taxing authorities—and no one has come up with a consistent scheme for taxation. This difficulty has been compounded in a number of states by the necessity of accommodating a community property system to a type of contract that was primarily a product of the common law. I believe, however, it is important to recognize that life insurance is merely another form of property, and that it is community property if such funds were used to purchase it. The wife's rights should be protected to the same extent in such property as they are in any other form of property and the tax consequences should follow accordingly.

DISCUSSION

Comment by Joseph T. Melczer, Jr.*

Dean Lyons, Mr. Thurman, ladies and gentlemen. The most appropriate comment that I can make concerning Mr. Thurman's talk is that it was a most thorough and clear presentation of his subject. I would like to ask Mr. Thurman one question concerning the story he related with respect to the exchange of the two twenty-year squaws for the forty-year squaw. Mr. Thurman, would you tell us if the exchange would be treated as a tax-free one?

Mr. Thurman elaborated on the advantages that can be secured in certain instances by use of the widow's election. As he pointed out, this poses certain gift and estate tax problems. He referred to the *Siegel* case which was decided by our Ninth Circuit Court. Judge Yankwich, from the District Court in Southern California, wrote the opinion, sitting with the Ninth Circuit on that particular case.

In the *Siegel* case the taxpayer and decedent were husband and wife, residents of California. Siegel died in California in 1949 leaving an estate consisting entirely of community property. The will provided that the provisions in the will for the taxpayer were in lieu of her community rights, and if she elected to take her community interest, then the provisions for her under the testamentary trust were to be of no force or effect. The taxpayer filed an election to take under the will. The Commissioner contended the taxpayer made a transfer of her remainder interest in one-half of the community property to her son, the remainder-

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man, without adequate consideration and assessed a gift tax in the amount of $51,144.24.

The Tax Court held that only the excess of value of her transfer over what she received was a taxable gift and determined the gift tax payable was in the amount of $4,314.87. The taxpayer was represented by Dana Latham, the present Commissioner of Internal Revenue.

The Ninth Circuit affirmed the Tax Court, holding that the amount of the gift should be measured by the taxpayer's community interest reduced by the present value of her life interest in the entire community property and a specific bequest of $35,000 granted to her under the will. The Ninth Circuit held that the property surrendered was consideration for that which was accepted.

I believe that the *Siegel* case is a very well-reasoned case and that the court was correct in holding that the property was a valid consideration for that which was accepted by the widow under the will.

There was a recent case in the Sixth Circuit that may be of some interest, the case of *Commissioner v. Vander Weele.*[1] Mrs. Vander Weele created an irrevocable trust, of which she was the sole life beneficiary, consisting of stocks, securities, and a contingent remainder interest in a trust created by the will of her grandfather. At the time the trust was created, the total value of Mrs. Vander Weele's stocks and securities and her remainder interest in the testamentary trust of her grandfather was $592,905.08. Under the terms of the trust Mrs. Vander Weele was to receive the trust income for life or until the receipt of the remainder interest in her grandfather's estate. Thereafter the trustees were empowered to pay her so much of the income of the trust as they in their discretion deemed desirable and ample for her comfortable well being and enjoyment. Upon receipt of the aforementioned remainder interest, the trustees were directed to pay to Mrs. Vander Weele $10,000 from the principal and an additional $10,000 therefrom every five years during her life.

The trust agreement provided that in the event the amounts so payable to Mrs. Vander Weele did not in the sole judgment and discretion of the trustees provide for her comfortable well being, the said trustees might from time to time pay to her such part or all of the principal of the entire trust estate, or any portion of the trust estate resulting from the accumulations of net income, as to said trustees in their sole judgment and discretion seemed advisable, without regard to any obligations set forth or implied to preserve or conserve any of the trust estate for her husband or any of the other beneficiaries designated in the trust agreement.

[1] 254 F.2d 895 (6th Cir. 1958).

Relying principally upon its decisions in *Alice Spauling Paolozzi*,[2] and *Estate of Christianna K. Gramm*,[3] the Tax Court held that the execution of the Deed of Trust by Mrs. Vander Weele did not constitute a gift taxable under the Internal Revenue Code of 1939. The United States Court of Appeals for the Sixth Circuit affirmed the decision of the Tax Court. The circuit court stated that the trust conveyance in effect created no completed taxable gift to the remaindermen and that there was no assurance that anything of value would pass to the remaindermen. The circuit court pointed out that Mrs. Vander Weele could in actuality retain the economic benefit and enjoyment of the entire trust income and corpus by borrowing money or by selling, assigning, or transferring her interest in the trust fund and relegating her creditors to the trust fund for payment. The circuit court further pointed out that it was not confronted with the decision on "the donative intent" for there was no gift whatever in praesenti, only a transfer which, upon contingencies, might become a gift at some future time. The court further stated parenthetically that, from the standpoint of practical taxation, the trust agreement made by the taxpayer did not necessarily cause the government to lose revenue, but would have the tendency to preserve the property transferred in trust for estate tax taxation.

Comment by Devens Gust*

Today we have heard about some recent modifications in our property law, brought about not only by legislative action, but also through state and federal court decisions, all of which have the force and effect of law, and it's easy to see why we as general practitioners of the law are not able to keep up to date on these changes. Particularly, to my mind, is this true in the field of federal taxation. Here the ordinary rules of common sense and logic, and the way of handling law problems which was instilled in us in law school, seem to have little or no application. Perhaps it's the language that's used in writing these laws and regulations. Because the law is so complicated, because it is continually changing, I think that institutes such as we have had here today are about our only means of keeping ourselves up to date. Here we can spend a few hours of our time and get the benefit of a great deal of thought and research and experience from men who have specialized in a particular field of law. I hope that the university law school and the continuing legal education committee of the State Bar will have more of these institutes for us.

[2] 23 T.C. 182 (1954).
[3] 17 T.C. 1063 (1951).
* Member of the Phoenix Bar.

One case which was discussed rather thoroughly by the speaker was the *Chase Manhattan Bank* case. In my opinion it is a very interesting, a very thorough, and a very well-written opinion. Incidentally, I might mention that Judge Wisdom, when he wrote this opinion, apparently relied rather heavily on Mr. Thurman, our speaker here today, because not only did he cite the law review article which Mr. Thurman has written on this general subject, but the text of the opinion shows that he rather liberally accepted Mr. Thurman's ideas. The thing in this case that interested me particularly, aside from the technical aspects, was the burden that the court placed upon the Commisisoner of Internal Revenue. As all of you know who have dealt with the internal revenue officials, the scuffle between the taxpayer and the government is not one that you could call an equal contest. It's always hard to argue about money with a man when he can put his hand in your pocket and take whatever he wants. But in this case I think the court recognized that fact. The taxpayer had taken one position throughout the early part of the litigation. By the time the case got to the court of appeals some Texas attorneys were brought in. Prior to that time, apparently no one working with the case on either side had much of an idea of community property. When the Texas lawyers came into the case, when it went to the circuit court, there were some rather drastic changes in theory; in fact the bank in several respects almost completely reversed or changed its position, and naturally the Commissioner screamed like an eagle when that happened, because he felt that that was taking improper advantage of him.

Judge Wisdom in his opinion had this to say. "'Indeed,' says the Commissioner, 'the taxpayer invited error.' We think that the taxpayer did invite error. Worse, the invitation was accepted. But an appellant has no vested right in an opponent's error of law in the lower court, especially when the protesting appellant is the Commissioner of Internal Revenue. The Commissioner owes a duty to the United States Government to litigate zealously in the interest of collecting taxes, but he owes a duty to all taxpayers, including the litigating taxpayer, to see that the tax law is applied justly." And I was very glad to read that. I was very glad because it seemed to me to be somewhat of an answer to those internal revenue agents and their superiors who apparently feel that they must take whatever position results in the greatest tax to the government. This case clearly shows that the internal revenue agent and those in the service should take the position which is fair and just. I might add that my dealings with our local people here have been very good; I think they are very fair in that regard. But I think elsewhere the trend has been very much the other way.

Specifically, I would like to mention one or two thoughts that I had on listening to Mr. Thurman's talk. One situation that interested me particularly was the one where the wife dies first, and there is community life insurance on the husband's life. I have just recently had that situation arise and it was a puzzle to me at the time. Of course, normally we plan our estates so that the husband will die first, and it crosses us up when the wife goes first, and then we have to think about things that maybe we should have thought of before and didn't. In the case I had, that was exactly my problem. The wife died first. There was some life insurance on the husband's life which was purchased with community funds. The question was: Should there be any mention of that made on the estate tax return? I didn't know what to do with the matter when I wrote up my inventory and appraisement to file in the probate court. I didn't know whether or not to put in half of the cash value as an asset of the estate; and on reviewing a little on the tax regulations, it appeared to me that they took the position that the replacement value, or one-half of the replacement value, should be included in the wife's estate. I had a little trouble finding out what the replacement value was. I wrote the insurance company, asking them to send it to me, and after going through a number of offices and ending up in the home office, I finally put in the cash value, which was all that anyone could seem to give me. I don't purport to have the right answer on this—whether you should list the cash value in your inventory in the probate estate or not. I did, because I figured that was the most logical solution. I do think that there has been a Washington case—the state of Washington—which has held contrary to the Texas cases. The Washington case held that since the executor of the wife's estate has no way of taking hold of this half of the replacement value or half of the cash value, it should not be subject to tax. So I think that there is a real split of authority on it, and it is very helpful to us that our speaker today has given some very cogent reasons why the wife's share in that should be taxed.

In concluding my comment I shall follow precedent by asking the speaker a question. We have this factual situation: The husband and wife have community property, one of the assets being a life insurance policy purchased with community funds. The husband, in working out his estate plans, names his estate as beneficiary—that is, the executors of his estate. At that time he makes the wife the beneficiary under the will which sets up a trust and gives her a life estate. Subsequently, the husband becomes enamoured of another lady and then he changes his will, making the girl friend the beneficiary.

Is that a transaction which, under the law of Arizona, the wife could set aside as being in fraud of her rights?

MR. THURMAN: One comment on the first observation of Mr. Gust. The *Chase* case was indeed very interesting from the standpoint of the change of theory on appeal. I don't know how many of you would be that lucky, though, and be allowed to change your argument that drastically. In New York they had some high-powered counsel before the Tax Court, and apparently every one conceded there—both the Commissioner and the New York counsel—that the husband had without question put his wife to an election and she had to take what he had set up by will before she got anything in his half. Consequently, the consideration argument was made out. Then these Texas attorneys got into it and pointed out very promptly to the court that the argument did not square with Texas community property law, and the court went along with them and in substance said, "We don't care if you're changing your theory. We agree that under Texas law this was not tantamount to putting the wife to an election; it was not sufficiently unambiguous." So the Texas lawyers were quite fortunate in that instance, and it was a little unfair to the Tax Court, because it didn't have the benefit of any of this argument under Texas law.

On this problem that Mr. Gust put, it seems to me that he has described the one situation where the cases have uniformly held, both in Arizona and Texas, that the transaction is in fraud of the wife; that is, when the husband names his estate as the beneficiary. In other words the husband can make a gift by means of insurance to third persons, but he can't make a gift to himself or to his estate, and when he compounded that by leaving everything to the girl friend, under the will, I would think you would have a very good argument that this was in fraud of the wife.

Comment by John L. Donahue, Jr.*

Of the many aspects of community property life insurance which Mr. Thurman has just discussed, I would like to comment on the *Siegel* and *Chase Manhattan* cases in connection with the widow's election.

Mr. Thurman has pointed out that in order to effect the widow's election the will, or other document in inter vivos transfers, must purport to dispose of not only the husband's half of the community property but the wife's as well, and that in exchange for agreeing to this arrangement the wife obtains a life interest in all of the community property. As you will recall from Mr. Thurman's discussion

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of the *Siegel* case, the husband's will purported to give the surviving wife a life interest in all of the community property, and the remainder over to an adopted son. The Commissioner assessed a tax of $51,144 as a gift tax on the transfer of the remainder interest in the wife's share of the community property to the son. The Court of Appeals for the Ninth Circuit reduced the tax from $51,144 to $4,315, a tax savings of $46,829, by allowing the wife to deduct from the remainder interest she gave (by her election to take under her husband's will) the value of the life interest in her husband's share of the community property which she received. In other words, the consideration for the remainder interest she gave was the life interest she received.

The question which comes to my mind is this: What about an inter vivos insurance trust featuring a widow's election in Arizona? In California, Mr. Thurman points out that increasingly, insurance proceeds are left in trust, the wife to receive the life income on all the insurance proceeds only if she consents to placing her half in the same trust. The wife in California, however, has well settled and substantial rights in life insurance and may avoid entirely any gift as to policy rights during the insured's life and to the extent of one-half the proceeds after death. The wife in California, then, has much to give up when she consents to an inter vivos insurance trust with the usual widow's election provisions. But what about Arizona? In Arizona, as in Texas, the husband has the absolute right to dispose of community personalty as he sees fit just so long as it does not constitute a fraud on the wife. As you well know, in *Gristy v. Hudgens*[1] the supreme court disposed of the argument that the husband had defrauded his wife in making a policy payable to an eleven-year-old minor who was not a member of the family, saying there was "no showing that the wife had not received even more than her share of the community property."

In the *Chase Manhattan* case, Mr. Thurman points out, the court held that the same power of disposition over personalty in Texas which we have in Arizona resulted in a taxable gift on the husband's death, of her interest in the life insurance less her life interest. In effect, the court held that under Texas law the husband made the gift for the wife of her interest under the husband's almost absolute power of disposition. Clearly, he couldn't have done this in California without her consent.

What, then, would the wife be giving up in Arizona or in Texas when she elects to take under an inter vivos insurance trust featuring a widow's election? In the *Siegel* case the court said she was

[1] 23 Ariz. 339, 203 Pac. 569 (1922).

giving up a remainder interest in exchange for a life interest and allowed the taxable gift to be reduced by the value of the consideration received. But in Arizona and Texas, would the court allow the same reduction in the value of the gift where the husband can dispose of the wife's community personalty whether she likes it or not, except in cases of fraud? An election by the wife in Arizona at best would only constitute a waiver of her rights regarding fraud, and if she were well provided for otherwise and the remaindermen were her children, it is difficult to see there that she would actually be giving up anything.

I would ask Mr. Thurman, then, assuming he agrees the wife is giving up nothing in an inter vivos widow's election insurance trust in Arizona, would that result be avoided by creating a trust which would include real property in which the Arizona wife does have substantial interests?

In the *Siegel* case, being able to use the widow's election reduced the gift tax by $46,000. On the other hand, this may be much ado about nothing if, as Mr. Thurman points out, the election by the widow may constitute the creation of a reserved life estate causing her half interest to be entirely taxable for estate tax purposes, in which event the reduced gift tax may not be an advantage at all.

MR. THURMAN: I believe Mr. Donahue is correct in concluding that the widow's election device is not available in Arizona when an inter vivos insurance trust is involved. The widow will normally have no election to make. Presumably, however, the inclusion of real property in an inter vivos trust could bring the election into play.

In reply to Mr. Donahue's final comment the consideration argument of the *Siegel* case should be applicable in an estate tax case as well as in a gift tax case inasmuch as both types of transfers are exempt where there is a "bona fide sale for an adequate consideration."