The Revenue Act of 1948

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By

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A. ESTATE AND GIFT TAX CHANGES

1. Legislative Background

The changes made by the Revenue Act of 1948, with respect to the estate and gift tax sections of the Internal Revenue Code, complete the cycle of Congressional attempts to equalize the tax burden between residents of community property and common law states. See Chapter on Community Property, pp. 152-159, and pp. 428-431.***

Prior to 1942, residents of community property states enjoyed a distinct Federal estate and gift tax advantage. Under the laws of those states, both spouses were regarded as possessing equal one-half interests in all community property owned by them. Thus, upon the death of a spouse, only one-half was taxable in his estate, because that was all which he could transmit at death. Similarly, inter vivos gifts were construed as being made one-half by each spouse, with the result that only one-half of the gift was taxable to each spouse. These consequences contrasted sharply with the tax incidence of residents in common law states where, upon the husband's death, the entire property owned by him was subject to tax; similarly, gifts made by either spouse were taxed in their entirety to the donor. This inequality was further accentuated by the sharply progressive estate and gift tax rates which caused the added portion of the property transferred to bear a disproportionately greater burden of such taxes.

The Revenue Act of 1942 sought to correct this inequitable distribution of the tax burden based upon the geographical residence of the taxpayer. It was accomplished by providing that, upon the death of a resident of a community property state, the entire community property was to be included in his estate except such portion as could be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation, or from the separate property of the surviving spouse; and, further, in no event should the estate of the first spouse to die be less, for Federal estate tax purposes, than the value of the property over which that spouse had a testamentary power of disposition. This pattern was also carried into the gift tax by the 1942 Revenue Act. Under its provisions, gifts of community property were to

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be considered as having been made by the husband, except to the extent that it could be proved that the property transferred was economically attributable to the wife.

These amendments were severely criticized by the community property states. The chief objection centered about the provision that at least half of the community property was taxable in the estate of the first spouse to die, regardless of economic source. Thus, in a community property state, if the wife died first, one-half of the community property would be taxable in her estate, irrespective of whether she had ever contributed anything to the community, because to that extent she had a power of testamentary disposition at her death. Moreover, if in her will the wife left all her property to her husband, the entire estate would be subject to Federal estate taxes upon the husband’s death. Under similar circumstances in a common law state, no part of property jointly held with her husband, to which she had made no economic contribution, would be taxable in the wife’s estate at her death. See pp. 139-152.

Further, difficult problems of tracing the economic source of the contribution made by each spouse to the acquisition of the community property imposed severe hardships. An equalization of the incidence of estate taxes was not accomplished and the advantage was shifted to the common law states. This, as a result of the widespread use of life tenancies to the wife with remainder over to the children which allowed the estate to escape the second Federal estate tax at the wife’s death. In community property states, the husband could not dispose of his wife’s share in the community property which, in the usual case, was first taxable as part of the husband’s estate and, again, at the wife’s death.

The Revenue Act of 1948 repealed all the 1942 amendments dealing with community property. As a result, the pre-1942 method of taxation of community property is restored. However, to avoid re-establishing the inequalities which then existed, the 1948 Revenue Act coupled the repeal of these amendments with a provision for a marital deduction in favor of husband and wife residents of common law states. This deduction will make available substantially the same tax benefits to married residents of common law states as are enjoyed by such residents of community property states. Thus, while the original attempt by Congress at equalization under the 1942 Revenue Act had been to make tax incidence in community property states accord with that of the common law states, the present solution seeks to accomplish the same objective in the reverse.

It is imperative to note that the new amendments do not change the over-all pattern of estate and gift taxation as it now exists, except that the community property provisions are now completely eliminated. The marital deduction provided for in the new law is superimposed as a credit against the gross estate after its value has been arrived at under the existing provisions of the Code; and, as to the gift tax, it operates as a deduction from the net gifts made by the donor-spouse during the calendar year.
During the lifetime of both spouses, the marital deduction does not create any rights of ownership in or control over the property of either spouse greater than that which such spouse enjoys under state law.

2. Estate Tax Provisions

a. REPEAL OF COMMUNITY PROPERTY PROVISIONS

Section 351 of the 1948 Revenue Act repealed all the sections of the Internal Revenue Code with respect to the Federal estate taxation of community property. These had been inserted in the Code by the 1942 Revenue Act. The repeal of these provisions is effective with respect to estates of decedents dying after December 31, 1947. The specific sections affected are: Section 811 (d) (5) relating to transfers during life of community property includible in the gross estate under Sections 811 (c) or (d) (such as transfers in contemplation of death, to take effect at death and revocable trusts), see pp. 158-159; Section 811 (e) (2) relating to the inclusion of community property in the gross estate of the decedent, see pp. 152-157; and Section 811 (g) (4) relating to proceeds of life insurance purchased with community property, see pp. 157-158.

Thus, in the case of decedents dying after December 31, 1947, the extent to which community property held by the decedent and his spouse at death shall be included in the gross estate will be determined in accordance with the rule which prevailed prior to the amendments made by the 1942 Revenue Act. This means that upon the death of a spouse in a community property state, only one-half of the community property will be taxed in the decedent’s estate. The surviving spouse thereafter enjoys estate tax-free his or her share of the community property. Upon the death of the surviving spouse, such share will be taxed as part of his or her estate.

Section 351 (c) of the Act provides that the retroactive application of the repeal of the community property provisions to December 31, 1947 shall not serve to increase the taxes which would have been imposed upon a decedent dying after that date but prior to April 2, 1948 (the date of enactment of the 1948 Revenue Act), had the new section not been enacted.

b. MARITAL DEDUCTION

(1) General

Section 361 of the 1948 Revenue Act introduces a marital deduction applicable to any interest in property passing from the decedent to the surviving spouse. This is an entirely new deduction not previously allowed. Its purpose is to put residents of common law states on a basis of equality, estate tax-wise, with residents of community property states. All the provisions of the 1948 Act with respect to this marital deduction are drawn to accomplish this objective.

(2) Legislative Provision

Section 812 of the Code, which relates to the allowable deductions in computing the net estate of a decedent for estate tax purposes, was amended under
Section 361 (a) of the 1948 Revenue Act by the addition of Subsection (e) and reads as follows:

"Section 812. Net Estate.

"For the purpose of the tax the value of the net estate shall be determined in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

\[(e) \text{ Bequests, Etc., to Surviving Spouse.—}\]

"(1) Allowance of Marital Deduction.—

"(A) In General.—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest in included in determining the value of the gross estate.

\[(H) \text{ Limitation on Aggregate of Deductions.—The aggregate amount of the deductions allowed under this paragraph (computed without regard to this sub-paragraph) shall not exceed 50 per centum of the value of the adjusted gross estate, as defined in paragraph (2).}\]

(3) Limitation—50 Percent of Adjusted Gross Estate

Under the 1948 amendments, a deduction is allowed equal to any interest in property which passes or has passed from the decedent to a surviving spouse but only to the extent that such interest is included in determining the value of the gross estate. Thus, if the surviving spouse inherits from the decedent property not includible in the decedent's gross estate, such as foreign real estate or property acquired from the decedent for full and adequate consideration, no deduction will be allowed for such property. This deduction, however, is limited under (1) (H) of Subsection (e) and cannot exceed fifty percent of the value of the adjusted gross estate. In other words, one-half of the decedent's property will escape Federal estate taxation provided that it passes or has passed to the surviving spouse, whether by will, intestacy or otherwise. The status of an individual as the surviving spouse is determined as of the date of death. Mere legal separation does not destroy this status. The deduction is not allowed with respect to a non-resident not a citizen of the United States.

(4) Adjusted Gross Estate

The "adjusted gross estate" is a new concept introduced for the first time, and its use is confined solely to the computation of the 50 percent marital deduction. It is defined as the gross estate less the aggregate amount of the deductions allowed under Section 812 (b) of the Code: Section 812 (e) (2). (A). These deductions include funeral expenses, administration costs, executors' and counsel fees, and debts; I.R.C., Section 812 (b). Other allowable deductions and the specific exemption are not to be deducted for purposes of computing the "adjusted gross es-
"This rule applies in all cases except where the decedent and his wife at any time held property as community property, as to which a special provision obtains: I. R. C. Section 812 (e) (2) (B), as added by Section 361 of the 1948 Revenue Act.

(5) Computation

The computation of the marital deduction is illustrated in the following examples: A husband in a common law state dies, leaving a gross estate valued at $110,000 and the aggregate amount of deductions allowed under Section 812 (b) is $10,000. The base upon which the marital deduction will be computed is thus $100,000.

(a) He disposes of his entire estate to his wife. Only $50,000 would be subject to Federal estate tax.

(b) He disposes of $50,000 to his wife and the remaining $50,000 to other beneficiaries. Only $50,000 would be taxable in his estate, since the marital deduction applies to all property passing to the wife, not exceeding 50 percent of the value of the decedent's adjusted gross estate.

(c) He disposes of $40,000 to his wife and $60,000 to other beneficiaries. $60,000 would be subject to tax in his estate. See (b) above.

(d) He disposes of $80,000 to his wife, and $20,000 to other beneficiaries. $50,000 would be taxable in his estate. See (b) above.

It is obvious from the above situations that even though the value of the decedent's estate exceeds the specific exemption of $60,000, no estate tax will be payable since the marital deduction leaves less than $60,000 subject to tax. Nevertheless, a Federal estate tax return must be filed whenever the value of the gross estate exceeds the exemption of $60,000 provided in Section 935 (c) of the Code.

This, in effect, equalizes the estate tax consequences which obtain in community property states. If a husband were to die resident in a community property state, leaving a gross estate of $100,000, one-half would automatically become the sole property of his wife, free of estate taxes. The remaining one-half would be taxable in his estate, irrespective of the identity of the beneficiaries. Thus, if a decedent in a community property state leaves his entire estate to his wife, 50 percent will still be taxable in his estate.

(6) Interest Passing from Decedent

Section 812 (e) (3) of the Internal Revenue Code, as added by Section 361 (a) of the 1948 Revenue Act, defines what is meant by "property passing from the decedent to any person". It provides:

"(3) Definition.—For the purposes of this subsection an interest in property shall be considered as passing from the decedent to any person if and only if—

"(A) such interest is bequeathed or devised to such person by the decedent; or

"(B) such interest is inherited by such person from the decedent; or
"(C) such interest is the dower or curtesy interest (or statutory interest in lieu thereof) of such person as surviving spouse of the decedent; or

"(D) such interest has been transferred to such person by the decedent at any time; or

"(E) such interest was, at the time of the decedent's death, held by such person and the decedent (or by them and any other person) in joint ownership with right of survivorship; or

"(F) the decedent had a power (either alone or in conjunction with any person) to appoint such interest and if he appoints or has appointed such interest to such person, or if such person taxes such interest in default upon the release or nonexercise of such power; or

"(G) such interest consists of proceeds of insurance upon the life of the decedent receivable by such person. Except as provided in subparagraph (F) or (G) of paragraph (1), where at the time of the decedent's death it is not possible to ascertain the particular person or persons to whom an interest in property may pass from the decedent, such interest shall, for the purposes of clauses (i) (ii) of subparagraph (B) of paragraph (1), be considered as passing from the decedent to a person other than the surviving spouse."

The concept of property "passing" from the decedent as defined by this subsection applies to all the provisions dealing with the marital deduction which refer to property passing from the decedent to the surviving spouse or to any person. Its broad outline covers all interests includible in a decedent's gross estate for Federal estate tax purposes under the various subsections of Section 811 of the Internal Revenue Code. It includes interests which would commonly be considered as passing from the decedent, such as interests bequeathed, devised, transferred or inherited from the decedent, or the dower and curtesy interests of the decedent's surviving spouse. In addition, the interests held by the decedent and spouse in a joint tenancy, tenancy by the entirety, joint bank account, or any form of co-ownership with right of survivorship, are also considered as an interest passing from the decedent to his surviving spouse. Similarly, with respect to interests over which decedent had a power of appointment, regardless of whether the person receiving such interest takes it by virtue of the exercise of the power or through default upon the release or nonexercise of the power. Proceeds of life insurance on the life of the decedent, payable to a named beneficiary, are also considered as having passed from the decedent at the time of death, regardless of whether the decedent had previously assigned the policy or paid the premiums by way of gift.

The Senate Finance Committee Report (Part 2, page 3) indicates that payments in satisfaction of claims against the estate or any indebtedness for which a deduction is allowed by Section 812 (b) will not be considered as an interest passing from the decedent. Nor will the amounts expended in accordance with local law for support of a surviving spouse during the administration of an estate be considered as an interest passing from the decedent to the surviving spouse.
The Report also states (Part 2, page 3) that generally a mere power of appointment is not an "interest in property". Accordingly, no deduction would be allowed for purposes of the marital deduction for the value of such a power which is given to a surviving spouse. There is an exception, however, in the case of certain trust and insurance proceeds with powers to appoint which will be discussed in a subsequent section.

Where a surviving spouse elects to take her statutory share in the decedent's estate instead of the interest left to her under the will, the interest received is considered as "passing" to her from the decedent: Section 812 (e) (3). However, the Senate Report indicates that if, as a result of a controversy involving a bequest, etc., to a surviving spouse, the spouse surrenders her interest in such bequest pursuant to a compromise agreement in settlement of the controversy, the amount so surrendered is not deductible as an interest passing from the decedent to such spouse. Furthermore, any interest received by the surviving spouse under a settlement which does not reflect her rights under local law, does not pass to her from the decedent: Senate Finance Committee Report, Part 2, pp. 4-5.

(7) Disclaimers

Section 812 (e) (4) of the Internal Revenue Code, as added by Section 361 (a) of the 1948 Revenue Act, provides as follows:

"(4) Disclaimers.—

"(A) By Surviving Spouse.—If under this subsection an interest would, in the absence of a disclaimer by the surviving spouse, be considered as passing from the decedent to such spouse, and if a disclaimer of such interest is made by such spouse, then such interest shall, for the purposes of this subsection, be considered as passing to the person or persons entitled to receive such interest as a result of the disclaimer.

"(B) Disclaimer by Any Other Person.—If under this subsection an interest would, in the absence of a disclaimer by any person other than the surviving spouse, be considered as passing from the decedent to such person, and if a disclaimer of such interest is made by such person and as a result of such disclaimer the surviving spouse is entitled to receive such interest, then such interest shall, for the purposes of this subsection, be considered as passing, not to the surviving spouse, but to the person who made the disclaimer, in the same manner as if the disclaimer had not been made."

This provision, in effect, states that for purposes of Section 812 (e) an interest disclaimed by a surviving spouse shall be considered as passing to the person receiving it as a result of the disclaimer, but an interest disclaimed by any other person is still considered as passing to that person if, as a result of the disclaimer, the interest would pass to the surviving spouse.

For example, if the surviving spouse disclaims a bequest of a decedent to her so that it passes to the other heirs, no marital deduction will be permitted since the
property will be considered as passing from the decedent to the other heirs. If a bequest to some other person is disclaimed and, as a result, it passes to the surviving spouse, no marital deduction will be allowed since such interest is not considered as passing from the decedent to the surviving spouse. Similarly, if the decedent exercised a power of appointment in favor of someone other than the surviving spouse and the appointee disclaimed the interest, with the result that the interest passes to the spouse who is the taker in default, no marital deduction is allowed.

An exception is referred to in the Senate Finance Committee Report (Part 2, page 5) where the surviving spouse is the residuary legatee, and she disclaims a bequest. The interest which she so disclaimed is considered as passing to her from the decedent for the purposes of the marital deduction.

Similarly, if during the lifetime of the decedent he attempted to make a gift of property to a person who, however, refused it, so that no gift was made; and thereafter, the decedent by his will bequeathed the property to his surviving spouse, a marital deduction will be allowed: Senate Finance Committee report, Part 2, pp. 5-6.

(8) Valuation of Interest Passing to Surviving Spouse

Section 812 (e) (1) (E) of the Internal Revenue Code, as added by Section 361 (a) of the 1948 Revenue Act, provides as follows:

"(E) Valuation of Interest Passing to Surviving Spouse.—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—

"(i) there shall be taken into account the effect which a tax imposed by this chapter, or any estate, succession, legacy, or inheritance tax, has upon the net value of the surviving spouse of such interest; and

"(ii) where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

These rules are generally applicable in determining the net value of gifts and bequests to charity under Section 812 (d) of the Code.

The application of clause (ii) is illustrated by the following examples from the Senate Finance Committee Report (Part 2, page 6):

"If the decedent by his will leaves to his surviving spouse real estate subject to a mortgage (whether or not such mortgage was a personal liability of the decedent) the value of the interest passing to the surviving spouse does not under this action include the mortgage. If, however, the decedent by his will directs the executor to pay off the mortgage, such payment constitutes an additional interest passing to the surviving spouse. If the decedent bequeaths certain property to his surviving spouse subject, however, to her agreement, or a charge on the property,
for payment of $1,000 to X, the value of the bequest (and, accordingly, the value of the interest passing to the surviving spouse) is the value, reduced by $1,000, of such property.

"The interest passing to the surviving spouse from the decedent is only such interest as the decedent can give. If the decedent by his will leaves the residue of his estate to the surviving spouse and she pays, or if the estate income is used to pay, claims against the estate so as to increase the residue, such increase in the residue is acquired by purchase and not by bequest. Accordingly, the value of any such additional part of the residue passing to the surviving spouse cannot be included in the amount of the marital deduction."

(9) Life Estate or Other Terminable Interest

Section 812 (e) (1) (B) of the Internal Revenue Code, as added by Section 361 (a) of the 1948 Revenue Act, provides:

"(B) Life Estate or Other Terminable Interest.—Where, upon the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur, such interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

"(i) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

"(ii) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under clauses (i) and (ii))—

"(iii) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For the purposes of this subparagraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term."

The marital deduction is allowed for absolute transfers of property from the decedent to the surviving spouse or their legal equivalents. (See Section 812 (e) (1) (F) and (G) discussed under separate headings.) It does not apply to a terminable interest, such as a life estate, passing from the decedent to the surviving spouse. Thus, if a decedent leaves his entire estate in trust, the income of which is payable to the surviving spouse for life and, upon her death, the corpus is to be distributed to decedent's issue, the entire property will be taxable in the decedent's estate. Although this section would seem to discriminate unduly against the creation of trusts, the reasons therefor are clear when it is remembered that the primary purpose of the marital deduction is to equalize the tax burden between residents
of common law and community property states. Since, in the community property states, the wife receives her tax-free one-half interest absolutely, it was felt that only a similar type of interest passing by devise in a common law state should be free of tax. Furthermore, in a community property state the one-half passing tax-free to the surviving spouse would be taxable in her estate upon death. If, however, the 50 percent deduction accorded to residents of common law states were to apply to life interests, the tax which would be levied on the death of a surviving spouse in a community property state could be avoided by residents of common law states. Thus, a devise of a life estate to a surviving spouse would mean that at the death of such spouse nothing would be taxable. The Revenue Act of 1948 contemplates that the full estate of a husband and wife should be automatically taxed one-half to the husband upon his death and the remaining half to the wife upon her death.

The Senate Finance Committee Report states that it is not necessary that the contingency or event referred to in Section 812 (e) (1) (B) (i) and (ii) must occur or fail to occur in order to make the interest terminable. For example, an interest bequeathed to the surviving spouse as long as she resides in Washington, D. C., is a terminable interest. Subparagraph (B) is intended to include all types of contingencies and conditions. It is, therefore, immaterial whether the interest passing to the surviving spouse is classified as a vested interest subject to divestment or a contingent interest. An interest given to a surviving spouse as long as she remains unmarried is a terminable interest.

It is the interest passing to the surviving spouse which must be terminable. Thus, if the decedent devises a parcel of real estate to X for life with remainder to his surviving spouse, Subparagraph (B) of 812 (e) (1) does not apply, inasmuch as the interest passing to the surviving spouse is not terminable. The value of such interest would, therefore, be deductible from the decedent's gross estate for purposes of calculating the marital deduction. Similarly, with respect to a devise to a surviving spouse and son as tenants in common: Senate Finance Committee Report, Part 2, page 8.

Where the statutory interest in lieu of dower or curtesy is a terminable interest such as a life estate, no deduction is allowed.

The following examples of the application of Subsection (B) (i) and (ii) of 812 (e) (1) are taken from the Senate Finance Committee Report, Part 2, pp. 9-10.

Example 1.—"The decedent owned the entire interest in Blackacre. He transferred Blackacre by gift to his son but retained a lease for 20 years. At his death the decedent bequeathed the lease to his surviving spouse. No marital deduction is allowed because the interest passing to the surviving spouse is a terminable interest in Blackacre in which an interest also passed from the decedent to his son who can possess or enjoy the property after the expiration of the lease. The facts of this case may be varied, but as long as an interest in Blackacre passed at any time by gift from the decedent to a person other than the surviving spouse, and
the lease (whether retained or reacquired by the decedent) was bequeathed or transferred from the decedent to the surviving spouse, no marital deduction will be allowed with respect to such lease. If, however, the decedent had sold Blackacre to any person for an adequate and full consideration in money or money’s worth and retained or purchased a 20-year lease in Blackacre which he subsequently bequeathed to the surviving spouse, the marital deduction with respect to the lease passing to the surviving spouse is not disallowed under subparagraph (B).

Example 2.—'The decedent by his will devised Blackacre to his wife and daughter as joint tenants. Both the wife and daughter have terminable interests in the same property, Blackacre. The daughter may (if she survives the wife) possess or enjoy such property after the termination of the wife’s interest. Accordingly, no marital deduction is allowed with respect to the interest passing to the surviving spouse. It is immaterial that the daughter may not possess or enjoy all of Blackacre in the event of a severance of the joint interest. It is sufficient under clause (ii) that any part of the property may (by all possibility) be possessed or enjoyed by the daughter after the termination or failure of the wife’s interest. Similarly, if the property were bequeathed in trust for the joint benefit of the wife and daughter with the corpus passing to the survivor, no marital deduction would be allowed. The daughter, by surviving the spouse, may possess or enjoy the property after the termination of the spouse’s interest.”

Example 3.—'If the decedent transferred Blackacre, in contemplation of death to his wife, Mary, for her life with remainder to X if surviving Mary, if not, to Mary’s estate, and X dies prior to the decedent’s death and while Mary is still living, the interest passing to Mary (the surviving spouse) is, viewed at the time of the decedent’s death, not disqualified for deduction under subparagraph (B).”

Example 4.—'Where the decedent during his lifetime transferred property by gift in contemplation of death to his wife for her life and then to her children and where, prior to the decedent’s death, the children by sale or gift transferred the remainder interest to the surviving spouse, the only interest passing to the surviving spouse from the decedent is a terminable interest in property in which an interest passed to the children. Viewed as of the date of the decedent’s death, no person other than the surviving spouse (or her estate) may possess or enjoy the property. However, such spouse is an assignee of other persons (the children) to whom an interest passed and accordingly the marital deduction is disallowed under clause (ii) of subparagraph (B).”

Example 5.—'Decedent in 1940 was given a power of appointment over Blackacre exercisable only in favor of his surviving spouse, his children, and the children of X (a stranger, not the creator of the power); to the extent not appointed Blackacre was to go to Y. The decedent in 1941 released his power except with respect to the power to appoint the income from Blackacre for 20 years; and at his death the decedent appointed such income interest to his surviving spouse. The power at the time of the partial release was not a taxable power. How-
ever, under the definition of 'passing', an interest in Blackacre passed (upon the release in 1941) from the decedent to Y and accordingly the interest appointed to the surviving spouse does not qualify for a deduction under the terminable interest provisions."

The mere fact that the interest passing to the surviving spouse is terminable is not in itself sufficient to exclude that interest from the marital deduction. Subsection (B) provides that the requirements of (B) (i) and (ii) must coexist before the rule applies. Thus, in addition to the terminable interest passing from the decedent to the surviving spouse, there must also be an interest passing for less than an adequate consideration in money or money's worth to some other person who may enjoy the property after the termination of the interest in the surviving spouse. For example:

"If the decedent by a transfer in contemplation of death creates a trust fund providing for all the income thereof to be paid to his spouse for 10 years and upon the end of such 10-year period or the prior death of the spouse the trust is to terminate and the corpus is to be paid to his spouse or her estate, the marital deduction is allowable, even though at the time of death the trust is still in effect. In this case, although the interest of the spouse in the trust for 10 years is a terminable interest, no person other than the surviving spouse has an interest in the trust. The value of the spouse's interest in the corpus is includible in the marital deduction under subparagraph (A) of section 812 (e) (1) inasmuch as it is not a terminable interest."


The conversion of terminable interests by a surviving spouse into different types of property is immaterial to the deduction. Thus, if a decedent bequeathed a life estate to his surviving spouse with remainder over to his son and thereafter the spouse sold her life estate for cash, the marital deduction is disallowed because the interest passing from the decedent was a terminable interest with remainder to the son. The same result would follow if the executor gave cash instead of the life estate to the surviving spouse.

Similarly, where the surviving spouse receives a life estate with remainder to her son and the son thereafter transfers his remainder interest by gift to the surviving spouse, so that she now holds the fee in the property, no marital deduction is allowed.

Where under the will a surviving spouse receives a terminable interest, no deduction will be allowed even though, had she chosen to take her statutory interest instead, she would have received a fee interest which would have been deductible. The Senate Finance Committee Report (Part 2, page 11) states that any theory that the statutory interest passed to her in such a case and was used by her to purchase the interest under the will is contrary to the intended application of this section.

(10) Interest Passing to Unascertainable Persons

Where, under a bequest, a future interest passed to a person whose identity cannot be ascertained at the time of the decedent's death, such interest shall be
considered as passing from the decedent to a person other than the surviving spouse for purposes of Subparagraph (B) (i) and (ii). This provision is not applicable with respect to trusts with powers of appointment which are specifically dealt with by Subsections (F) and (G) of 812 (e) (1) and which will be discussed subsequently: Section 812 (e) (3).

Thus, if the decedent bequeathed a life estate to his wife with remainder to such of his grandchildren as survive the wife, but if none survive then to the wife's estate, no marital deduction is allowable. An interest is considered to have passed to the grandchildren even though they are not in being at the time of the decedent's death.

Similarly, where the decedent devised a life estate to his wife with remainder to such of his wife's heirs as B shall appoint and in default of appointment to X. An interest is considered to pass from the decedent to the appointees of B or to X and no marital deduction is allowable: Senate Finance Committee Report, Part 2, page 12.

(11) Bequests of Property of Inherent Terminable Nature

Of course, there are certain types of property, such as patents, leaseholds, etc., which by their very nature are terminable and an outright bequest of such property would not invalidate the marital deduction since Subsection (B) (ii) would not apply. Thus, if a decedent bequeaths his entire interest in a patent to a wife and daughter as tenants in common, the marital deduction is allowed with respect to the wife's interest. On the other hand, if the bequest were for their joint lives and then to the survivor, the marital deduction would not be allowed.

An interest is not to be considered as terminable merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term. Where, however, a partial interest in such bonds or notes is bequeathed to a surviving spouse, Subsection (B) (i) and (ii) would apply to disallow the deduction. Similarly, under clause (iii) of Subsection (B), where an executor is directed to lend money to a trust and acquire its note for the surviving spouse with terms providing for the payment of principal and interest to the surviving spouse in equal installments over a term of years, the deduction would not be allowed: Senate Finance Committee Report, Part 2, page 13.

(12) Life Insurance Proceeds and Annuities

The same principle is applicable with respect to insurance proceeds and annuity contracts, as illustrated by the following examples which are provided by the Senate Finance Committee Report, Part 2, pp. 12-13:

"Example (1).—The entire proceeds of an insurance policy on the life of the decedent are payable to the surviving spouse and the value of such proceeds is included in determining the value of the gross estate. A marital deduction is allowed with respect to the value of the proceeds because no person other than the surviv-
ing spouse has an interest in the proceeds. The result will be the same whether such proceeds are payable in a lump sum; are payable in installments to the surviving spouse, her heirs, or assigns, for a term; or are payable to the surviving spouse for her life with no refund of the undistributed proceeds or with such a refund to her estate. It is also immaterial whether any such mode of payment is determined by an option exercised by the decedent or exercised by the surviving spouse.

"Example (2).—The decedent during his lifetime purchased an annuity contract under which the annuity was payable during his life and then to his spouse during her life if she survived him. The value of the interest of the decedent's surviving spouse in such contract at the death of the decedent is included in determining the value of his gross estate. A marital deduction is allowed with respect to the value of such interest so passing to the decedent's surviving spouse inasmuch as no other person has an interest in the contract. If upon the death of the surviving spouse the annuity payments were to continue for a term to her estate, or the undistributed portion thereof was to be paid to her estate, the deduction is nevertheless allowable with respect to such entire interest. If, however, upon the death of the surviving spouse, the payments are to continue to another person (not through her estate) or the undistributed fund is to be paid to such other person, no marital deduction is allowable inasmuch as an interest passed from the decedent to such other person."

For a more complete discussion of this subject see pp. 669-672.

(13) Direction to Executor to Acquire Terminable Interest for Spouse

Clause (iii) of Subsection (B) disallows the marital deduction where the decedent directs his executor or the trustee of a trust to acquire a terminable interest for the surviving spouse. Thus, where a decedent instructs his executor to purchase an annuity contract for his spouse for life, no marital deduction is allowed. It is immaterial that no other person has an interest in the contract since clause (iii) applies, irrespective of clauses (i) and (ii) of Subsection (B). This clause was inserted in the 1948 Revenue Act as a result of the contention by the Treasury Department that an obvious opportunity for tax avoidance would exist unless such direction to the executor brought with it a disallowance of the deduction.

(14) Interest in Unidentified Assets

Section 812 (e) (1) (C) of the Internal Revenue Act, as added by Section 361 (a) of the 1948 Revenue Act, provides as follows:

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"(C) Interest in Unidentified Assets.—Where the assets (included in the decedent's gross estate) out of which, or the proceeds of which, an interest passing to the surviving spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets passed from the decedent to such spouse, then the value of such interest passing to such spouse
shall, for the purposes of subparagraph (A), be reduced by the aggregate value of such particular assets."

This rule has particular reference to situations where the surviving spouse is a pecuniary or residuary legatee, or is the beneficiary of a trust created by decedent during life or by will, or is the heir of a decedent who dies intestate. In such circumstances, the interest passing to the surviving spouse is not represented by specified assets but by all the assets included in the decedent's estate. Under this rule, if any assets in the decedent's general estate would, if specifically passing to the surviving spouse, not be deductible, the value of the interest passing to the surviving spouse shall for purposes of the marital deduction be reduced by the aggregate value of such particular assets.

The application of this rule is illustrated by the following example set forth in the Senate Finance Committee Report, Part 2, Page 14:

"Example (1).—The decedent bequeaths $50,000 to his surviving spouse. The general estate includes a term for years (valued at $60,000 in determining the value of the decedent's gross estate) in Blackacre—an interest retained by the decedent after a gift of Blackacre to his son. Accordingly, the marital deduction with respect to the bequest of $50,000 is reduced to zero. It is immaterial whether the surviving spouse actually receives the term for years.

"Example (2).—The decedent during his life created a trust reserving the income for himself (and his estate). The trust was to terminate upon the death of the survivor of himself and his wife, at which time the corpus was to be paid to his children. The decedent died with his wife surviving and the income interest fell into the residue of his estate. The decedent bequeathed one-half of the residue to his surviving spouse. The amount of the marital deduction for the value of one-half of the residue is to be decreased by the value at the time of the decedent's death of such income interest in the trust (and for any other terminable interest included in such residue for which a marital deduction would not be allowed if specifically bequeathed or devised to the decedent's surviving spouse)."

(15) Exceptions to Terminable Interest Rule

The 1948 Revenue Act recognizes that the use of trusts under certain circumstances is highly desirable. Therefore, certain specific exceptions to the terminable interest rule are included under its provisions. These exceptions, contained in Sections 812 (e) (1) (D), (F) and (G), were added by Section 361 (a) of the 1948 Revenue Act and read as follows:

"(D) Interest of Spouse Conditional on Survival for Limited Period.—For the purposes of subparagraph (B) an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail upon the death of such spouse if—

"(i) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding six months after the decedent's death, or only
if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such events; and "(ii) such termination or failure does not in fact occur.

(F) Trust with Power of Appointment in Surviving Spouse.—In the case of an interest in property passing from the decedent in trust, if under the terms of the trust the surviving spouse is entitled for life to all the income from the corpus of the trust, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire corpus free of the trust (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the corpus to any person other than the surviving spouse—

"(i) the interest so passing shall, for the purposes of subparagraph (A), be considered as passing to the surviving spouse, and

"(ii) no part of the interest so passing shall, for the purposes of subparagraph (B) (i), be considered as passing to any person other than the surviving spouse. This subparagraph shall be applicable only if, under the terms of the trust, such power in the surviving spouse to appoint the corpus, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

(G) Life Insurance with Power of Appointment in Surviving Spouse.—In the case of proceeds of insurance upon the life of the decedent receivable in annual or more frequent installments commencing within one year after the decedent's death, if under the terms of the policy all amounts payable during the life of the surviving spouse are payable only to such spouse, and if such spouse has the power to appoint all amounts payable after such spouse's death (exercisable in favor of the estate of such spouse, whether or not the power is exercisable in favor of others)—

"(i) such proceeds shall, for the purposes of subparagraph (A), be considered as passing to the surviving spouse, and

"(ii) no part of such proceeds shall, for the purposes of subparagraph (B) (i), be considered as passing to any person other than the surviving spouse. This subparagraph shall be applicable only if, under the terms of the policy, such power in the surviving spouse to appoint, whether exercisable by will or during life, is exercisable by such spouse alone and in all events."

(a) Interest Conditioned on Survival for Limited Period and Common Disaster Clause

Subsection (D) provides that the marital deduction shall not be affected by the fact that the interest of the surviving spouse will fail where her death occurs within a six month period after the decedent's or as a result of an ordinary common disaster. Such common disaster clauses are frequently found in wills. Under this rule, a marital deduction is allowed for an interest passing from a decedent to his surviving spouse, even though the interest would have terminated in the event she...
died within six months thereafter or in a common disaster, if in fact she did not so die. This section applies a realistic approach to the incidence of tax under such situations.

(b) Trust with Power of Appointment

The most important exception to the terminable interest rule is contained in Subsection (F). This Section is designed to permit the marital deduction for certain interests in trust passing from the decedent to the surviving spouse where, by virtue of the powers granted to the surviving spouse in the trust instrument, she is the virtual owner of the corpus. Under such circumstances, the trust corpus would be ultimately taxable for Federal estate tax purposes in her estate upon death. Here, again, realism prevails.

Subsection (F) provides that if the decedent creates a trust for the benefit of the surviving spouse entitling her to all the income for life payable at least annually, with a power exercisable by her and in all events, either during her life or at death, to appoint the entire corpus to herself or to her estate, and with no power in any other person to appoint any part of the corpus other than to the surviving spouse, the interest so passing in trust shall be considered as passing from the decedent to the surviving spouse and not as passing to any other person. Under such circumstances, Section 812 (e) (1) (B) (ii) will not apply and the interest will be deductible for purposes of the marital deduction.

The following elements must be present for this exception to apply:

(1) The trust must be created by the decedent during his lifetime or under his will, with all the trust income payable at least annually to the surviving spouse for life. However, it is not necessary that the trust shall terminate upon the death of the surviving spouse. The requirement that the income be payable for life refers only to so long a period as the trust is in existence, since the wife can terminate the trust prior to her death by appointing the corpus to herself.

(2) The surviving spouse must have the power to appoint the entire corpus, free of the trust, and this power must be exercisable in favor of herself or her estate or either. The power to appoint may be exercisable either by will or during life, but in any event it must be exercisable by such spouse alone and in all events. The surviving spouse may have a combination of powers but one of them must permit appointment of the trust corpus to herself or her estate. If the power is exercisable only by will, the trust is not disqualified because of the fact that the surviving spouse has the power to invade only part of the corpus during her lifetime. Where the trust complies with the requirements of subparagraph (F), it may provide that upon the failure of the surviving spouse to exercise the power of appointment, the trust corpus is to pass to the decedent's children, without affecting the marital deduction for such interest. Similarly, if in addition to a power to appoint the entire estate to herself, the surviving spouse has a power to appoint part to others, the trust will qualify for the marital deduction. The power must be of the type commonly classified as a general power. It may be exercisable in favor
of others, and in fact may be so exercised, so long as it is also exercisable in favor of the surviving spouse or her estate. Where any person other than the surviving spouse has a power to appoint, it must be exercisable only in favor of the surviving spouse.

(3) The power in the surviving spouse, whether exercisable by will or during life, must be exercisable by such spouse alone and in all events. Thus, a power which would terminate on a particular date unless sooner exercised does not meet the requirements of this rule. Similarly, with respect to a power exercisable by will but only if the surviving spouse does not remarry. The power must also be exercisable by the surviving spouse alone. Thus, a power exercisable in conjunction with, or with the consent of another person is insufficient.

(c) Life Insurance Proceeds and Insurance Trust with Power of Appointment

An exception similar to that applicable to trusts with powers of appointment, as discussed above, is allowed with respect to proceeds of life insurance on the life of a decedent. Whether the proceeds are payable to the surviving spouse under one of the options contained in the policy, either in cash or in installments, the marital deduction will be allowed, if the surviving spouse is entitled to receive all the installments payable during her life and has a power, alone and in all events, to appoint any residue upon death to her estate. The power of appointment may be exercisable by such spouse by will or during life. The exception applies only with respect to proceeds of insurance which are receivable in installments commencing within one year after the decedent's death. Payment in installments of interest alone on the proceeds is insufficient. The installments must be such as reduce the aggregate proceeds of the policy available for future payments. As in all other interests passing from the decedent to the surviving spouse, the life insurance proceeds must form part of the decedent's gross estate for Federal estate tax, if the marital deduction is to be allowed. Therefore, proceeds of life insurance which are received by beneficiaries and are not includible in the decedent's gross estate may not be applied in computing the marital deduction.

There would seem to be no reason why life insurance proceeds cannot be made payable to a trustee under a life insurance trust, if its provisions comply with the requirements of Section 812 (e) (1) (F) and (G). Neither the wording of subparagraph (G) nor the explanations contained in the Senate Finance Committee Report shed any positive light on this alternative. Until such clarification is provided, it would seem safer to have the proceeds made payable directly from the insurance company to the surviving spouse so as to eliminate any doubt that the marital deduction will be allowed.

(16) Application of Marital Deduction to Community Property

Section 812 (e) (2) of the Internal Revenue Code, as added by Section 361 (a) of the 1948 Revenue Act, now provides for the computation of the "adjusted gross estate" in cases involving community property, as follows:

"(2) Computation of Adjusted Gross Estate,—"
"(A) General Rule.—Except as provided in subparagraph (B) of this paragraph the adjusted gross estate shall, for the purposes of paragraph (1) (H), be computed by subtracting from the entire value of the gross estate the aggregate amount of the deductions allowed by subsection (b) of this section.

"(B) Special Rule in Cases Involving Community Property.—If the decedent and his surviving spouse at any time held property as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, then the adjusted gross estate shall, for the purposes of paragraph (1) (H), be determined by subtracting from the entire value of the gross estate the sum of:

"(i) the value of property which is at the time of the death of the decedent held as such community property; and

"(ii) the value of property transferred by the decedent during his life, if at the time of such transfer the property was held as such community property; and

"(iii) the amount receivable as insurance under policies upon the life of the decedent to the extent purchased with premiums or other consideration paid out of property held as such community property; and

"(iv) an amount which bears the same ratio to the aggregate of the deductions allowed by subsection (b) of this section which the value of the property included in the gross estate, diminished by the amount subtracted under clauses (i), (ii), and (iii) of this subparagraph, bears to the entire value of the gross estate. For the purposes of clauses (i), (ii), and (iii) community property (except property which is considered as community property solely by reason of the provisions of subparagraph (C) of this paragraph) shall be considered as not 'held as such community property' as of any moment of time, if, in case of the death of the decedent at such moment, such property (and not merely one-half thereof) would be or would have been includible in determining the value of his gross estate without regard to the provisions of section 811 (e) (2). The amount to be subtracted under clause (i), (ii), or (iii) shall not exceed the value of the interest in the property described therein which is included in determining the value of the gross estate.

"(C) Same—Conversion Into Separate Property.—

"(i) If during the calendar year of 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of subparagraph (B) of this paragraph as not so held) was by the decedent and the surviving spouse converted, by one transaction or a series of transactions, into separate property of the decedent and his spouse (including any form of co-ownership by them), the separate property so acquired by the decedent and any property acquired at any time by the decedent in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of clauses (i), (ii), and (iii) of subparagraph (B), be considered as 'held as such community property'.
"(ii) Where the value (at the time of such conversion) of the separate property so acquired by the decedent exceeded the value (at such time) of the separate property so acquired by the decedent's spouse, the rule in clause (i) shall be applied only with respect to the same portion of such property of the decedent as the portion which the value (as of such time) of such separate property so acquired by the decedent's spouse is of the value (as of such time) of the separate property so acquired by the decedent."

The rule laid down in subsection (B) applies only to decedents and their spouses who hold property as community property under the law of any jurisdiction.

In general, the effect of this rule is to compute the first marital deduction on the adjusted gross estate by first subtracting the gross estate of all community property which would be included therein and the deductions under Section 812 (b) which are not allocated to such community property. The value of the community property to be subtracted under this subsection is specified in clauses (i) (ii) and (iii) relating, respectively, to community property held at death, community property transferred during life and insurance on the life of the decedent purchased out of community property. Thus, if the decedent's gross estate consisted entirely of community property, the adjusted gross estate on which the marital deduction is computed would be zero and no marital deduction would be allowed.

There is an exception, however, with respect to community property which was never treated as such for Federal estate tax purposes. This provision is designed to cover community property in California acquired prior to July 29, 1927. The community property laws of that state prior to that time were held to be ineffective for Federal tax purposes: Robbins v. United States, 269 U.S. 315 (1926); United States v. Malcolm, 282 U.S. 792 (1931). Such property would, therefore, be included in the adjusted gross estate for purposes of the marital deduction.

Section 812 (e) (2) (B) has application only to a decedent's interest in community property and does not apply to his separate property under state law. Such property, except as provided in (2) (C) (i) and (ii), is treated in the same manner as property owned by a decedent in a common law state. For example, if a decedent resident in a community property state dies, leaving a net estate of $200,000, consisting of $100,000 representing his interest in community property and $100,000 separate property, and he wills the entire estate to his wife, the Federal estate tax will be levied on $150,000. The decedent's interest in community property is entirely taxable and a marital deduction is allowed up to 50 percent of the value of the separate property. It is immaterial that the decedent bequeathed his interest in the community property to the surviving spouse. Reference to a decedent's interest in community property is intended to include only his one-half interest in all property held in community by the decedent and his spouse as of the date of death.

However, under Subparagraph (2) (C) of Section 812 (e) there is included in the category of property held as community property certain separate property
acquired by the decedent as a result of a conversion of community property to separate property.

Subparagraph (2) (C) refers to separate property, or any property acquired in exchange therefor, which was originally community property and was converted into separate property during the calendar year 1942 or at any time after April 2, 1948, the date of the enactment of the 1948 Revenue Act, by one transaction or by a series of transactions. In other words, such property, even though it be separately owned by the decedent at death, will be treated as if it were still community property and the marital deduction will have no application thereto. This provision is obviously designed to prevent residents of community property states from further reducing their estate taxes by converting community property into separate property and taking advantage of the marital deduction. The rule applies to any type of conversion of community property, whether it be partition or conversion to joint tenancy, tenancy by the entirety or any other form of co-ownership. Thus, if in 1949 husband and wife partition a parcel of land which they owned in community, so that half becomes the separate property of each spouse, upon the death of either spouse such property will, for the purposes of the marital deduction, still be considered as if it were community property. Senate Finance Committee Report, Part 2, page 20.

Section 812 (e) (2) (C) (ii) has a special rule applicable to cases where the value of the separate property so acquired by the decedent at the time of the conversion exceeded the values of the separate property acquired by the decedent’s spouse. In such cases, the decedent’s separate property so acquired shall be considered as community property. It will not be within the scope of the marital deduction, except only with respect to the same portion of such separate property of the decedent as the portion which the value of the spouse’s separate property so acquired is of the value of the separate property so acquired by the decedent. The Senate Finance Committee Report (Part 2, page 21) supplies the following examples to illustrate this rule:

"Blackacre and 100 shares of stock were held by H and W, his spouse, as community property, and in 1942 H received the shares of stock as his separate property and W received Blackacre as her separate property. At the time of the conversion, the shares of stock were worth $100,000, and Blackacre was worth $30,000. Thereafter H sold the shares of stock and invested the proceeds in Whiteacre, which he owned at the time of his death in 1949. Only 30 percent of Whiteacre is considered as property "held as such community property". Such 30 percent is obtained in dividing $30,000 (value of property received by W) by $100,000 (value of property received by the decedent at the time of the conversion)."

Section 364 of the 1948 Revenue Act amended Section 811 (j) of the Internal Revenue Code, relating to optional valuation. The last sentence of this section was amended to read as follows:

c. OPTIONAL VALUATION

"Blackacre and 100 shares of stock were held by H and W, his spouse, as community property, and in 1942 H received the shares of stock as his separate property and W received Blackacre as her separate property. At the time of the conversion, the shares of stock were worth $100,000, and Blackacre was worth $30,000. Thereafter H sold the shares of stock and invested the proceeds in Whiteacre, which he owned at the time of his death in 1949. Only 30 percent of Whiteacre is considered as property "held as such community property". Such 30 percent is obtained in dividing $30,000 (value of property received by W) by $100,000 (value of property received by the decedent at the time of the conversion)."
"In case of an election made by the executor under this subsection, then—

"(A) for the purposes of the deduction under section 812 (d) or section 861 (a) (3), any bequest, legacy, devise, or transfer enumerated therein, and

"(B) for the purpose of the deduction under section 812 (e), any interest in property passing to the surviving spouse,

shall be valued as of the date of the decedent's death with adjustment for any difference in value (not due to mere lapse of time or the occurrence or nonoccurrence of a contingency) of the property as of the date one year after the decedent's death (substituting, in the case of property distributed by the executor or trustee, or sold, exchanged, or otherwise disposed of, during such one-year period, the date there- of).

See pp. 291-295 for full discussion of optional valuations before these amendments.

The value of the marital deduction is determined as of the date of death unless the executor has chosen the optional valuation date, as of one year after the decedent's death. In the latter case, the valuation of the marital deduction is determined in the same manner as the valuation of charitable contributions deductible from the gross estate. In either case, the value is as of the date of death adjusted for any difference in value, which is not due merely to lapse of time or the occurrence of a contingency, as of a year after the date of death. Where the property was distributed, sold, exchanged, etc., prior to the expiration of one year, the value as of the date of distribution governs.

Merely because an executor has chosen to value the estate as of a year after death does not mean that the character of the interest passing from the decedent is also to be determined as of that date. As previously indicated, the interest passing to the surviving spouse is to be determined as of the date of the decedent's death. Section 811 (j) relates only to valuation of interests transferred as of the date of death. For example, if the decedent devised a life estate to his spouse and X, remainder to the survivor of X and his spouse, and X dies within a year after the decedent, no marital deduction is allowed for the interest passing to the surviving spouse even though the executor chooses, under Section 811 (j), to value the estate as of a year after the decedent's death. The interest passing from the decedent to the spouse is a terminable interest, despite the fact that as of a year thereafter she is the owner of the fee.

The following illustration of the application of this rule is furnished by the Senate Finance Committee Report (Part 2, page 4):

"The decedent's will directs the executor to sell certain described real estate and with the proceeds thereof to purchase stock of the X corporation and to turn such stock over to the widow. The value of the real estate at the decedent's death was $10,000 but it was sold by the executor prior to 1 year after the decedent's death for $12,000. The stock was purchased for $12,000 but had a fair market value of $8,000 at the death of the decedent. If the gross estate is valued at the date of the decedent's death, the marital deduction is $10,000 (the value of the
real estate at the time of death) since such value was the value of the interest included in determining the value of the gross estate. If the value of the gross estate is determined under the optional valuation rule of section 811 (j), the marital deduction is $12,000, the value of the real estate at the time of the sale within the 1-year period."

d. AMENDMENT WITH RESPECT TO PROPERTY PREVIOUSLY TAXED

Section 812 (c) of the Internal Revenue Code, relating to the deduction for property previously taxed, was amended by section 362 of the 1948 Revenue Act by the addition of two new paragraphs, which read as follows:

"The following property shall not, for the purposes of this subsection, be considered as property with respect to which a deduction may be allowed: (A) property received from a prior decedent who died after December 31, 1947, and was at the time of such death the decedent's spouse, (B) property received by gift after the date of the enactment of the Revenue Act of 1948 from a donor who at the time of the gift was the decedent's spouse, and (C) property acquired in exchange for property described in clause (A) or (B).

"Where, under the provisions of Section 1000 (f), a gift received by the decedent was considered as made one-half by the donor and one-half by the donor's spouse, one-half of the gift shall be considered as received by the decedent from each such spouse."

Prior to the enactment of the 1948 Revenue Act, the Internal Revenue Code provided that in computing the net estate of a decedent, for purposes of the Federal estate tax, there should be allowed as a deduction from the gross estate the value of any property included therein which formed a part of the gross estate of any person who died within five years prior to the death of the decedent, if it was received from the prior decedent by gift, bequest, devise, or inheritance: Section 812 (c), I.R.C.

A similar deduction is allowed for the value of property which the decedent received by gift within five years prior to his death. These deductions have been allowed only where an estate or gift tax was paid. See "Credit for Property Previously Taxed", page 263, for complete discussion prior to these amendments.

The amended section now provides that the deduction will not be allowed with respect to property received from a prior decedent who died after December 31, 1947 and who was, at the time of such death, the decedent's spouse. Similarly, the deduction will not be allowed with respect to property received by gifts after April 2, 1948, the date of the enactment of the 1948 Revenue Act, from a donor who, at the time the gift was made, was the decedent's spouse. The same prohibition applies to property acquired in exchange for the types of property above described.

The deduction is disallowed under this amendment regardless of whether a marital deduction was allowed in computing the net estate of the prior decedent or in computing the net gifts of the donor.
The Senate Finance Committee Report (Part 2, pp. 22-23) indicates that, for the purposes of this rule, where property is held at the time of the prior decedent's death in joint ownership with right of survivorship, the interest of the surviving spouse is considered received from such prior decedent to the extent of the part of such property included in determining the value of the prior decedent's gross estate. Where property is given by a third party to a husband and wife as joint tenants and one-half of such property was included in the gross estate of the husband upon his death, then one-half of such property is received by the surviving spouse from the husband and one-half is received from the donor.

The amendment also provides that where a gift to decedent is, by reason of the new amendments to the gift tax law, considered as made one-half by a husband and one-half by his wife, the gift tax rule is to be applied for the purpose of the deduction of previously taxed property and each spouse is considered as the donor to the extent of one-half the gift. The Senate Finance Committee Report gives the following examples of the application of this rule. A gift from an individual of $50,000.00 to the decedent will be considered, for purposes of Section 812 (c), as a gift of $25,000.00 from such individual and $25,000.00 from his spouse, if the gift is so considered for gift tax purposes. In such a case, if the husband paid a gift tax with respect to any part of the $25,000.00 considered as a gift by him, but no gift tax was paid with respect to the $25,000.00 considered as a gift by his spouse (by reason of the $30,000.00 exemption under the gift tax), deduction under Section 812 (c) is allowed only with respect to the $25,000.00 gift (or property acquired in exchange therefor) from the husband.

e. CREDIT FOR GIFT TAX

Section 363 (a) of the 1948 Revenue Act amended Section 813 (a) (2) (A) by inserting before the period at the end thereof the following: "reduced by the aggregate amount of the deductions allowed under subsections (d) and (e) of Section 812".

Subparagraph (B) of Section 813 (a) (2) of the Code was amended by Section 363 (b) of the 1948 Revenue Act as follows:

"(B) In applying, with respect to any gift, the ratio stated in subparagraph (A), the value at the time of the gift or at the death, referred to in such ratio, shall be reduced—

"(i) by such amount as will properly reflect the amount of such gift which was excluded in determining (for the purposes of section 1003 (a), or of section 504 (a) of the Revenue Act of 1932) the total amount of gifts made during the year in which the gift was made;

"(ii) if a deduction with respect to such gift is allowed under section 812 (e) (the so-called 'marital deduction')—then by an amount which bears the same ratio to such value (reduced as provided in clause (i) of this subparagraph) as the aggregate amount of the marital deductions allowed under section 812 (e) bears
to the aggregate amount of such marital deductions computed without regard to subparagraph (H) of section 812 (e) (1); and

"(iii) if a deduction with respect to such gift is allowed under section 812 (d) (the so-called 'charitable deduction')—then by the amount of such value, reduced as provided in clause (i) of this subparagraph.

"(C) Where the decedent was the donor of the gift but, under the provisions of Section 1000 (f), the gift was considered as made one-half by his spouse—

"(i) the term 'the amount of the tax paid under chapter 4', as used in subparagraph (A) of this paragraph, includes the amounts paid with respect to each half of such gift, the amount paid with respect to each being computed in the manner provided in subparagraph (D); and

"(ii) in applying, with respect to such gift, the ratio stated in subparagraph (A) of this paragraph, the value at the time of the gift or at the time of the death, referred to in such ratio, includes such value with respect to each half of such gift, each such value being reduced as provided in clause (i) of subparagraph (B) of this paragraph.

"(D) (i) For the purposes of subparagraph (A), the amount of tax paid under chapter 4, or under title III of the Revenue Act of 1932, with respect to any gift shall be an amount which bears the same ratio to the total tax paid for the year in which the gift was made as the amount of such gift bears to the total amount of net gifts (computed without deduction of the specific exemption) for such year.

"(ii) For the purposes of clause (i) the 'amount of such gift' shall be the amount included with respect to such gift in determining (for the purposes of section 1003 (a), or of section 504 (a) of the Revenue Act of 1932) the total amount of gifts made during such year, reduced by the amount of any deduction allowed with respect to such gift under section 1004 (a) (2), or under section 505 (a) (2) of the Revenue Act of 1932 (the so-called 'charitable deduction'), or under section 1004 (a) (3) (the so-called 'marital deduction')."

Sections 936 (b) (1) and (b) (2) of the Internal Revenue Code were amended by Sections 363 (c) and (d) respectively of the 1948 Revenue Act as follows:

(c) Section 939 (b) (1) of the Internal Revenue Code (relating to credit for gift tax) is hereby amended by inserting after the words "entire gross estate" in clause (A) thereof the following: "reduced by the aggregate amount of the deductions allowed under subsections (d) and (e) of section 812".

(d) Paragraph (2) of section 936 (b) of the Internal Revenue Code (relating to credit for gift tax) is hereby amended to read as follows:

"(2) In applying, with respect to any gift, the ratio stated in clause (A) of paragraph (1), the value at the time of the gift or at the time of the death, referred to in such ratio, shall be reduced—

"(A) by such amount as will properly reflect the amount of such gift which was excluded in determining (for the purposes of section 1003 (a), or of section
504 (a) of the Revenue Act of 1932) the total amount of gifts made during the year in which the gift was made:

"(B) if a deduction with respect to such gift is allowed under section 812 (e) (the so-called 'marital deduction')—then by an amount which bears the same ratio to such value (reduced as provided in subparagraph (A) of this paragraph) as the aggregate amount of the marital deductions allowed under section 812 (e) bears to the aggregate amount of such marital deductions computed without regard to subparagraph (H) of section 812 (e) (1); and

"(C) if a deduction with respect to such gift is allowed under section 812 (d) (the so-called 'charitable deduction')—then by the amount of such value, reduced as provided in subparagraph (A) of this paragraph.

"(3) Where the decedent was the donor of the gift but, under the provisions of section 1000 (f), the gift was considered as made one-half by his spouse—

"(A) the term 'the amount of the tax paid under chapter 4', as used in paragraph (1) of this subsection, includes the amounts paid with respect to each half of such gift, the amount paid with respect to each being computed in the manner provided in paragraph (4); and

"(B) in applying, with respect to such gift, the ratio stated in clause (A) of paragraph (1), the value at the time of the gift or at the time of the death, referred to in such ratio, includes such value with respect to each half of such gift, each such value being reduced as provided in subparagraph (A) of paragraph (2).

"(4) (A) For the purposes of paragraph (1), the amount of tax paid under chapter 4, or under title III of the Revenue Act of 1932, with respect to any gift shall be an amount which bears the same ratio to the total tax paid for the year in which the gift was made as the amount of such gift bears to the total amount of net gifts (computed without deduction of the specific exemption) for such year.

"(B) For the purposes of subparagraph (A) the 'amount of such gift' shall be the amount included with respect to such gift in determining (for the purposes of section 1003 (a), or of section 504 (a) of the Revenue Act of 1932) the total amount of gifts made during such year, reduced to such gift under section 1004 (a) (2), or under section 505 (a) (2) of the Revenue Act of 1932 (the so-called 'charitable deduction'), or under section 1004 (a) (3) (the so-called 'marital deduction')."

These amendments give effect in computing the credit for the gift tax to the estate and gift tax provisions for the marital deduction under Sections 812 (e) and 1004 (a) (3) of the Code and to the gift tax provisions for splitting of gifts of spouses to third parties under Section 1000 (f), as amended by the 1948 Revenue Act.

They are effective in estates of decedents dying after December 31, 1947.

The general pattern under the prior law for computing the credit for gift tax is retained under the 1948 Revenue Act. (See pages 279-284).
In general, under existing law this provision limits the credit to (1) an amount which bears the same ratio to (2) the basic estate tax as (3) the value of so much of the property which constitutes the gift as is included in the gross estate bears to (4) the value of the entire gross estate. The only change in such subparagraph (A) itself is the elimination from (4), the value of the entire gross estate, of the aggregate amount of the deductions allowed under Sections 812 (d) and (e) (relating respectively to the charitable deduction and the marital deduction). The effect of this provision is to make the amount in (4) smaller and accordingly, to allow, generally, a larger credit for the gift tax where this limitation is applicable than would be allowed if this change were not made.

The amount in (3), the value of so much of the property which constitutes the gift as is included in the gross estate, in the ratio stated in subparagraph (A) is to be reduced as provided in new subparagraph (B). The value (which is the value at the time of the gift or at the time of the death, whichever is lower) is to be reduced first by such amount as will properly reflect the amount of such gift which was excluded on account of the annual exclusion in determining the total amount of gifts made during the year in which the gift was made. (See pp. 442-443.) This reduction has long been prescribed by Treasury regulations and represents existing law.

The amount in item (3) in the ratio is also to be reduced if a marital deduction with respect to the gift is allowed under section 812 (e).

The computation of the credit for gift tax is required separately with respect to each gift and the law is intended to operate on the basis of such separate computations.

A new subparagraph, (C), was added to Section 813 (a) (1) for determining the credit for gift tax in cases of gifts which, for the purposes of gift tax, (under Section 1000 (f) of the Code, as added by Section 374 of the 1948 Revenue Act) are considered made half by the decedent and half by his spouse. The principal effect of this provision is to allow the estate of a decedent who was the actual donor of the gift a gift-tax credit with respect to the entire gift, including the proportionate part of the gift tax of his spouse paid with respect to the half considered as a gift made by her. Each half, however, must first be reduced by the applicable annual exclusions, etc., as provided in subparagraph (B).

In the case of property jointly held by the decedent and his spouse, a gift of such property by them results, if section 1000 (f) of the Code is made applicable by a proper consent, in a gift by each spouse of one-half of his undivided interest and of one-half of his spouse's undivided interest. In such a case, the decedent is entitled to a credit for the gift tax paid with respect to his interest in the property which can be included in the value of his gross estate. Therefore, the credit is allowed in the case of such a decedent for the gift tax paid with respect to the half of his interest considered a gift by him and for the other half of his interest considered a gift by his spouse.
Amendments corresponding to those made in Section 813 (a) (1) are also made in Section 936 (b), relating to the credit against the additional estate tax for gift taxes paid.

These amendments are applicable in computing the credit against the estate tax in the case of estates of non-residents not citizens of the United States (although the amendments with respect to gifts for which a marital deduction is allowed will have more limited effect because such deduction is not allowed in the case of a non-resident alien donor and a non-resident alien decedent). See Senate Finance Committee Report, Part 2, pp. 23-27.

f. LIABILITY OF LIFE INSURANCE BENEFICIARIES AND RECIPIENTS OF PROPERTY SUBJECT TO POWER OF APPOINTMENT

The following amendments were made by Section 365 of the 1948 Revenue Act to Sections 826 (c) and (d) of the Internal Revenue Code:

(a) Section 826 (c) of the Internal Revenue Code (relating to liability of life insurance beneficiaries) is hereby amended by adding at the end thereof the following new sentence: "In the case of such proceeds receivable by the surviving spouse of the decedent for which a deduction is allowed under section 812 (e) (the so-called 'marital deduction'), this subsection shall not apply to such proceeds except as to the amount thereof in excess of the aggregate amount of the marital deductions allowed under such subsection."

(b) Section 826 (d) of the Internal Revenue Code (relating to liability of recipient of property over which decedent had power of appointment) is hereby amended by adding at the end thereof the following new sentence: "In the case of such property received by the surviving spouse of the decedent for which a deduction is allowed under section 812 (e) (the so-called 'marital deduction'), this subsection shall not apply to such property except as to the value thereof reduced by an amount equal to the excess of the aggregate amount of the marital deductions allowed under section 812 (e) over the amount of proceeds of insurance upon the life of the decedent receivable by the surviving spouse for which proceeds a marital deduction is allowed under such subsection."

See page 288 for full discussion of this problem.

Sections 826 (c) and (d) provide a rule of apportionment with respect to the share of estate tax to be borne by recipients of proceeds of insurance on the life of a decedent, and recipients of property over which the decedent had a power of appointment. The instant amendments were technical in nature and intended to take into account the effect of the marital deduction on the apportionment rule.

If the aggregate amount of marital deductions under Section 812 (e) is allowed (without limitation under Section 812 (e) (1) (H) to 50-percent of the adjusted gross estate) Section 826 (c) and Section 826 (d) do not apply to such insurance proceeds or property (subject to the power) for which a marital deduction is allowed. If the 50-percent limitation is applicable, an order of priority is established by the
amendment for determining the portion of the insurance proceeds or property (subject to the power) receivable by the surviving spouse for which the marital deduction was allowed. In such a case, the marital deduction is considered allowed first with respect to the insurance proceeds to the extent of the amount of such proceeds so receivable, and second (the balance of the marital deduction) is considered allowed with respect to the property (subject to the power) to the extent of the value of such property. See Senate Finance Committee Report, Part, 2, page 28.

g. BASIS OF SURVIVING SPOUSE’S INTEREST IN COMMUNITY PROPERTY

Section 366 of the 1948 Revenue Act amended Section 113 (a) (5) of the Internal Revenue Code, relating to basis of property for determining gain or loss for income tax purposes, in respect of property transmitted at death, as follows:

(a) Section 113 (a) (5) of the Internal Revenue Code (relating to basis of property transmitted at death) is hereby amended by adding at the end thereof the following sentences: "For the purposes of this paragraph the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State, Territory or possession of the United States or any foreign country shall be considered to be property 'acquired by bequest, devise, or inheritance' from the decedent, if the death of the decedent was after December 31, 1947, and if at last one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate under section 811. In the case of property held by a decedent and his surviving spouse under the community property laws of any State, Territory, or possession of the United States or any foreign country, if the value of any part of the surviving spouse's one-half share of such property was included in determining the value of the gross estate of the decedent and a tax under chapter 3 was payable upon the transfer of the net estate of the decedent, then for the purposes of this paragraph such part of such one-half share of the surviving spouse shall be considered to be property 'acquired by bequest, devise, or inheritance' from the decedent, if the death of the decedent was after the date of the enactment of the Revenue Act of 1942 and on or before December 31, 1947; but nothing in this sentence shall reduce basis below that which would exist if the Revenue Act of 1948 had not been enacted."

(b) If the allowance of a credit or refund of any overpayment of tax resulting from the application of this section is prevented on the date of the enactment of this Act, or within one year from such date, by the operation of any law or rule of law (other than section 3761 of the Internal Revenue Code, relating to compromises), credit or refund of such overpayment may, nevertheless, be allowed or made if claim thereof is filed within one year from the date of the enactment of this Act. No interest shall be paid on any overpayment resulting from the application of the last sentence of Section 113 (a) (5) of such code, as amended by this section, if such overpayment is for a taxable year beginning before January 1, 1948.
This provision has application only to those spouses who own community property. It indicates the basis of the surviving spouse's interest in community property for purposes of computing gain or loss for income tax purposes. Under the amendment, the surviving spouse is regarded as acquiring her interest in the community property by "bequest, devise, or inheritance" from the decedent, and, therefore, the property takes the same basis as if it had been acquired from the decedent. The basis of property passing from the decedent is its value as of the date of death or one year thereafter, depending on the executor's election under Section 811 (j). Thus, the basis of the surviving spouse's interest in community property held with the decedent as of the date of death is determined in accordance with this rule. The amendment is effective as to decedents dying after December 31, 1947 and also as to decedents who died on or after October 22, 1942 (the date of the enactment of the 1942 Revenue Act) and on or before December 31, 1947. However, the basis cannot be reduced by this provision below that which would exist if the 1948 Revenue Act had not been enacted.

An allowance of a credit or refund, without interest, for any overpayment of tax resulting from the application of this section is made available and the time for claiming same is extended, if otherwise barred, to within one year after the enactment of the 1948 Revenue Act.


a. REPEAL OF COMMUNITY PROPERTY PROVISIONS

Section 371 of the 1948 Revenue Act amended Section 1000 (d) of the Internal Revenue Code, as follows:

Section 1000 (d) of the Internal Revenue Code (relating to gifts of property held as community property) is amended by adding at the end thereof a new sentence to read as follows: "This subsection shall be applicable only to gifts made after the calendar year 1942 and on or before the date of the enactment of the Revenue Act of 1948."

This section limits the applicability of Section 1000 (d) of the Code, dealing with the taxation of gifts of community property, to gifts made after 1942 and on or before April 2, 1948, the date of the enactment of the 1948 Revenue Act. Thereafter, all gifts of community property will be taxed in the same manner as they were prior to the enactment of the Revenue Act of 1942. Thus, where a husband makes an absolute gift of community property to his wife so that it becomes her separate property, the gift tax will be levied only on one-half the value of the property, since under the community property law the wife is already the owner of the other half. See pp. 428-429. Similarly, gifts of community property made to third parties will be regarded as one-half the gift of the husband and one-half the gift of the wife.

For purposes of Section 1001 of the Code, Section 1000 (d), as it read prior to its amendment by the 1948 Revenue Act, remains applicable in determining net gifts of community property made after 1942 but prior to the date of the enactment
of the 1948 Revenue Act. The net gifts of prior years are important since, under the gift tax pattern, they are added to the gifts of the current year in order to determine the rate at which the current gifts will be taxed.

To equalize the gift tax between residents of community property and common law states, the same 'splitting' technique applied to the income and estate tax is also made available under the gift tax, as amended by the 1948 Revenue Act.

b. MARITAL DEDUCTION

(1) General

Section 372 of the 1948 Revenue Act amended Section 1004(a) of the Internal Revenue Code, relating to deductions in computing net gifts in the case of a citizen or resident of the United States, by adding a new paragraph thereto, to read as follows:

"(A) In General.—Where the donor transfers during the calendar year (and after the date of the enactment of the Revenue Act of 1948) by gift an interest in property to a donee who at the time of the gift is the donor's spouse—an amount with respect to such interest equal to one-half of its value."

Under these provisions, outright gifts between spouses in common law states are taxable only to the extent of one-half the value thereof. Thus, if a husband gives his wife $100,000 the 50 percent deduction will apply and the tax will be computed only on $50,000.

The marital deduction applies to each individual gift made by one spouse to the other. It is calculated without reference to the annual exclusion of $3,000 for gifts made by an individual. For example, if a husband makes a gift of $10,000 to his wife during the year, an exclusion of $3,000 is allowed. The marital deduction, however, will still be $5,000 (50 percent of the gift) and only $2,000 will be subject to gift tax.

(2) Gifts of Life Estate or Other Terminable Interest

Subparagraph (B) of Section 1004(a)(3), as added by Section 372 of the 1948 Revenue Act, provides as follows:

"(B) Life Estate or Other Terminable Interests.—Where, upon the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur, such interest transferred to the spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

"(i) if the donor retains in himself, or transfers or has transferred (for less than an adequate and full consideration in money or money's worth) to any person other than such donee spouse (or the estate of such spouse), an interest in such property, and if by reason of such retention or transfer the donor (or his heirs or assigns) or such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination of failure of the interest transferred to the donee spouse; or
"(ii) if the donor immediately after the transfer to the donee spouse has a power to appoint an interest in such property which he can exercise (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse. For the purposes of this clause the donor shall be considered as having immediately after the transfer to the donee spouse such power to appoint even though such power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur.

An exercise or release at any time by the donor, either alone or in conjunction with any person, of a power to appoint an interest in property, even though not otherwise a transfer, shall, for the purposes of clause (i) of this subparagraph, be considered as a transfer by him. Except as provided in subparagraph (E), where at the time of the transfer it is impossible to ascertain the particular person or persons who may receive from the donor an interest in property so transferred by him, such interest shall, for the purposes of clause (i) of this subparagraph, be considered as transferred to a person other than the donee spouse."

This limitation of the general rule expressed in Section 1004 (a) (3) (A) corresponds to that contained in the estate tax amendments with respect to life estates and terminable interests. See discussion of Section 812 (e) (1) (B), pp. 617-622. It provides that no deduction will be allowed where the gift to the spouse is of a terminable interest, if the reversionary or remainder interest is in the donor or has been transferred by him to another person for less than adequate and full consideration in money or money's worth; and if the donor or such other person may possess or enjoy the property after the termination or failure of the interest transferred to the spouse. For example:

"If a donor purchases an annuity contract payable to his wife for her life with refund of any undistributed portion of the fund to the donor or his estate, no marital deduction will be allowed. If the donor purchases an annuity contract providing for payments to be made first to the donor for his life and then to his spouse for her life, if surviving the donor, and for no refund of any unpaid portion of the fund, no marital deduction is allowed; for the donor may, if he survives his spouse, possess or enjoy his retained interest after the failure of her interest. If the contract provides for a refund to the spouse's estate or any unpaid portion of the fund, a marital deduction is not allowed; for the right to any refund may terminate prior to the donor's death." See Senate Finance Committee Report, Part 2, pp. 30-31.

The exercise or release at any time by the donor, alone or in conjunction with any person, of a power of appointment, even though not otherwise a transfer, will for the purposes of Section 1004 (a) (3) (B) (i) be considered as a transfer by the donor.
The Senate Finance Committee Report (Part 2, page 31) supplies the following example of the application of this rule:

"In a case in which the donor was the sole beneficiary of the income from a trust and had the power to appoint the corpus of the trust upon its termination, if the donor released his power to appoint (his spouse not being the taker in default of appointment) and assigned his entire income interest to his spouse, the marital deduction is not allowed with respect to the gift to the spouse. The release of the power is considered a transfer by the donor to the taker in default. It is immaterial whether the power so released is a power of appointment within the definition in section 1000 (c) of the code or whether such release was for gift tax purposes (other than clause (i) considered a transfer, or whether the power was released any time before or at the same time as the gift to the spouse. A release of a power includes the failure to exercise a power to the extent such failure has the effect of terminating the power."

Where the donor after making a gift to his spouse retains a power of appointment which he can exercise for the benefit of someone other than the spouse and such other person may possess the property after the termination of the interest in the spouse, no marital deduction is allowable. For example, if the donor has a power of appointment over certain real estate and appoints a life estate to his spouse, retaining the power to appoint to another remainder interest, no marital deduction is allowed with respect to the gift to his spouse.

3. Interest in Unidentified Assets

Section 1004 (a) (3) (C) of the Internal Revenue Code is also new and was added by Section 372 of the 1948 Revenue Act. It provides as follows:

"(C) Where the assets out of which, or the proceeds of which, the interest transferred to the donee spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets were transferred from the donor to such spouse, then the value of the interest transferred to such spouse shall, for the purposes of subparagraph (A), be reduced by the aggregate value of such particular assets."

This section corresponds to Subsection (C) of Section 812 (e) (1) under the estate tax. It is especially applicable to gifts in trust under which the donor's spouse has the remainder interest or the trust income and a power to appoint to herself or her estate. Under such circumstances, this provision has the effect of reducing the marital deduction on account of the value of assets transferred by the donor in trust for which a marital deduction would not be allowed if such assets were transferred by gift from the donor to such spouse: Senate Finance Committee Report, Part 2, pp. 31-32.

4. Exceptions to Terminable Interests Rule

(a) Joint Interests

Section 1004 (a) (3) (D) of the Internal Revenue Code, added by Section 372 of the 1948 Revenue Act, provides:
"(D) Joint Interests.—If the interest is transferred to the donee spouse as sole joint tenant with the donor or as tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, shall not be considered for the purposes of subparagraph (B) as an interest retained by the donor in himself."

This provision permits the application of the marital deduction to transfers of interests to a donee-spouse to be held with the donor in joint tenancy or by the entitites. The mere fact that the donor may survive the donee-spouse, so that he will again regain the property through rights of survivorship, does not render the interest transferred a terminable interest.

(b) Trusts with Powers of Appointment

Section 1004 (a) (3) (E) of the Internal Revenue Code, added by Section 372 of the 1948 Revenue Act, provides:

"(E) Trust with Power of Appointment in Donee Spouse.—Where the donor transfers in trust an interest in property, if under the terms of the trust his spouse is entitled for life to all the income from the corpus of the trust, payable annually or at more frequent intervals, with power in the donee spouse to appoint the entire corpus free of the trust (exercisable in favor of such donee spouse, or of the estate of such donee spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the corpus to any person other than the donee spouse—

"(i) the interest so transferred in trust shall, for the purposes of subparagraph (A), be considered as transferred to the donee spouse, and

"(ii) no part of the interest so transferred in trust shall, for the purposes of subparagraph (B) (i), be considered as retained in the donor or transferred to any person other than the donee spouse.

"This subparagraph shall be applicable only if, under the terms of the trust, such power in the donee spouse to appoint the corpus, whether exercisable by will or during life, is exercisable by such spouse alone and in all events."

This provision corresponds to Section 812 (e) (1) (F) of the estate tax law. See discussion under that section, pp. 629-631 which is equally applicable here.

(5) Gifts of Community Property

Section 1004 (a) (3) (F) of the Internal Revenue Code, added by Section 372 of the 1948 Revenue Act, provides:

"(F) Community Property.—

"(i) A deduction otherwise allowable under this paragraph shall be allowed only to the extent that the transfer can be shown to represent a gift of property which is not, at the time of the gift, held as community property under the law of any State, Territory, or possession of the United States, or of any foreign country."

"(ii) For the purposes of clause (i), community property (except property which is considered as community property solely by reason of the provisions of
clause (iii) shall not be considered as 'held as community property' if the entire value of such property (and not merely one-half thereof) is treated as the amount of the gift.

"(iii) If during the calendar year 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of clause (ii) as not so held) was by the donor and the donee spouse converted, by one transaction or a series of transactions, into separate property of the donor and such spouse (including any form of co-ownership by them), the separate property so acquired by the donor and any property acquired at any time by the donor in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of clause (i), be considered as 'held as community property'.

"(iv) Where the value (at the time of such conversion) of the separate property so acquired by the donor exceeded the value (at such time) of the separate property so acquired by such spouse, the rule in clause (iii) shall be applied only with respect to the same portion of such separate property of the donor as the portion which the value (as of such time) of such separate property so acquired by such spouse is of the value (as of such time) of the separate property so acquired by the donor."

This provision disallows the marital deduction with respect to gifts of community property or of certain separate property considered as community property and held with the person who is the donor's spouse at the time of the gift.

The rules herein contained for the determination of such separate property which is considered as community property are generally similar in principle to the provisions contained in Section 812 (e) (2) (B) and (C) with respect to the estate tax law. See discussion thereunder, pp. 632-636.

(6) Extent of Deduction

Section 1004 (c) of the Internal Revenue Code, relating to the extent of deductions allowed in computing net gifts, was amended by Section 373 of the 1948 Revenue Act to read as follows:

"(c) Extent of Deductions.—The deductions provided in subsection (a) (2) or (3) or in subsection (b) shall be allowed only to the extent that the gifts therein specified are included in the amount of gifts against which such deductions are applied."

The effect of this provision is to limit the marital deduction in any one year to the amount of gifts included for the purpose of computing net gifts to the spouse. For example, if the only gift by a donor to his spouse during a calendar year is $5,000, an exclusion of $3,000 is allowed so that the amount included in net gifts is $2,000. A marital deduction is allowed in the amount of $2,500 (50 percent of the entire gift). This section limits the deduction, however, to $2,000, so that the extra $3,000 cannot be used to offset net gifts to others on which the gift tax is computed.
The Senate Finance Committee Report (Part 2, pages 32-33) furnishes the following example:

"A donor transferred $4,000 by gift to his spouse in January 1949 and $4,000 by gift to her in July 1949 and made no other gifts to her during the year. The marital deductions allowed (without regard to Sec. 1004 (c)) total $4,000 (that is two deductious of $2,000 each). Since only one $3,000 annual exclusion is allowed for the gifts to the donee spouse, the extent to which the two gifts (total $8,000) are included in the amount of gifts for the purpose of determining net gifts is $5,000. Accordingly, since the total marital deductions ($4,000) do not exceed $5,000, the marital deductions are allowed in full."

c. GIFT OF HUSBAND OR WIFE TO THIRD PARTY

(1) Gift Deemed Made One-half by Each Spouse

Section 374 of the 1948 Revenue Act amended Section 1000 of the Internal Revenue Code, relating to the imposition of a gift tax, by adding a new subsection (f) (1) (A), as follows:

"(f) Gift of Husband or Wife to Third Party.—

(1) Considered as Made One-Half by Each.—

(A) In General.—A gift made after the date of the enactment of the Revenue Act of 1948 by one spouse to any person other than his spouse shall, for the purposes of this chapter, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. This subparagraph shall not apply with respect to a gift by a spouse of an interest in property if he creates in his spouse a power of appointment, is defined in subsection (c) of this section, over such interest. For the purposes of this subsection an individual shall be considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year."

This section seeks to equalize the situation between residents of community property and common law states with respect to gifts by husband or wife to third parties. In the community property states, a gift of community property to a third party is deemed to be made one-half by the wife and one-half by the husband. Because of the sharply progressive rates and personal exemptions permitted under the gift tax, the tax on such gifts in community property states would be accordingly less than a gift of the same property in common law states where the entire value of the gift is chargeable to the donor. This section, therefore, provides that after the enactment of the 1948 Revenue Act, the husband and wife in a common law state may elect to have the gift made to a third party treated as though each had made one-half of the gift. Thus, where a father makes a gift of $50,000 to a child, the gift will be considered to have been made by each spouse to the extent of $25,000 and will be taxable in that amount to each accordingly.
For purposes of this rule, an individual is considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year. Thus, if an individual who is not married makes a gift to X and later in the same calendar year marries Y, no marital deduction is allowed since he was unmarried at the time the gift was made, even though the gift tax return was not filed until the end of the year, at which time he was married.

(2) Exception: Power of Appointment in Donor's Spouse

This rule does not apply to gifts over which the donor creates in his spouse a power of appointment, as defined in Section 1000 (c) of the Code. For example:

"A husband creates a trust, the income of which is to be accumulated, and provides that his spouse shall have a testamentary power of appointment exercisable in favor of any person, but in the event of a failure to exercise such power the property shall pass free of the trust to X. In such a case, no part of the interest subject to the spouse's power of appointment may for the purposes of section 1000 (f) of the Code be considered as a gift to a third party." Senate Finance Committee Report, Part 2, page 33.

(3) Consent of Both Spouses and Revocation of Consent

Section 1000 (f) (1) (B) of the Internal Revenue Code, added by Section 374 of the 1948 Revenue Act, provides as follows:

"(B) Consent of Both Spouses.—Subparagraph (A) shall be applicable only if both spouses have signified (in accordance with the regulations provided for in paragraph (2)) their consent to the application of subparagraph (A) in the case of all such gifts made during the calendar year by either while married to the other."

The splitting of gifts made by either spouse to third parties is not mandatory. It is permitted only if both spouses consent. The consent, if made with respect to any gift during the calendar year, applies with respect to all gifts made to third parties during such calendar year. A consent signified with respect to gifts made in a calendar year is effective with respect to such gifts in computing the gift tax for all future calendar years in which such gifts enter into the base for computing the tax for such future years.

The consent if made with respect to any gift during the year applies to all gifts to third parties during the calendar year made out of community property, or property held by the spouses as joint tenants or as tenants by the entirety. In such a case each spouse is considered to have made a gift of one-half of his interest and one-half of his spouse's interest in the joint property given. A consent signified does not have the effect of "splitting" any gift to the donor's spouse, even though no marital deduction is allowed under Section 1004 (a) (3) for such gift. It does not affect the basis for income tax purposes under Section 113 (a) (2) of the Code.
The consent which is signified is effective to split the gifts of a spouse only for the purpose of the gift tax except as expressly provided elsewhere.

Paragraphs (2) and (3) of Section 1000 (f) provide special rules relating to the time and manner of signifying the consent and the revocation of a consent, as follows:

"(2) Manner and Time of Signifying Consent.—

(A) Manner.—A consent under this subsection shall be signified in such manner as is provided under regulations prescribed by the Commissioner with the approval of the Secretary.

(B) Time.—Such consent may be so signified at any time after the close of the calendar year in which the gift was made, subject to the following limitations—

(i) the consent may not be signified after the 15th day of March following the close of such year, unless before such 15th day no return has been filed for such year by either spouse, in which case the consent may not be signified after a return for such year is filed by either spouse;

(ii) the consent may not be signified after a notice of deficiency with respect to the tax for such year has been sent to either spouse in accordance with section 1012 (a).

(3) Revocation of Consent.—Revocation of a consent previously signified shall be made in such manner as is provided under regulations prescribed by the Commissioner with the approval of the Secretary, but the right to revoke a consent previously signified with respect to a calendar year—

(A) shall not exist after the 15th day of March following the close of such year if the consent was signified on or before such 15th day; and

(B) shall not exist if the consent was not signified until after such 15th day.

A consent and the revocation of a consent shall be signified in such manner as is provided under regulations prescribed by the Commissioner with the approval of the Secretary. The Commissioner may require the consent to be signified on the returns of the spouses.

The consent may not be signified after the 15th day of March following the close of the calendar year in which the gift was made. An exception to this rule is made in cases where before such date, no return was filed for such year by either spouse. In such cases, the consent may not be signified after a return for such year is filed by either spouse. Under this rule, if an extension of time is obtained for both spouses for filing their returns for the calendar year in which the gift was made, the consent may be signified at any time on or before the day the return of the spouse first to file is filed. A limitation on the exception is provided in cases in which a notice of deficiency, with respect to the tax for the year in which the gift was made is, before both spouses have signified the consent, sent to either spouse in accordance with Section 1012 (a) of the Code. In such cases the consent cannot be signified after the deficiency notice is mailed.
The right to revoke a consent previously signified with respect to a calendar year is subject to the time limitations prescribed in paragraph (3) of Section 1000 (f). The first limitation is that a consent signified on or before the 15th day of March following the close of the calendar year in which the gift was made cannot be revoked after such 15th day. The second limitation is that a consent signified after such 15th day cannot be revoked. Thus, if the spouses obtain an extension of time for filing their returns to a date after March 15 and file the consent after March 15, such consent cannot be revoked regardless of when the returns are filed. See Senate Finance Committee Report, Part 2, pages 33-34.

(4) Liability for Tax Where Consent Signified

Section 1000 (f) (4) of the Internal Revenue Code added by Section 374 of the 1948 Revenue Act reads as follows:

"(4) Joint and Several Liability for Tax.—If the consent required by paragraph (1) (B) is signified with respect to a gift made in any calendar year the liability with respect to the entire tax imposed by this chapter of each spouse for such year shall be joint and several."

Paragraph (4) of Section 1000 (f) provides that if the consent is signified for a gift in any calendar year, the liability with respect to the entire tax imposed on each spouse for such year by the gift tax provisions of the Code shall be joint and several. The consent referred to in this provision is a consent which is validly signified and not revoked. It is not contemplated under this provision that where one spouse pays the entire tax liability of both spouses, any gift tax will result by reason of payment of the liability of the other spouse.