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Payments to Widows--Taxable Income?

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PAYMENTS TO WIDOWS–TAXABLE INCOME?

Ten years ago the Income Tax Unit of the Bureau of Internal Revenue ruled that "irrespective of a 'plan,' voluntary or involuntary, definite or indefinite, . . . payments made by an employer to the widow of a deceased officer or employee, in consideration of services rendered by the officer or employee, are includible in the gross income of the widow for Federal income tax purposes."[1] At the time it was written of this ruling that "it is clear that if I.T. 4027 meets the approval of the courts, another type of income has been removed from that very exclusive category of tax-free income."[2]

The courts, however, have in practice continued to be somewhat reluctant to tax these payments to widows from the former employers of their deceased husbands. Courts have maintained a very liberal view as to these payments. After a number of adverse court decisions the Internal Revenue Service (hereinafter referred to as IRS) declared in 1958 that it would no longer litigate, under the 1939 Code, the taxability of voluntary payments to widows by their deceased husbands' employers, unless there is clear evidence that such payments are intended to be compensation for services or may be considered to be dividends.[3] The IRS went further, however, and emphasized that this announcement "represents a litigation policy, implemented by consistent administrative action, pertaining to 1939 Code cases only."[4] Since that announcement the IRS has indicated[5] its position that such payments under the 1954 Code will be taxed to the widow. Why then is the IRS so obstinate, in the face of the court decisions in maintaining its contention that these payments are taxable?

First the possible sections of the Internal Revenue Code of 1954 that may be involved in these payments should be examined. The amounts received may be fully taxable under Section 61 as gross

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1 I.T. 4027, 1950-2 Cum. Bull. 9 at 10-11, revoking O.D. 1017, 5 Cum. Bull. 101 (1921), and modifying I.T. 3329, 1939-2 Cum. Bull. 153. Under I.T. 3329, 1939-2 Cum. Bull. 153, prior to 1950 the Internal Revenue Service held that a payment by an employer to the widow of a deceased employee, made without any enforceable obligation, was a gift to the widow. It was also held that payments were deductible by the employer when paid in recognition of services rendered by the deceased employee.

2 Note, "Payments to Widows of Deceased Employees as Taxable Income of the Widow–I.T. 4027," 39 Ky. L.J. 363, 367 (1951).

3 Rev. Rul. 50-613, 1958-2 Cum. Bull. 914.

4 *Ibid.*

5 See Reed v. United States, 177 F. Supp. 205 (W.D. Ky. 1959), where it was held that where the corporate employer of the taxpayer's deceased husband paid to the taxpayer, over a period of twelve months, the sum of $50,000, there was a gift, not includible in taxable income; *aff'd*, 277 F.2d 456 (6th Cir. 1960).

income.[6] They may also be taxable as annuities under Section 72.[7] However, Section 72 contemplates the receipt of these payments under a contract, but contracts have been noticeably absent in the cases litigated. Another possibility is that the payments may be excluded from gross income as gifts under Section 102.[8] A fourth possibility is that the amounts up to $5,000 of the death benefits are excludable from gross income but that all in excess of that amount would be included in gross income under Section 101(b).[9]

Generally the payments by an employer to the widow of a deceased employee are taxable to the widow, as compensation for past services, unless it can be shown that the payments were intended as a gift to her. This question ordinarily turns on the determination of whether the payments were made under an obligation from the employer to the former employee or his widow or whether the payments were made voluntarily. If there was a binding obligation to make the payments, the possibility of a gift is ruled out.

The obligation which binds the employer to make the payments may take several forms. It is not necessary to have a legal obligation if there is a moral obligation to make the payments.[10] The obligation may be only the corporation's long-established plan, consistently followed, by which valuable employees have been encouraged to remain in their employment.[11] Also, the obligation may include agreements or contracts wherein the employer agrees to pay an amount to the employee's widow or estate following his death.[12] Payments made by an employer to a beneficiary (including a widow) are not gifts even

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[6] Int. Rev. Code of 1954, § 61(a), "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) . . . (14) Income in respect of a decedent. . . ."

[7] Int. Rev. Code of 1954, § 72(a), "Except as otherwise provided in this chapter, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract."

[8] Int. Rev. Code of 1954, § 102, "Gross income does not include the value of property acquired by gift. . . ."

[9] Int. Rev. Code of 1954, § 101(b)(1), "Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employer and are paid by reason of the death of the employee.

(2) . . . (A) $5,000 limitation—The aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed $5,000."

This was Int. Rev. Code of 1939, § 22(b)(1)(B) which excluded from gross income amounts up to $5,000 received "under a contract of an employer providing for payment of such amounts to the beneficiaries of an employee paid by reason of the death of the employee."

[10] Simpson v. United States, 261 F.2d 497, 501 (7th Cir. 1958).

[11] *Ibid.*; Bausch's Estate v. Commissioner, 186 F.2d 313 (2d Cir. 1951).

[12] Hatch v. Commissioner, 190 F.2d 254 (2d Cir. 1951), Amounts taxable as income included only the excess of amounts received over the commuted value of the contract for Federal estate tax purposes; Flarsheim v. United States, 156 F.2d 105 (8th Cir. 1946). *Cf.* F. E. Carr, 28 T.C. 779 (1957).

though the beneficiary has done nothing to earn them, if the payments are made pursuant to an enforceable contract between the employer and the employee. This is based on the theory that the recipient has a legal right to them as a third-party beneficiary.[13] A statute can provide the binding obligation which will render payments pursuant thereto taxable as income.[14] Termination payments to which the employee had a right prior to his death but which were paid to his widow after his death constitute income received under a binding obligation.[15] These cases were decided under the Internal Revenue Code of 1939. However, the position of the IRS is logically the same under the Internal Revenue Code of 1954 and so far no cases have challenged the issue.

Voluntary payments, by the former employer to a deceased employee's widow, provide the great field of controversy. This is the area in which the IRS and the courts have been in disagreement for years and still continue to disagree. The basic issue, as regards *voluntary* payments, is whether the employer intends that the payments be gifts to the widow or whether they are compensation for the deceased husband's past services as an employee.

Congress does not have the power to impose a direct and unapportioned tax on amounts received as gifts even under the Sixteenth Amendment.[16] The narrow line of distinction between taxable compensation and tax-free gifts is illuminated by *Bogardus v. Commissioner*[17] on the one side and by *Old Colony Trust Co. v. Commissioner*[18] on the other. It is implicit from the *Bogardus* majority opinion that the determination of whether payments are gifts as distinguished from compensation may be a problem to be decided on an *ad hoc* basis, usually turning on the intent of the payor. The language of the *Bogardus* case would seem to be favorable to declaring voluntary payments, by the employer to widows of former employees, to

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[13] Rodner v. United States, 149 F. Supp. 233, 235 (S.D. N.Y. 1957), citing Lawrence v. Fox, 20 N.Y. 268 (1859).

[14] Varnedoe v. Allen, 158 F.2d 467 (5th Cir. 1946); I.T. 3972, 1949-2 Cum. Bull. 15; Note, 39 Ky. L.J. 363, 364-365 (1951).

[15] A. W. Davis, 11 CCH Tax Ct. Mem. 814 (1952).

[16] U. S. Const. art. I, § 2, cl. 3; U. S. Const. art. I, § 9, cl. 4; U. S. Const. amend. XVI; United States v. Grace P. Reed, 177 F. Supp. 205 (W.D. Ky. 1959), *aff'd*, 277 F.2d 456 (6th Cir. 1960); Cowan v. United States, CCH 1960 Stand. Fed. Tax Rep. (60-2 U. S. Tax Cas.) ¶ 9674 (N.D. Ga. Aug. 25, 1960), Int. Rev. Code of 1954, § 102(a); Int. Rev. Code of 1939, § 22(b)(3).

[17] 302 U. S. 34 (1937), where payments to present and former employees of a corporation, by its former stockholders, acting through a successor corporation, were held to be gifts.

[18] 279 U. S. 716, 730 (1929), where payments of income taxes assessable against compensation of employee were held to be additional taxable income of the employee even though they were entirely voluntary and for many purposes a gift.

be gifts. The Court said, "A gift is none the less a gift because inspired by gratitude for the past faithful services of the recipient."[19] In that case the Court noted that the facts indicated that the intention of the persons who decided that the payments should be made "was to make gifts in recognition of, not payments for, former services."[20] If these payments can be made to former employees and held to be gifts, a fortiori voluntary payments to their widows should be held to be gifts.

Prior to 1950 there would have been little question raised over holding employers' voluntary payments to widows of deceased employees, made without any enforceable obligation, to be gifts.[21] Even before 1950, however, the *Bogardus* concept was somewhat curtailed in one case where it was stated that the payments of additional sums to an employee before, during, or after termination of service, or to his estate, are strongly presumed to be made for services rendered and consequently, are not gifts.[22] Since 1950 the taxability of these payments has become more uncertain.

The IRS Position

In 1950, as was mentioned in the beginning of this note, the IRS changed its ruling by holding that "irrespective of a plan, voluntary or involuntary, definite or indefinite, payments made by an employer to the widow of a deceased employee in consideration of services rendered by the employee are taxable to the widow."[23] This ruling was to become effective January 1, 1951, and was to apply thereafter. Obviously the IRS intended to remove these payments from the non-taxable category with this ruling.

As a partial alternative to making these payments wholly taxable, the IRS attempted to limit the exemption to $5,000. The $5,000 exemption was introduced in 1951 as an amendment to the Internal Revenue Code of 1939.[24] In the 1951 amendment, however, the exemption applied only where the benefits were paid "*under a contract* of an employer," (emphasis added); these words were omitted in the 1954 version,[25] thus making the exemption applicable to *all* death benefits both gratuitous and contractual. At least this interpretation

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19 Bogardus v. Commissioner, 302 U. S. 34, 44 (1937).
20 *Id.* at 43.
21 See generally Note, 39 Ky. L.J. 363 (1951).
22 Wilkie v. Commissioner, 127 F.2d 953 (6th Cir. 1942).
23 I.T. 4027, 1950-2 Cum Bull. 9 at 10-11, modifying I.T. 3329, 1939-2 Cum. Bull. 153, revoking O.D. 1017, 5 Cum. Bull. 101 (1921) and T.D. 2090 (Dec. 14, 1914); 1 P-H 1960 Fed. Tax Serv. ¶ 7054.
24 Int. Rev. Code of 1939, § 22(b)(1)(A) and (B) as amended by 65 Stat. 483 (1951).
25 Int. Rev. Code of 1954, § 101(b).

was placed upon the 1954 provision by the judges in two circuits[26] by way of dicta in cases decided under the 1939 Code as amended by the 1951 provision. No doubt this was the intention of the IRS in removing from the present Code the words "under a contract of an employer." However, the courts, once they had an opportunity to interpret this section under the 1954 Code, chose to make it inapplicable to gratuitous payments.

The Court's Position

In every case since 1950 the courts have held gratuitous payments by employers to widows of their deceased employees to be gifts and non-taxable. Furthermore, the Commissioner's position has been expressly rejected by the overruling of I.T. 4027.[27] Whether these payments are "voluntary" and "gifts" or not, is determined by the intent of the payor or donor. The question is one of fact[28] and where the employer does not indicate unequivocally whether payments to the widow are intended as gifts it is for the courts as "triers of the facts to seek among competing aims or motives the ones that dominated conduct."[29] Inasmuch as "intent" is a very elusive and ambiguous term to define, it will be worthwhile to examine some of the factors which the courts have considered as determining "gratuitous intent" and some of the factors which the courts have chosen to minimize.

Some of the factors which the courts, since 1950, have recognized as showing gratuitous intent are:

(a) The employee had been fully compensated for his services during his lifetime.[30]

(b) There was no agreement with either the employee or the widow obligating the employer to make the payments.[31]

(c) The employer had no established policy of making such payments.[32]

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[26] Bounds v. United States, 262 F.2d 876, 878, n. 2 (4th Cir. 1958); Rodner v. United States, 149 F. Supp. 233, 237 (S.D.N.Y. 1957).

[27] Estate of Arthur W. Hellstrom, 24 T.C. 916, 919 (1955); Rodner v. United States, *supra* note 26.

[28] Alice M. Macfarlane, 19 T.C. 9 (1952).

[29] Peters v. Smith, 221 F.2d 721, 725 (3d Cir. 1955), citing Bogardus v. Commissioner, 302 U.S. 34, 45 (1937).

[30] Greenberg v. United States, 59-2 U. S. Tax Cas. ¶ 9676 (D. Neb. 1959); Estate of Albert W. Morse, 17 CCH Tax Ct. Mem. 261 (1958); Carley v. United States, 163 F. Supp. 429 (S.D. Ohio 1958).

[31] Greenberg v. United States, *supra* note 30; Neuhoff v. United States, 58-1 U. S. Tax Cas. ¶ 9506 (S.D. Fla. 1958). Estate of Arthur W. Hellstrom, 24 T.C. 916 (1955).

[32] Reed v. United States, 177 F. Supp. 205 (W.D. Ky. 1959) *aff'd* 277 F.2d 456 (6th Cir. 1960) (Payments were made on 6 previous occasions); Greenberg

(Footnote continued on next page)

(d) The payment was made to the widow and not to her husband's estate.[33]

(e) The corporation derived no benefit for the payment.[34]

(f) The recipient (widow) had performed no services for the corporation.[35]

Some of the factors which the courts have stated that do not necessarily imply that an otherwise gratuitous payment is ordinary income are:

(a) The deceased employee owned at least twenty-five per cent (25%) of the outstanding stock in the corporation at the time of his death.[36]

(b) The amount of the payments was based on the salary which the deceased employee would have received for the period over which it was paid (not based on need of the widow).[37]

(c) A statement was made by the corporation that its reasons for making the payment were "because of" or "in recognition of" or "in consideration of" the past services of the deceased employee.[38]

(Footnote continued from preceding page)
v. United States, 59-2 U.S. Tax Cas. ¶ 9676 (D. Neb. 1959); Rodner v. United States, 149 F. Supp. 233 (S.D. N.Y. 1957) (Payments were made on 9 previous occasions); Estate of John Hekman, 16 CCH Tax Ct. Mem. 304 (1957) (Payments were made on 8 previous occasions). The establishment of a policy is rather ambiguous from the court decisions. What is necessary to the recognition by the courts that the company has an established policy of making payments to widows of former employees? Apparently the courts look for a pattern which may be followed. This raises, however, an additional question as to whether this pattern has to apply to all employees or only to employees who were executive personnel. The courts have held that payments of this nature on as many as nine previous occasions does not constitute an established policy. Rodner v. United States, *supra*.

[33] Estate of Arthur W. Hellstrom, 24 T.C. 916 (1955); Estate of Albert W. Morse, 17 CCH Tax Ct. Mem. 261 (1958); Rodner v. United States, *supra* note 32; Jackson v. Granquist, 169 F. Supp. 442 (D. Ore. 1957); *Cf.* Estate of Edward Bausch, 186 F.2d 313 (2d Cir. 1951) (The payment was held to be income under those circumstances, one of which was that the payment was made to the estate.); *Contra,* Estate of Frank J. Foote, 28 T.C. 547 (1958).

[34] Estate of Arthur W. Hellstrom, *supra* note 33; Ethel G. Mann, 16 CCH Tax Ct. Mem. 212 (1957); Estate of Ralph W. Reardon, 14 CCH Tax Ct. Mem. 577 (1955); Baur v. United States, 57-1 U. S. Tax Cas. ¶ 9210 (S.D. Ind. 1956).

[35] Estate of Arthur W. Hellstrom, 24 T.C. 916 (1955); Elizabeth R. Matthews, 15 CCH Tax Ct. Mem. 204 (1956); Bledsoe v. United States, 57-1 U.S. Tax Cas. ¶ 9211 (S.D. Ind. 1956).

[36] Carley v. United States, 163 F. Supp. 429 (S.D. Ohio 1958) (83.63%); Nixon v. United States, 57-2 U.S. Tax Cas. ¶ 9982 (E.D. Tenn. 1957) (family controlled corporation); Jackson v. Granquist, 169 F. Supp. 442 (D. Ore. 1957) (Deceased and his mother owned 100% of the common stock).

[37] Reed v. United States, 177 F. Supp. 205 (W.D. Ky. 1959), *aff'd* 277 F.2d 456 (6th Cir. 1960); Slater v. Riddell, 56-2 U. S. Tax Cas. ¶ 9892 (S.D. Calif. 1956); Estate of Ralph W. Reardon, 14 CCH Tax Ct. Mem. 577 (1955).

[38] Reed v. United States, *supra* note 37; Estate of Arthur W. Hellstrom, 24 T.C. 916 (1955); Estate of Albert W. Morse, 17 CCH Tax Ct. Mem. 261 (1958); Ethel G. Mann, 16 CCH Tax Ct. Mem. 212 (1957).

(d) The corporation claimed deductions on its returns for the amount paid to the widow, inconsistent with the intention to make a gift.[39]

(e) The widow owned a large block of the outstanding stock and was a member of the board of directors of the corporation when the resolution was adopted to make the payments to her, although she did not participate in the voting on the resolution.[40]

(f) The corporate resolution authorizing such payments referred

(g) The corporate books called the payments "salary."[42]

to a "contract."[41]

(h) The widow of one of two principal stockholders of a family-owned corporation received payments pursuant to a voluntary agreement between the two principal stockholders that if either one predeceased his wife, the corporation would pay to the widow an amount equal to the salary of the deceased at the time of his death for a period not to exceed one year.[43]

(i) The corporate resolution authorizing payments to a widow of amounts equivalent to the salary of her deceased husband for two years also authorized payments, similarly computed, to the wives of two living corporate officers upon their husbands' respective deaths.[44]

(j) At the time the resolution was adopted to make the payments, the widow was a member of the board of directors, and it is not clear from the opinion whether the recipient participated in the voting on the resolution.[45]

(k) The payment to the widow of the deceased general manager included salary and bonus. This bonus was nearly twice her

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[39] Bounds v. United States, 262 F.2d 876 (4th Cir. 1958); Carley v. United States, 163 F. Supp. 429 (S.D. Ohio 1958); Linoff v. United States, 58-1 U.S. Tax Cas. ¶ 9204 (D. Minn. 1957); Estate of John Hekman, 16 CCH Tax Ct. Mem. 304 (1957). See discussion in Commissioner v. Duberstein, 363 U.S. 278, (1960) where the Court apparently does not accept this inconsistency argument.

[40] United States v. Bankston, 254 F.2d 641 (6th Cir. 1958); Estate of Albert W. Morse, 17 CCH Tax Ct. Mem. 261 (1958); Marie G. Haskell, 14 CCH Tax Ct. Mem. 788 (1955) (Where the widow and her daughter owned controlling stock interest the argument that the payments constituted dividends was negotiated by the dividend record).

[41] Nixon v. United States, 57-2 U.S. Tax Cas. ¶ 9982 (E.D. Tenn. 1957).

[42] Nixon v. United States, *supra* note 41; Ruth Hahn, 13 CCH Tax Ct. Mem. 308 (1954); Slater v. Riddell, 56-2 U. S. Tax Cas. ¶ 9892 (S.D. Calif. 1956).

[43] United States v. Allinger, 275 F.2d 421 (6th Cir. 1960) (The District Court ruled that the wife did not have a vested right to the payments at her husband's death under the oral contract; thus payments were voluntary).

[44] Florence S. Luntz, 29 T.C. 647 (1958).

[45] Hardy v. United States, 58-2 U. S. Tax Cas. ¶ 9521 (W.D. Ky. 1958).

deceased husband's annual salary, but an identical bonus had been paid to the officer in the two previous years.[46]

(l) The deceased employee owned more than seventy per cent (70%) of the outstanding-voting stock of the corporation. The widow was on the board of directors but refrained from voting on the resolution to make these payments. Her deceased husband's stock, however, was voted by the executor.[47]

(m) Some payments have been in one lump sum while others have been in monthly installments.[48]

(n) The time over which the payments extended has not been significant although attempts to make a "gift" over a period of more than two years have been infrequent.[49]

(o) The amount of the payment has not been asserted as an indication of either a "gift" or "compensation."[50]

All of these cases cited were decided under the 1939 Code except for the *Reed* case[51] and the *Cowan* case,[52] both of which were decided under the 1954 Code. Although these are only two cases, it is nevertheless apparent from these cases that the courts are taking the same position under the 1954 Code that they took under the 1939 Code, *i.e.*, that gratuitous payments to widows of deceased employees are gifts and are not taxable to the widow. This is true notwithstanding dicta to the contrary in two other federal court opinions.[53] Based on the *Reed* case and the *Cowan* case, the limitation of Section 101(b)(2)(a) is not applicable; only Section 102 applies to voluntary and gratuitous payments to widows.[54] It is submitted that this is the proper interpretation of the 1954 Code provisions.

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[46] Elizabeth R. Matthews, 15 CCH Tax Ct. Mem. 204 (1956).

[47] Bank of the Southwest Nat'l Ass'n, Houston v. United States 165 F. Supp. 200 (S.D. Tex. 1958).

[48] *E.g.*, Reed v. United States, 177 F. Supp. 205 (W.D. Ky. 1959); *aff'd* 277 F.2d 456 (6th Cir. 1960) (monthly installments); Bledsoe v. United States, 57-1 U. S. Tax Cas. ¶ 9211 (S.D. Ind. 1956). *E.g.* Rodner v. United States 149 F. Supp. 233 (S.D. N.Y. 1957) (lump sum payment).

[49] *E.g.*, Cowan v. United States, CCH 1960 Stand. Fed. Tax Rep. (60-2 U. S. Tax Cas.) ¶ 9674 (N.D. Ga. Aug. 25, 1960); (payments over a 24 month period); E. M. Jones v. Squire, 58-2 U. S. Tax Cas. ¶ 9588 (W.D. Wash. 1958). The two-year limitation is derived from the Tax Court's definition of a "limited period" for deduction of these payments by the employer in I. Putnam, Inc., 15 T.C. 86 (1950), *acq.*, 1950-2 Cum. Bull. 4.

[50] See, *e.g.* Reed v. United States, 177 F. Supp. 205 (W.D. Ky. 1959), *aff'd* 277 F.2d 456 (6th Cir. 1960) (payments totaled $50,000).

[51] *Ibid.*

[52] Cowan v. United States, CCH 1960 Stand. Fed. Tax Rep. (60-2 U. S. Tax Cas.) ¶ 9674 (N.D. Ga. Aug. 25, 1960).

[53] Bounds v. United States, 262 F.2d 876, 878, n. 2 (4th Cir. 1958); Rodner v. United States, 149 F. Supp. 233, 237 (S.D. N.Y. 1957).

[54] Both sections are in Int. Rev. Code of 1954.

Employers' Position

Prior to 1951 the payments by an employer to the widow of a deceased employee were deductible as business expenses, even if made without a contractual obligation. Under I.T. 3329[55] it was only necessary that the payments be reasonable and be paid for a "limited period." However, the courts did not go as far as the implications of I.T. 3329 but disallowed the deduction in the absence of a contractual obligation to make the payments even prior to 1951.[56] The payments, when deductible, were deductible as additional compensation due.

I.T. 4027[57] did not alter the effect on the payor for these payments to widows of deceased employees. Under this ruling, beginning in 1951, the payments, whether voluntary or involuntary, definite or indefinite, or whether or not made in consideration of services rendered by the employee, were deductible by the payor.

Under the 1954 Code these payments to widows may still constitute a proper deduction but they no longer come under the trade and business expenses.[58] Payments to widows by their deceased husbands' former employers now are deductible under Section 404.[59] Section 404 pertains to pension and annuity plans and compensation under a deferred-payment plan. Making deductions come under this section, however, is consistent with the position of the IRS that these payments are merely additional compensation and taxable as such.[60]

Where the employer is concerned the questions of when the deduction may be taken and for how long a period of time are more important than whether the payments are deductible. Under the 1954 Code[61] the deduction is to be available only in the year when the payments are made. Apparently the Tax Court's current attitude toward the deductibility problem is reflected in *Fifth Avenue Coach Lines, Inc.*[62] In order to be deductible, the payments need not be in the nature of additional compensation.[63] The payments, in recog-

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55 I.T. 3329, 1939-2 Cum. Bull. 153.

56 For discussion see Note, 39 Ky. L.J. 363, 363-365 (1951). See also Ethel M. Black, 55-1 U. S. Tax Cas. ¶ 9361 (N.D. Ala. 1955); Commissioner v. Bear Film Co., 219 F.2d 231 (9th Cir. 1955); Philadelphia-Baltimore Stock Exchange, 19 T.C. 355 (1952).

57 I.T. 4027, 1950-2 Cum. Bull. 9, modifying I.T. 3329, 1939-2 Cum. Bull. 153; See also Treas. Reg. 118, § 39.23(a)-9 (1953).

58 Int. Rev. Code of 1954, § 162; Treas. Reg. 1.162-10 (1958).

59 Int. Rev. Code of 1954.

60 See, *e.g.*, Champion Spark Plug Co., 30 T.C. 295 (1958).

61 Int. Rev. Code of 1954, § 404. Under § 162 the accrual-basis taxpayer could accrue the entire amount of authorized payments in one year, though payments might be over a period of several years.

62 31 T.C. 1080 (1959).

63 *Id.* at 1096, reaffirming I. Putnam, Inc., 15 T.C. 86 (1950).

nition of past services rendered, are deductible if they are reasonable and paid only for a "limited period."[64] The court noted also that the "limited period" was construed as a measure of the reasonableness of the amounts to be paid rather than merely stating a limitation as to the time over which the payments are made.[65] In declaring that the payments in the *Fifth Avenue Coach Lines* case were deductible as an ordinary and necessary business expense, the court gave weight to the fact that the payor's directors "were aware of the possible favorable effect created upon the morale and incentive of the [corporation's] . . . other executives, and the benefit accruing therefrom to the [corporation]. . . ."[66]

Even this most recent case as to the allowance of the deduction to the employer was still decided under the provisions of the Internal Revenue Code of 1939. Except as to the period when the deduction may be taken, however, there is no reason to believe that the position of the court would be any different under the Internal Revenue Code of 1954.

Conclusion

At present it seems that well-advised employers are still able to make gratuitous payments to the widows of former employees in such a manner that the payments are deductible to the employer yet not includible in the income of the widow. The IRS considers this to be an anomalous situation but apparently the Supreme Court does not.[67]

The fact that the IRS ceased to litigate the matter under the 1939 Code,[68] does not indicate that the Commissioner is retreating from his position. The IRS still considers voluntary payments received by a widow from the former employer of her deceased husband, under the circumstances of the *Reed* case,[69] as death benefits under Section 101(b) rather than gifts.[70] The *Reed* decision will not be followed by the IRS as a precedent in subsequent disposition of similar cases.[71]

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64 *Id.*, again invoking I.T. 3329, 1939-2 Cum. Bull. 153.

65 *Id.*, citing Rev. Rul. 54-625, 1954 Cum. Bull. 85, 87. The company payments to the widow of its former president were made over a period of eleven years but equalled only thirty-one months' salary. This was held to be a "limited period" and the payments were deductible.

66 *Id.* at 1096.

67 See Commissioner v. Duberstein, 363 U.S. 278, 287 (1960), where the Government made this contention and the Court recognized this anomalous situation but gave it only limited weight, if any, in determining the test of a "gift."

68 Rev. Rul. 50-613, 1958-2 Cum. Bull. 914.

69 United States v. Reed, 177 F. Supp. 205 (W.D. Ky. 1959), *aff'd* 277 F.2d 456 (6th Cir. 1959).

70 Rev. Rul. 60-326, 1960 Int. Rev. Bull. No. 42, at 11.

71 *Ibid.*

The IRS has not tested the deductibility of these payments to widows by the payor under the Internal Revenue Code of 1954. If, however, these payments continue to be viewed as "gifts" to the widow, the IRS may direct its emphasis upon the disallowance of the deduction to the employer.

In two recent cases it seems that the Commissioner may be winning the battle as to the widow's return. In *Estate of Mervin G. Pierpont*[72] the Tax Court, relying on the *Duberstein* case,[73] held that voluntary payments to the widow of a former corporate officer were "in recognition of [the deceased's] . . . services" and represented a "continuation of salary." Even though the IRS agreed that the deceased had been compensated in full for his services up to his death, the court viewed the payments as taxable income from services, subject to the $5,000 death benefit exclusion under Section (101)(b). The second case, *Estate of Martin Kuntz, Sr.*,[74] had a similar holding.

Under the *Duberstein* case[75] the Supreme Court has stated that the proper criterion in determining whether a transfer is a *gift* "is one that inquires what the basic reason for [the payor's] . . . conduct was in fact—the dominant reason that explains his action in making the transfer."[76] The Court noted that there was no conclusive test and that each gift-versus-income case must be decided on its own facts with primary weight to be given to the conclusion of the trier of fact.[77]

Before the battle is conceded to the Commissioner's views one last case should be considered. In *United States* v. *Kasynski*[78] the Tenth Circuit also used the "Duberstein Rule" again to hold that these voluntary payments to widows are "gifts."

We can conclude only that the taxability (or deductibility) of voluntary payments to widows from former employers of their deceased husbands is still an unsettled area. The employer may still deduct the payments, which are nevertheless excluded entirely from the widow's income. The key factor seems to be the intention of the transferor. We must recognize, however, that the Commissioner is relentlessly working to remove this anomalous "loophole."

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[72] 35 T.C. —, No. 10, CCH Tax Ct. Rep. Dec. 24, 408 (1960).
[73] 363 U.S. 278 (1960).
[74] 19 CCH Tax Ct. Mem. 1379 (1960).
[75] 363 U.S. 278 (1960).
[76] *Id.* at 286.
[77] *Id.* at 287-290.
[78] 284 F.2d 143 (10th Cir. 1960).