Tax Court decisions involving postnuptial settlements, however, distinguished the *Wemyss* and *Merrill* cases on the ground that the Supreme Court's reasoning applied only to antenuptial agreements.<sup>14</sup> Finally<sup>15</sup> in E. T. 19<sup>16</sup> the Commissioner acquiesced in the Tax Court's position to the extent that that court had held that a wife's relinquishment of her right to support and maintenance was sufficient consideration in divorce settlements to take a husband's transfer out of the scope of the gift tax.<sup>17</sup> The relinquishment of other

---

13. Whenever the term "marital property rights" is used in this note it will connote a wife's common law dower right, or any statutory right to a share in the spouse's property.

14. Clarence B. Mitchell, 6 T. C. 159 (1946); Edmond C. Converse, 5 T. C. 1014 (1945) (three judges dissenting); Mathew Lahti, 6 T. C. 7 (1946) (three judges dissenting).

15. The Commissioner's ruling was not published until August, 1946, five months after the decision in the *Wemyss* and *Merrill* cases.

16. The Commissioner also ruled that the establishment of a reasonable allocation of a settlement between support rights and marital property rights is an administrative problem in the absence of a reasonable allocation by the parties. E. T. 19, 1946-2 CUM. BULL. 166. But in no case has the Tax Court allowed the Commissioner to allocate a value to marital property rights and tax that value. In one instance of a lump-sum settlement the Commissioner attempted to allocate a value to support rights and tax the difference between this value and the sum transferred. He based the value of the support rights on the present worth of a payment (estimated amount the wife had received annually for her expenses) each year until the death of the husband or the earlier death or remarriage of the wife. The possibility of the death of the parties, and the wife's remarriage, was determined by the use of actuarial tables. The court found, because the negotiations had been carried on at "arm's length" and because of the ultimate agreement of the parties themselves, that there was adequate consideration. The court added that no factor for the wife's prospects of remarriage should enter into the computation; however, the court went on to say that ". . . The limiting factor is only [the] decedent's [taxpayer's] life expectancy, since the wife's was greater than his." This would seem to imply that, although the Commissioner could not allocate the value of a transfer between support rights and other material rights in the case then being decided, in other cases he might. Frank M. Gould, P-H 1947 TC MEM. DEC. SERV. ¶ 47,176 (1947).

17. Any explanation of why the Commissioner changed his position in regard to support rights must be conjectural; yet, there are plausible reasons. First, the present position of the Commissioner fits in logically with the primary purposes of the gift tax—to tax *inter vivos* transactions which deplete the estate that the donor would otherwise have had at death. See note 4 *supra*. A husband would ordinarily discharge any obligation to support his wife before his death; hence, a liquidation of this obligation would not be depriving the estate of something which it would otherwise have included at his death. Secondly, although the *Wemyss* and *Merrill* cases sub-

marital rights, *e.g.*, dower, is not such consideration, it was ruled. But the courts<sup>18</sup> accepted E. T. 19 only to the extent that it was favorable to the taxpayer, and continued to hold that the relinquishment of marital property rights was consideration. Although in most of these cases the settlement had been incorporated in a divorce decree, this was not a significant factor until the doctrine of the *Converse* case was enunciated by the Court of Appeals for the Second Circuit:<sup>19</sup> the legal duty imposed by the decree is sufficient consideration for a transfer.

In the face of this hostility to the Treasury's position, the Commissioner, in the *McLean* case, did not contend that all of the transfer which might be attributable to the release of marital property rights was subject to gift tax. In an attempt to save some measure of taxability in the field of postnuptial settlements, he sought to tax only that portion of the transfer attributable to the agreement to pay even though the wife should remarry. That portion, he urged, was not transferred in consideration of the relinquishment either of the right to support,<sup>20</sup> or of marital property rights, but was a gift subject to taxation.

In deciding in favor of the taxpayer in the *McLean* case the Tax Court gave scant attention to the Commissioner's

---

stantiated the position of the Commissioner and held that the relinquishment of marital rights was not consideration for purposes of Section 1002, the facts of those cases did not deal with support rights.

18. Josephine S. Barnard, 9 T. C. 61 (1947) (A transfer by the wife to the husband with no support rights involved); Albert V. Moore, 10 T. C. 393 (1948). Junius R. Judson, P-H 1947 TC MEM. DEC. SERV. ¶ 47,050 (1947). See note 19 *infra*.

19. *Converse v. Commissioner*, 163 F.2d 131 (2d Cir. 1947), a gift tax case, relied on a line of estate tax cases (see note 28 *infra*) in reaching the conclusion that the incorporation of an agreement in a divorce decree gave it the force of a judgment debt and a transfer to the wife in payment of the judgment was for an adequate consideration for purposes of § 1002.

20. The Nevada statute provides that all alimony to the wife shall cease upon her remarriage unless, subsequent to the remarriage, it is otherwise ordered by the court. NEV. COMP. LAWS ANN. (Supp. 1941) § 9463. The present tendency of the statutes in most states is to make similar provision, or to provide that the husband is not obligated to provide for the spouse's support after her remarriage. II VERNIER, AMERICAN FAMILY LAWS § 106 (1932), and Supplement 64-65 (1938). Those states which do not have specific statutes on the point ordinarily reach the same result by decisions setting aside the decree for alimony after remarriage, or by allowing the fact of the wife's remarriage as an adequate defense when a wife sues for failure to make alimony payments. *E.g.*, *Thompson v. Mentzer*, 216 Ill. App. 470 (1920); *Fisch v. Marler*, 1 Wash.2d 698, 97 P.2d 147 (1939); *Nelson v. Nelson* 282 Mo. 412, 221 S. W. 1066 (1920).

argument that this case was not controlled by past decisions.<sup>21</sup> Reiterating broadly that the relinquishment of marital property rights is consideration for gift tax purposes, the court also advanced the *Converse* argument that the incorporation of the agreement in the divorce decree gave it the force of a judgment debt, the payment of which was money or money's worth under section 1002.<sup>22</sup> Finally, the court stressed the point that the agreement was made at "arm's length" and without "donative intent,"<sup>23</sup> and concluded that the settlement therefore was not a gift.<sup>24</sup> None of these oft-repeated arguments of the Tax Court seem adequate grounds for the position that it has again taken.

Of the absence of "donative intent" and the transaction's being at "arm's length," it suffices to say that in the *Wemyss* case Justice Frankfurter expressly discarded the test of "donative intent" for gift tax purposes;<sup>25</sup> and in the *Fahs* case he dismissed the idea that marital settlements were intended to fall within the term "ordinary course of business"<sup>26</sup>

---

21. The closest the court came to deciding that issue was its *arguendo* holding in the last paragraph of the opinion: *assuming* the Commissioner to be correct in his contention, McLean made no taxable gift in 1943 because the contingency on which the tax was sought to be imposed, the wife's remarriage, had not at that time occurred. See *McLean* case at 549.

22. In this connection, the Court voiced a new objection to E. T. 19, stating that it was "invalid in so far as it does not also except transfers made to settle presently enforceable claims." See *McLean* case at 549.

23. The Commissioner has excluded business transactions from the gift category if they are bona fide, at arm's length, and free from donative intent. U. S. Treas. Reg. 108, § 86.8 (1943).

24. As in the earlier cases the *Wemyss* and *Merrill* cases were distinguished on the ground that they involved antenuptial agreements. See *McLean* case at 549.

25. "Congress chose not to require an ascertainment of what too often is an elusive state of mind. For purposes of the gift tax it not only dispensed with the test of 'donative intent.' It formulated a much more workable external test. . . ." Commissioner v. *Wemyss*, 324 U. S. 303, 306 (1945); See 2 PAUL, FEDERAL ESTATE AND GIFT TAXATION 713 (Supp. 1946) (approves *Wemyss* case); Rand, *What is a Gift?*, 34 KY. L. J. 99 (1945) (criticizes *Wemyss* case). But there are situations, other than ordinary business transactions, where "donative intent" may seem to be the only practical test. *E.g.*, Catherine S. Beveridge, 10 T. C. 915 (1948). Here the taxpayer's estranged daughter threatened to bring suit for restitution of property conveyed to the taxpayer without consideration. In exchange for a promise to forbear suit the taxpayer created a trust for the daughter's benefit. The Tax Court upheld the taxpayer and the Commissioner has since acquiesced in the decision. 1949 INT. REV. BULL. No. 2 at 1 (1949).

26. See note 23 *supra*,

so as to remove from such transfers the character of a gift.<sup>27</sup> That the *Wemyss* and *Merrill* cases are concerned with antenuptial transfers is of no import; the Supreme Court's reasoning applies with equal force and logic to any marital settlement.

It is arguable that the *McLean* facts do not present a proper case for the application of the *Converse* rule.<sup>28</sup> A more basic point is that that case subverts substance and by its reliance on formality has opened wide the gates to tax avoidance. The severe criticism<sup>29</sup> to which the *Converse* case has been subjected need not again be detailed. It should be noted that *Converse* has been limited even by the Tax Court in *Roland M. Hooker*.<sup>30</sup>

As long as the *McLean* case and its predecessors remain intact, a gift tax on a divorce settlement may easily be

---

27. "To find that the transaction, was 'made in the ordinary course of business' is to attribute to the Treasury a strange use of English." *Merrill v. Fahs*, 324 U. S. 308, 313 n.1 (1945).

28. The *Converse* case might have been distinguished and rendered inapplicable to the present case. By the terms of settlement incorporated into the decree in the *Converse* case the wife received an absolute interest in the lump sum. In the *McLean* settlement, however, it was provided that all the taxpayer's obligations were to cease upon the death of either the taxpayer or the wife. Obviously, the wife could have no absolute interest in a lump sum settlement, as in the *Converse* case, if the wife's interest was defeasible. Thus *McLean's* obligation was only contingent, the judgment of the divorce court did not place an absolute liability upon him, and the obligation was materially different from that in the *Converse* case.

29. "As a result of this decision, the very relinquishment of rights which Congress and the courts have declared not to be adequate consideration, becomes adequate solely because a divorce court ratified a prior agreement of the parties." 48 COL. L. REV. 152, 153 (1948). "The state court judgment should be only prima facie conclusive as to the amount which will satisfy the wife's right of support and constitute adequate consideration." Note, 43 ILL. L. REV. 545, 550 (1948). See also 96 U. OF PA. L. REV. 287, 289 (1948). The *Converse* case relied on the line of estate tax cases represented by *Commissioner v. Maresi*, 156 F.2d 929 (2d Cir. 1946); *Commissioner v. State Street*, 128 F.2d 618 (1st Cir. 1942). These cases have likewise been criticized as unrealistic and formalistic. Rudick, *Marriage, Divorce and Taxes*, 2 TAX. L. R. 123, 161 (1947); 56 HARV. L. R. 314 (1942).

30. 10 T. C. 388 (1948). Here a transfer for support of a minor child, made pursuant to a judgment enforcing a separation agreement and divorce decree, was held to be a gift to the extent that it exceeded the obligation to support. The court in commenting on the Court of Appeals for the Second Circuit's decision in the *Converse* case said: ". . . if it means that no payment in liquidation of a judgment is a taxable gift within § 1002, then this court disagrees and, with all due respect, declines to follow that decision." For an explanation of why the Tax Court allowed the Commissioner to look through the judgment to determine the reasonable value of the children's rights to support see Note, 43 ILL. L. REV. 545 (1948).

avoided. If the husband and wife or their attorneys engage in give-and-take negotiations, preferably in an acrimonious atmosphere,<sup>31</sup> if they reach an agreement for a lump-sum settlement, reciting that the consideration for the husband's transfer is the complete release of all the wife's rights by virtue of the marriage,<sup>32</sup> and if they secure the incorporation of the settlement in the divorce decree,<sup>33</sup> no gift tax will be due. This will be true whether the husband's obligation is to make a single payment of the amount due<sup>34</sup> or to pay the amount due in installments,<sup>35</sup> and whether his obligation is absolute<sup>36</sup> or contingent.<sup>37</sup>

If this is to remain the law on the gift taxation of divorce settlements, the Tax Court must continue to distinguish the *Wemyss* and *Merrill* cases on the ground that they govern only antenuptial agreements. The *Wemyss* and *Merrill* cases made it clear that the relinquishment of marital property rights is not consideration for an antenuptial transfer so far as the federal gift tax is concerned. If there are sound policy reasons for the existing illogical distinction<sup>38</sup> which

31. Edward B. McLean, 11 T. C. 543 (1948); Roland M. Hooker, 10 T. C. 388 (1948); Mathew Lahti, 6 T. C. 7 (1946); also cases cited in note 34 *infra*.

32. As in Edward B. McLean, 11 T. C. 543 (1948); Edmond C. Converse, 5 T. C. 1014 (1945); Albert V. Moore, 10 T. C. 393 (1948); Josephine S. Barnard, 9 T. C. 61 (1947) (a transfer by the wife to the husband with no support rights involved). Cf. Clarissa H. Thomson, P-H 1947 TC MEM. DEC. SERV. ¶ 47,194 (1947) (Held: a gift where wife transferred property to husband, the parties having stipulated that the transfer was not in exchange for the husband's curtesy right, there being no duty of wife to support husband in Mass.)

33. *Converse v. Commissioner*, 163 F.2d 131 (2d Cir. 1947); Albert V. Moore, 10 T. C. 393 (1948); Josephine S. Barnard, 9 T. C. 61 (1947) (But here the transfer to the wife was made prior to the incorporation of the agreement in the divorce decree.)

34. *Converse v. Commissioner*, *supra* note 33; Josephine S. Barnard, 9 T. C. 61 (1947); Albert V. Moore, 10 T. C. 393 (1948).

35. Edward B. McLean, 11 T. C. 543 (1948).

36. See note 33 *supra*.

37. Edward B. McLean, 11 T. C. 543 (1948).

38. There is no logical reason why such relinquishment should have a different effect when the transfer is a postnuptial one. See dissent, Edmund C. Converse, 5 T. C. 1014, 1016 (1945); see also the dissent in the *McLean* case, *supra* n.37 at 551. On the contrary, logic requires that such relinquishment not be consideration. Section 1002 is a definitive section. It defines what transactions are taxable gifts. Its application was intended to be uniform. Thus for the purposes of § 1002, if relinquishment of marital property rights is not consideration in one type of transaction, it should not be consideration for any other type transaction.



gives different legal effect to transactions identical except in point of time, the Tax Court has yet to spell them out.

In the final analysis the soundness of the present state of the authorities on the gift taxation of postnuptial settlements must depend upon its furtherance of Congressional policy.<sup>39</sup> The position of the Commissioner is in harmony with that policy. The Tax Court and Courts of Appeal decisions are not. Thus it seems probable that the Commissioner's position will eventually be upheld by the Supreme Court, or that Section 1002 will be amended by Congress to provide explicitly that the relinquishment of marital property rights<sup>40</sup> is not consideration for any transfer incident to a settlement between spouses or prospective spouses.

---

39. "The gift tax was supplementary to the estate tax. The two are in *pari materia* and must be construed together. *Burnet v. Gugenheim*, 288 U. S. 286 (1932). . . . An important, if not the main, purpose of the gift tax was to prevent or compensate for avoidance of death taxes by taxing the gifts of property *inter vivos* which, but for the gifts, would be subject in its original or converted form to the tax laid upon transfers at death. See also *Sanford v. Comm'r*, 308 U. S. 39 (1939)." See summary of Commissioner's position as noted in *Merrill v. Fahs*, 89 L. Ed. 963, 965 (1944).

40. See note 13 *supra*.