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Edmund C. Grainger, Jr.

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Cover Page Footnote

Member of the New York Bar.

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COMMENTS

NON-COMMERCIAL ANNUITIES

EDMUND C. GRAINGER, JR.†

The use of Non-Commercial Annuities can be utilized effectively to save income, gift and estate taxes in tax planning.[1] Generally speaking a non-commercial annuity will take one of the following forms:

1. A transfer of property to the members of the taxpayer's family or to a corporation or business controlled by the family or to an unrelated purchaser in return for life payments.
2. A transfer of money or property to schools, hospitals, churches or other eleemosynary institutions in return for life payments.
3. The settlement of a will contest or other estate contest by the acceptance of life payments from the estate, the heirs or the legatees; or the renunciation of a legacy in return for life payments.
4. Life payments to an employee on retirement either, by the employer directly, by a pension trust fund, or from an annuity contract purchased for the employee.

This paper is concerned, unless otherwise stated, with tax aspects of only the first of the foregoing and primarily with a transaction similar to the following: A, who is advanced in years, transfers property to B, his son, in exchange for B's promise to pay an annual sum to A for A's life.

The recently decided case of *Donald H. Sheridan*[2] focuses attention anew on the inconsistent and often conflicting theories which have pervaded and to some extent still pervade this field. The tax consequences of a normal commercial annuity transaction are well settled.[3] The conflicting theories and apparently inconsistent results arrived at by courts in dealing with non-commercial annuity transactions may well be considered as arising from the anomalous nature of such transactions. As the Court in *Steinbach Kresge Co. v. Sturgess*[4] pointed out, the difficulty arises from applying "a statute phrased in terms of economic commonplaces to an economically unique transaction."[5] Actually the

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† Member of the New York Bar.

1. A Non-Commercial annuity is an annuity under which there is a promise to pay a stated amount of money for a set period, which is not underwritten by a commercial organization whose business is the writing of annuities. Ordinarily there are two primary differences between a so called non-commercial annuity and a commercial annuity: (1) In the non-commercial the transfer is usually of property or a right to property rather than cash and (2) the value of the property transferred is seldom the same at the time of the transfer as the commercial value of the annuity received even assuming it may be valued.

2. 18 T.C. 381 (1952) (A).

3. Int. Rev. Code Sec. 22 (b) (2) (A).

4. 33 F. Supp. 897 (D. N.J. 1940).

5. Id. at 898. The Court continued: "The uniqueness of this simple arrangement lies in the fact that it mixes two ordinarily distinct economic structures—a purchase of stock, and an annuity venture. . . .

"If our circumstance is likened to a stock purchase, the annuity payments become

same court has reached different results in nearly identical situations depending upon whether the issue involved was one of income or deduction[6] and in another whether a loss deduction or depreciation was involved.[7]

The problems which more frequently arise in connection with the assumed problem are:

1. Does A realize taxable gain at the time of the transfer?
2. How does A report the payments to him?
3. How does B handle the payments made by him in his return?
4. Problems in connection with A and B's basis: (a) What is A's basis on a subsequent disposal by him of his right to receive payments from B? (b) If A dies before receiving payments equivalent to his basis does he have a deductible loss? (c) What is B's basis for purposes of determining gain or

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installments of the purchase price. They are, in that event, capital expenditures, and no gain or loss is realized until the transaction is closed in the orthodox manner by the purchaser's disposition of the stock."

If the transaction is treated as an annuity venture, the "annuity is deemed to be issued for cash equal to the fair market value of the property transferred. So, annuity payments in excess of the value of the consideration for the annuity contract (the property transferred) are considered deductible as losses in the year in which made. Curiously, there is little, if any, actual conflict in the decisions. . . .

"The clash, therefore, is between theories rather than precedents. . . . To be sure, these stock-for-annuity transactions do not fit the usual pattern of a purchase, because purchase prices are almost by definition fixed, and not elastic. As a practical matter, however, it seems possible to wait until that elasticity has ceased by reason of the annuitant's death, and to use the "price" so determined as the annuity writer's cost basis of capital gain or loss upon the eventual disposition of the stock. If the writer disposes of the stock before the annuitant dies, it would seem reasonable to defer the calculation of gain or loss until death occurs. The transaction, in view of its uniqueness, may be deemed to remain open, even after disposition, to await the fixing of cost. There is no statutory command for a reckoning of tax immediately upon disposition which would compel the establishment of cost by actuarial values on analogy to federal estate tax practice. See Ithaca Trust Co. v. U.S., 279 U.S. 151, 9 Boston University Law Review 288. Similarly unique transactions have been deemed to remain open after disposition to await the fixing of selling price. Burnet v. Logan, 283 U. S. 404. The annuity venture theory, on the other hand, though achieving the same result in the long run, entails by that very token, the anomalous realization of both gains and losses from what is essentially the same transaction. In addition it presents the difficulty of finding property values in every case. The most that can be said in its favor is that it conforms to the somewhat obscure concept of property for annuity transactions developed conversely with respect to the annuitant's capital gain or loss. But that concept has been moulded to fit a special statute which taxes annuity returns as income—a statute which does not, by its terms, apply to annuity writers." For a thorough discussion of the economic aspects of non-commercial annuity transactions see Galvin, Income Tax Consequences of Agreements Involving Non Commercial Annuities, 29 Texas L. Rev. 469 (1951).

6. Edwin M. Klein, 31 B.T.A. 910 (1934), aff'd, 84 F. 2d 310 (7th Cir. 1936); Florence L. Klein, 6 B.T.A. 617 (1927) (A).

7. John C. Moore Corp., 15 B.T.A. 1140 (1929), aff'd, 42 F. 2d 186 (2d Cir. 1930); John C. Moore Corp., 3 B.T.A. 430 (1926).

loss on a subsequent transfer by him of the property received by him from A or for deductions for depreciation or depletion?

5. Gift tax problems.
6. Estate tax problems.

Certain basic rules have been established by the decided cases and are now apparently beyond dispute. On the other hand there is an area where disagreement, inconsistency, and even directly contrary results still prevail. The *Sheridan* case was concerned primarily with the tax treatment of the transferee in the ordinary situation,[8] and this paper will also be concerned primarily with the transferee's problems. A statement of the general principles applicable to the transferor's problem may, however, be helpful in predicting the treatment which B might expect and some consideration will also be given to the applicability of the estate and gift taxes.

GAIN OR LOSS TO THE TRANSFEROR

It is now well settled that there is no recognizable gain or loss to the transferor regardless of solvency or financial worth of the transferee. The rule is established by a long line of cases[9] and is predicated on the holding of the Supreme Court in *Burnet v. Logan*,[10] that the promise of an individual or of a corporation not engaged in the business of writing annuities has no fair market value. Initially the Treasury Department had taken the opposite view[11] and the Treasury's position had been sustained in one case.[12] However, the Commissioner's original non-acquiescence in all of the cases establishing the present rule was withdrawn in 1950,[13] and he may now be taken as reconciled to the rule.[14]

TAXATION OF TRANSFEROR ON PAYMENTS RECEIVED

In this area the basic rules are also established, but there is some variation within the framework of the established doctrines. Plainly the transferor is taxed under Sec. 22 (b) (2) (A) on 3% of the cost of the annuity.[15] The balance of the payments are tax free until the transferor has recovered his basis. When he has recovered his basis further payments made are treated as

8. For convenience A in our example will sometimes hereinafter be referred to as the transferor or the annuitant and B as the transferee or obligor.

9. Comm. v. Kann's Est., et al., 174 F. 2d 357 (3d Cir. 1949); Evans v. Rothensies, 114 F. 2d 958 (3d Cir. 1940); Bella Hommel, 7 T.C. 992 (1946); Frank C. Deering, 40 B.T.A. 984 (1939); J. Darsie Lloyd, 33 B.T.A. 903 (1936) (NA), withdrawn and (A) see note 13 infra.

10. 283 U.S. 404 (1931).

11. G.C.M. 1022, VI-I Cum. Bull. 12 (1927).

12. Guaranty Trust Co. of N.Y. (Sherry Est.), 15 B.T.A. 20 (1929).

13. 1950-1 Cum. Bull. 1.

14. For a criticism of the basic premise upon which the rule is so firmly established see Galvin, note 5 supra.

15. Ware v. Comm., 159 F. 2d 542 (5th Cir. 1947); Hills Est. v. Maloney, 58 F. Supp. 164 (D. N.J. 1944).

a capital gain until the payments made equal the market value of the property transferred and all further payments are taxed in full as ordinary income. The rationale of the *Hills Est.* case has been generally accepted with the qualification that the Court erred in holding that income taxed as a capital gain was taxable to the extent of 3% under Sec. 22 (b) (2) (A).[16] Thus far the *Hills* case has been neither accepted nor rejected although it was cited with apparent approval in a dissenting opinion in the Tax Court.[17]

TREATMENT OF THE PAYMENTS BY THE TRANSFEREE

Interest

Although logically it would seem that the transferee might deduct as interest[18] the payments made to the annuitant, neither the Treasury Department[19] nor the Courts[20] have accepted this view, even where the deduction was sought only as to the amount taxable to the annuitant under Sec. 22 (b) (2) (A).[21]

The reasoning of the courts is predicated upon the rationale of a 1934 Board of Tax Appeals case.[22] In that opinion the court reasoned that there could be no interest unless there was a concomitant indebtedness. With this as a major premise the court could not come to the conclusion that the annuity payments by the transferee were deductible by him as interest since such payments were contingent upon the life of the transferor, and there was, therefore, no indebtedness.

In reaching its conclusion, the court took the somewhat questionable view that its holding was not inconsistent with its decision in a case involving the taxation of the transferor in the very same transaction wherein it was held

16. Casey, How to Use Intra-Family Annuities, N.Y. University, 8th Annual Institute on Federal Taxation 1109 (1950); Rabkin & Johnson, Federal Income, Gift and Estate Taxes § 63.07.

17. Lydia Hopkins, 13 T.C. 952 (1949) (NA). In Continental Illinois Bank & Trust Co. v. Blair, 45 F. 2d 345 (7th Cir. 1930) the court overruled the Board of Tax Appeals (14 B.T.A. 890) and held that the transferor in a transfer to an organization in return for a life annuity was taxable on the payments as if they were annuity payments. In Michael Fay, 34 B.T.A. 662 (1936) the Board refused to follow the Continental case, held there were no annuity payments and relied on the reasoning in Bettendorf v. Comm., 49 F. 2d 173 (8th Cir. 1931); in Sallie Cosby Wright, 38 B.T.A. 746 (1938) the court stated that it regarded the Continental case as being overruled by the opinion of the Supreme Court in Helvering v. Butterworth et al., 290 U.S. 365 (1933).

18. Int. Rev. Code § 23 (b).

19. I.T. 1242, I-1 Cum. Bull. 61 (1922).

20. Steinbach Kresge Co. v. Sturgess, 33 F. Supp. 897 (D. N.J. 1940); Reliable Incubator & Brooder Co., 6 T.C. 919 (1946), Paul Autenreith, 41 B.T.A. 319, aff'd, 115 F. 2d 856 (3rd Cir. 1940); Robert Long, 5 B.T.A. 438 (1926); Denman Est. Co., 2 B.T.A. 633 (1925); but see Comm. v. John C. Moore Corp., 42 F. 2d 186 (2d Cir. 1930); Contra: Corbett Inv. Co. v. Helvering, 75 F. 2d 525 (D. C. Cir. 1935).

21. Gillespie & Sons Co. v. Comm., 154 F. 2d 913 (10th Cir.), cert. denied, 329 U. S. 781 (1946).

22. Edwin M. Klein, 31 B.T.A. 910 (1934), aff'd, 84 F. 2d 310 (7th Cir. 1936).

that the transferor received taxable income with respect to part of each payment.[23]

The *Edwin M. Klein* decision and reasoning was reaffirmed in the *Steinbach Kresge* case and consistently since.[24] The opinion in the *Sheridan* case, however, inferentially casts doubt on the wisdom of unquestioned acceptance of such views. While the *Sheridan* case was concerned with the deductibility of payments under Sec. 23 (e) (2) as a loss in a transaction entered into for profit, the first sentence of the opinion proper indicates that certain portions of the payments made by the transferee in that case were claimed and allowed as interest deductions in past years.[25] The opinion indicates that for a nine-year period total payments of $31,500 were made of which $1,875.80 was claimed by and allowed to the transferee as an interest deduction.

While the brief passing reference in the *Sheridan* opinion to an interest deduction should not be taken as an indication that the Courts are now ready to reject the soundness of the heretofore unquestioned reasoning of the *Klein, Steinbach-Kresge, Reliable Incubator* and other cases, it is submitted that such a course would be more in accord with the economic realities of the transaction. Support for the premise that the payments should be deductible as interest could be found in *Comm. v. Moore Corp.*[26] The *Moore* case was concerned with two problems, the deductibility of part of the annual payments and the cost basis of the transferee. The court held that a portion of the transferee's annual payments were deductible as interest expense by the transferee and that the same portion was taxable as interest income to the transferor.

The varying dispositions of the courts of the arguments advanced in support of allowing an interest deduction sharply delineates the differences in approach of the courts to the problem, the lack of conformity between the legal doctrines and the apparent economic realities, and the differences in results which occur when different courts are dealing with the identical problem as well as the differences in results which occur when the same court is dealing with different aspects of the same transaction.

Transaction entered into for profit

The transferee has another arrow in his quiver, however, which he may aim at the deduction target. If prudence should dictate that it is inadvisable to rely on the interest arrow, the transferee may seek deduction under Sec. 23 (e) (2) on the theory that the entire transaction is an annuity venture entered into for profit. Of course if he is successful in this approach the transferee would not be entitled to annual deductions as he would if a portion of the payments were deductible as interest, but would be relegated to waiting to take deductions until the payments made by him had equaled the value of the property transferred. Thereafter he could deduct the payments made.

23. Florence L. Klein, 6 B.T.A. 617 (1927) (A).

24. See note 20 supra.

25. As a matter of fact initially the taxpayer had claimed an interest deduction for the tax year in question.

26. 42 F. 2d 186 (2d Cir. 1930).

The *Sheridan* case is a square holding on this point. The transferor in the *Sheridan* case released $40,000 of a $100,000 mortgage to the taxpayer and his uncle as a gift and discharged the remaining $60,000 of the mortgage in return for the promise of the taxpayer and his uncle to pay her $7,000 a year for the remainder of her life. The mortgage which was transferred was a purchase money mortgage which had been executed as part consideration on property purchased by the taxpayer and his uncle from his aunt nine years previous to the annuity transaction. From 1935 through 1944 the taxpayer paid $31,500 to the transferor of which $1,875.80 had been claimed and allowed as an interest deduction. In 1945 the taxpayer made a further payment of $3,500 to the transferor and claimed $3,124 thereof as a deductible loss on a transaction entered into for profit.[27] The latter figure was the amount of the excess of the payments made by the taxpayer to the transferor over his share of the principal of the discharged mortgage with the exception of the amount which he had deducted as interest in prior years. The Commissioner resisted the argument on the ground that the payments constituted capital expenditures. Support for this position could be found in previously decided cases and rulings.[28]

An early Board ruling[29] had stated that when the total amount paid equaled the principal sum, the installments thereafter paid were deductible as a business expense provided the transaction was entered into for profit. The Courts, however, did not completely accept this approach and seemed to follow two theories with regard to such payments. One is that there is an exchange of property for the annuity promise valued at the time of transfer.[30] The second is that there is a purchase of property at a cost to be eventually determined on the death of the transferor.[31] A recent article indicates that the latter theory, which is more recent, is more generally followed at the present time.[32] The *Steinbach Kresge* opinion discussed these two different approaches and characterized them as the "annuity venture" and "capital expenditure" theories.[33]

Conceivably the Court in the *Sheridan* case might have rejected the capital expenditure theory because in that case the fact was that the value of the

27. Initially the transferor claimed a deduction of $1,121.05 as interest. This was disallowed, although as discussed in the text above interest deductions had previously been allowed and the taxpayer thereupon sought deduction under Sec. 23 (e) (2).

28. S.M. 3141-A, IV-1 Cum. Bull. 193 (1925); I. T. 1662, Cum. Bull. 121 (1923); Burnet v. Logan, 283 U.S. 404 (1931); Hills Est. v. Maloney, 58 F. Supp. 164 (D. N.J. 1944); Bella Hommel, 7 T.C. 992 (1946); Frank C. Deering, 40 B.T.A. 984 (1939); J. Darsie Lloyd, 33 B.T.A. 903 (1936).

29. J. Darsie Lloyd, 33 B.T.A. 903 (1936).

30. J. C. Moore Corp., 15 B.T.A. 1140 (1929); Nelson Trottman, P-H 1944 TC Mem. ¶ 44, 112 (1944); O. D. 945, 4 Cum. Bull. 44 (1921).

31. Citizens National Bank, 122 F. 2d 1011 (8th Cir. 1941); Mastin v. Comm., 28 F. 2d 748 (1928), aff'g, 7 B.T.A. 72 (1927); D. Bruce Forrester, 4 T.C. 907 (1945) (A).

32. Burks, Private Annuities, 1952 Major Tax Problems, University of Southern California Tax Institute 225.

33. 33 F. Supp. 897 (D. N.J. 1940).

property transferred was readily ascertainable. An inference might be drawn from the *Steinbach Kresge* opinion that the applicability of one or the other theory depends upon whether or not the property transferred has a known value at the time of the transfer. Another old Board of Tax Appeals case applied the test of whether or not the value of the property was known at the time of the transfer in rejecting the venture theory and in adopting the capital expenditure theory.[34]

In the converse situation the Bureau has held that a loss may be taken if the basis of the property transferred is more than the value of the annuity and if the disposition occurred in a transaction entered into for profit.[35] No Court, however, has ever applied this rule as far as can be determined. In two cases in which the Commission claimed there was a gain the Tax Court held to the contrary because it found that the taxpayer's basis was higher than the value of the property at the time of the transfer or the cost of the annuity, but no question of loss was involved.[36] Likewise it has been held that the yearly payments in reduction of the principal obligation are deductible under Sec. 23 (1) as depreciation payments if it could be proved that the property acquired was a life estate.[37] The lack of uniformity in this area as in many areas in this field is observed from the fact that in dealing with the transferor the Courts are inclined to treat the payments as annuity receipts, while most of the Courts in dealing with the transferee regard the same payments as expenditures in connection with the acquisition of property. Since the Commissioner has acquiesced in the decision in the *Sheridan* case and consequently no early re-examination by a Circuit Court of the opinions and holdings in the field can be anticipated, whether a Sec. 23 (e) (2) deduction will be allowed will still depend upon whether the Court adopts the annuity venture or capital expenditure theory.

BASIS PROBLEMS

The problem of establishing a basis for both the property transferred and also in the transferor's contractual right to receive stated payments for his life is not merely a separate aspect of the over-all problem. It pervades every aspect of the problems discussed previously herein as well as the problems to be discussed hereinafter in connection with the applicability of the gift and estate taxes.

Transferor's basis in right to receive payments from transferee.

The transferor's basis in his right to receive payments from the transferee is, under Sec. 113 (a), the cost of such right unless some other provision of Sec. 113 is applicable. No such other section is by its terms specifically

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34. Victor J. Evans, 23 B.T.A. 156 (1931).

35. See note 11 supra.

36. Bella Hommel, 7 T.C. 992 (1946); Frank C. Deering, 40 B.T.A. 984 (1939).

37. Bell v. Harrison, 108 F. Supp. 300 (N.D. Ill. 1952); Floyd M. Shoemaker, 16 B.T.A. 1145 (1929) (NA); Elmer J. Keitel, 15 B.T.A. 903 (1929); but see Citizens National Bank, 42 B.T.A. 539, aff'd, 122 F. 2d 1011 (8th Cir. 1941).

applicable. The difficulty then is to determine the "cost" to the transferor of his right to receive the annual payments from the transferee. In applying Sec. 113 the Courts have established divergent tests. Thus under the decisions the transferor's basis in his right to receive payments might be the commuted value of the annual payments according to the tables published in the gift and estate tax regulations[38] or it might be the price a corporation in the business of writing commercial annuities would charge for a similar annuity,[39] or it might be the market value of the property transferred. In support of the latter proposition it could be argued that inasmuch as no gain is recognized at the time of the transfer the philosophy of Sec. 112 (b) dealing with transactions in which no gain is recognized should apply. If this were so the basis could be determined under Sec. 113 (a) (6) which establishes the basis for property acquired in an exchange in which no gain is recognized by reason of received is the same as the basis of the property transferred and the transferor's Sec. 112 (b) (1) to (6) and (1). In such cases the basis of the property basis in his right to receive the annual payments would thus be the same as his basis in the property transferred to the obligor.

Cases in which a determination of the cost of the annuity or the consideration paid has been involved have arisen in various ways. In some instances the issue arose in determining the liability of the transferor for gift and estate taxes; in other instances the issue was presented in order to determine the principal sum to which the 3% rule should apply. Under the present statute and decisions, no hard and fast rule can be laid down for determining the transferor's basis; it will depend on which of the three theories set forth above is adopted and in what connection the issue arises.

Mortality loss

It seems settled that the transferor's estate is not entitled to a loss deduction if the transferor dies before receiving payments either equal to the value of the property or his basis therein.[40] The obvious justification for this rule is that, notwithstanding how long the transferor lives after the transfer, he will have received at his death exactly what he bargained for, i.e., payments for life. This result has been criticized, however, on the ground that no return on the transferor's investment is permissible under the rule. It is submitted that this conflict in approach results from the very nature of the annuity transaction, which is in some respects a gamble on the part of the transferor and is also a conscious and deliberate act on his part to reduce his total tax burden and at the same time make a desirable intra-family transfer. Furthermore, the

38. Sarah A. Bergan Est., 1 T.C. 543 (1943); Edmund A. Steenburg et ux. B.T.A. Dckt. No. 101173 (1941).

39. Comm. v. Kann Est. et al., 174 F. 2d 357 (3d Cir. 1949); Beattie v. Comm., 159 F. 2d 788 (6th Cir. 1947), aff'g 6 T.C. 609; Gillispie v. Comm., 128 F. 2d 140 (9th Cir. 1942), reversing 43 B.T.A. 399; Anna L. Raymond, 40 B.T.A. 244, aff'd, 114 F. 2d 140 (7th Cir. 1940), cert. denied, 311 U.S. 710 (1940).

40. I.T. 2915, XIV-2 Cum. Bull. 98 (1935); Industrial Trust Co. et al. v. Broderick, 94 F. 2d 927 (1st Cir. 1938); Helvering v. Louis, 77 F. 2d 386 (D.C. Cir. 1935).

transferor if he is successful in this gamble and lives a sufficient length of time will have been able to buy more income through the use of the non-commercial annuity than he would by using a comparable commercial annuity.

Transferee's basis in property received

There is much less uncertainty in determining the transferee's basis at least insofar as establishing his basis for computing gain or loss on a sale by the transferee subsequent to the death of the transferor. His basis will apparently be equivalent to the total of the payments made by him to the annuitant.[41]

It is difficult to apply, however, if the sale by the transferee occurs prior to the death of the annuitant and it is even more difficult to apply for purposes of determining the amount allowable annually for depreciation or depletion. The Bureau's present position as to such eventuality is that the transferee's basis will be the sum of: (a) the payments made plus (b) the present commuted value of the payments to be made in the future based on the tables set forth in the Estate and Gift Tax Regulations.[42]

The American Law Institute in its tentative draft of a proposed new Federal Income Tax Statute provides in Sec. X 126 (f) for the establishment of a basis which as to the transferor would be ascertained by regarding the consideration received by the transferor in the form of the annuity promise as property in computing the amount realized. The transferee, on the other hand, would include in his unadjusted basis under the proposed statute the value of the annuity contract. Thus the transferee will get an immediate fixed basis rather than an annually fluctuating one.[43] The draft also provides that mortality gains or losses shall be governed by regulations to be adopted by the Bureau.

GIFT TAX

Refreshingly enough most Courts[44] and the Bureau[45] agree that when the value of the property transferred is substantially in excess of the value of the consideration received by the transferor in the form of the annuity promise, a gift tax is payable. This result seems sound. Of course, the Courts must still

41. See note 21 supra.

42. O.D. 945, 4 Cum. Bull. 44 (1921) as revoked in part by G.C.M. 11655, the revocation to that extent being approved in I.T. 2689, Cum. Bull. 60 (1933); D. Bruce Forrester, 4 T.C. 907 (1945) (A); Nelson Trottman P-H 1944 TC Mem. ¶ 44,112 (1944); Florence L. Klein, et al., 6 B.T.A. 617 (1927) (A) John C. Moore Corp., 3 B.T.A. 430 (1926).

43. American Law Institute, Federal Income Tax Statute, Tentative Draft No. 6 (1952), pages 262-4.

44. Est. of Koert Bartman, 10 T.C. 1073 (1948); Est. of Sarah A. Bergan, 1 T.C. 543 (1943); May Rogers, 31 B.T.A. 994 (1935); Anna L. Raymond, 4 B.T.A. 244, aff'd, 114 F. 2d 140 (7th Cir.), cert. denied, 311 U.S. 710 (1940); but cf. Merrill v. Fahs, 324 U.S. 308 (1945); Comm. v. Wemyss, 324 U.S. 303 (1945); Gillespie v. Comm., 128 F. 2d 140 (5th Cir. 1942), reversing 43 B.T.A. 399; Elizabeth L. Beattie, 6 T.C. 609, aff'd, 159 F. 2d 788 (6th Cir. 1947).

45. I.T. 2397, VII-I Cum. Bull. 90 (1928).

inquire as to whether there has been a completed gift,[46] whether there is donative intent, and into the ever-present valuation problems. The Bureau ruling cited in the footnote involved a gift to a college in return for a life annuity and it was concluded that the difference between the purchase price of a commercial annuity and $50,000, the amount of the cash transferred, was a contribution. The *Raymond*[47] case also involved a transfer to a charitable organization in return for life payments and the opinion held that the excess of the value of the securities transferred over the cost of a commercial annuity was a taxable gift. As to valuation, the accepted practice seems to be to use the tables in the gift and estate tax regulations rather than the commercial annuity tables.

As the Court in the *Mabel Adams* case said "the factors which are significant" in determining whether or not there is a taxable gift "in large measure determine also the applicability of the estate tax. . . ."[48]

ESTATE TAX OF ANNUITANT

Whether or not the property transferred is includible in the estate of the annuitant on his death for the purpose of subjecting it to an estate tax seems to depend upon whether there are any arrangements in connection with the transfer which are security to the transferor for the transferee's obligation, or whether the transferor retains any control over the transferred property in any other manner. The most obvious instance of such control is that in which the annuity payments to the transferor are equal to the income from the property transferred. The rationale in such instance is that the transferor has retained for his life the right to the income from the property and is, therefore, squarely within the provisions of Sec. 811 (c) (1) (B) (i).

In most of the cases in which the property has been held includible in the estate of the annuitant the facts permitted a finding that the transfer was one made in contemplation of death.[49] Since the "contemplation of death" cases were decided before the amendment made by the Revenue Act of 1950 of Sec. 811 (c) (1) (A)[50] which established the presumption that transfers made more than three years before the death of the decedent were not made in contemplation of death, their applicability will undoubtedly be limited in the future. The "reservation of income" theory[51] must, however, still be considered.

46. Elizabeth S. Hettler, 5 T.C. 1079 (1945); Nelson Trottman, P-H 1944 T.C. Mem. ¶ 44,112 (1944); Mabel Adams, 44 B.T.A. 1091 (1941).

47. 40 B.T.A. 244, aff'd, 114 F. 2d 140 (7th Cir.), cert. denied, 311 U.S. 710 (1940); and see the excellent discussion at pages 1078-9 of the Bartman opinion.

48. 44 B.T.A. 1091, 1093 (1941).

49. Updike v. Comm., 88 F. 2d 807 (8th Cir.), cert. denied, 301 U.S. 708 (1937); Est. of Cornelia B. Schwartz, 9 T.C. 229 (1947).

50. Int. Rev. Code § 811 (1).

51. See Est. of Cornelia B. Schwartz, 9 T.C. 229, 238 (1947). Moreover if the transferor receives as payment the exact income from the property, whether the transfer is in trust or otherwise, he will be taxed on the income from the property. Michael Fay, 34 B.T.A. 662 (1936); See Bettendorf v. Comm., 49 F. 2d 173 (8th Cir. 1931) and Sallie Wright,

On the other hand it has been held that so long as there are no security arrangements or retained strings[52] and the transfer was irrevocable and unconditioned and was not made in contemplation of death, no estate tax is assessable on the estate of the transferor because of a bare promise on the part of the transferee to make annual lifetime payments.[53] The distinction drawn seems to be that where the property is transferred in trust and the transferor is to receive income payments from the trust, whether or not the payments are exactly equivalent to the actual income of the property, an estate tax will be assessed and if the transfer is not in trust no estate tax is payable.[54]

It is submitted that the cases involving the simultaneous purchase of a single premium life insurance contract and an annuity contract[55] are inapplicable. As a matter of fact even with respect to such transaction there is a conflicting authority.[56] Seemingly the *Bergan* case is still valid authority for the proposition that a simple transfer of property in return for an unsecured life time annuity promise will not require the inclusion of the property transferred in the transferor-annuitant's estate for estate tax purposes.

38 B.T.A. 746 (1938) but see Continental Ill. Bank v. Blair, 45 F. 2d 345 (7th Cir. 1930); Comm. v. Kann's Est. et al., 174 F. 2d 357 (3d Cir. 1949), suggests the theory should also apply to intra-family transfers even though the annual payment does not correspond to the income from the property.

52. Compare Est. of Pamelia D. Holland, 47 B.T.A. 807 (1942), with Est. of Wm. F. Hofford, 4 T.C. 790 (1945) in which the court modified an earlier opinion and reversed itself on the 811 (c) issue.

53. Est. of Sarah A. Bergan, 1 T.C. 543 (1943); cf. Lincoln v. U.S., 65 Ct. Cl. 198 (1928).

54. The Schwartz opinion at p. 240 seeks to distinguish the Bergan case on this ground.

55. Goldstone et al. v. U.S., 325 U.S. 687 (1945); Conway v. Glenn, 193 F. 2d 965 (6th Cir. 1952): Burr et al. v. Comm., 156 F. 2d 871 (2d Cir. 1946), cert. denied, 329 U.S. 785 (1946); Bohnen et al. v. Harrison, 100 F. Supp. 118 (N.D. Ill., 1951); Est. of Cora C. Reynolds, 45 B.T.A. 44 (1941).

56. Compare the opinions in Conway v. Glenn, 193 F. 2d 965 (6th Cir. 1952) and Burr et al. v. Comm., 156 F. 2d 871 (2d Cir. 1946) with the opinion in Bohnen et al. v. Harrison, 100 F. Supp. 118 (N.D. Ill. 1951).