Louisiana Law Review

Volume 6 | Number 4
The Work of the Louisiana Supreme Court for the 1944-1945 Term
May 1946

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Martha E. Kirk

LOUISIANA LAW REVIEW

LOUISIANA STATE UNIVERSITY LAW SCHOOL
UNIVERSITY STATION, BATON ROUGE, LOUISIANA

Subscription per volume $4.00 (Foreign $4.50) Single Copy, $1.00

VOLUME VI MAY, 1946 NUMBER 4

Comments

INCLUSION OF COMMUNITY PROPERTY IN GROSS ESTATE UNDER FEDERAL ESTATE TAXATION

In the decision of *Fernandez v. Wiener*[1] the United States Supreme Court upheld as constitutional Section 402(b)(2) of the 1942 revenue act, as applied to the estate of a Louisiana decedent. That act, amending Section 811(e) of the Internal Revenue Code, imposes an estate tax measured by the value of the entire community upon the death of one of the spouses.[2] While giving effect to an attempt on the part of Congress to alleviate an inequitable situation as far as the estate tax burden is con-

1. 66 S.Ct. 178, 90 L.Ed. 147 (U.S. 1945). See also the case of United States v. Rompel, 90 L.Ed. 163 (U.S. 1945), a case involving the application of Section 402(b)(2) of the 1942 revenue act [56 Stat. 798 (1942), 26 U.S.C.A. § 811(e) (Supp. 1944)] in Texas, decided by the Supreme Court at the same time and with the same result as the *Wiener* case.

2. 56 Stat. 798 (1942), 26 U.S.C.A. § 811(e) (Supp. 1944).

cerned, the court gave scant heed to prior decisions concerning taxation of community income[3] and left a serious doubt among community property advocates as to the correctness of the ruling.

In considering the merits and implications of the decision, it will first be necessary to gain some understanding of the nature and importance of the issues involved. This can be accomplished only by a thorough consideration of the federal estate tax provisions in the light of the Louisiana community property system.

Issues involved

An estate tax is a form of death tax which is levied upon the transmission of property or property rights at death,[4] before the administration of the estate. Under the current federal estate tax, which has been in effect since September 8, 1916, the tax is measured by the value of the decedent's "gross estate."

What actually constitutes a part of the gross estate often presents many complex and confusing problems in considering whether the deceased was owner of the property so that it might be taxable to his estate. These problems can be settled only with reference to the property laws of the state in which the deceased was domiciled.[5] As a consequence, the differences in theories and property concepts in the various states have unevenly distributed this tax burden in the past. Perhaps the most obvious example of this lack of uniformity has been the manner in which the eight community property states have been favored under Section 811 (e) (1) of the Internal Revenue Code, which provides that the gross estate shall include any interest held as "joint tenants by the decedent and any other person, or as tenants by the entirety by deceased and spouse."

Since the community of acquets and gains existent in Louisiana comprehends distinct, undivided interests in the spouses, as distinguished from a "joint tenancy" or a "tenancy by the en-

3. Arnett v. Read, 220 U.S. 311, 31 S.Ct. 425, 55 L.Ed. 477 (1910); Bender v. Pfaff, 282 U.S. 127, 51 S.Ct. 64, 75 L.Ed. 252 (1930); Goodell v. Koch, 282 U.S. 118, 51 S.Ct. 62, 75 L.Ed. 247 (1930); Hopkins v. Bacon, 282 U.S. 122, 51 S.Ct. 62, 75 L.Ed. 249 (1930); Poe v. Seaborn, 282 U.S. 101, 51 S.Ct. 58, 75 L.Ed. 239 (1930); Hoeper v. Tax Commission, 284 U.S. 206, 52 S.Ct. 120, 76 L.Ed. 248 (1931).

4. Bromley v. McCaughn, 280 U.S. 124, 50 S.Ct. 46, 74 L.Ed. 226 (1929); Burnet v. Wells, 289 U.S. 670, 53 S.Ct. 761, 77 L.Ed. 1439 (1932).

5. Tyler v. United States, 281 U.S. 497, 50 S.Ct. 81, 74 L. Ed. 607 (1929); Poe v. Seaborn, 282 U.S. 101, 51 S.Ct. 58, 75 L.Ed. 239 (1930); Freuler v. Helvering, 291 U.S. 35, 54 S.Ct. 308, 78 L.Ed. 634 (1933); Blair v. Commissioner of Internal Revenue, 300 U.S. 5, 57 S. Ct. 33, 81 L.Ed. 469 (1937); Sharp v. Commissioner of Internal Revenue, 303 U.S. 624, 58 S.Ct. 748, 82 L.Ed. 1087 (1937).

tirety,"[6] there had been included in the measure of the tax in Louisiana and other community property states only one-half of the property held as community. In the other states a tax is collected upon the whole of the property held as tenants by the entirety by the spouses.[7] Due to the large basic exemption and the steeply progressive rates of the tax, citizens of community property states have not only been able to reduce the amount which must be paid into the United States treasury, but have been able, in a substantial number of cases, to avoid tax liability altogether.

In an effort to obviate this lack of uniformity, Congress amended the revenue code in 1942, placing an additional paragraph in Section 811(e).[8] This amendment stipulated that the term "gross estate" would be expanded to cover

> ". . . the extent of the interest therein held as *community property* by the decedent and surviving spouse under the law of any state of the United States, except such part thereof as may 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 separate property of the surviving spouse."

Committee reports show that in so amending the revenue code, Congress relied upon the decisions of the Supreme Court in *Tyler v. United States*[9] and *United States v. Jacobs*[10] (cases in which the constitutionality of paragraph one had been upheld) as an indication that this amendment would not be declared unconstitutional. However, whether or not the court would actually uphold the enactment under the same line of reasoning as had been used to decide the *Tyler* and *Jacobs* cases remained, in the minds of the students of the subject, a doubtful question.

It was hoped the *Succession of Wiener*,[11] a case arising in the Louisiana courts, involving the validity of Act 119 of 1932,[12]

6. For a discussion of the differences between joint tenancies, tenancies by the entirety, and tenancies in common, see Tiffany, The Law of Real Property (3 ed. 1939) § 418 et seq.

7. Certain allowances and deductions are made in these situations dependent upon who paid for the property in question.

8. Revenue Act of 1942, § 402, 56 Stat. 798, c. 617, 26 U.S.C.A. § 811(e) (Supp. 1944).

9. 281 U.S. 497, 50 S.Ct. 81, 74 L.Ed. 607 (1929).

10. 306 U.S. 363, 61 S.Ct. 133, 83 L.Ed. 763 (1938).

11. 203 La. 649, 14 So. (2d) 475 (1943).

12. This act is typical of the "take up" clauses which were passed by several states for the purpose of taking advantage of the 80 per cent credit allowed under the provisions of the Federal Revenue Act of 1926. The usual provision of these clauses is that whenever the amount of all inheritance

would terminate this uncertainty and make clear the position of the United States Supreme Court on the subject.

However, when the case was appealed to the Supreme Court (under the title of *Flournoy v. Wiener*[13]) the majority treated the case, in substance, as one in which there was an independent state ground of decision below, which rendered it unnecessary to determine the question of whether the federal statute violated the Fifth Amendment. A final decision of the question was thus delayed, until such time as a direct enforcement of the provision should be attempted.[14]

The question again came before the court in *Fernandez v. Wiener*,[15] a case involving the same succession. The constitutionality of Section 402(b) (2) was placed directly at issue. The heirs of Sam Wiener had filed a federal estate tax return, in which they reported only one-half of the net value of the community property as subject to the tax. The commissioner assessed a deficiency in estate tax based upon the failure to include in the gross estate the entire value of all community property.[16] The deficiency was paid, and when a claim for refund was rejected, the present suit was brought to recover the amount of the deficiency payment. It was not contended that there had been a misapplication or misconstruction of the statute. The sole ground upon which recovery was sought was the alleged unconstitutionality of the enactment.

taxes paid to the state is less than 80 per cent of the estate tax payable to the United States under the Federal Revenue Act, the difference between that amount and the 80 per cent will be paid to the state. What brought the new community property provision of the federal law into the state case was the collector's contention that all community property was to be included in computing the federal tax under the 1926 act for purposes of determining the amount of the 80 per cent credit.

13. 321 U.S. 253, 64 S.Ct. 548, 88 L.Ed. 708 (1944).

14. It is interesting to note, in connection with that case, the expression of opinion by the Louisiana Supreme Court on the question of the constitutionality of Section 402(b)(2): "It is obvious, therefore, that the interpretation sought here with respect to Section 402(b)(2) of the Revenue Act of 1942 is to the same effect as that sought with reference to Act No. 119 of 1932, that is, *the inclusion of his wife's property in the taxable estate of the Fifth Amendment of the Constitution of the United States.*" (Italics supplied.) Succession of Wiener, 203 La. 649, 662, 14 So. (2d) 475, 479 (1943).

15. 66 S.Ct. 178, 90 L.Ed. 147 (U.S. 1945).

16. The commissioner also included in the gross estate of the decedent the entire proceeds of fifteen policies of insurance on the life of decedent, which had been effected by decedent during the marriage with community funds, as beneficiary. The validity of Section 404 of the Revenue Act of 1942, under which the commissioner acted, was also challenged. The court upheld the validity of this section of the act along with that of Section 402(b)(2).

Constitutionality of Section 402(b)(2)

As has been pointed out, the amendment in question was enacted in the hope that its constitutionality was assured under the *Tyler* and *Jacobs* decisions, despite the fact that the Supreme Court had previously held in cases involving the community property relationship that inclusion of the income of the entire community in a computation of the income tax of one of the spouses amounted to a tax upon one person for property owned by another, and thus was a deprivation of due process.[17]

In the *Tyler* and *Jacobs* cases the Court upheld the action of Congress in substituting for the test of transfer or extinguishment of proprietary interests that of the "shifting of economic interests" as a basis for taxation under that provision of the estate tax relating to joint tenancies and tenancies by the entirety. The Court stated in the *Tyler* case that under a tenancy by the entirety the wife's rights were inseparably intermingled with those of her husband and that the far greater privileges and extent of ownership which she gained at the death of her husband could legitimately become the basis for estate taxation. The issue, as stated by the Court, was not whether there had been, in the strict sense of the word, an actual transfer of property by the death of the decedent, but whether the death had "brought into being or ripened for the survivor property rights of such character as to make appropriate the imposition of a tax upon that result, to be measured in whole or in part by the value of such rights."[18] In the *Jacobs* case, the Court refused to distinguish a joint tenancy from a tenancy by the entirety and held that the change in ownership occurring at the death of one joint tenant was a sufficient "event" for the levying of an estate tax measured by the entire joint estate, thus employing the same method of reasoning set forth in the *Tyler* case.

The Court, in the *Wiener* case, applied exactly the same test in holding that the statute was constitutional and that Congress might validly impose an estate tax measured by the value of the entire community upon the death of one of the spouses.

It must be conceded that the power of Congress to levy a tax upon a transfer of economic benefits is a well established proposition.[19] Whether or not there was justification for holding that the community property relationship was such that the death of one of the spouses would effect a transfer of interests sub-

17. See cases cited supra note 3.
18. 281 U.S. 497, 503 (1929).
19. See cases cited supra note 4.

stantial enough to support such a tax was the sole issue before the Court in this case.

The technical distinctions between the Louisiana community property system and joint tenancies and tenancies by the entirety are too numerous and too well known to merit discussion here. However, the most significant and determinative of these differences is the fact that in the case of joint tenancies and tenancies by the entirety neither party has power of testamentary disposition over any part of the estate before the death of the other. In both tenancies, the doctrine of survivorship prevails, the interest of decedent automatically vesting in the survivor.[20] Under the Louisiana community property regime, however, each spouse has power of testamentary disposition over one-half of the community, neither spouse having any right of survivorship in the half of the other.[21] Whether or not the practical differences between these two situations is great enough to merit the application of different tax rules has been a much discussed question.

To apply the test set forth in the *Jacobs* and *Tyler* decisions in determining whether or not there actually is a shift of economic interests under the community property system, suppose first a situation where the husband predeceases his wife. In this case, there is a cessation of his power of management over the wife's half of the community. However, in a group of test income tax cases decided by the Supreme Court in 1930,[22] it was pointed out that the husband was no more than an agent of the community, and that he had been given these powers purely in the interests of a wise administration of the community. In defining the nature of the husband's powers as agent, the court in one of the cases, *Bender v. Pfaff,* stated:

> "While the husband is the manager of the affairs of the marital partnership, the limitations upon the wrongful exercise of his power over community property are more stringent than in many states which have a community system. In Louisiana, if the husband proves, by reason of financial difficulties or the like, an unfit manager, the wife may bring about an immediate dissolution and liquidation of the community property. And when the wife sues for a separation of the

20. Tiffany, op. cit. supra note 6, at 199, § 419.

21. See Daggett, The Community Property System of Louisiana (1945) 95-101, c. xvi.

22. Bender v. Pfaff, 282 U.S. 127, 51 S.Ct. 64, 75 L.Ed. 252 (1930); Goodell v. Koch, 282 U.S. 118, 51 S.Ct. 62, 75 L.Ed. 247 (1930); Hopkins v. Bacon, 282 U.S. 122, 51 S.Ct. 62, 75 L.Ed. 249 (1930); Poe v. Seaborn, 282 U.S. 101, 51 S.Ct. 58, 75 L.Ed. 239 (1930).

> property, she is entitled to an accounting from the husband for community income or property in his hands and to reimbursement and retribution for any act done by him in fraud of her rights."[23]

The Court in the *Wiener* case concedes that the interest of the wife is vested, exactly as was set forth in these decisions, and admits the foregoing limitations upon the power of the husband. Nonetheless, despite these decisions, as a practical matter, it is clear that the husband is not seriously limited in his disposition of the community and that the cessation of management by the death of the husband is a definite "excisable event," so far as an actual transfer of economic interests is concerned.

However, the doctrine of the *Jacobs* and *Tyler* cases becomes extremely weak when applied in a situation where the wife predeceases the husband. In this situation, there is not even the cessation of bare management upon which to "hang" a tax. The husband has gained for the first time the right to have his property separated from that of his wife. Yet, as a practical matter, has the husband actually enjoyed a gain? The property over which he formerly had full control, with power of disposition in any manner in which he should deem fit (subject however to certain limitations which will be hereinafter enumerated), is now divided, and one-half of the community passes to the heirs of the wife. The husband, having lost control and power of management and enjoyment over his wife's share of the community, may no longer sell, mortgage, lease, or otherwise alienate the property except insofar as his own undivided half is concerned.[24]

The Court, in this connection, finding that the husband did gain some economic interest upon the death of the wife, stated:

> ". . . her death, by ending the marital community, liberates her husband's share from the restrictions which the existence of the community had placed upon his control of it."[25]

Aside from a certain moral duty to the wife to act prudently and in good faith, it would seem that the husband has never actually been restricted in the disposition of *his* half of the community property during the existence of the community. While he may not separate his own half of the property from that of his wife, yet for purposes of selling or otherwise disposing of it, he could convey a perfectly good title of all or any part of the community.

23. 282 U.S. 127, 132, 51 S.Ct. 64, 75 L.Ed. 252, 254 (1930).
24. See Daggett, loc. cit. supra note 21.
25. Fernandez v. Wiener, 66 S.Ct. 178, 186, 90 L.Ed. 147, 157 (U.S. 1945).

The Civil Code lays down certain restrictions on the husband's power of disposition. He may not dispose of the immovables gratuitously, unless it be for the establishment of children of the marriage, and he may not give away all or a quota of the movables. However, in case of a violation of the provisions, the wife may not assert her claim of injury *until a dissolution of the community has been effected.*[26] At that time, the damage done to *her* half of the property must be repaired by the husband. His half of the community is in no way affected thereby.

The court further stated:

> "The precept that the wife is equal co-owner with her husband of community property undoubtedly calls into play within the marital relationship personal and psychological forces which have great importance in the practical determination of how community property shall be managed by the husband. Though it may be impossible fully to translate these imponderables into legal rules, the death of the wife undoubtedly brings, in every practical aspect, greater freedom to the husband in his disposition of that share of community property which is technically his, than is to be gathered solely from a reading of statutes and case law."[27]

Indefinite though this "psychological factor" may be, yet the court finds that it, together with whatever freedom from restrictions the husband has gained upon the death of his wife, is substantial enough to warrant the imposition of a tax.

The amendment is fortified by a provision which allows a deduction for any part of the community which may be shown to have been received for personal services rendered by the surviving spouse, or to have been derived originally from such compensation or from separate property of the surviving spouse. However, because of the difficulty of proof of the origin of such funds, in the absence of regularly kept records, the majority of people would not now be able to take advantage of the provision. The amendment stipulates: "In no case shall such interest be less than the value of such part of the community as was subject to decedent's power of testamentary disposition." Thus, the maximum credit is fifty per cent of the community at death.

The court's conclusion was further fortified by the old, almost forgotten, case of *Moffitt v. Kelley,*[28] decided in 1910. In

26. See also Daggett, loc. cit. supra note 21; id. at 57-70, c. xi.
27. 66 S.Ct. 178, 186, 90 L.Ed. 147, 157 (U.S. 1945).
28. Moffitt v. Kelley, 218 U.S. 400, 31 S.Ct. 79, 54 L.Ed. 1086 (1910).

that case, a wife was forced to pay an inheritance tax on her half of the community, upon the death of her husband, under a California statute covering all property passing from any person who "may die seized or possessed of same." The Supreme Court held that a state did have the power to include the entire community in such a case without thereby violating the Fourteenth Amendment. There was some doubt, at the time this case was decided, as to whether or not the wife in California actually had a present vested interest in the community. The court, however, made it clear that its disposition of the case would have been the same under either situation.

Under the estate taxation principles laid down by the *Wiener* case, Louisiana and the other community property states will henceforth share the burden equally with the other states of the union. It will be noted, however, the principal case does not establish a precedent for income taxation,[29] as the previous income tax cases were not overruled. The court did not find it necessary to distinguish them. Legislation would be required, as matters stand, to effect a change in that field of taxation. In view of the fact that changes will very likely be presented for congressional approbation in the near future, the community property states may well weigh the merits of joining in an attempt to work out a fair statutory adjustment of the problem, rather than standing adamant in opposition to any change which would destroy the present income tax advantages of their people.

MARTHA E. KIRK

PRESENT INSANITY — ITS SCOPE AND DETERMINATION

Under Article 261 of the Code of Criminal Procedure there are four special pleas open to an accused in a criminal trial in Louisiana. Included in these is the plea of insanity, which has two separate and distinct aspects: insanity at the time of the commission of the alleged crime and insanity at the time of the trial. The two have often been confused and, as a result, Louisiana jurisprudence on the subject presents a varied and conflict-

29. It is interesting to note that the Bureau of Internal Revenue has accorded income tax recognition to the Oklahoma mandatory community property law, which became effective July 27, 1945. The bureau specifically holds that income earned and received after that date is community income, and one-half may be reported by each spouse. Prentice-Hall, 1946 Fed. Tax. Serv. ¶ 76,087 (Jan. 18, 1946).