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# Some Community Property Aspects of the 1948 Revenue Act

ALVIN B. RUBIN\* AND SIDNEY A. CHAMPAGNE\*\*

In April, 1930, the United States Supreme Court said: ". . . taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax was paid."<sup>1</sup> However, in November of the same year, the Supreme Court held that income taxation was indeed predicated upon title as determined by state law,<sup>2</sup> at least in a community property state. Therefore, in community property states, one-half of the community income was held taxable to the husband and one-half taxable to the wife, with a resulting tax savings because of the progressive surtax rates. Since that time the battle for tax equalization has been waged in legislative halls as well as in the press. The tax advantages enjoyed by community property states were obvious enough to attract some converts to their system,<sup>3</sup> even though this might

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1. *Carliss v. Bowers*, 281 U.S. 376, 378, 50 S.Ct. 336, 74 L.Ed. 916 (1930).

2. *Poe v. Seaborn*, 282 U.S. 101, 51 S.Ct. 53, 75 L.Ed. 239 (1930). See also *Bender v. Pfaff*, 282 U.S. 127, 51 S.Ct. 64, 75 L.Ed. 252 (1930).

3. There were eight community property states before enactment of the income tax amendment to the Constitution in 1913: California, Washington, Arizona, Idaho, Nevada, Louisiana, Texas and New Mexico. In 1945 Oklahoma enacted its second community property law; the first being declared invalid for federal tax purposes because of its "elective" feature. In 1947 Oregon enacted its second community property law; the first one contained an "elective" feature similar to the Oklahoma law. In 1947 Michigan and Nebraska enacted community property laws which were held to be valid for federal tax purposes. Since enactment of the Revenue Act of 1948 Michigan has repealed its community property laws. Pennsylvania adopted the community property system in 1947, but the supreme court of that state declared it unconstitutional. *Willcox v. Penn Mutual Life Ins. Co.*, 357 Pa. 531, 55 A.(2d) 521 (1947).

Congress was fully aware of the tax reduction efforts of many married persons, as indicated by the following excerpt from the Senate Finance Committee Report. "The incentive for married couples in common-law States to attempt the reduction of their taxes by the division of their income through such devices as trusts, joint tenancies, and family partnerships will be reduced materially. Administrative difficulties stemming from the use of such devices will be diminished, and there will be less need for meticulous legislation on the income tax treatment of trusts and family partnerships." Sen. Rep. No. 1013, 80th Cong., 2d Sess. (1948) 25.

be at a detriment insofar as community property laws operated to restrict legal rights available in other states.

The ingenuity of the taxpayers, and their lawyers, in seeking the advantages of income splitting in non-community property states, resulted in a series of litigations, particularly over the creation of family partnerships. By using this device many taxpayers hoped to achieve a division of income for federal tax purposes. However, this device was ultimately defeated in the *Tower*<sup>4</sup> and *Lusthaus*<sup>5</sup> cases except where the spouse-partner either "invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services. . . ."<sup>6</sup>

The tax advantages of community property states survived intact until 1942, when the estate and gift tax privileges of community property were legislatively removed.<sup>7</sup> The constitutionality of the amendments was upheld in the now famous case of *Fernandez v. Wiener*.<sup>8</sup>

These amendments not only removed the tax advantages previously enjoyed by community property states in connection with estate and gift taxes, but placed community property states at a tax *disadvantage* in some regards.<sup>9</sup> The Revenue Act of 1948, amending the Internal Revenue Code, which was enacted April 2, 1948, over presidential veto, not only repealed the community property amendments of 1942,<sup>10</sup> but also brought a substantial measure of equality into the income tax provisions.

### INCOME TAX

The principal features of the income tax provisions of the Revenue Act of 1948 are (1) the income splitting provisions; (2) the reduction of the effective tax rate; and (3) increased exemptions. These apply entirely to individual taxpayers; corporations are not affected by the act.

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4. *Commissioner of Internal Revenue v. Tower*, 327 U.S. 280, 66 S.Ct. 532, 90 L.Ed. 670 (1946).

5. *Lusthaus v. Commissioner of Internal Revenue*, 327 U.S. 293, 66 S.Ct. 539, 90 L.Ed. 679 (1946).

6. 327 U.S. 280, 290, 66 S. Ct. 532, 537, 90 L.Ed. 670, 677 (1946).

7. Revenue Act of 1942, §§ 402, 404 (a), 453.

8. 326 U.S. 340, 66 S. Ct. 178, 90 L. Ed. 116 (1945).

9. See Irion, *The Surviving Husband and the Wiener Case* (1947) 25 *Taxes—The Tax Magazine* 64.

10. Revenue Act of 1948, § 351, repealing I.R.C. §§ 811(d)(5), 811(e)(2), 811(g)(4).

### *Income Splitting*

Income splitting is effected by permitting husbands and wives to file a joint return. In such a return the combined taxable income is divided by two, the tax is then computed and multiplied by two in order to determine the total tax.<sup>11</sup> Substantially the same result was available to Louisiana residents as to community income, when separate returns were filed, and each spouse reported his or her share of the community income. Thus, under the new act, taxpayers in community property states will continue to enjoy income splitting, sharing this with their fellow taxpayers in other states.

Something new, however, has been added which makes possible an additional tax saving. *Separate* income of either spouse may be split in exactly the same fashion as community income. Thus, if husband and wife have community income of ten thousand dollars and the wife has, in addition, separate income of fifty thousand dollars from her separate property, by filing a joint return, the husband and wife need pay only twice the rate on thirty thousand dollars, instead of the higher rates hitherto effective. Community income may be divided by filing either separate or joint returns. However, to gain the advantage of dividing *separate* income, the taxpayers must use a joint return.

The capital gains and losses provisions were not changed. However, in its report on the new act, the House Ways and Means Committee stated that, in the case of a joint return, losses from sale or exchange of capital assets had to be combined by husband and wife and such loss could be taken to the extent of their combined net income or one thousand dollars, whichever is the lesser.<sup>12</sup> Assuming the capital asset to be community property, in some cases it may be advantageous to file separate returns with *each* spouse taking a maximum one thousand dollars capital loss in the event the loss is two thousand dollars or more.<sup>13</sup> Of course, in determining whether it is advantageous thus to secure the additional one thousand dollar loss deduction, it is necessary to consider any disadvantage which might result from the inability to divide any separate income, which might otherwise be split by filing a joint return.

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11. Revenue Act of 1948, § 301, amending I.R.C. § 12, by adding (d).

12. H.R. Rep. No. 1274, 80th Cong., 2d Sess. (1948).

13. See, however, remarks in (1948) 26 Taxes—The Tax Magazine 671, 862.

### *Reduction of the Effective Tax Rate*

Although the new act retains the same tentative normal and surtax rates the effective rate is decreased by reducing the aggregate of the tentative normal tax and surtax as follows:<sup>14</sup>

<i>If the aggregate tentative tax is</i>	<i>The reduction shall be</i>
Not over \$400	17% of the aggregate
Over \$400 but not over \$100,000	\$68 plus 12% of excess over \$400
Over \$100,000	\$12,020 plus 9.75% of excess over \$100,000

It is further provided that the combined normal tax and surtax shall not exceed 77% of net income, the previous ceiling having been 85½%.

The above reductions are to be used in lieu of the 5% reduction provided by the Revenue Act of 1945. Therefore, a taxpayer in the first group will not in fact receive a 17% cut, but only a reduction of about 12.63% from last year's actual tax.

### *Increased Exemptions*

In addition to increasing the personal exemption from five hundred dollars to six hundred dollars the new law allows additional exemptions of six hundred dollars for the blind and for taxpayers who are sixty-five years of age or older. These exemptions apply to both taxpayer and spouse, provided the taxpayer files a separate return, and the spouse has no gross income and is not the dependent of another taxpayer for the calendar year in which the taxable year of the taxpayer begins.<sup>15</sup> Should the spouse have gross income, the total personal exemptions may be claimed by filing a joint return, since there are two taxpayers on such a return. It can be seen that under the new law it is possible for a married couple to claim a total of six of the above exemptions if they are both blind and sixty-five years of age or older.

The six hundred dollar exemption for the blind replaces the special deduction of five hundred dollars previously allowed. Formerly, a blind person had to "itemize his deductions" in order to get the benefit of this special deduction. Since the *deduction* is now an *exemption* the blind person may now also use the

14. Revenue Act of 1948, § 101, amending I.R.C. § 12(c).

15. Revenue Act of 1948, § 201, amending I.R.C. § 25(b).

“standard deduction”—a right lost under the old law when he used the *deduction* for the blind.

The exemption amount for a dependent is increased from five hundred dollars to six hundred dollars, although the tests for determining dependency are not changed.<sup>16</sup> Generally speaking, the taxpayer must furnish more than one-half of the actual amount used for the dependent's support and the dependent cannot have *five* hundred dollars or more gross income for the taxpayer's taxable year.

The standard deduction was previously limited to five hundred dollars if the adjusted gross income exceeded five thousand dollars. This deduction could be taken on each return filed; therefore residents of community property states who filed separate returns were allowed a total of one thousand dollars standard deduction. Under the new law “the standard deduction shall be one thousand dollars or an amount equal to ten per centum of the adjusted gross income, whichever is the lesser, except that in the case of a separate return by a married individual, the standard deduction shall be five hundred dollars.”<sup>17</sup> Thus, spouses who elect to file joint returns in either group of states will suffer no loss of standard deduction—another step toward tax equalization between residents of community and non-community property states.

#### ESTATE TAX

As in the case of the income tax changes, virtually all the changes made in the estate tax law were designed to equalize the burden of the estate tax as between residents of community property states and those of other states. As we have seen, most of the income tax “equalizing” was done by reducing the tax for married couples in non-community states to the level enjoyed by those living in community property states. Most of the estate tax equalization was accomplished by reducing the tax basis in *both* groups of states. The first step in the process was repeal of the community property provisions of the 1942 act. Those amendments, in effect, taxed all the community property on death of the husband prior to his wife except what was derived from personal services rendered by the wife or from separate property of the wife. On prior death of the wife, the portion of the com-

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16. *Ibid.*

17. Revenue Act of 1948, § 302(a), amending I.R.C. § 23(aa)(1)(a).

munity derived from her income from personal services or from her separate property was taxed, but in any event at least one-half of the community, since that was subject to her power of testamentary disposition.<sup>18</sup>

Similar rules were applied to community property transferred in contemplation of death, and the proceeds of insurance the premiums on which were paid with community funds.<sup>19</sup>

As a result of this repeal, *community property* is included in the gross estate of a deceased spouse only to the extent of the decedent's one-half interest. Thus, the situation under the 1948 amendments in regard to community property is identical to that which existed prior to passage of the 1942 act. Regardless which spouse dies first, one-half the community is included in the estate of the deceased, and the other one-half passes to the surviving spouse tax free.

With this accomplished, the next step in the equalization process was to arrange the tax base so that married decedents in non-community property states could achieve the same results with their estates. As part and parcel of the general revision, this basic theme was also made applicable to the separate property of taxpayers living, or, to use the *mot juste*, dying in community property states.

The device used to accomplish this is entitled the "marital deduction."<sup>20</sup> "Marital" because it accrues only between spouses. "Deduction" because a subtraction from the gross estate is created. This deduction is limited to fifty per cent of what is termed the "adjusted gross estate." The *adjusted* gross estate is the gross estate *less* the following types of deductions:<sup>21</sup>

1. Funeral expenses
2. Administration expenses
3. Claims against the estate
4. Unpaid mortgages and debts on property in the gross estate
5. Alimony or support paid to the decedent's dependents

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18. Revenue Act of 1942, § 402(b)(2), 56 Stat. 942 (1942), amending I.R.C. § 811(e).

19. Revenue Act of 1942, § 402 (a), 56 Stat. 941 (1942), amending I.R.C. § 811 (d); Revenue Act of 1942, § 404 (a), 56 Stat. 944 (1942), amending I.R.C. § 811(g)(4).

20. Revenue Act of 1948, § 361(a), amending I.R.C. § 812 by adding (e)(1).

21. I.R.C. §§ 812(b) and 812(e)(2) as amended by Revenue Act of 1948, § 361(a).

6. All community property and all separate property which may have been converted from community property to separate property, to the extent both are included in the gross estate.

After the computation of the adjusted gross estate is made, the value of any interest in property which has been included in the gross estate and which passes or has passed by operation of law, testament, or a gift made during lifetime but nonetheless subject to estate tax is deductible from the adjusted gross estate, subject to a maximum deduction of fifty per cent of the value of the adjusted gross estate.<sup>22</sup> This deduction is made on the basis of property valuations alone, however, and not on the basis of the community or separate nature of the *particular property* passing to the surviving spouse.<sup>23</sup>

To illustrate what has been said thus far, let us assume that T, the perennial taxpayer, has an estate consisting of separate property, inherited by T, valued at \$100,000, and of community property with a total value of \$130,000. T, of course, is married. Let us assume, for the sake of simplicity, that this unusual T owes no debts, and that his funeral expenses and the expenses of administration of the estate are \$5,000.

*T's gross estate consists of:*

1/2 the community property.....	\$ 65,000
Plus T's separate property .....	100,000
	165,000

*His adjusted gross estate is:*

Gross estate .....	\$165,000
Less: Funeral and administration expenses .....	\$ 5,000
The value of the community property included in the gross estate .....	65,000      70,000
<i>Adjusted gross estate</i> .....	95,000

Any interests passing to T's wife, not to exceed fifty per cent of the adjusted gross estate, is now deductible. In other words, T may leave up to \$47,500 to his wife tax free. This may come

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22. Revenue Act of 1948, § 361(a), amending I.R.C. § 812 by adding (e)(1)(A) and (e)(1)(H).

23. Revenue Act of 1948, § 361(e), adding I.R.C. § 812(e)(1)(E).

from *either* his share of the community *or* from his separate property.

In order to secure this deduction it is necessary only that there be an adjusted gross estate (that is, some separate property which is not the result of conversion of community property in the case of community property states); and that something in excess of the community interest of the surviving spouse pass to that spouse. If these two conditions are met, the value of the property passing to the surviving spouse is deductible, subject to a maximum deduction of fifty per cent of the adjusted gross estate.

### *Terminable Interests*

Certain interests in property which are subject to termination, either by lapse of time or by a contingency, may not be included in the marital deduction. Thus if T, a husband, leaves to his surviving spouse an interest in property which is terminable upon conditions noted below, *that interest* may not be deducted.<sup>24</sup> To encompass all, a terminable interest is defined as an interest in property which will either fail or terminate upon the lapse of time, upon the occurrence of an event or condition, or upon the failure of an event or condition to occur.<sup>25</sup>

The mere fact, however, that an interest is terminable (for example, a usufruct) does not disallow it. It is disallowed only if the following conditions apply to the interest:<sup>26</sup>

1. If an interest in the same property passes, for less than an adequate consideration in money or money's worth, from the decedent to any person other than the surviving spouse or the latter's estate, and
2. The person acquiring that interest (or his heirs or assigns) may possibly, under any circumstance, possess or enjoy the property *after* the termination or failure of the interest passing to the surviving spouse.

Thus, apparently, if T bequeaths a usufruct on *his* share of the community to his wife, there is a terminable interest. An "interest" because less than full ownership has passed. "Terminable" because it will end upon the wife's death. And the value of such a usufruct is apparently *not* deductible from the adjusted

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24. Revenue Act of 1948, § 361(a), amending I.R.C. § 812 by adding (e)(1)(B).

25. *Ibid.*

26. *Ibid.*

gross estate if naked ownership has been bequeathed to some other person. Condition (1) has been met: there was no adequate consideration in money or money's worth. Condition (2) has been met: the person acquiring an interest (the naked owner) will enjoy the naked ownership *plus* the usufruct when the usufruct ends. Apparently the same situation would apply if the usufruct arose by operation of law where the decedent died intestate.

It would appear that the conclusion applies to both the perfect and the imperfect usufruct. The safe course, therefore, to secure the maximum benefit under the provisions allowing a marital deduction is so to plan T's estate that the interests passing to his surviving spouse will pass either in full ownership, or through a trust carefully framed so that it will comply with the conditions stated.

Four exceptions are provided to the rule disallowing deduction of terminable interests. These are<sup>27</sup>

1. Interests which will terminate only if the surviving spouse should die within six months after the decedent, or as the result of a common disaster fatal to the decedent, or in either of these two events. In such cases, the deduction is allowed if the surviving spouse does not in fact die within the six month period or as a result of the common disaster. This is designed to permit the usual common disaster clause in a will, without prejudice to the marital deduction.
2. An interest is not to be considered a terminable interest merely because it is the ownership of a bond or a similar contractual obligation, and the discharge of that interest would *not* have the effect of an annuity for life or for a term. But a partial interest in such property, such as a life estate (and a usufruct?), is a terminable interest.
3. Certain life estates in trust coupled with a power of appointment.
4. Life insurance proceeds payable in installments, with a power of appointment to the surviving spouse.

#### *Property Previously Taxed*

The 1948 amendments give, but they also take away. As a

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27. Revenue Act of 1948, § 361(a), amending I.R.C. § 812 by adding (e)(1)(D), (e)(1)(B), (e)(1)(F), (G).

general rule, property in the estate of a decedent, which passed to the decedent within five years prior to his death from another decedent's estate, and was there taxed, is not taxable. However, under the 1948 act, this deduction is not allowable with regard to property which passed from one spouse to another, whatever the intervening period.<sup>28</sup>

This provision may, especially in the case of aged persons or spouses in poor health, act as a deterrent to utilizing the marital deduction; for the taxation of the property in the estate of the later dying spouse within a fairly short period, together with that spouse's share of the community property, may more than offset any tax savings realized through employment of the marital deduction, particularly if that spouse has substantial separate property.

### *Basis*

Prior to passage of the 1948 amendments, when the community ceased by reason of death of one of the spouses, the estate tax might, as pointed out above, be levied on the surviving spouse's share of the community. Nevertheless, the *basis* to that spouse, in the event of a later sale of that property, was the original basis.<sup>29</sup> Let us suppose that T, a married man, had purchased a farm which was community property for \$100,000. At T's death the farm had appreciated in value to \$200,000. The full \$200,000 was includible in T's gross estate. But his wife's basis on her one-half interest remained \$50,000 (one-half the cost). Therefore, if the wife later sold her one-half interest for \$100,000—its exact *estate* tax basis—she owed *income* tax on the \$50,000 "profit."

With elimination of the estate tax on the one-half interest the anomaly of this situation was corrected and perhaps supplanted by another. For the code was further amended to provide that the basis of the surviving spouse's interest in community property shall be the fair market value of the property at the time of the decedent's death, or as of the optional valuation date if that is used with respect to the estate of the deceased spouse.<sup>30</sup>

This provision is made retroactive in part, creating the pos-

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28. Revenue Act of 1948, § 362 (a), amending I.R.C. § 812(c).

29. I.R.C. § 113 (a)(5) as amended by Revenue Act of 1942; I.T. 3808, 1946—2 Cum. Bull. 58; I.T. 3862, 1947—2 Cum. Bull. 76. See also Irion, *The Widow's Basis and the Wiener Case* (1947) 25 *Taxes—The Tax Magazine* 130.

30. Revenue Act of 1948, § 366(a), amending I.R.C. § 113(a)(5).

sibility of claims for refunds.<sup>31</sup> If, under the 1942 act, any part of the surviving spouse's interest in the community was taxed upon death of the deceased spouse, the basis of such property as was included in the estate of the deceased spouse shall be considered to be the valuation for estate tax purposes.

Thus, if the same T, used in the last illustration, had died in 1944, his estate tax would have been determined by including the value of the entire farm in his estate. If his wife had in 1945 sold her community one-half interest in the farm for \$100,000, she would have paid the appropriate income tax on her \$50,000 "profit." She may now apply for a refund, even if the refund is otherwise barred by the statute of limitations, provided she does so within one year from the date of passage of the 1948 act.

If she has not yet sold her interest, her basis is nevertheless converted to the estate tax basis.<sup>32</sup> However, there is a saving clause protecting the surviving spouse from any *reduction in basis* on assessment of deficiency by reason of the change in basis. This clause provides that "nothing in this sentence shall reduce basis below that which would exist if the Revenue Act of 1948 had not been enacted."<sup>33</sup>

#### *Insurance Proceeds*

In 1942, a provision was inserted which provided for attributing insurance premiums paid with community funds on the life of the insured to the insured, except such portion of the payments as could be shown to have been derived from compensation for personal services rendered by, or from separate property belonging to, the surviving spouse.<sup>34</sup> Since "who pays the premium" may determine whether or not insurance is included in the gross estate, this provision in effect made insurance proceeds generally fall into the estate of a deceased taxpayer in a community property state in the same fashion as community property would, regardless of whether the insured or the surviving spouse paid the premiums if they were paid with community funds. These provisions were repealed by the 1948 act.<sup>35</sup>

The repeal has the effect of restoring the prior rule that only one-half of the total insurance proceeds are includible in the

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31. Revenue Act of 1948, § 366(b).

32. Revenue Act of 1948, § 366(a), amending I.R.C. § 113(a)(5).

33. *Ibid.*

34. Revenue Act of 1942, § 404(a), 56 Stat. 944, amending I.R.C. § 811(g)(4).

35. Revenue Act of 1948, § 351 (a), repealing I.R.C. §§ 811(d)(5), 811(e)(2) and 811(g)(4).

gross estate where premiums were paid with community funds.

Insurance proceeds payable to the surviving spouse were includible in the marital deduction under the 1948 act only where they were receivable in annual or more frequent installments, in addition to other qualifications.<sup>36</sup>

The specific terms of this section appeared to preclude inclusion in the marital deduction of insurance proceeds payable on other terms, and an amendment has already been passed to make this section more embracive in its coverage.<sup>37</sup> The amendment extends the marital deduction coverage, and, combining the latest amendment with the 1948 act, the "interest passing from the decedent" is included in the marital deduction provided:

1. The proceeds are payable in installments *or* are held by the insurer subject to an agreement to pay interest thereon; (it would appear to be immaterial whether the option as to mode of payment has been exercised by the decedent or by the surviving spouse) and
2. The installment or interest payments are payable annually or at more frequent intervals; and
3. Installments commence within thirteen months after decedent's death; and
4. The surviving spouse will be the only person to receive payments during the life of such spouse; and
5. The surviving spouse has a "power to appoint," (that is, the power to determine who shall receive, the proceeds) exercisable in the favor either of the surviving spouse or the estate of the surviving spouse, whether or not the power is also exercisable in favor of others; and
6. No *other* person has power to appoint anyone other than the surviving spouse to receive any proceeds.

Where the premiums on insurance are paid with community funds, the proceeds of the insurance, like community property, are *not* included in the *adjusted gross estate*, for the purpose of computing the marital deduction. One-half such proceeds, however, would be included in the *taxable estate*.

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36. Revenue Act of 1948, § 361(a), amending I.R.C. § 812 by adding (e)(1)(G).

37. Pub. L. No. 869, 80th Cong., 2d Sess. (July 1, 1948), amending I.R.C. § 812(e)(1)(G).

The question has been expressed whether the repealed provisions mentioned in the last paragraph may still operate to require inclusion in the gross estate of some proportion of the insurance proceeds. This would be based on the theory that the repealed provisions still attribute to the insured the payment of premiums between 1942 and 1948. Although the commissioner has not yet published regulations elaborating the appropriate section of the code, such a theory appears untenable. The old provisions have been repealed, and the 1948 act provides that the estate of any decedent dying after December 31, 1947, shall not be affected in any way by the repealed provisions. This interpretation is further strengthened by expressly retroactive provisions retained as to other repealed material.<sup>38</sup>

### *State Death Taxes*

Any state or local death taxes payable out of interests passing to the surviving spouse must be subtracted from such interests in computing the amount of the marital deduction.<sup>39</sup> This is also true of any encumbrances or charges resting on the interest passing to the surviving spouse,<sup>40</sup> and of any amounts paid by the surviving spouse in compromise or settlement of will contests.<sup>41</sup>

### *Other Valuation Problems*

Where the surviving spouse is made residuary legatee of the decedent, "there has passed to the surviving spouse an interest in property represented by all the assets included in the decedent's general estate."<sup>42</sup> Therefore, it would appear that the residuary legatee is deemed to have received a single interest, measured by all the different assets comprising the residue.

Suppose the residuary estate includes an asset as to which no marital deduction is allowable, for example, a terminable interest. The value of the interest passing to the survivor must be reduced by the value of all such non-allowable assets.

This result is specifically decreed by Section 812 (e) (1) (C) which states that "Where the assets . . . out of which . . . an in-

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38. Revenue Act of 1948, § 371, amending I.R.C. § 1000(d).

39. Revenue Act of 1948, § 361, amending I.R.C. § 812 by adding (e) (1) (E) (i).

40. Revenue Act of 1948, § 361, amending I.R.C. § 812 by adding (e) (1) (E) (ii).

41. See Sen. Rep. No. 1013, 80th Cong. 2d Sess. (1948) 4-5.

42. Sen. Rep. No. 1013, 80th Cong., 2d Sess. (1948) 14.

terest 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 . . . be reduced by the *aggregate value* of such particular assets."

However, under the phraseology of that section, it appears that if only one-half of a residue which contains a non-allowable asset is bequeathed to the surviving spouse, the full value of the non-allowable asset must be deducted from her share in computing the marital deduction. Thus suppose H dies leaving a will by which his \$250,000 separate estate is bequeathed "in equal shares to my wife, W, and my son, S." The \$250,000 estate includes a \$100,000 non-allowable asset. At first thought it would seem that the marital deduction should be one-half of \$250,000, less one-half of \$100,000, or \$75,000. But, as phrased, the code requires, apparently, that the value of the full \$100,000 non-allowable asset be deducted from W's share in computing the marital deduction. Therefore, the marital deduction would be one-half of \$250,000, or \$125,000 less the full \$100,000, or \$25,000 net.

Likewise if the same H left a special bequest of \$100,000 to W, without specifying the particular allowable assets under which it was to be satisfied, the full value of the non-allowable assets in the estate would be subtracted in computing the marital deduction.

#### *Optional Valuation Date*

Where the optional valuation date is elected for the estate of the deceased, the same date applies for valuation of the marital deduction.<sup>43</sup>

#### GIFT TAX

The 1942 act inserted into Section 1000(d) of the Internal Revenue Code gift tax provisions relating to community property similar to those applicable to the estate tax. The 1948 act provides that this shall be applicable *only* to gifts made after 1942 and on or before the date of enactment of the 1948 act. This provision repeals the Section 1000(d) for the future, but preserves that section for the purpose of determining the prior gifts

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43. Revenue Act of 1948, § 364(a), amending I.R.C. § 811 (j).

and the rate bracket applicable to the subsequent gifts of the donor.

The marital deduction is provided for separate property, to permit one-half of all gifts between spouses to pass tax free.<sup>44</sup> The repeal for the future of Section 1000 (d) makes the community property gifts between spouses taxable, as under the law prior to 1942, to the extent of one-half the gift.

The rules governing the gift tax marital deduction are substantially the same as those relating to the estate tax deduction. To qualify for the deduction, the spouses must be married at the time the gift is made.<sup>45</sup> If they are later divorced, it is immaterial.<sup>46</sup> Similarly, a gift in anticipation of marriage does not qualify.<sup>47</sup>

Because of the marital deduction the effective *specific exemption* for inter-spousal gifts, whether of community property or of separate property (so long as the marital deduction is allowable) is now \$60,000. The *annual exclusion* remains \$3,000, but in interspousal gifts of either community property or separate property there will of course be no tax unless the gifts exceed \$6,000, provided gifts of separate property qualify for the marital deduction.

The marital deduction is computed on the full value of the gift, prior to allowance of the annual exclusion.<sup>48</sup> Thus, if H makes a gift of separate property to W of \$20,000, the marital deduction is one-half of \$20,000, or \$10,000. From the \$10,000 is subtracted the donor's annual exclusion of \$3,000, making the taxable gift \$7,000. Computing the taxable gift by first subtracting the annual exclusion would result in a larger tax. The \$20,000 less \$3,000 would leave \$17,000. Subtracting one-half of \$17,000 as the marital deduction would make the taxable gift \$8,500.

In the case of the community property the taxable gift would be the same. On the \$20,000 gift, \$10,000 is attributed to the donor-spouse. Subtracting the \$3,000 annual exclusion, the taxable gift is \$7,000.

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44. Revenue Act of 1948, § 372, amending I.R.C. § 1004 by adding (a)(3)(A).

45. Revenue Act of 1948, § 374, amending I.R.C. § 1000 by adding (f)(1)(A).

46. Sen. Rep. (Supp.) No. 1013, 80th Cong., 2d Sess. (1948) 30.

47. *Ibid.*

48. Revenue Act of 1948, § 373, amending I.R.C. § 1004(c); Sen. Rep. No. 1013, 80th Cong., 2d Sess. (1948) 30.

*Gifts to Third Persons* .

A new subsection has been added to Section 1000 of the code providing that a gift by either the husband or wife to a third person may be treated as made one-half by such spouse.<sup>49</sup> This treatment, together with repeal of the provisions relating to taxation of gifts inserted in the 1942 act, is intended to equalize the gift tax as between residents of community and non-community property states.

The gift must be made to a third person, and both spouses must consent in order for the split to apply.<sup>50</sup> However, in the case of a gift of community property, presumably no consent on the part of the wife is required, in view of the repeal for the future of Section 1000 (d), discussed above.

The commissioner is empowered to prescribe the manner of signifying consent, which must be done *after* the close of the calendar year if either spouse has filed a gift tax return.<sup>51</sup> If neither has filed a return, consent may be indicated at any time until a return is filed by one of the spouses or until a notice of deficiency has been sent to one of the spouses.<sup>52</sup> If both spouses consent to split a gift, they are jointly and severally liable for the *entire gift taxes* which *either* of them may owe for the year involved.<sup>53</sup>

## CONCLUSION

The material covered in this article is only a brief resume of some of the changes wrought in our federal income, gift, and estate tax structure in particular relation to taxpayers in community property states by the 1948 revision. Only detailed study of the provisions can accomplish full familiarity with them.

Many tax savings to residents of community property states will result from the new act. But, more fundamental, it is the opinion of the authors that for the first time since 1930, some sort of equality, even if not an absolutely precise one, has been achieved between residents of community property states and

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49. Revenue Act of 1948, § 374, amending I.R.C. § 1000 by adding (f) (1)(A).

50. Revenue Act of 1948, § 374, amending I.R.C. § 1000 by adding (f) (1)(B).

51. Revenue Act of 1948, § 374, amending I.R.C. § 1000 by adding (f) (2)(B).

52. *Ibid.*

53. Revenue Act of 1948, § 374, amending I.R.C. § 1000 by adding (f)(4).

their fellow taxpayers in other states. At the same time the interests of taxpayers living in community property states has been protected. No small part of the credit for the latter achievement is due to the Louisiana Community Property Taxpayers Committee.<sup>54</sup> It is to be hoped that, whatever changes in our federal tax law are made in the future, this basic equality will not be disturbed.

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54. See Statement of Charles E. Dunbar, Jr., Attorney for the Louisiana Community Property Taxpayers Committee, New Orleans, La. Hearings before Committee on Ways and Means on H.R. Rep. No. 4790, 80th Cong., 2d Sess. (1948) 347.