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Gift Tax: Valuation Difficulties and Gift Completion

*Mitchell M. Gans**

I. Introduction

Fair market value is the basis upon which transfer taxes are imposed. While ascertaining value is easy for some transfers, it is frequently an imprecise and difficult process. Occasionally, the transferred item is incapable of valuation—either because the transfer is subject to a contingency having a probability of occurrence that cannot be actuarially determined or because some aspect of the transferred item prevents even valuation experts from rendering a reasonable judgment.

Two formats are available for taxing these difficult-to-value transfers. The first alternative is to tax the transfer at the time the transferor severs his control, the point at which transfers are generally subject to taxation. Using this format, the determination of value is necessarily speculative. That is, the process requires taxpayers, the Internal Revenue Service, and the courts to hazard the best guess that the circumstances will permit. The second alternative is to defer the imposition of the transfer tax until the difficult-to-value aspect of the transfer becomes susceptible to more accurate valuation.

In the estate tax context, the former alternative has generally been applied because, unlike the latter, it makes it possible to compute the estate tax within a reasonable time after death, facilitating prompt estate administration. In the gift tax setting, however, a valuation-difficulty rule has evolved, which in some situations defers the computation and payment of the tax where the gift is difficult to value. Since this deferral approach allows the tax computation to be made when valuation is no longer difficult, its application increases valuation accuracy. This article will argue that this increase in accuracy warrants a more expansive application of the valuation-difficulty rule than has thus far been the case.

It has been suggested, however, that the valuation-difficulty rule ought to be categorically rejected in the gift tax context as well because its application would produce results that are incongruous with conventional gift tax theory. Ordinarily, a gift is deemed complete

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and the tax is immediately imposed upon value at the time the donor severs his control over the gift. The gift tax system therefore normally excludes post-severance events from the tax base. The valuation-difficulty rule, on the other hand, effects a deferral and takes post-severance events into account. This deviation in theory produced by the valuation-difficulty rule can be minimized, it will be suggested, by excluding all post-severance events from the valuation process other than those that merely reveal what was unascertainable at the time of severance.

In some instances, application of the valuation-difficulty rule would create the potential for tax-free wealth transfers. This possibility for abuse can be averted by applying the rule selectively—only to those gifts that do not have this potential inherent in them—or, as will be proposed, by adopting a death-completion rule requiring all gifts made subject to the rule to be viewed as becoming complete no later than the date of the donor's death.

If this death-completion proposal is adopted, the increased accuracy afforded by the valuation-difficulty rule is accomplished without permitting transferors to abuse the system, while the deviation from conventional principles is minimized.

II. Formation of the Valuation-Difficulty Rule

A. *Enforceable Obligation to Make a Gift*

The transfer of an interest in property becomes subject to gift tax when the donor relinquishes his control over the property.[1] Where, however, the donor divides his transfer into two time frames—first contractually obligating[2] himself to make the transfer and then discharging his obligation by making the actual transfer of the property—a timing question arises: is the gift complete when the contractual obligation is undertaken or when the property is transferred in discharge of the obligation? The courts have concluded that the gift is complete when the donor's contractual obligation becomes enforceable under state law.[3]

This question resolved, it became necessary to decide whether the gift should be deemed complete where the contractual obligation

1 Treas. Reg. § 25.2511-2 (1958).

2 *See* Merrill v. Fahs, 324 U.S. 308 (1945); Commissioner v. Wemyss, 324 U.S. 303 (1945).

3 Rosenthal v. Commissioner, 205 F.2d 505 (2d Cir. 1953); Estate of Copley v. Commissioner, 15 T.C. 17 (1950), *aff'd*, 194 F.2d 364 (2d Cir. 1952); Harris v. Commissioner, 178 F.2d 861 (2d Cir. 1949), *rev'd on other grounds*, 340 U.S. 106 (1950).

had a contingent nature. In *Rosenthal v. Commissioner*,[4] the donor entered into a separation agreement with his wife in which it was agreed that he would make certain payments to his children in future years.[5] The donor's obligation to make these payments, however, was contingent upon the death of his mother during his lifetime. The Commissioner argued that because the obligation was contingent, the gift would not be complete until the donor discharged his obligation by making the required payments. The court, rejecting this argument, held that since the contingency was susceptible to actuarial valuation,[6] the gift became subject to tax when the enforceable contractual obligation was undertaken, at the time the separation agreement was executed.

The *Rosenthal* court did indicate in dicta that where the nature of the contingency renders the contractual obligation incapable of valuation, the gift is not complete at the time the obligation is undertaken. The court illustrated this principle by referring to its earlier decision in *City Bank Farmers Trust Co. v. Hoey*.[7] There, the court held that an enforceable obligation embodied in a judicial decree subject to modification did not effect a completed gift until payments were made pursuant to the decree, for the court's power of modification made it impossible to value the gift at the time the decree became effective.[8]

Thus, at least insofar as the *Rosenthal* court is concerned, a gift is not complete at the time that a contingent contractual obligation is undertaken if the contingency is such that the probability of its outcome cannot be actuarially determined. The IRS adopted this principle in Revenue Ruling 69-346.[9] There, a husband and wife, residing in a community property state, entered into an agreement that required the wife to transfer her one-half interest in their com-

4 205 F.2d 505 (2d Cir. 1953).

5 The court concluded that the fact that the agreement arose in the divorce context did not preclude application of the gift tax. *Id.*

6 *See* Smith v. Shaughnessy, 318 U.S. 176 (1943) (actuarial principles applied in determining the value of the donor's reversion, which was contingent upon his outliving the life tenant).

7 101 F.2d 9 (2d Cir. 1939).

8 *See also* Bradford v. Commissioner, 34 T.C. 1059 (1960). There, a wife discharged an obligation that her husband owed to a bank by delivering to the bank a note in the amount of $205,000. Because the wife's net worth was only $15,780, the court held that her delivery of the note did not effect a completed gift, reasoning that there was no certainty at the time of the note's delivery that she would discharge it. *Bradford* may be read as holding that where a contingency makes the value of a contractual obligation speculative, the gift is not complete merely because the obligation is enforceable.

9 1969-1 C.B. 227.

munity property to a trust to be created under the husband's will. Although the agreement became enforceable when it was executed, the IRS ruled that the wife did not make a taxable gift until the husband's death,[10] when it first became possible to calculate the value of her gift.[11] The IRS formulated the rule as follows:

> [T]he effective date of the gift for Federal gift tax purposes is the date upon which a promise to make a future transfer becomes enforceable under State law, and not the date upon which an actual transfer of property is made, provided the gift is susceptible of valuation at the time it becomes enforceable.[12]

B. *Valuation-Difficulty Rule Expanded to Non-Contractual Gifts*

Reiterating this formulation in several rulings,[13] the IRS has sought somewhat subtly to expand the application of this rule beyond the scope of Revenue Ruling 69-346. In Revenue Ruling 79-231,[14] for example, an employee assigned his rights under an employer-provided group life insurance plan to his spouse. The assignment included not only his rights under the policy then in force but also his rights under any policy subsequently acquired by his employer. After the employee executed the assignment, the employer acquired a new group policy, changing its insurance carrier. The IRS ruled that the employee's gift of his rights under the new policy would not be complete until the employer acquired the new policy, even if it were assumed that the employee's conveyance of his rights under the new policy had been enforceable under state law upon his earlier execution of the assignment.[15] The IRS's citation of Revenue

10 Since a donor's retention of dominion and control over a gift renders the gift incomplete, Treas. Reg. § 25.2511-2 (1958), and since, in the ruling, the wife's dominion and control continued after the agreement was entered into—by spending or saving, she would affect the amount of community property—it is arguable that the conclusion that the gift was incomplete until the husband's death was not dependent upon a finding of valuation difficulty. *See* Macris, *Open Valuation and the Completed Transfer: A Problem Area in Federal Gift Taxation*, 34 TAX L. REV. 273, 294 (1979).

11 While the IRS did not specify what contingency made the wife's gift difficult to evaluate, presumably it was the inability to determine, at the time the agreement was entered into, the value of community property that they would own at the time of the husband's death.

12 1969-1 C.B. 227.

13 Rev. Rul. 69-347, 1969-1 C.B. 227; Rev. Rul. 73-61, 1973-1 C.B. 408; Rev. Rul. 75-71, 1975-1 C.B. 309; Rev. Rul. 79-231, 1979-2 C.B. 323; Rev. Rul. 79-384, 1979-2 C.B. 344. *See also* Ltr. Rul. 8140016; Ltr. Rul. 8109032; Ltr. Rul. 7944009; Ltr. Rul. 7935013; Ltr. Rul. 7910004.

14 1979-2 C.B. 323. *But see* Rev. Rul. 80-289, 1980-2 C.B. 270 (revoking Rev. Rul. 79-231).

15 The ultimate conclusion reached by the IRS was that since gift tax principles indicated that the transfer was not complete until the new policy was purchased, the transfer

Ruling 69-346 makes it apparent that the IRS premised its conclusion on its inability to calculate the value of the employee's rights under the policy, since the policy had not yet been purchased.

Superficially, the IRS reliance on Revenue Ruling 69-346 seems appropriate. However, Revenue Ruling 79-231 is distinguishable from Revenue Ruling 69-346 in one respect: while the latter ruling involved a donor's contractual promise to make a transfer of property in the future, the employee in Revenue Ruling 79-231 severed all connections to the gift at the time of assignment, leaving him with no rights under any subsequently acquired policy and, of course, no obligation to make any further property transfers.

One must surmise that, ignoring this distinction, the IRS concluded that the valuation-difficulty rule adopted in Revenue Ruling 69-346 for gifts promised in an enforceable contract should be extended to gifts of all types, not just those of the contractual variety. In other words, the valuation-difficulty rule of Revenue Ruling 69-346, first enunciated by the *Rosenthal* court, transcends the *Rosenthal* factual setting of a promise to make a gift, at least according to the IRS in Revenue Ruling 79-231.

III. Scope of the Valuation-Difficulty Rule

A. *Valuation-Difficulty Rule Capable of Producing Tax Avoidance*

To illustrate the consequence of this extension, assume that a taxpayer owns a mineral interest located somewhere in the Persian Gulf region. Assume further that the country in which the interest is located is involved in an incandescent war. If the country within which the interest is located does not prevail, the victorious countries may confiscate the interest, depriving the taxpayer of his ownership in the minerals without any compensation. While in this precarious position, the taxpayer makes an outright gift of the mineral interest.[16]

If, as the IRS seemingly suggested in Revenue Ruling 79-231, the valuation-difficulty rule is to be applied in the non-contractual context, the gift is incomplete, since its value is contingent upon the outcome of the war and, therefore, impossible to calculate with any certainty.[17] Putting aside for the moment the wisdom from the policy viewpoint of any rule that would render this gift incomplete,

should similarly be deemed incomplete for I.R.C. § 2035 (1976) purposes until the purchase of the new policy was effected.

16 For a similar hypothetical, see Macris, *supra* note 10, at 299.

17 *See* Treas. Reg. § 25.2511-2, which provides that a gift is complete when the donor

there are difficult practical problems inherent in such a rule in the context of this illustration. If the taxpayer dies after having conveyed his ownership in the mineral interest but prior to the gift having become complete[18] in the tax sense, the transfer of the minerals will have escaped transfer taxation, even though the value of the minerals may eventually prove to be substantial. At the time of the conveyance of his rights in the mineral interest, the taxpayer is not deemed to have made a gift by virtue of the valuation-difficulty rule; at the time of the taxpayer's death, the mineral interest cannot be included in his gross estate, for he will have relinquished all of his control and rights with respect to the property prior to his death.[19] The difficulty here is that although the gift will be deemed complete when its value becomes ascertainable at the conclusion of the war,[20] by our hypothesis that will not occur until the taxpayer has died. Since, under the present transfer tax system, the gift tax does not apply to any transfer when the transferor is dead at the time the gift becomes complete,[21] the gift tax cannot apply here.[22]

Contrast these difficulties, engendered by application of the valuation-difficulty rule in the non-contractual context, with the results that stem from application of the rule to a contractual gift, such as that in Revenue Ruling 69-346. There, the wife contractually obligated herself to make a gift upon the death of her husband of property that would not be determinable until his death. As will be recalled, the IRS ruled that because of valuation problems, the gift was not complete until the husband died. Unlike the hypothesized conveyance of the mineral interest, there was no potential for the complete avoidance of transfer tax created by application of the valuation-difficulty rule in Revenue Ruling 69-346. If the wife had died after having entered into the enforceable agreement but prior to the tax gift having become complete (i.e., at her husband's death), she would not have made any transfers pursuant to the agreement, since it required her to make the transfer only if she were to survive her

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relinquishes his dominion and control over the gift. Interestingly, the regulation does not provide for a deferral where the gift is difficult to value.

18 *See, e.g.*, Rev. Rul. 69-346, 1969-1 C.B. 227 (the IRS indicated that a gift subject to the rule becomes complete when value can be ascertained). *But see* note 94 *infra*.

19 I.R.C. §§ 2033, 2036, 2038 (1976). *See* R. STEPHENS, G. MAXFIELD & S. LIND, FEDERAL ESTATE AND GIFT TAXATION 10-22, 10-23 (4th ed. 1978) [hereinafter cited as STEPHENS]; Macris, *supra* note 10, at 299.

20 *See* note 18 *supra*.

21 Treas. Reg. § 25.2511-2(f) (1958). *See* STEPHENS, *supra* note 19, at 10-25 n.110. *But see* note 60 *infra* and accompanying text.

22 *But see* Macris, *supra* note 10, at 299.

husband. Nevertheless, all of her assets, including those that she transferred pursuant to the agreement, would have been includible in her gross estate. Having survived her husband, she was subject to gift tax; had she failed to survive, the estate tax would have been applicable.

Thus, deferring the taxable gift because of valuation problems will not create the potential for complete avoidance of transfer tax in the context of a promise to make a gift contained in an enforceable contract. Such a contractual gift will become subject to gift tax when valuation can be accomplished,[23] or, if the donor dies prior to the completion of the gift, the property that is the subject of the gift will be included in the donor's gross estate, the donor having control over it at death.[24]

In Revenue Ruling 79-231, the IRS's extension of the valuation-difficulty rule to the non-contractual gift there at issue[25] did not produce any potential for transfer tax avoidance. If the employee had died after having made an assignment of his rights under any subsequently acquired group policy but before the employer acquired a new policy, there would have been no transfer tax with regard to any such subsequently acquired policy. The gift would have been deemed incomplete by virtue of the valuation-difficulty rule, and since no such policy would have been in existence at the employee's death, it could not have been included in his estate. This, however, is a sensible result, for neither the employee nor his assignee would have enjoyed the benefits of a subsequent policy, the employee having died prior to his employer's purchase of any such policy.[26]

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23 Presumably, this will occur when the contractual obligation is discharged.

24 I.R.C. § 2033 (1976). No deduction will be permitted under I.R.C. § 2053, inasmuch as contractual claims against an estate are only deductible if the decedent received consideration in return for undertaking the claim. I.R.C. § 2053(c)(1)(A) (1976). Since a contractual promise to make a gift is not supported by consideration in the tax sense (though, perhaps, consideration would be found present under state law), no deduction is allowable for any claim founded on such a contractual promise. *See, e.g.*, Merrill v. Fahs, 324 U.S. 308 (1945); Commissioner v. Wemyss, 324 U.S. 303 (1945).

25 Perhaps Rev. Rul. 73-61, 1973-1 C.B. 408, should be viewed as the IRS's initial attempt to extend the rule. There, a father made an interest-free loan on a demand basis to a corporation wholly owned by his son. The IRS ruled that since the value of such a loan was impossible to determine at the time that the funds were lent, the gift of the use of the money would not be complete until the close of each taxable unit (i.e., the calendar quarter) during which the loan remained outstanding. Thus, although the interest-free loan in the ruling was not a promise to make a gift embodied in a contract, the IRS relied on the valuation-difficulty rule. *See also* Dickman v. Commissioner, 690 F.2d 812 (11th Cir. 1982). *But see* Crown v. Commissioner, 585 F.2d 234 (7th Cir. 1978).

26 Rev. Rul. 73-61, 1973-1 C.B. 408, is perhaps another example of a non-contractual gift made subject to the valuation-difficulty rule without the potential for creating transfer tax

In sum, applying the valuation-difficulty rule to a contractual gift does not pose any tax-avoidance problems. On the other hand, applying the valuation-difficulty rule in the context of a non-contractual gift will, in some instances, precipitate transfer tax avoidance, while in other cases, it will not. The gift of the mineral interest in the hypothetical posited earlier could result in a complete avoidance of transfer tax if the gift were subjected to the valuation-difficulty rule; in contrast, the assignment of rights under a yet-to-be-acquired policy in Revenue Ruling 79-231 did not create any tax-avoidance problems when the assignment was analyzed under the rule.[27]

B. *Tax-Avoidance Potential Shapes Valuation-Difficulty Rule*

Perhaps, concern with tax avoidance potential led the court in *Galt v. Commissioner*[28] to its rejection of the rule, at least in the context of the facts before it. In *Galt*, the taxpayer owned a parcel of land, which had produced little, if any, income for the taxpayer during his entire period of ownership. Then in 1939 he leased the property to a county fair organization, which constructed a grandstand and a track for harness racing on the property. The race track was not successful, and the taxpayer continued to receive little income from the property.

In 1945 the state in which the property was located legalized pari-mutuel harness racing, enabling the taxpayer to lease the property to a trotting association. In February 1946, the taxpayer executed such a lease, providing that the taxpayer would receive, as rent, a fixed number of dollars each year plus a percentage of the bets wagered at the race track. On the same day on which the taxpayer executed the lease, he assigned to each of his three sons a twenty percent share in the contingent portion of the rent. In October 1946 the trotting association made its first payment of the contingent portion of the rent; each of the three sons received twenty percent, and the taxpayer received the remaining forty percent.

The Commissioner argued that no gift was made to the sons un-

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avoidance. The interest-free loan in that ruling (*see* note 25 *supra*) was held to be an incomplete gift at the time of the loan's consummation. Presumably, as the father allowed the loan to remain outstanding each day, the gift was complete to the extent of the value of the use of the funds for that day. According to the IRS, if the father were to die prior to demanding repayment, the value of the use of the money for each day prior to his death would constitute a gift. Thus, applying the valuation-difficulty rule in this context does not create any transfer tax avoidance.

27 *See* STEPHENS, *supra* note 19, at 10-22, 10-23; Macris, *supra* note 10, at 299, 300.

28 216 F.2d 41 (7th Cir. 1954), *cert. denied*, 348 U.S. 951 (1955).

til they received their first payment in October 1946.[29] According to the Commissioner, additional gifts would be deemed completed as the lessee made each additional rental payment. The taxpayer, on the other hand, argued that the gift was completed in February 1946, when he made the assignment to his sons. Supporting his argument, the taxpayer introduced expert testimony in the trial court to the effect that the assigned rental payments had a value of $34,090[30] as of February 1946, when the assignment was made. The Commissioner did not offer any valuation evidence.

The court held that a taxable gift in the amount of $34,090 was completed in February.[31] The court's decision not to apply the valuation-difficulty rule could perhaps be explained on the ground that there was unrefuted evidence before the court of the value of the contingent rental payment. On the other hand, there was an admission by the taxpayer in the record to the effect that the value was speculative and not readily susceptible to calculation.[32]

The court, however, did not rest its holding on the narrow factual ground that the lease had an ascertainable value as of February 1946. Instead of temporizing in this manner, the court explicitly concluded that valuation difficulties should have no bearing on the timing of a taxable gift:

> It is true, we think, that the value of the gift as represented by the assignment which petitioner [taxpayer] made to his sons was speculative, uncertain and contingent upon future developments. . . . Even so, this is an immaterial factor in determining whether a gift was made at that time.[33]

The court relied on two different rationales to support this seemingly categorical rejection of the valuation-difficulty rule. First, the court cited *Smith v. Shaughnessy*[34] for the proposition that valuation difficulties should not prevent application of the gift tax.[35] Second, the court was of the view that the concept of "transfer," as contemplated in the Code and regulations, is inconsistent with any notion that a transfer could be incomplete merely because of valuation

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29 The aggregate payment to the three sons in October 1946 was $23,923.83. 216 F.2d at 44. This, in the Commissioner's view, was the amount of the 1946 taxable gift.

30 Although the taxpayer did offer this expert testimony, he had admitted in a letter to his sons that accompanied the assignment that the value of the gift was speculative and impossible to calculate. *Id.* at 51.

31 *Id.*

32 *See* note 30 *supra*.

33 216 F.2d at 50.

34 318 U.S. 176 (1943).

35 216 F.2d at 50.

difficulties.[36]

1. *Smith* and *Robinette*

Although *Smith v. Shaughnessy* did contain language suggesting that the gift tax should apply to the transfer of an interest subject to contingencies,[37] the Supreme Court's companion decision in *Robinette v. Helvering*[38] hints that the view it took of contingencies in *Smith v. Shaughnessy* should be limited to contingencies that are susceptible to valuation. In *Smith*, the taxpayer funded a trust, which created a life estate in his wife. The taxpayer's reversion was to become possessory only if he was living at the time of his wife's death. If the taxpayer failed to survive his wife, the remainder would become subject to a power of appointment exercisable by his wife. The government conceded that the value of the reversion was not subject to the gift tax,[39] and the taxpayer conceded that the value of the life estate was subject to the tax. Thus, the only issue before the Court was whether the value of the remainder, which was contingent upon the taxpayer's failure to survive his wife, was a taxable gift. The Court held that the value of the contingent remainder was subject to the gift tax. In *Robinette*, the Court revealed the premise that was essential to its decision in *Smith*: the contingency in *Smith* was readily susceptible to actuarial valuation. The *Robinette* Court did not explicitly indicate that the remainder in *Smith* was susceptible to valuation. However, the Court pointed out that the reversion in *Smith* was contingent upon the grantor surviving his wife and was, therefore, susceptible to valuation.[40] Since the contingency attached to the remainder in *Smith* was the mirror image of the contingency attached to the reversion, it too was susceptible to valuation.

Whether the gift tax should be applied where the contingency is not susceptible to valuation was not discussed in either *Robinette* or *Smith*. Thus, the citation to *Smith* by the *Galt* court for the proposi-

36 *Id.* at 50-51.

37 The court extracted the following from *Smith v. Shaughnessy*:

> Even though these concepts of property and value may be slippery and elusive they cannot escape taxation so long as they are used in the world of business. The language of the gift tax statute, "property . . . real or personal, tangible or intangible", is broad enough to include property, however conceptual or contingent.

216 F.2d at 50 (quoting Smith v. Shaughnessy, 318 U.S. at 180).

38 318 U.S. 184 (1943).

39 318 U.S. at 188. *See* Treas. Reg. § 25.2511-2; Peschel, *The Impact of Fiduciary Standards on Federal Taxation of Grantor Trusts: Illusion and Inconsistency*, 1979 DUKE L.J. 709, 712; STEPHENS, *supra* note 19, at 10-23 n.102.

40 318 U.S. at 188.

tion that a gift subject to contingencies that cannot be valued is nevertheless subject to the gift tax is misplaced.[41]

2. The "Transfer" Concept

As an alternative ground for its holding, the *Galt* court reasoned that the Code imposes the gift tax on a "transfer of property"[42] and that the taxpayer made the transfer when he conveyed his rights under the lease to his sons, not when his sons received the rental payments. Commentators have also suggested that the Code contemplates that determining when a "transfer of property" occurs is to be accomplished without regard to any valuation difficulties.[43]

Examining this proposition requires a return to *Rosenthal*. There, the taxpayer undertook an enforceable obligation to make a gift. Although the obligation was subject to contingencies, the court

41 In *Robinette*, the taxpayer funded a trust, retaining a reversion that would become possessory if certain difficult-to-value contingencies occurred. The Court held that the reversion was subject to the gift tax. One might read this case as establishing the proposition that the transfer of an interest that is contingent and not readily subject to valuation constitutes a taxable gift. However, unlike the facts before the court in *Galt* (i.e., the transfer of property was difficult to value), the value of the property transferred by the donor was unquestionably ascertainable. It was only the reversion retained by the donor that was difficult to value. In these circumstances, the Court concluded that since the donor had the burden of proving the value of the retained interest and since the donor created the contingencies that made valuation difficult, it was appropriate to impose the gift tax on the value of the property transferred into the trust, disregarding the difficult-to-calculate value of the reversion. Thus, the Court did not address the question whether the gift tax should apply to the transfer of property not capable of actuarial valuation, but only decided that the taxpayer failed to sustain his burden of proving the value of the reversion.

Perhaps the *Robinette* analysis should be extended to the transfer of a property interest difficult to value. After all, it is the taxpayer who chooses the property he wishes to transfer; if he cannot prove the value of it, he should suffer the consequences, as the taxpayer did in *Robinette*. The difficulty with this approach, however, is that the government is equally unable to establish a value. *Cf.* Llorente v. Commissioner, 649 F.2d 152 (2d Cir. 1981); Weimerskirch v. Commissioner, 596 F.2d 258 (9th Cir. 1979) (in both cases, the courts indicated a willingness to depart from the normal burden-of-proof rules unless the government first established that its proposed deficiency had some validity). At least in *Robinette* the government was able to assert a value for the property transferred into the trust, leaving it to the taxpayer to prove the value of the reversion. Where, however, neither side is able to establish the value of the subject of the transfer, it may be inappropriate to apply *Robinette*.

42 The court cited § 1000(b) of the Internal Revenue Code of 1939, the predecessor of I.R.C. § 2511(a) (1976). The court also cited Regulation 108, Sec. 86.2(a), the predecessor of Treas. Reg. § 25.2511-1(c). 216 F.2d at 50.

43 STEPHENS, *supra* note 19, at 10-21 (suggesting that the IRS's application of the valuation-difficulty rule is a deviation from conventional theory, though a sensible one); Macris, *supra* note 10, at 301 (arguing that I.R.C. § 2512 and Treas. Reg. § 25.2511-2(a) dictate the conclusion that valuation difficulties should not impact on the analysis of a gift's timing); Wolk, *The Pure Death Benefit: An Estate and Gift Tax Anomaly*, 66 MINN. L. REV. 229, 273 (1982).

held that the transfer was complete when the obligation was undertaken, suggesting, however, that it would not have viewed the gift as complete at that time had the contingency rendered the obligation incapable of valuation. Indeed, the *Rosenthal* court distinguished the facts before it from those in its earlier decision in *City Bank Farmers Trust Co. v. Hoey*,[44] where it had held that the transfer was not complete until the obligation was discharged because the obligation was subject to difficult-to-value contingencies at the time it was undertaken.[45] The *Rosenthal* court viewed the concept as a flexible one: where an enforceable obligation is susceptible to valuation, the transfer occurs when the obligation becomes enforceable; on the other hand, where the obligation is contingent and cannot be readily valued, the transfer occurs when the obligation is discharged. The premise underlying this view is that Congress could not have intended to impose the gift tax on the undertaking of a contingent obligation incapable of valuation. Rather, it would be preferable, for administrative convenience, to impose the tax when property presumably having an ascertainable value is actually transferred in discharge of the obligation.[46]

Is the *Galt* court's conclusion that a "transfer of property" was effected when the taxpayer made an assignment of his contingent and difficult-to-value rights inconsistent with the *Rosenthal* court's flexible approach? Unfortunately, *Galt* did not cite *Rosenthal*, leaving it for us to speculate about its view of the *Rosenthal* analysis.

While the statute and regulations may be viewed as ambiguous when applied to a contractual gift, this ambiguity evanesces in the context of non-contractual gifts. The gift in *Galt* was not one of the contractual variety. The taxpayer did not make a binding promise to make a transfer of property in the future. Rather, the taxpayer made a valid assignment of his rights under the lease, thereby immediately shifting to his sons ownership of the assigned rights. Once the assignment was accomplished, the taxpayer had no further transfer to make and no further obligation to his sons. In these circumstances, it is difficult to quarrel with the court's conclusion that the "transfer of property" occurred at the time the assignment was made. So, *Galt* is not inconsistent with *Rosenthal*—one involved a contrac-

44 101 F.2d 9 (2d Cir. 1939).

45 *Id.* at 10. *See* notes 7-8 *supra* and accompanying text.

46 Moreover, applying the valuation-difficulty rule in the contractual-gift context does not create the potential for transfer-tax avoidance. In the non-contractual context, however, application of the rule could create such potential. *See* notes 16-27 *supra* and accompanying text.

tual gift, and the other did not.[47]

Thus, with respect to contractual gifts, there is enough latitude in the statute and regulations to find a "transfer of property" either at the time the obligation is undertaken or at the time the obligation is discharged—the selection being a function of whether the contingency and hence the obligation can be valued at the time the obligation is undertaken. On the other hand, in the non-contractual gift setting, the statute seemingly provides much less leeway, appearing on the surface at least to require imposition of the tax when the transfer is made even if valuation difficulties are present at that time.

But what of the judicial gloss imposed upon a similarly unequivocal income tax statute by the Supreme Court in *Burnet v. Logan*?[48] There, the taxpayer sold stock in a corporation that indirectly owned an interest in minerals. The sales price was contingent in part upon the amount of minerals that would be extracted. Although the income tax statute[49] provided, as it does now,[50] that the gain upon the sale of an asset should be computed by subtracting the taxpayer's

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47 The *Galt* court did use language, however, suggesting that the gift tax be imposed when enforceable rights are created in the donee without regard to whether valuation difficulties are present:

> We think it is hardly open to dispute but that petitioner's sons as donees at the time of the execution of the lease and assignments acquired a property right, that is, a right to receive income, a right to participate in the rental proceeds. The manner of the enforcement of that right or what it might mean to the donees in the future is of no consequence. As was stated in Harris v. Commissioner, 340 U.S. 106, 111 . . . "We, however, think that the gift tax statute is concerned with the source of rights, not with the manner in which rights at some distant time may be enforced. Remedies for enforcement will vary from state to state. It is 'the transfer' of the property with which the gift tax statute is concerned, not the sanctions which the law supplies to enforce transfers."

216 F.2d at 50.

In quoting from *Harris*, did the court intend to indicate that the gift tax can never be applied to the discharge of a contractual gift—i.e., that, contrary to *Rosenthal*, in the contractual-gift context, the gift is always complete at the time the obligation is undertaken regardless of valuation difficulties? The answer must be no. First, the court did not have before it a contractual gift. Second, if the court had decided to posit a contractual gift, one would think that at least a citation of *Rosenthal*, decided the previous year, would have been appropriate. Finally, the quotation from *Harris* does not even deal with the timing of gifts. Rather, the Court in *Harris* was concerned with whether the transfers there at issue were founded upon a promise or agreement within the meaning of I.R.C. § 2053, which would have made it appropriate to apply the gift tax; or upon some marital duty under state law, which would have made it inappropriate to apply the gift tax. In other words, the language quoted from *Harris* related to whether or not the taxpayer's transfer was an appropriate subject for the gift tax, not the timing of a gift.

48 283 U.S. 404 (1931).

49 Revenue Act of 1918, c.18, § 214(a), 40 Stat. 1066 (current version at I.R.C. § 162(a)).

50 I.R.C. § 1001 (1976).

basis in the asset from the sum of the cash and *the fair market value of other property received by the taxpayer*, the Court held that the taxpayer, who reported on a cash basis, was not required to include the contingent portion of the sales price as income until the taxpayer received it.[51] In effect, the Court concluded that the purchaser's contractual obligation was too contingent to be considered property within the meaning of the income tax statute.[52] Obviously, the Court was influenced by the administrative inconvenience it perceived in a contrary rule:[53]

> The liability for income tax ultimately can be fairly determined without resort to mere estimates, assumptions and speculation. When the profit, if any, is actually realized, the taxpayer will be required to respond.[54]

A similar judicial gloss could be as easily employed in the gift tax context. Just as the Code imposes an income tax on *the fair market value of the property received* as a result of a sale,[55] it imposes a gift tax on *the fair market value of the property transferred*.[56] Identical administrative convenience concerns loom in both contexts:[57] if the value of the property transferred or received is too contingent to value, it is impractical to impose a tax based on value before it becomes ascertainable. Yet, the *Galt* court refused to borrow the *Burnet v. Logan*[58] mode

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51 More specifically, the Court held that the taxpayer should be permitted to exclude from income all sales receipts until the taxpayer fully recovered his basis; payments received after basis had been recovered would then be fully taxable. 283 U.S. at 312.

52 Congress has now indicated that the doctrine laid down by the Supreme Court in Burnet v. Logan should be restricted to "those rare and extraordinary cases involving sales for a contingent price where the fair market value of the purchaser's obligation cannot reasonably be ascertained." *See* S. REP. NO. 1000, 96th Cong., 2d Sess. 24, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4696, 4719 (1980). *See also* Treas. Reg. § 1.1001-1(a); Rev. Rul. 58-402, 1958-2 C.B. 15.

53 *Cf.* Diamond v. Commissioner, 56 T.C. 530 (1970), *aff'd*, 492 F.2d 286 (7th Cir. 1974). There, the court held that the receipt of a profits interest in a partnership received in return for services is not taxable upon its acquisition when its value is not readily ascertainable. But see Cowan, *Receipt of an Interest in Partnership Profits in Consideration for Services: The* Diamond *Case*, 27 TAX L. REV. 161 (1972), where the author suggests that the taxability of the profits interest should not turn upon whether or not its value is ascertainable at the time of its acquisition.

54 283 U.S. at 412-13.

55 I.R.C. § 1001 (1976).

56 I.R.C. § 2512 (1976).

57 The Supreme Court in Burnet v. Logan did impliedly suggest that, in the estate tax context, it might be necessary to place some value upon the estate at the time of death (or on the alternate-valuation date) even if valuation difficulties were present. This difference in treatment between the estate tax and the income tax is presumably made necessary by the policy objective of facilitating prompt estate administration. *See* note 91 *infra*.

58 The court did not even cite Burnet v. Logan.

of analysis, holding instead that the statutory concept "transfer of property" does not permit a deferral merely because the value of the gift is difficult to calculate.

On policy grounds, the *Galt* court's rejection of *Burnet v. Logan* was sensible. If the court had permitted a deferral, when would the taxpayer have been required to pay transfer tax on the assignment of his rights under the lease to his sons? Presumably, the taxpayer would have been required to pay the gift tax as the value of the lease rights became ascertainable, that is, when the lessee made rental payments to the sons. But if the taxpayer had died before the lessee had made all of the payments required by the lease, those payments made after the taxpayer's death would have been subject to neither the estate tax[59] nor the gift tax.[60] This potential for transfer tax avoidance obviously led the court to its rejection of a valuation-difficulty rule insofar as non-contractual gifts are concerned.

In sum, then, the gift tax statute as presently drafted can be made to accommodate a valuation-difficulty rule in the context of non-contractual as well as contractual gifts.[61] However, the potential for transfer tax avoidance inherent in non-contractual gifts if the rule is applied to them argues against its application in this context.[62]

C. *Gifts Deemed Complete at Donor's Death: Revenue Ruling 81-31*

The valuation-difficulty rule could be extended to non-contractual gifts without producing any tax avoidance were the Code amended to provide a mechanism whereby the gift tax would be imposed as the value of the deferred gift became ascertainable.[63] The IRS attempted a similar solution through non-legislative means in Revenue Ruling 81-31.[64] There, an employer and employee entered into a contract providing that, upon the employee's death, the em-

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59 Since, at the time of the taxpayer's death, he would have had no interest under state law in the assigned lease rights, they could not have been included in his gross estate. I.R.C. § 2033 (1976). *See* Macris, *supra* note 10, at 297.

60 Since the gift tax is only applicable to living donors, Treas. Reg. § 25.2511-2(f), the gift tax cannot apply to a transfer deemed to occur after the donor's death. *See* note 21 *supra* and accompanying text. *But see* Macris, *supra* note 10, at 299 n.90 (suggesting that the sons might be responsible for the gift tax as transferees under I.R.C. § 6901).

61 *But see* Macris, *supra* note 10, at 298-300.

62 Indeed, it has been argued that the absence of a mechanism in the Code for closing deferred gifts dictates that the valuation-difficulty rule be rejected, even in the context of contractual gifts. *See* Macris, *supra* note 10, at 302.

63 Perhaps, such an amendment should provide that in no event would the deferral continue beyond the donor's death. *See* note 89 *infra* and accompanying text.

64 1981-1 C.B. 475.

ployer would pay an amount equal to twice the annual salary of the employee at the time of his death to his surviving spouse. If the employee were no longer employed by his employer at the time of his death or if the employee were not survived by a spouse, the employer would not be required to make any payment.

The issue addressed by the IRS was whether, and if so, when, the employee made a taxable gift of the death benefit to his spouse. Ordinarily, an employee who enters into a death benefit agreement with his employer designating a beneficiary without retaining any right to modify the beneficiary's interest is deemed to have made a taxable gift at the time the agreement is executed.[65] However, three contingencies made valuation of the gift at the time the agreement was executed difficult: (1) the amount of the death benefit was contingent upon the employee's annual salary at the time of his death; (2) the payment would only be made if the employee were still employed by the employer at the time of his death;[66] and (3) the employee had to be married at the time of his death to qualify for the payment. Applying the valuation-difficulty rule it had previously adopted in Revenue Ruling 69-346,[67] the IRS ruled that inasmuch as the contingencies rendered the death benefit incapable of valuation at the time the agreement was executed, the gift was not complete at that time.[68]

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65 In the estate tax context, it is settled that when an employee designates a beneficiary of his death benefit, he has made a transfer within the meaning of I.R.C. § 2035, § 2036, § 2037, or § 2038. *See, e.g.*, Estate of Tully v. United States, 528 F.2d 1401 (Ct. Cl. 1976); Estate of Bogley v. United States, 514 F.2d 1027 (Ct. Cl. 1975); Estate of Fried, 445 F.2d 979 (2d Cir. 1971); Kramer v. United States, 406 F.2d 1363 (Ct. Cl. 1969); Worthen v. United States, 192 F. Supp. 727 (D. Mass. 1961). The concept "transfer" as used in these estate tax provisions is similar to its counterpart in the gift tax context. *See* Rev. Rul. 79-231, 1979-2 C.B. 323. *But see* Rev. Rul. 80-289, 1980-2 C.B. 270 (revoking Rev. Rul. 79-231). Thus, just as the beneficiary designation of an employee death benefit constitutes a transfer for estate tax purposes, it also constitutes a transfer for gift tax purposes. If, however, the employee retains the right to alter the beneficiary, the gift is not complete until the right of alteration ceases. *See* Treas. Reg. § 25.2511-2 (1958).

66 It has been suggested that the employee's ability to eliminate the death benefit, i.e., to revoke it, by terminating employment was sufficient dominion and control to negate the gift and that, therefore, it was unnecessary for the IRS to reach the valuation-difficulty issue. *See* SURREY, WARREN, MCDANIEL & GUTMAN, FEDERAL WEALTH TRANSFER TAXATION 181 (2d ed. 1982). But compare Estate of Tully v. United States, 528 F.2d 1401 (Ct. Cl. 1976), where the court held that the ability to alter a death benefit by terminating employment is not a power within the meaning of I.R.C. § 2038. It follows that for gift tax purposes as well such a power should be disregarded; that is, the retention of such a power should not be deemed to negate the gift.

67 Rev. Rul. 69-346, 1969-1 C.B. 227. *See* text accompanying notes 9-12 *supra*.

68 The IRS's issuance of Rev. Rul. 81-31 may have been motivated largely by the frequent failures it has sustained in the courts when seeking to require inclusion of death-benefit

Although the IRS relied exclusively on Revenue Ruling 69-346 as support for its application of the valuation-difficulty rule, it must be emphasized that, unlike Revenue Ruling 69-346, Revenue Ruling 81-31 involved a gift of a non-contractual nature.[69] Thus, without even discussing the issue or the distinction between the two rulings, the IRS in Revenue Ruling 81-31 extended the valuation-difficulty rule into the non-contractual setting.[70]

What, then, does the IRS propose to do about the potential for transfer tax avoidance inherent in applying the rule to non-contractual gifts? Such potential does not inhere in the employee benefit plan of Revenue Ruling 81-31, says the IRS. The ruling's rationale was that all of the contingencies had to be fulfilled by the time the employee died. At that time, it would be known whether the employee would be married, whether he would still be employed by his employer, and the amount of his annual salary. So, according to the IRS, the value of the death benefit would become ascertainable and, therefore, subject to gift tax at the time of the employee's death. If, on the other hand, the employee were no longer employed by the employer or were not married at his death, the employer would not be required to make a payment. The employee would, therefore, not have made a gift.

In these facts the IRS claims to have found the mechanism necessary to prevent transfer tax avoidance where the valuation-difficulty rule is applied to non-contractual gifts: the gift, viewed as incomplete at the time the agreement is executed, becomes complete and subject to gift tax at the time of the employee's death if the contingencies have been fulfilled; or if the contingencies have not been fulfilled and the employer is therefore not required to make the payment, no transfer is deemed to occur.

In sum, the IRS has extended the valuation-difficulty rule to the non-contractual gift of Revenue Ruling 81-31 on the implicit rationale that there was no potential for transfer tax avoidance. Consequently, according to the IRS, the valuation-difficulty rule is no

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payments in the gross estate. *See* Esterces, *Analysis of Gift and Estate Tax Consequences of Death Benefits Under Non-qualified Plans*, 56 J. TAX'N 100 (1982); Wolk, *supra* note 43, at 273.

69 Rev. Rul. 81-31 cannot be viewed as involving a contractual gift. The employee did not make an agreement to make a transfer in the future; instead, once the agreement was executed, he was required to make no further transfers, and he had no further obligations concerning the death benefit plan.

70 The IRS had previously attempted to extend the valuation-difficulty rule to a non-contractual gift in Rev. Rul. 79-231, 1979-1 C.B. 323. There, also, potential for transfer tax avoidance was lacking. *See* notes 13-15 *supra* and accompanying text.

longer applicable solely to contractual gifts, but can also be used in a non-contractual setting provided that the potential for transfer tax avoidance is not present.

Under the present statute, can the IRS dichotomize non-contractual gifts, applying the valuation-difficulty rule only to those non-contractual gifts that do not have potential for transfer tax avoidance? As suggested previously, the *Burnet v. Logan* judicial gloss can be superimposed upon the gift tax statute so that non-contractual gifts of a speculative value can be treated as incomplete until their value becomes ascertainable.[71] The only impediment to giving the gift tax statute this construction in the context of non-contractual gifts is the potential for transfer tax avoidance, an impediment that is sufficiently significant to warrant a rejection of the gloss. If, however, application of the valuation-difficulty rule to a particular type of non-contractual gift does not produce tax avoidance potential, then there is no impediment to applying the rule to that gift. The statute, therefore, can be applied on a bifurcated basis to non-contractual gifts.[72] Indeed, it should be so applied since, as will be suggested later,[73] policy considerations dictate that the valuation-difficulty rule be implemented in as many contexts as possible.

D. *Is Revenue Ruling 81-31 Inconsistent with Regulations?*

This bifurcated approach to non-contractual gifts required the IRS to decide in Revenue Ruling 81-31 whether there was potential for transfer tax avoidance. The IRS's implicit determination that the facts in the ruling did not spawn such potential was presumably premised on the theory that the gift could be valued at the employee's death and would, therefore, become subject to gift tax at that time.[74] Unfortunately, the IRS did not address the ostensible inconsistency of this theory with section 25.2511-2(f) of the regulations,[75] which provides, in part:

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71 *See* notes 48-62 *supra* and accompanying text.

72 In effect, it is suggested here that the statute be given a trifurcated construction: contractual gifts, as well as non-contractual gifts that do not have the potential for tax avoidance, are permissible candidates for the valuation-difficulty rule; on the other hand, non-contractual gifts that do have such potential should not be made subject to the rule unless the death-completion proposal (*see* notes 87-96 *infra* and accompanying text) is adopted.

73 *See* notes 104-06 *infra* and accompanying text.

74 According to the IRS, if, at the time of the employee's death, the contingencies were not fulfilled, the employer would not make any payment and no gift would be deemed to occur.

75 *But see* G.C.M. 38273 (Feb. 7, 1980), where the IRS, in a somewhat conclusory fashion, suggests that there is no inconsistency:

> The relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by the death of the donor (*the statute being confined to transfers by the living donors*), is regarded as the event which completes the gift and causes the tax to apply.[76]

The emphasized portion of the regulation, when read in conjunction with the language preceding it, suggests that where a gift becomes complete by reason of the donor's death, the gift tax is not applicable. If this is the meaning of the regulation and if it is valid,[77] then the view taken by the IRS in the ruling that the gift became complete and subject to gift tax at the time of the employee's death must be rejected.

When, however, the emphasized portion of paragraph (f) of the regulation is examined in context, the apparent inconsistency of the regulation and the ruling disappears. Paragraph (c) of the same section of the regulations provides that where a donor makes a gift while reserving a power to either revoke or modify the interests of the beneficiaries, the gift is incomplete. Paragraph (f) then provides that a donor who makes a gift with such a retained power is deemed to complete the gift when the power is subsequently terminated. The draftsman of paragraph (f) apparently foresaw that it should not apply where the power would terminate by virtue of the donor's death. For if the paragraph were applicable to a termination arising at death, donors making gifts with retained powers would be subject at the time of death not merely to the gift tax but also to the estate tax.[78] Obviously, to prevent the same transfer from being subjected

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> We acknowledge that the postponement of taxation until the decedent's final quarter is subject to certain criticisms. Chief among these is that such postponement makes the transfer appear testamentary rather than intervivos. However, the rationale for the result is that, prior to having a completed gift upon which the gift tax is imposed, two requirements must be satisfied. There must be an irrevocable transfer, and the property transferred must have an ascertainable value. In the instant case, as discussed above, the transfer takes place when the decedent enters into the employment contract. Therefore, it is the absence of ascertainable value, not the absence of a transfer by a "living donor," Treas. Reg. § 25.2511-2(f), to which the postponement of taxation is attributable.

76 Treas. Reg. § 25.2511-2(f) (emphasis added). This regulation had been in effect in substantially the same form for quite some time; indeed, the regulation derives from the 1932 Act. Congress' many reenactments of the gift tax without any adverse mention of this regulation, to be sure, gives it much vitality. *See, e.g.*, Burnet v. Guggenheim, 288 U.S. 280 (1933); Camp v. Commissioner, 195 F.2d 999 (1st Cir. 1952).

77 Its validity would appear to be unquestionable. *See* note 76 *supra*.

78 I.R.C. § 2038 provides that where a decedent has made a transfer during life retaining the power to revoke or to modify the interests of the beneficiaries, the subject of the gift is includible in his gross estate. *See also* I.R.C. § 2036. Section 2038 will even require inclusion

to both the estate tax and the gift tax,[79] the parenthetical "occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors)" was included in paragraph (f), thus negating the operation of the gift tax.[80]

This concern about the simultaneous imposition of the estate

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where the decedent has merely retained the power to alter the timing of the beneficiary's enjoyment. On the other hand, where a donor makes a transfer retaining such a power over timing, he is, nevertheless, deemed to have made a complete gift. Treas. Reg. § 25.2511-2(d) (1958).

79 In Burnet v. Guggenheim, 288 U.S. 280 (1933), the Court indicated that by enacting § 501(c) of the Revenue Act of 1932, Pub. L. No. 154, 47 Stat. 169, 245 (1932), the regulation's antecedent, "Congress did not mean that the tax should be paid twice." 288 U.S. at 285. That is, the Supreme Court perceived the congressional scheme as imposing a gift tax or an estate tax (but never both) on an interest transferred subject to the donor's retained power. The substance of the Burnet v. Guggenheim analysis was embodied in the regulations, and Congress, of the view that no statute was needed because the conclusions of the court in Burnet v. Guggenheim had become firmly entrenched in gift tax theory, repealed § 501(c) in 1934. H.R. REP. NO. 704, 73d Cong., 2d Sess. 40 (1934); S. REP. NO. 558, 73d Cong., 3d Sess. 50 (1934). *See also* Camp v. Commissioner, 195 F.2d 999 (1st Cir. 1952). In Estate of Sanford v. Commissioner, 308 U.S. 39 (1939), it was the double taxation potential that motivated the adoption of the rule that where a donor transfers an item subject to a reserved power and retains the power until his death, the item is includible in the donor's gross estate but not subject to gift tax. Retreating from this approach, the Court, in Smith v. Shaughnessy, 318 U.S. 176 (1943), held that property transferred in trust could be subject to gift tax at the time of the trust's creation and, nevertheless, subject to estate tax under § 2037's predecessor at the time of death. Double taxation, the Court concluded, would be avoided by providing a credit for the gift tax against the estate tax under § 2012's predecessor, thus giving the credit provision a more expansive reading than the *Sanford* Court was prepared to give it.

Under current law, by virtue of Smith v. Shaughnessy, it is possible that an item subject to estate tax under § 2037 may have been previously subject to gift tax. Double taxation is avoided by removing the gift from the category of adjusted taxable gifts and providing a credit against the estate tax for the gift tax payable. I.R.C. § 2001(b) (1976). On the other hand, by virtue of *Sanford*, an item subject to estate tax under I.R.C. § 2036 because of a retained power to revoke or change beneficiaries is not subject to gift tax. *See* Treas. Reg. § 25.2511-2 (1958).

Even if, however, the rule in the regulation were removed and the termination of the power at death were, therefore, made subject to both the estate tax and the gift tax, double taxation would not result under the present statute. Pursuant to I.R.C. § 2001(b), the gift would not constitute an adjusted taxable gift, and any gift tax paid would be credited against the estate tax. So, while the rule was adopted to prevent double taxation, it serves no practical purpose under the current statute.

80 By establishing that the gift tax does not apply to the termination of a power at death, the regulation does not precipitate a loss in revenue for the government. In fact, the estate tax that was generated by virtue of subjecting the transfer to taxation under I.R.C. § 2038's predecessor was greater than the foregone gift tax, since the estate tax rates were higher than the gift tax rates. Of course, the Tax Reform Act of 1976, Pub. L. No. 94-455, § 2001, 90 Stat. 1520, 1846 (1976) [hereinafter cited as The Tax Reform Act of 1976], equalized the estate and gift tax rates. Moreover, although the scope of the provision authorizing a credit for gift taxes paid against the estate tax was not clear, Estate of Sanford v. Commissioner, 308 U.S. 29 (1939), any gift tax that would have been payable had the parenthetical not been inserted in paragraph (f) would, presumably, have been creditable against the estate tax.

and gift taxes, which prompted the inclusion of the parenthetical in paragraph (f), should have no bearing on the IRS's position in Revenue Ruling 81-31 that the gift became complete at the time of the employee's death. In the ruling, the IRS was confronted with two alternatives: (1) to apply the gift tax at the time the employee entered into the agreement with his employer, even though the value of the death benefit was not susceptible to calculation at that time; or (2) to apply the gift tax at some subsequent time when valuation would become possible. Choosing the latter alternative, the IRS imposed the gift tax at the time of the employee's death, when the benefit became susceptible to valuation. Given its choice, the IRS had to apply the gift tax at the time of death, lest transfer tax avoidance result.

So, when the valuation-difficulty rule is applied, as in the ruling, the imposition of the gift tax at death prevents tax avoidance. In contrast, when the termination of a power is at issue, the imposition of the gift tax at death would produce double taxation.[81] It is sound policy, therefore, to reject, as the regulation does, the imposition of the gift tax at death in the context of the termination of a power, while accepting it, as the ruling does, in the context of a gift subject to the valuation-difficulty rule.

Is it possible that, despite this logic, the draftsman of the parenthetical intended to apply it not merely to the termination of a power but also to gifts subject to the valuation-difficulty rule? Inasmuch as neither the Code nor the regulations provide for a valuation-difficulty rule and inasmuch as the IRS did not even mention such a rule until 1969,[82] it must be concluded that it was not contemplated when the parenthetical's antecedent was drafted (in 1932)[83] that a valuation-difficulty rule would subsequently evolve and that the parenthetical would affect it. Thus it is likely that the parenthetical was designed to serve only one function: prevent double taxation where a power is terminated by reason of the donor's death. It should not be

81 *But see* note 79 *supra*.

82 *See* Rev. Rul. 69-346, 1969-1 C.B. 227.

83 The parenthetical first appeared as § 501(c) in the Revenue Act of 1932, Pub. L. No. 154, 47 Stat. 169, 245 (1932). *See* note 79 *supra*. In Burnet v. Guggenheim, 288 U.S. 280 (1933), the Court indicated that the 1932 legislation was, in substance, the same as sections 319 and 320 in the earlier 1924 gift tax statute. Revenue Act of 1924, Pub. L. No. 176, 43 Stat. 253, 313 (1924). In 1934, Congress repealed § 501(c) of the 1932 Act on the rationale that its substance was made implicit in the gift tax statute by Burnet v. Guggenheim. Revenue Act of 1934, Pub. L. No. 216, 48 Stat. 680, 758 (1934).

extended, beyond its intended function, to create transfer tax avoidance in the context of a gift subject to the valuation-difficulty rule.

Even though it is clear that the parenthetical, when analyzed from a policy and historical viewpoint, should not have been applied in Revenue Ruling 81-31,[84] the phrase "the statute being confined to transfers by living donors" does suggest that the employee's death was not an appropriate event upon which to impose the gift tax. If the phrase does create any doubt, the doubt should be resolved in favor of limiting its application to the termination of powers. For extending the phrase to the facts in the ruling would result in either a rejection of the valuation-difficulty rule—i.e., apply the gift tax at the time the death-benefit agreement is executed even though its value is impossible to calculate—or transfer tax avoidance. The latter alternative being unacceptable and the valuation-difficulty rule being attractive as a matter of policy,[85] the decision seems easy: construe the phrase as applicable only to power terminations.

IV. Death-Completion Rule: A Proposal

The valuation-difficulty rule provides a more accurate measurement of the value of a gift and should therefore be applied in as many contexts as possible when the gift is difficult to value.[86] One constraint, however, that prevents expansive application of the rule is that when it is applied to some gifts, tax avoidance can result.[87] This tax avoidance can be eliminated if a provision is adopted requiring all gifts subject to the rule to become complete no later than the death of the donor, thereby preventing any gift subject to the rule from escaping the donor's transfer tax base.[88] Thus, the adoption of such a rule would permit the valuation-difficulty rule to be applied to any difficult-to-value gift without any concern about tax avoidance.

What kind of rule would accomplish these objectives? First, of course, the principle that gifts subject to the valuation-difficulty rule become complete when valuation first becomes possible would be

84 *But see* Wolk, *supra* note 43, at 274-75.

85 *See* notes 104-06 *infra* and accompanying text.

86 *See* text accompanying notes 104-06 *infra*.

87 *See* notes 16-27 *supra* and accompanying text.

88 Contrast this death-completion rule proposed in text with the IRS's conclusion in Rev. Rul. 81-31 that the employee's gift became complete at the time of his death. In the ruling, value would necessarily become ascertainable at the time of death. *See* note 94 *infra*. If the rule proposed in text were adopted, it would view difficult-to-value gifts as completed at the time of the donor's death, even if value were still unascertainable at that time.

continued. Second, all gifts subject to the rule that have not become susceptible to valuation by the death of the donor would be deemed complete at the time of the donor's death.[89] Thus, all gifts subject to the rule would eventually enter the donor's tax base.[90]

If, at the time of the donor's death, the gift were still not capable of valuation, a speculative approximation of value would be necessary. This need to speculate, however, is not produced by the valuation-difficulty rule or the rule requiring that the gift be deemed complete by the donor's death, but rather by the notion that events occurring after the transferor's death should not affect the transfer tax base.[91] Indeed, the testamentary transfer of difficult-to-value items requires the same speculative approximation for estate tax pur-

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89 Since a principal purpose of the gift tax is to prevent avoidance of the estate tax, Estate of Sanford v. Commissioner, 308 U.S. 39, 44 (1939); Crown v. Commissioner, 585 F.2d 234 (7th Cir. 1978), the gift tax statute should not be construed so as to bring within its scope events, such as those occurring after death, that would be excluded from the estate tax base were the gift instead testamentary. Thus, gifts subject to the valuation-difficulty rule should be viewed as becoming complete no later than the date of the donor's death.

90 *Cf.* McDonald, *Capital Gains and Losses in Canada*, 29 CANADIAN B. REV. 908 (1951). The Canadian capital gains tax is imposed at the time of death on the appreciation that has occurred during the decedent's lifetime. The Canadian approach was rejected by Congress in 1976 when it opted instead for a carryover basis concept. The Tax Reform Act of 1976, Pub. L. No. 94-455, § 2005, 90 Stat. 1520 (1976). See I.R.C. § 1023 (1978), which was repealed in 1980 by The Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, § 401(a), 94 Stat. 229 (1980).

91 Generally, events occurring after death do not affect the estate tax base, on the theory that the estate tax ought to be immediately calculable so that a prompt distribution of the estate can be made. *See* Ithaca Trust v. United States, 279 U.S. 151 (1929); Macris, *supra* note 10, at 298; Note, *Estate and Income Tax: Claims Against the Estate and Events Subsequent to Date of Death*, 22 U.C.L.A. L. REV. 654, 680 (1975); Comment, *Effect of Events Subsequent to the Decedent's Death on the Valuation of Claims Against His Estate Under Section 2053 of the Federal Estate Tax*, 1972 U. ILL. L.F. 770, 781-82. Consequently, when a difficult-to-value item is owned at the time of death, the value of the item as it can best be determined is included in the gross estate, with post-death events that may reveal the true value as of the date of death being disregarded. *See, e.g.*, Burnet v. Logan, 283 U.S. 404 (1931); Estate of Curry v. Commissioner, 74 T.C. 540, 551 (1980); Estate of Cardeza v. Commissioner, 5 T.C. 202 (1945), *aff'd*, 173 F.2d (3d Cir. 1949); Estate of Houston v. Commissioner, 44 T.C.M. (CCH) 284 (1982); Rev. Rul. 67-370, 1967-2 C.B. 324.

The principal exception to this rule excluding post-death events from the estate tax base concerns the deduction for claims against the estate authorized by I.R.C. § 2053. In the § 2053 context, the courts have held that at least in some circumstances it is appropriate to consider the post-death disposition of the claim, disallowing a deduction in those cases where the creditor fails to properly assert his claim. *See, e.g.*, Estate of Van Horne v. Commissioner, 78 T.C. 728 (1982); Estate of Cortney v. Commissioner, 62 T.C. 317 (1974); Estate of Hagmann v. Commissioner, 60 T.C. 465 (1973), *aff'd*, 492 F.2d 796 (5th Cir. 1974). *See generally* Note, *Estate and Income Tax: Claims Against the Estate and Events Subsequent to Date of Death*, 22 U.C.L.A. L. REV. 654 (1975). *But see* Propstra v. United States, 680 F.2d 1248 (9th Cir. 1982). Taking into account post-death events in determining the deductibility of claims does not, however, significantly disturb the policy objective of prompt estate administration, for

poses.[92] So, unless the notion that post-death events be disregarded for transfer tax purposes is abrogated, speculative approximation will be necessary for those gifts subject to the valuation-difficulty rule that do not become capable of valuation by the time of the donor's death.

The combined application of the valuation-difficulty rule and the rule that requires completion of the gift at the time of death creates a time period after the gift is initially made during which an accurate measurement of value may be accomplished. This time period ends, however, at the time of the donor's death. If valuation becomes possible during this time period, an accurate measurement of value is obtained. If, on the other hand, valuation does not become possible by the time of the donor's death, the rough approximation that would have been made earlier is made instead at the time of death. Thus, the approach suggested here provides possibly a more

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the disposition of claims usually occurs shortly after death and in most, if not all cases, no later than the time the fiduciary of the estate renders his final accounting.

There are other situations in which post-death events are similarly permitted to affect the payment of estate tax. *See* I.R.C. §§ 6166 and 2032A (where certain post-death dispositions may trigger a greater or more immediate estate tax payment). But, with respect to both of these sections, the largest amount of estate tax that can possibly become payable is immediately determinable. Also, the period during which a disposition may have an effect is limited to 15 years. Thus, with few limited exceptions, the estate tax is computed without regard to post-death events. *But cf.* I.R.C. § 691 (1976) (where income tax obligations arising out of arrangements entered into by a decedent prior to death can be affected by post-death events, such as a post-death failure by the person with whom the decedent contracted to make payments in accordance with the contract).

In the gift tax context, on the other hand, Congress has been more inclined to permit post-transfer events to affect the tax base. Indeed, it is impossible to determine in most instances the amount of transfer tax attributable to an *inter vivos* gift until the death of the donor. For example, a taxpayer making a gift of $600,000 in 1987 would not be required to pay any gift tax by virtue of the unified credit. I.R.C. § 2505 (1976). Yet, if, at the donor's death, he were to have sufficient assets to create a taxable estate, a transfer tax would be imposed on the $600,000 gift made earlier. Thus, the exact amount of transfer tax attributable to an *inter vivos* gift cannot be calculated until the donor's taxable estate is determined, a determination that obviously must await the donor's death. *See also* I.R.C. § 2602 (1976) (which makes generation-skipping tax a function, to some extent, of prior *inter vivos* gifts).

Since the policy objective that dictates disregard of post-transfer events in the estate tax context—prompt estate administration—is not operative in the gift tax context, post-severance events should be permitted to affect the gift tax calculation when the gift is initially difficult to value and including the post-severance event in the valuation process will increase accuracy in measuring the transfer. But so long as post-death events are excluded from the estate tax base, such events should similarly be excluded from the gift tax base. Thus, all gifts subject to the valuation-difficulty rule should be deemed complete no later than the donor's death. *See* note 89 *supra*.

92 Estate of Cardeza v. Commissioner, 5 T.C. 202 (1945), *aff'd*, 173 F.2d 19 (3d Cir. 1949); Rev. Rul. 67-370, 1967-2 C.B. 324. *See also* Wolk, *The Pure Death Benefit: An Estate and Gift Tax Anomaly*, 66 MINN. L. REV. 229, 280 n.250 (1982).

accurate measurement of value or, at worst, the rough approximation that would have had to have been made in any event.

Does administrative inconvenience create any insurmountable obstacles to this approach? The most nettlesome aspect of the valuation-difficulty rule is its requirement that the gift be considered complete when the value of the gift can first be ascertained. In many instances, it would be impossible for a taxpayer to determine with certainty the year in which value first becomes ascertainable. If, however, interest is made to accrue on the gift tax deficiency commencing with the year in which value first becomes ascertainable,[93] no advantage will be enjoyed by taxpayers who fail to report their gifts as soon as they can ascertain value.[94] In addition, taxpayers can be deterred from playing the "audit lottery" by imposing a greater interest rate where the taxpayer is found to lack a reasonable ground for the reporting position he takes.[95]

The second concern about the valuation-difficulty rule is the potential it creates for a gift subject to the rule to fall through the tax

93 For a suggestion that an interest charge be imposed even prior to the time when value becomes ascertainable, see text accompanying notes 115-19 *infra*.

94 On those occasions when the valuation-difficulty rule was applied, the date on which the value of the gift became ascertainable and, hence, the date on which the gift was deemed to become complete could not be disputed. *See, e.g.*, City Bank Farmers Trust Co. v. Hoey, 101 F.2d 9 (2d Cir. 1939) (where the gift was deemed to become complete when cash was actually transferred by the donor); Rev. Rul. 81-31, 1981-1 C.B. 475 (where the value of the death benefit became ascertainable at the time of the employee's death); Rev. Rul. 75-71, 1975-1 C.B. 309 (where the value of a gift of the right to receive a bequest became quantifiable at the time of the testator's death); Rev. Rul. 69-36, 1969-1 C.B. 227 (where the nature of the donor's transfer to a trust created under her husband's will became calculable at the time of the husband's death).

In each of these instances, the happening of a specific event triggered the transfer of property to the donee, making it possible to calculate value. If, however, the valuation-difficulty rule is extended, as suggested in text, to situations where the donor makes an outright transfer of a difficult-to-value item and no further transfer of property will be made to the donee, the only event that can be viewed as completing the gift is value becoming ascertainable—there being no subsequent transfer of property to act as a triggering event. Determining exactly when value becomes ascertainable can, of course, be problematic. Perhaps this problem warrants a rejection of the valuation-difficulty rule when the donor makes an outright transfer and does not have an obligation to make any further transfers.

As suggested in the text, however, the problem is adequately addressed by imposing an interest charge on donors who fail to file a return and pay the gift tax in the year in which value becomes ascertainable. Of course, some administrative inconvenience does inhere in an interest charge of this nature since the IRS and the courts will be required to determine the year in which value becomes ascertainable. Weighing this administrative inconvenience against the alternative of not applying the valuation-difficulty rule to outright gifts, the author is of the view that the increased accuracy in measuring transfers afforded by the valuation-difficulty rule makes its application desirable.

95 *Cf.* I.R.C. § 6653 (1976) (providing in effect an increased interest rate for deficiencies attributable to negligence).

collector's net, resulting from the IRS's inability to detect a gift when it is not reported at the time initially made because not complete under the rule. To prevent this, taxpayers should be required to file a gift tax return at the time the gift is made, even though the valuation-difficulty rule is applicable.[96] When the value of the gift subsequently becomes ascertainable, an additional return would be filed, and the tax would be paid. If the taxpayer fails to file the second return either because value does not become ascertainable prior to the donor's death or because the taxpayer chooses not to file, the IRS would presumably make inquiry about the missing return in connection with the audit of the estate tax return.

In sum, adoption of this death-completion proposal will make possible an expansive application of the valuation-difficulty rule without permitting tax avoidance. Since application of the valuation-difficulty rule increases valuation accuracy, the rule should be expansively applied, complemented by the death-completion rule to prevent tax avoidance.

V. Valuation

A. *Selecting the Valuation Time Frame*

In Revenue Ruling 81-31, the IRS used the valuation-difficulty rule to determine that the gift of death benefits became complete at the employee's death. The IRS then turned its attention to the valuation question: what was the amount of the taxable gift? The IRS had little difficulty with this question, concluding that the amount of the gift was the value, at the time of death, of the benefit payable to the employee's spouse. According to the IRS, when a gift is made subject to the valuation-difficulty rule, the amount of the gift is equal to its value at the time the gift becomes complete, when value becomes ascertainable.[97]

Neither the Code nor the regulations explicitly indicate the date on which a gift subject to the valuation-difficulty rule is to be valued. Section 2512, the only provision in the Code that addresses gift tax valuation, states that "if the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the

96 *Cf.* I.R.C. § 1034 (1976) (requiring taxpayers who sell their residence to report the sale on their income tax return even though they intend to secure nonrecognition by purchasing a new residence).

97 The IRS first suggested this position, albeit somewhat subtly, in Rev. Rul. 69-346, 1969-1 C.B. 227. Then in Rev. Rul. 75-71, 1975-1 C.B. 309, the IRS applied the rule that it had merely hinted at in Rev. Rul. 69-346.

gift." But is "the date of the gift" the date enforceable rights are created in the donee under the state law or the date those rights subsequently became capable of valuation? Thus far, the courts' answer has unanimously been the same as the IRS's—that the amount of a gift subject to the valuation-difficulty rule is its value on the date it becomes capable of valuation.[98]

Support can be found for this position in section 2501 of the Code. This section provides, in part, that the gift tax is "imposed for each calendar year on the transfer of property during such calendar year by any individual."[99] Thus, if a gift is rendered incomplete by applying the valuation-difficulty rule, no "transfer of property" within the meaning of section 2501 is deemed to occur until valuation can be ascertained. When valuation subsequently becomes possible, the "transfer of property" occurs, triggering the gift tax. So, the date of a gift subject to the valuation-difficulty rule for section 2501 purposes is the date on which valuation can be accomplished.

Is it not likely that Congress intended that the "date of the gift" as the phrase is used in the valuation section 2512, would have the

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98 *See* City Bank Farmers Trust Co. v. Hoey, 101 F.2d 9 (2d Cir. 1939) (holding that the actual payments made in discharge of an obligation previously imposed upon the taxpayer by a court were subject to the gift tax); Estate of Bressani v. Commissioner, 45 T.C. 373 (1966) (indicating in dicta that a wife who had agreed with her husband to make a gift at the time of her husband's death made a gift equal to the value on the date of his death of the property she was required to transfer); *see* Macris, *supra* note 10, at 301 (suggesting that partly because I.R.C. § 2512 requires valuation as of the date the gift becomes subject to valuation, the valuation-difficulty rule should be rejected). *Cf.* Robinson v. Commissioner, 675 F.2d 774 (5th Cir. 1982) (the court suggested that the amount of the gift is its value on the date it becomes complete and the events occuring before completion are not relevant to the valuation process).

In *Robinson*, the taxpayer's husband died, leaving a will that required the taxpayer to transfer her property to a trust as a condition to her receiving the benefits provided for her in his will. The taxpayer fulfilled the condition imposed upon her in the will by transferring her property to the trust. The terms of the trust enabled the taxpayer to alter the interests of the remaindermen. Consequently, her transfer of property to the trust did not effect a gift of the remainder. Treas. Reg. § 25.2511-2. Four years later, the taxpayer relinquished her power over the remainder. At that time, her gift became complete. Treas. Reg. § 25.2511-2(f). The question presented was whether the amount of her gift could be reduced by the value of the benefits she had received under the will four years earlier. The court held that the gift tax is imposed on the value of the gift when the gift was made, and the events occurring after the gift was made but before the gift's completion do not affect the amount of the gift.

It should be noted that none of the authorities cited in this footnote, other than the Macris article, squarely considered the appropriate valuation mechanism for gifts subject to the valuation-difficulty rule. In *Estate of Bressani*, the court was not required to, and indeed did not, analyze the amount of the taxable gift. In *Hoey*, the gift was of cash, not property, and the court did not discuss the appropriate date on which to value a gift subject to the rule. And, of course, *Robinson* did not involve the valuation-difficulty rule at all.

99 I.R.C. § 2501 (1976).

same meaning as the date on which a "transfer of property" is deemed to occur within the meaning of section 2501? To be sure, Congress did contemplate that the section 2501 time-frame and the section 2512 time-frame would be the same, so that the amount of a gift would always equal its value on the date it became subject to the gift tax.[100] But, while contemplating the relationship of these two sections, Congress gave no thought to applying them to a gift subject to the valuation-difficulty rule. Perhaps, therefore, the time-frame connection of sections 2501 and 2512 need not be applied to gifts subject to the rule. That is, such gifts, while becoming subject to the gift tax when valuation is feasible, could possibly be valued as of the earlier date on which enforceable rights were created in the donee.[101] Whether gifts subject to the rule should be split for completion and valuation purposes or treated like all other gifts—valuation and completion occurring simultaneously—is a question that can only be resolved by examining the underlying policy of the gift tax,[102] since Congress failed to incorporate an explicit resolution in the statute.[103]

By hypothesis, the valuation-difficulty rule is only applied to those gifts that are not immediately capable of valuation. If the rule were not utilized, how would the value of the transfer be measured? Presumably, a rough approximation of value would be made;[104] and, of course, in some cases, a rough approximation would not even be possible, resulting in a tax-free transfer of wealth.[105]

On the other hand, if the rule is utilized, the value of the transfer is accurately measured, and no wealth transfer escapes the transfer tax because of difficulties in valuation. The rule, therefore, is a

100 *See* Robinson v. Commissioner, 675 F.2d 774 (5th Cir. 1982); Goodman v. Commissioner, 156 F.2d 218 (2d Cir. 1946); Treas. Reg. § 25.2512-1.

101 *But see* Macris, *supra* note 101, at 301, 302. On the other hand, one could certainly argue that I.R.C. §§ 2501 and 2512 are clear on their face and that the unified time frame that they create for valuation and completion purposes should be applied to all gifts, even those subject to the valuation-difficulty rule.

102 *See* text accompanying notes 108-09 *infra*.

103 On the other hand, one could certainly argue that I.R.C. §§ 2501 and 2512 are clear on their face and that the unified time-frame that they create for valuation and completion purposes should be applied to all gifts, even those subject to the valuation-difficulty rule.

104 See Galt v. Commissioner, 216 F.2d 41 (7th Cir. 1954), *cert. denied*, 348 U.S. 951 (1955), where the court did not utilize the rule, though value was speculative and difficult to calculate. There was, however, unrefuted expert testimony in the record that did establish a value. *See* note 30 *supra* and accompanying text.

105 Where a value is selected for transfer tax purposes at a time when difficult or impossible to value contingencies are present, the transfer can be assigned a nominal value. *See* Estate of Cardeza v. Commissioner, 5 T.C. 202 (1945), *aff'd*, 173 F.2d 19 (3d Cir. 1949); Rev. Rul. 67-370, 1967-2 C.B. 324. If the value of the transferred item ultimately proves to be in excess of nominal value, this excess escapes the transferor's tax base.

salutory one and should, as a matter of policy, be applied to any gift producing valuation uncertainty.[106]

The principal problem created by the rule concerns the selection of the correct time-frame for the computation of value. If sections 2501 and 2512 are construed as effecting a unified time-frame for both valuation and gift completion purposes, then the amount of a gift subject to the rule will be its value on the date valuation becomes possible. This construction would require all events occurring after the donor had severed control over the gift but prior to valuation becoming possible to enter the valuation calculus. This result, however, violates the inveterate transfer tax precept that all events occurring after the donor has severed control over the given item should not affect the computation of the gift's value.[107]

106 Some have suggested, however, that the rule should either be restricted or rejected because of insurmountable problems inherent in it. STEPHENS, *supra* note 19, at 10-23; Macris, *supra* note 10, at 300-03.

107 Unless a gift is subject to the valuation-difficulty rule, a gift is complete and its value at that time is subject to tax. Treas. Reg. § 25.2511-2. *See* STEPHENS, *supra* note 19, at 10-24 to 10-29; Macris, *supra* note 10, at 292. If, on the other hand, the donor makes a gift but retains control over the transferred item—the ability to change the interests of the beneficiaries, to revoke the transfer, or to alter the timing of the beneficiaries' enjoyment—then all events occurring after the initial transfer is made up until the donor dies, or the retained control terminates, are included in the valuation process. I.R.C. §§ 2036(a)(2), 2038 (1976). Thus, as a general matter, valuation for transfer tax purposes does not take into account any events occurring after the donor relinquishes control.

An exception to this general rule was contained in I.R.C. § 2035. Prior to the enactment of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (1981) [hereinafter cited as Economic Recovery Tax Act of 1981], § 2035 provided that a transfer made within three years of death would be included in the gross estate, the amount included being the value of the transferred item at the time of the donor's death. Thus, a donor could transfer an item, completely severing his control over it, and if he died within three years of the transfer, its value at the time of his death would be subject to tax—even though the item might have substantially increased in value between the time of transfer and death. *See, e.g.*, Rev. Rul. 72-282, 1972-1 C.B. 306.

Realizing that this result was inconsistent with general transfer tax theory, Congress, in the Economic Recovery Tax Act of 1981, amended § 2035 to provide that "post-gift appreciation will not be subject to transfer taxes." S. REP. NO. 144, 97th Cong., 1st Sess. 127, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 228. The substance of the amendment is that § 2035(a) will no longer require that items transferred within three years of death be included in the gross estate; instead, the value of the transferred item at the time it is initially transferred is made subject to the gift tax, and that same value concomitantly becomes an adjusted taxable gift, thereby affecting the donor's estate tax calculation. Hence, § 2035 is now compatible with the transfer tax principle that post-transfer events do not affect the valuation process.

Curiously, Congress did not bring § 2035 into full compliance with general transfer tax theory. Instead, it provided that if a donor retains a power or interest under §§ 2036, 2037, 2038, 2041, or 2042, or transfers or relinquishes the power or interest within three years of death, the value of the transferred item at the time of the donor's death is included in the gross estate. To illustrate, assume a donor transfers an item in trust but retains the power to

This violation of transfer tax theory is produced by a clash of three principles: 1) the valuation-difficulty rule; 2) the notion that events occurring after the donor has severed control (post-transfer events) should have no bearing on the valuation process; and 3) the construction of sections 2501 and 2512 as creating a unified time-frame.

To resolve this clash, a comparison of the policies underlying each of these three principles is necessary. As suggested, the valuation-difficulty rule is beneficial, since it permits the accurate measurement of transfers that are inherently difficult to value when initially made. Omitting post-transfer events from the valuation process also serves an important function: donors can compute their gift tax liability at the time that they sever their control over the gift.[108] In contrast, applying the third principle, the unified-time-frame construction, to all gifts subject to the valuation-difficulty rule without any limitation does not fulfill any policy objective;[109] indeed, as sug-

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revoke the trust. Shortly after creating the trust, the donor relinquishes his power to revoke, at which time the value of the transferred item is $100. If the donor dies within three years of relinquishing his power, the value of the transferred item at the time of death is included in his gross estate, even if the value at the time of death has increased to $1,000,000. There is no policy justification for including in the transfer tax base all of the appreciation that occurs after the donor severs his control, when he relinquishes the power of revocation. Indeed, if the donor had instead made an outright transfer of the item when it had a value of $100, the appreciation would not have been subject to transfer tax, even if the decedent had died within three years of making the transfer. It must be conceded, however, that it may be administratively convenient to tax life insurance, as the amendment provides, on the value at death where an insured dies within three years of transferring his policy, because of the difficulties involved in establishing a value for a policy on the date of its transfer, particularly where the insured is seriously ill on that date.

108 Consider, for example, the donor who decides to transfer property having a value of $100 to his son. When informed that the gift tax will be, say, $20, the donor decides to make the transfer, indicating that if the tax were any greater, he would not make the transfer. Should the fact that the gift doubles in value the day following the date of the gift increase the donor's gift tax liability? If this were possible, the donor would be required to pay the increased gift tax even though he would have no right under state law to revoke the gift and enjoy the benefit of the appreciation. Obviously, the inclusion of post-transfer events in the valuation process would make gift tax liability unpredictable, deterring many donors from making gifts that they would otherwise want to make.

It should be noted, however, that under the present statute some post-transfer events, though excluded from the valuation process, can affect the transfer tax liability attributable to an *inter vivos* gift. When a gift is made, the gift tax liability is computed without regard to the remaining estate of the donor. However, at the donor's death, that *inter vivos* gift becomes subject to estate tax at the estate tax marginal bracket. Thus, as the donor's remaining estate increases after the *inter vivos* gift has been made, the concomitant increase in the estate tax marginal bracket will generate an increase in the transfer tax attributable to the gift. Still, the amount of the gift added to the estate is not affected by post-transfer events. I.R.C. § 2001 (1976).

109 With respect to all other gifts, it is sound policy to apply a unified-time-frame con-

gested previously, Congress never even contemplated that the statute would be given such a construction in the context of gifts subject to the rule. The valuation-difficulty rule can be used while excluding, in many instances, post-transfer events from the valuation process, if the unified time frame construction is not rigidly applied. Since a rigid construction is not grounded in any policy objective, at least insofar as gifts subject to the valuation-difficulty rule are concerned, and since the valuation-difficulty rule and the rule excluding post-transfer events from the valuation process do serve important objectives, a flexible approach to the section 2501 and section 2512 time frames is desirable. In other words, while as a general rule it is appropriate to calculate value as of the date the donor severs control over the gift—excluding post-severance events—it is nevertheless appropriate, with respect to difficult-to-value gifts, to calculate value at the time valuation becomes possible, taking into account post-severance events.

B. *Revelation v. Non-Revelation Events*

Whenever the valuation-difficulty rule is applied, at least one post-transfer event—the ultimate outcome of the contingency inherent in the gift that makes it necessary to apply the valuation-difficulty rule—must affect the valuation. That is not to say, however, that all other post-transfer events must also be included in the valuation process. Indeed, it will be argued that the only post-transfer events that should affect the valuation process are those that reveal the outcome of the contingencies that made it appropriate to invoke the valuation-difficulty rule in the first instance. Such post-transfer events will be termed "revelation events."

The approach suggested here works an accomodation of two conflicting policy objectives. On the one hand, transfer tax theory generally requires that post-transfer events be disregarded. On the other hand, when the valuation-difficulty rule is applied to permit the accurate measurement of a transfer that is difficult to value at the time it is initially made, it is obviously necessary to include in the valuation process the post-transfer outcome of the difficult-to-value

struction, taxing the gift on its value at the time it becomes complete—i.e., when the donor severs his control over the gift. Value at the time control is severed is certainly an appropriate basis upon which to impose a transfer tax. On the other hand, if such a unified approach were taken with respect to gifts subject to the rule, post-transfer events would be included in the valuation process. So, while it is sound to apply a unified construction to gifts that are not subject to the rule, there is no policy justification for applying such a construction to gifts that are subject to the rule.

contingency. So, the compromise is struck by eliminating all post-transfer events other than the revelation of the outcome of the difficult-to-value contingency from the valuation process.

To illustrate, assume a father owns an interest in an oil well that he wishes to transfer to his daughter. Anxious to induce his daughter to attend college, he enters into an agreement with her obligating him to provide her with the income generated by the oil well for a ten-year period if the daughter attends college. The daughter agrees and in fact does enroll in a college program.[110] At the time the contract is executed, oil is selling for $30 per barrel. The value of the father's gift to his daughter is not ascertainable at the time of contract execution because it is scientifically impossible to determine the number of barrels of oil that the well will produce.

Five years after the contract is executed, the oil well produces 1,000 barrels, and it is determined that the well is incapable of producing any more oil. The 1,000 barrels are sold on behalf of the daughter at the market price of $60 per barrel, the market price per barrel having doubled since the contract between the father and daughter was executed.

Were it not for the valuation difficulty—the inability to predict at the time of contract execution the number of barrels of oil that would be produced by the well—the father would be deemed to have made a gift to his daughter at the time his obligation became enforceable under state law, when the daughter enrolled in the college program.[111] Applying the valuation-difficulty rule, the gift will be deemed complete when it is ascertained that the well is capable of producing only 1,000 barrels.[112]

What is the amount of this gift? To resolve this question, one must first determine which post-transfer events should be permitted to affect the valuation process. The discovery that the well can only produce 1,000 barrels is, to be sure, a post-transfer event, since it occurs five years after the father severed his control by irrevocably committing himself to the gift. This event, however, merely reveals a fact that was in existence but could not be determined at the time the

110 Assume that the father's obligation becomes enforceable under state law and irrevocable once the daughter enrolls in the college program. *Cf.* Rev. Rul. 79-384, 1979-2 C.B. 344 (where the obligation did not become enforceable until the child graduated).

111 A contractual gift is ordinarily deemed complete when the obligation to make it becomes enforceable under state law. *See* note 3 *supra* and accompanying text. The daughter's enrollment in the college program is not deemed sufficient consideration to avoid the imposition of the gift tax. *See* Rev. Rul. 79-384, 1979-2 C.B. 344.

112 *But see* note 94 *supra*.

contract was executed. Indeed, it was the inability to ascertain the number of barrels of oil that the well would produce that made application of the valuation-difficulty rule appropriate. Since the purpose of the valuation-difficulty rule is to defer valuation until the outcome of the difficult-to-value contingency reveals itself, the revelation that the well can only produce 1,000 barrels must be used to value the gift.

The increase in the price per barrel of oil that occurred during the five years after the father and daughter had executed the contract is a post-transfer event of a different kind. This occurrence does not reveal any condition in existence at the time of contract execution. In fact, pricing a barrel of oil at that time did not create any valuation difficulties. The price was $30. Adhering to the general notion that post-transfer events ought to be excluded from valuation, the price increase (a post-transfer event of a non-revelation character) should be disregarded in computing the amount of the gift.

Consequently, the amount of the gift should be $30,000 (1,000 barrels at the price of $30).[113] It must be emphasized that two valua-

113 If the oil were not immediately available to the donee, determining the amount of the gift would require a present-value analysis. The difficulty with this analysis is that, as time elapses, the price of oil may well experience an inflationary increase in value. How does this inflationary increase in value interact with the discount rate applied to compute present value? In this context, the discount rate must serve two functions: offset the anticipated inflation and reduce the value of the oil by the real cost of capital, which is the rate of return an investor could earn in a non-inflationary marketplace. *See* DOCA v. Marina Mercante Nicaraguense, S.A., 634 F.2d 30 (2d Cir. 1980).

To illustrate, assume an anticipated inflation rate of 7% and that an investor could earn 3% if the market were non-inflationary. Given these expectations about inflation and the real rate of return on capital, a prudent investor would seek a return of 10% during the course of a year. Of course, only 3% will represent a true economic return, i.e., the real rate of return on capital, for the remaining 7% of profit merely keeps the investor even with inflation. If the investor were to buy one unit of oil, when oil is selling for $1 per unit, to be delivered one year from the date of purchase, what amount would he pay—or, in other words, what would be the present value of the right to receive one unit of oil one year hence? When the investor receives the unit of oil, its value will be $1.07, assuming its value increases in accordance with the 7% inflation rate. The value in today's dollars of the right to receive $1.07 in one year would be 97.47 cents (1.07 divided by 1.10). Thus, the 10% discount rate utilized accomplished its dual purpose: it offset the inflation and reduced the 1.07 value by an amount necessary to reflect the real rate of return on capital that a prudent investor would seek on an investment of 97.47 cents.

The present-value tables contained in the regulations (Tres. Reg. § 25.2512-9 (1958)), however, take a different approach to the inflation question—they simply ignore it. For example, assume that the corpus of a trust consists of one unit of oil, having a current value of $1. If the table (premised on a 6% discount rate) were utilized in valuing the remainder interest in this trust, which is to become possessory in one year, its present value would be 94.3

tion time frames have been used in reaching this conclusion.[114] With respect to price, value is computed as of the date the father irrevoca-

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cents (1.00 divided by 1.06). The calculation is made by applying the 6% discount to the value in today's dollars of the corpus without taking into account the potential for inflation.

This failure to include inflation in the calculus results in an undervaluation of the remainder interest. This undervaluation is offset to some extent, however by the use of a 6% discount rate, a rate that is certainly low in our assumed economy anticipating 7% inflation and providing a real rate of return of 3%. Since a 10% discount rate, which would be more appropriate in our assumed economy, produces a present value of 97.27 cents (1.07 divided by 1.10) when inflation is taken into account—contrast this with the present value of 94.3 when inflation is disregarded and a 6% discount rate is applied—the undervaluation attributable to disregarding inflation is not fully offset by the use of an artificially low discount rate of 6%. Thus, a discount rate of less than 6% would have to be utilized in order to fully offset the undervaluation attributable to the disregard of inflation.

That is not to suggest, however, that the 6% discount rate incorporated in the tables should be reduced. Indeed, the 6% rate, when applied in other situations, could be low in the context of our assumed economy. To illustrate, assume a trust having a corpus of $1, which is invested in a note payable in one year. The value of the remainder interest in this trust, to become possessory in one year, should not be greater than 90.9 cents (1.00 divided by 1.10), for a prudent investor investing 90.9 cents would expect one year later to have 1.00 by virtue of the 7% inflation rate and the 3% real return on capital—a borrower would certainly be willing to pay the invester interest of 10%, given the assumed economic conditions. Yet the tables, by applying a 6% discount rate, would produce a present value for this remainder of 94.3 cents (1.00 divided by 1.06). Thus, in the context of this hypothetical, the 6% discount rate is too low—the higher, more appropriate rate of 10% would produce a lower (and, given the economic conditions, a more accurate) present value of 90.9 cents.

In sum, the discount rate of 6% is too high where the remaindermen will enjoy the benefits of inflation, such as in the hypothetical where the trust corpus consists of a unit of oil, while the rate is too low if the corpus is held in investments that are not sensitive to inflation, such as a note. The tables are designed to apply to all types of investments (*see* Rev. Rul. 77-195, 1977-1 C.B. 295) without regard to whether the remainderman is entitled to enjoy the benefits of inflation—indeed without regard to inflation at all. The tables' use of a 6% rate may well effect a reasonable compromise in light of this failure to distinguish between the inflation-and-noninflation sensitive remainder.

114 In the estate tax context, a two-time-frame approach to valuation similar to the one suggested in the text has been utilized. In Commissioner v. Shively's Estate, 276 F.2d 372 (2d Cir. 1960), a decedent had obligated himself to make payments to his surviving spouse for her life or until she remarried. Before the decedent's executor was required to file the estate tax return, the spouse remarried. The court held that the I.R.C. § 2053 deduction for the spouse's claim against the estate could not exceed the amount actually paid to her by the estate prior to her remarriage. In other words, while all other items were valued as of the date of the decedent's death, the court took into account a post-death factor, the spouse's remarriage, in determining the amount of the § 2053 deduction.

In Estate of Shedd v. Commissioner, 37 T.C. 394 (1961), *aff'd*, 320 F.2d 638 (9th Cir. 1963), the court similarly took into account a post-death factor in the context of a § 2053 deduction. There, at the time of decedent's death, a contingent claim was outstanding that her estate might ultimately be required to discharge. The court held that the § 2053 deduction should be equal to the amount that the estate was actually held responsible for in the litigation. Thus, the outcome of the litigation, a post-death factor, was taken into account in computing the taxable estate. *See also* Estate of Moor v. Commissioner, 43 T.C.M. (CCH) 1530 (1982), where the court said: "Thus, subsequent events are irrelevant except insofar as they cast light on the facts and circumstances which were in existence or to be anticipated as

bly committed himself to the gift. On the other hand, the quantity factor is measured as of five years later, when it is first ascertained.

Would the amount of the father's gift have been different had the quantity factor been ascertainable at the time the contract became enforceable? Not at all. The product of the $30 price and the 1,000 barrel quantity would, of course, have been the amount of the gift, the same computation suggested when the gift could not be valued initially. Thus, if one uses two time frames (taking into account the revelation event and disregarding the non-revelation event) to value the gift where quantity is not ascertainable at the outset, the conclusion reached is the same as that reached for the gift where quantity is immediately ascertainable. This parity is sensible. Indeed, it would be inequitable to tax the two transfers differently merely because, in one case, the quantity could not be ascertained at the time the contract between father and daughter became enforceable. In short, the price per barrel used in computing value should be the same whether or not quantity is immediately ascertainable.

C. *Neutralization of Deferral*

Although the gift having a quantity that can be determined immediately and the gift with an unascertainable quantity superficially appear to be entitled to equivalent treatment, there is a difference between the two, warranting, perhaps, different treatment. The gift whose value is calculable at the outset is immediately subject to tax, while the other does not become subject to tax until its value becomes ascertainable. There is no policy rationale to support the deferral of the tax obligation in one case while requiring an immediate payment of the tax in the other. To remove the deferral, an interest charge accruing from the date the father becomes legally obligated to make the gift until the date the quantity becomes ascertainable should be imposed on the tax obligation.[115] If an interest charge were imposed, the disparity between the two hypothesized gifts would be neutralized.

Of course, the Code does not presently provide for an interest charge. Consequently, gifts subject to the valuation-difficulty rule will enjoy preferential treatment if all non-revelation events are disre-

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of the date of death." *Cf.* Estate of Van Horne v. Commissioner, 78 T.C. No. 728 (1982). *See* note 91 *supra* and note 120 *infra*.

115 Congress has previously imposed an interest charge in order to remove the benefit of tax deferral. *See* I.R.C. §§ 667, 668 (1976), added by section 1014 of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976).

garded in calculating value. Unless the Code is amended to provide for an interest charge, this preferential treatment can only be ameliorated by including some post-transfer increases in value, although non-revelation events, in the gift tax base. If the post-transfer increase in value approximates the inflation rate, the deferral will be roughly neutralized (taking into account the relationship between the inflation rate and the appropriate interest rate).[116]

That is not to say, however, that all non-revelation events should be indiscriminately permitted to affect the valuation process. Assume, for example, the same facts previously hypothesized about the father who promises his daughter the income generated by his oil well in return for her agreement to enroll in college. Although the number of barrels of oil the well was capable of producing was not scientifically ascertainable at the time of contract execution, assume that it is determined one year later that the well can produce 1,000 barrels. The price of oil, which was $30 per barrel at the time of contract execution, has increased in accordance with the 10% inflation rate experienced in the one-year period between the time the father committed himself to the gift and the time the quantity of oil to be produced by the well is ascertained. This $3-per-barrel increase in value is not the only fortunate event to have occurred during the

116 Assume for example, that a gift having a value of $100 is made on January 1, 1982. If the donor is in a 50% gift tax bracket, he is required to make a gift tax payment of $50. If, because of some difficult-to-value contingency, the valuation-difficulty rule is applied to the gift, the donor is not required to make any gift tax payment. Assuming that the value of the gift becomes ascertainable on January 1, 1983, and that its value has increased by the inflation rate of, say, 10% to $100, the amount of the gift tax required to be paid would be $55 ($110 taxed at 50%). Thus, by including the post-transfer increase in value, which is here equal to the inflation rate, in the gift tax base, the taxpayer enjoys the deferral provided by the valuation-difficulty rule at a cost of $5. This $5 cost is, in effect, the equivalent of a 10% non-deductible interest charge on the $50 tax obligation paid one year late by virtue of the valuation-difficulty rule. So, if the inflation rate approximates a fair interest rate (generally, the inflation rate is a few percentage points less than the prevailing interest rate, *see Current Investment Questions and the Prudent Person Rule*, 13 REAL PROP. PROBATE & TRUST J. 650, 664 (1978)), and the post-transfer increase in value approximates the inflation rate, the inclusion of the post-transfer increase in value in the tax base roughly neutralizes the deferral.

It should be noted that an increase in the donor's marginal gift tax bracket will increase the cost of the deferral. For example, if, in the example posited in this note, the taxpayer had been in a 60% marginal bracket with respect to the $10 post-transfer increase in value, the cost of the deferral (i.e., the interest-charge equivalent) would have been $6 (the $10 increase at the marginal rate of 60%). Thus, an increase in the marginal bracket may result in an interest-charge equivalent that is greater than the inflation rate. This, however, is not an unattractive prospect, for the inflation rate tends, generally, to be somewhat less than the prevailing interest rate. Moreover, the Economic Recovery Tax Act of 1981 has significantly reduced the progressive aspect of the transfer tax rates, resulting, in fact, in a maximum transfer tax bracket of 50%.

one-year time period. Assume that, in addition, shortly after the father irrevocably obligated himself to this gift, a process was discovered whereby, at no cost, a barrel of oil could be converted into a diamond with a value of $500.

Which post-transfer events should be included in the gift tax base? As previously suggested, the determination that the well can produce 1,000 barrels is a post-transfer event of a revelation character and, therefore, must be taken into account. On the other hand, the 10% increase in the price of oil and the discovery of the oil-diamond conversion process are non-revelation events and should, therefore, be excluded from the valuation process. However, if both non-revelation events are excluded from the valuation process, the amount of the gift is $30,000 (1,000 barrels at $30 per barrel), and the taxpayer enjoys the benefit of an unwarranted deferral.

Without a code provision imposing an interest charge, there are only two alternatives that can be used to neutralize the deferral: Take into account in valuing the gift either the $3-per-barrel increase in the price of oil or the discovery of the oil-diamond conversion process.[117] If only the $3-per-barrel price increase is included in value, the amount of the gift is $33,000 (1,000 barrels at $33 per barrel). This is an equitable result, for it is equivalent to the result that would occur if all non-revelation events were excluded from the valuation process and a 10% interest charge were imposed to neutralize the deferral.[118] The other alternative, including the oil-diamond conversion process in the valuation calculus, does not merely neutralize the deferral; instead, it converts what hindsight indicates was a $30,000 gift one year earlier into a $500,000 gift (1,000 diamonds which derive from the 1,000 barrels of oil, at a price of $500 each).

While the former alternative may be more equitable, its selec-

117 While, in the context of other facts, it might be appropriate to include all non-revelation events in the valuation process in order to neutralize the deferral, it would add little to the analysis to do that here. For if the oil-diamond conversion discovery is included in the valuation process, the increase in the price of oil becomes irrelevant. Indeed, it can hardly be disputed that the value of the oil as of the date quantity becomes ascertainable is solely a function of its worth as a substance capable of being converted to diamonds. In short, no reasonable seller would be willing to sell a barrel of oil for $33 when he could convert that same barrel of oil, at no cost, into a diamond having a $500 value.

118 Since the price of oil increased by 10%—the inflation rate—including the price increase in the tax base should neutralize the deferral. *See* note 116 *supra*. It should be noted, however, that when the inflation rate is substantially less than the prevailing interest rate, including the price increase in the tax base will not fully neutralize the deferral. Although the inflation rate is, generally, only a few percentage points less than prevailing interest rates, recent economic conditions indicate that the inflation rate can, at least temporarily, deviate significantly from interest rates.

tion is difficult to rationalize on a principled basis. The only distinction between the two non-revelation events is that the inclusion of the other has the effect of taxing what is, in essence, a $30,000 gift as if it were a $500,000 gift. The decision whether to include a particular non-revelation event in value cannot rationally be made to turn upon whether its inclusion will produce neutralization of the deferral. Indeed, it would be easy to posit hypotheticals where each of the non-revelation events, when included in the tax base, would fail to produce neutralization.[119] The preferable approach would be to neutralize the deferral by imposing an interest charge, excluding all non-revelation events from the tax base. Unless, however, this approach is embodied in the Code, an alternative to "picking and choosing" the particular non-revelation event that will produce neutralization must be found.

D. *Death-Benefit Plans and Revenue Ruling 81-31*

Some types of gifts do have inherent in them non-revelation events that intrinsically neutralize the deferral, perhaps creating a rational basis for excluding all other non-revelation events from the tax base. The employee death benefit in Revenue Ruling 81-31 is an example of such a gift.

In the ruling, as will be recalled, the IRS applied the valuation-difficulty rule because the death benefit was explicitly made to depend upon three difficult-to-value contingencies: (1) the employee was required to be employed at the time of his death; (2) the employee was required to be survived by a spouse; and (3) the amount of the death benefit was twice the employee's annual salary at the time of death. The IRS ruled that, at the time of the employee's death, when the outcome of these contingencies would be revealed, a gift in the amount of the death benefit payable by the employer would become complete.

In reaching the conclusion that the entire amount payable by the employer should be subject to gift tax, the IRS implicitly included two non-revelation events in the valuation process. First, it included in the gift tax calculus the increase in the value of the benefit that accrued as the time remaining before the employee's spouse would receive the death benefit became shorter—that is, each year, the value of the benefit would increase by virtue of the time-value of

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119 If, for example, the increase in the price per barrel of oil were $100, instead of $3, its inclusion, as well as the inclusion of the oil-diamond conversion process, in the tax base would distort the amount of the gift, rather than merely neutralize the deferral.

money until, at the time of the employee's death, its value would equal the amount payable by the employer. Second, the IRS also included in the calculus any post-severance increase in the value of the death benefit attributable to premature death.

To illustrate the effect of the IRS's inclusion of these non-revelation events in its valuation analysis, assume that a twenty-one-year-old employee executes a death-benefit agreement with his employer such as the one described in the ruling. One year after executing the agreement, the employee is a victim of a fatal accident. Assuming that the employee is survived by a spouse, is still employed at the time of death, and that his annual salary at death is $50,000—each of which is a revelation event—the employee's spouse is entitled to receive $100,000, which, according, to the IRS, would be the amount of the gift.

If, however, only the revelation events are taken into account and the non-revelation events—i.e., post-severance increases in value attributable to the time-value of money and the employee's premature death—are disregarded, the amount of the gift would be substantially less than $100,000. To calculate the amount of the gift with only revelation events considered, one must determine the value of the right to receive $100,000 at the end of the life expectancy of a twenty-one-year-old.[120] Using the tables provided in the regulations, the amount of the gift, stripped of both non-revelation events in the

120 In the estate tax context, premature death has been removed from the valuation process in a manner similar to that suggested in text. In Ithaca Trust v. United States, 279 U.S. 151 (1929), the decedent's will created a trust that provided that income was to be paid to the decedent's widow for life and the remainder was to go to charity. The widow having died prior to the filing of the estate tax return, the court had to decide whether the value of the remainder, for charitable deduction purposes, was to be determined with or without regard to the widow's premature death. The Court held that it was to be valued as of the date of the decedent's death on the assumption, though it was known to be false, that she would live a normal life expectancy. *See also* Estate of Van Horne v. Commissioner, 78 T.C. 728 No. 48 (1982); Rev. Rul. 82-97, 1982-1 C.B. 138.

But cf. Shedd v. Commissioner, 37 T.C. 394 (1961), *aff'd*, 320 F.2d 638 (9th Cir. 1963); Commissioner v. Shiveley's Estate, 276 F.2d 372 (2d Cir. 1960). In both cases, the presence of contingencies at the time of the decedent's death made it impossible to value certain claims against the estate for I.R.C. § 2053 purposes. The courts determined the amount of the deduction by taking into account the facts that actually occurred after the decedent's death. In effect, these post-death facts were revelation events in that their outcome merely indicated what could not have been actuarially determined on the date of death. In contrast, the premature deaths that occured in *Ithaca Trust*, *Van Horne* and Revenue Ruling 82-97 were post-death facts of a non-revelation character—life expectancy was actually ascertainable on the decedent's death, permitting valuation on that date without the need to take into account any post-death events. This willingness to allow revelation events to affect the valuation process in the estate tax context may only have application when a § 2053 deduction is at issue. *But see* note 114 *supra*.

manner suggested, is $8,954.[121]

In the year following the employee's severance of control over the benefit, its value increases to $100,000 as the non-revelation events occur: (1) Each day after severance, the employee's life expectancy grows shorter, and, concomitantly, the date of payment of the benefit approaches, thereby increasing the value of the right to receive the payment by virtue of the time-value of money; and (2) while, at the moment before the employee's accidental death, the value of the benefit is still substantially less than $100,000, the employee's sudden, premature death triggers an immediate right to receive the payment, thereby precipitating an increase in value to $100,000. Because this increase in value of $91,046 ($100,000-$8,954) occurs in the post-severance period and is not attributable to the outcome of revelation events, it should be excluded from the transfer tax base, just as post-transfer appreciation of gifts not subject to the valuation-difficulty rule does not affect the valuation process. In short, no rationale supports including these non-revelation events in the valuation process merely because difficult-to-value contingencies make it necessary to defer the computation and payment of the gift tax until the revelation events occur. The IRS's conclusion to the contrary in Revenue Ruling 81-31 is inconsistent with transfer tax policy concerning post-transfer events and should, therefore, be rejected.

The non-revelation events, premature death and time-value of money, having been stripped out, the taxpayer is taxed on the same amount as if the death benefit had been a non-fluctuating $100,000 and not subject to any contingencies. The difficulty, of course, is that while the taxpayer would be deemed to have made a gift of $8,954 on the date he severed control if the death benefit is non-contingent, he is deemed to have made a gift of this amount one year later, at the time of his death, if the death benefit is contingent. To maintain parity between the contingent and non-contingent arrangements, the deferral must be removed. Since the inclusion of the time-value of money in the valuation of a death-benefit plan would intrinsically neutralize the deferral,[122] and since the preferable approach of im-

121 Treas. Reg. § 25.2512-9.

122 Assuming an interest rate of 10%, the value of the benefit would increase each year by 10% as a result of the time-value of money. If this increase were included in the tax base, the amount of the gift tax payable would similarly increase by 10% each year. But see note 116 *supra* for a discussion concerning changes in the marginal tax bracket. Thus, so long as the interest rate used in computing the post-transfer increase in the amount of the gift is approximately equal to the interest rate prevailing in the marketplace, inclusion of the time-value of

posing an interest charge is not presently provided for in the Code, it is perhaps sensible to require that the time-value-of-money factor always be embodied in the tax base, at least where a death benefit plan is the subject of the gift.[123]

Thus, in the context of death-benefit plans, and, perhaps, in the context of many other gifts subject to the valuation-difficulty rule as well,[124] inclusion of the time-value of money in the tax base will neutralize the deferral.[125] On the other hand, for those gifts subject to the rule that do not automatically increase in value as time lapses,[126] an alternative approach must be taken, of which there are basically four.

E. *Available Alternatives*

First, exclude all non-revelation events from the valuation process and amend the Code to provide for the imposition of an interest charge. From the policy viewpoint, this is the most attractive alternative, since it closely approximates the tax treatment applicable to gifts that are not too difficult to value.[127] But to achieve the equity

money in the tax base will neutralize the deferral. The tables in Treas. Reg. § 25.2512-9 assume an interest rate of 6% and thus, in the present economy, would not sufficiently neutralize the deferral. Compare I.R.C. § 6601 (1982), which calculates an interest rate by rounding to the nearest full percentage point the adjusted prime rate banks charged in September of the preceeding year.

123 Including the time-value of money in the tax base will neutralize the deferral for any gift of a right to receive money or property in the future. This is so because as the time remaining before the property or money is to be received grows shorter, the value of the right to receive the property or money grows larger in accordance with an appropriate interest rate. Many gifts subject to the valuation-difficulty rule involve the right to receive property or money in the future. Indeed, in each of the rulings in which the IRS has thus far applied the valuation-difficulty rule, other than Rev. Rul. 73-61, 1973-1 C.B. 408, the subject of the gift was the right to receive property or money in the future.

124 *Id.*

125 It could be argued, however, that the deferral in Rev. Rul. 81-31 was neutralized by the inflationary increases in the amount of the benefit—the benefit being equal to twice the employee's salary at his death, the value of the benefit would increase as inflation increased his salary—and therefore, it was inappropriate to include the time-value of money in the tax base. Including the inflationary increases in the value of the benefit in the amount of the gift, however, does not neutralize the deferral. Indeed, the use of an appropriate discount rate to determine the present value of the benefit effectively eliminates the inflation from the calculus. *See* note 113 *supra*.

126 *See* text accompanying note 117 *supra*.

127 This alternative would not create complete parity between gifts immediately capable of valuation and those that are not. With respect to gifts subject to the valuation-difficulty rule, post-transfer events of the revelation type would be taken into account, while no post-transfer event of any kind is considered for gifts not subject to the rule. This inequality in treatment is necessary, however, if difficult-to-value gifts are to be accurately measured.

To illustrate, consider the death-benefit plan in Rev. Rul. 81-31. The employee's spouse

offered by this alternative, Congress must act.

Second, "pick and choose" among the non-revelation events, including in the valuation process only those that approximately neutralize the deferral. The objective of this alternative is to create an interest-charge effect without any interest-charge legislation. The only criterion to be used in selecting among non-revelation events would be whether or not the inclusion of the particular event in the tax base would produce the proper amount of tax. A process such as this—where the proper amount of tax to be paid is computed first and then the tax base that will produce this tax is determined—is antithetical to our system of taxation.

Third, exclude all non-revelation events from the tax base. In the absence of an interest charge, this alternative treats gifts subject to the valuation-difficulty rule more favorably by conferring on those who make gifts of this type the benefits of deferral. The disparity between gifts subject to the rule and gifts immediately capable of valuation that is created by this alternative renders it unattractive.

The fourth alternative, which has been adopted by the IRS, would include in the valuation calculus all non-revelation events. Although this alternative does deviate from general transfer tax policy concerning post-transfer events more than the other alternatives, it can be rationalized, perhaps, on the ground that its consequences, which are generally adverse to the taxpayer,[128] are self-inflicted. That is, the donor can choose to give an asset that is difficult to value as easily as he can choose an asset immediately capable of valuation. By selecting a difficult-to-value asset, the donor himself creates valuation doubts, which, since voluntarily created, ought to be resolved

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was entitled to receive twice the annual salary he was receiving at death. In order to accurately measure the transfer, it was necessary to wait until the employee's death to value the benefit. Obviously, increases and decreases in salary that might occur after he severed his control over it were permitted to affect valuation. In contrast, gifts immediately subject to valuation are measured as of the moment control is severed, with events occurring thereafter having no effect on value.

128 *See* Rev. Rul. 81-31, 1981-1 C.B. 475; Rev. Rul. 75-71, 1975-1 C.B. 309. In both rulings, the IRS concluded that the amount of the gift was equal to its value at the time valuation first became possible. In neither ruling did the IRS strip out the non-revelation event of premature death. Had the IRS stripped out this event, the amount of the gift would have been less—although neither ruling contained sufficient facts concerning life expectancy, making it impossible to determine whether, in fact, any premature deaths were involved. Non-revelation events can, however, benefit the taxpayer in some instances. This will occur, for example, where the value of the gift decreases during the period after control is severed but before the difficult-to-value contingency attached to the the gift becomes susceptible to valuation.

against him.[129] The division of risk created by this alternative also makes it attractive. Just as the taxpayer bears the risk that the inclusion of non-revelation events will result in subjecting post-transfer appreciation to tax, the government bears the risk that the inclusion of such events will result in post-transfer depreciation reducing the amount of the gift below its value on the day control is severed.[130] Finally, the inclusion in the tax base of post-transfer increases in value, if approximately equal to the inflation rate, should neutralize the deferral.[131]

Since, however, some assets outperform inflation and other assets do not perform as well as inflation or suffer a decline in value despite inflation, the first alternative, which, unlike the last alternative, provides an accurate measurement of value of the gift on the date control is severed and which imposes an interest charge to neutralize the deferral, is preferable.[132] The first alternative being unavailable without the necessary legislation, however, the last alternative is the least unacceptable one and should be applied to all gifts subject to the valuation-difficulty rule—except, of course, to gifts of a death benefit and similar items which, as suggested, should be stripped of all non-revelation events other than the increase in value attributable to the time-value of money.[133]

VI. Conclusion

The valuation-difficulty rule has generally been applied in limited contexts, namely, where the gift is the subject of an enforceable

129 Robinette v. Helvering, 318 U.S. 184, 188-89 (1943).

130 *See* Macris, *supra* note 10, at 302, 303.

131 *See* note 118 *supra*.

132 Some administrative inconvenience does inhere in the first alternative. Indeed, some have argued that it may be difficult to isolate and strip out the non-revelation events with respect to some difficult-to-value gifts. *See* Macris, *supra* note 10, at 301-02. It should not be too difficult, however, to classify contingencies on the basis of whether or not they are susceptible to actuarial valuation at the time control is severed, stripping out of the valuation process the outcome of those contingencies that can be immediately valued while allowing the outcome of the difficult-to-value contingencies to affect value. For example, in Rev. Rul. 81-31 there were five post-transfer events that might have affected value: (1) married status at the time of death; (2) salary at the time of death; (3) employment at the time of death; (4) time value of money; and (5) life expectancy. The last two were susceptible to actuarial valuation at the time control was severed while the others were not. Thus, there would have been no difficulty in isolating the last two factors as non-revelation events and treating them appropriately.

133 It is certainly arguable that there is no basis under the Code to treat such gifts differently from all other gifts subject to the valuation-difficulty rule. While the argument does have merit, it is suggested that the policy considerations discussed in the text dictate its rejection.

obligation or where the gift is one of rights arising out of a death-benefit plan. Since application of the rule in these contexts does not create tax avoidance potential, the improvement in valuation accuracy afforded by the rule has made this limited application salutary.

Extending the rule into other contexts can, however, produce tax avoidance. To prevent taxpayers from enjoying this tax avoidance, two alternatives are available. First, apply the rule on a limited basis—that is, only when application of the rule does not produce tax avoidance. But, of course, this alternative fails to secure the increase in valuation accuracy offered by the rule insofar as all other difficult-to-value gifts are concerned. Second, apply the rule to all difficult-to-value gifts, adopting a death-completion rule to forestall tax avoidance. This second alternative is, from the policy viewpoint, the preferable one, since it effects an increase in valuation accuracy for all difficult-to-value gifts without permitting any tax avoidance.

Nevertheless, two deficiencies inherent in the rule must be confronted.

First, to the extent that the rule requires that post-severance events be taken into account in measuring the transfer, gift tax theory is violated. The significance of this violation is minimized, however, if, as suggested, only those post-severance events revealing what was initially unascertainable are taken into account.

Second, the rule permits a deferral of the gift tax payment until value becomes ascertainable, creating an inequitable advantage for difficult-to-value gifts. To maintain parity with gifts not difficult to value, an interest charge should be added to the gift tax imposed on gifts subject to the rule.

Thus, the valuation-difficulty rule should be applied to all gifts not immediately capable of valuation if: (1) an interest charge is imposed to neutralize the deferral; (2) only those post-severance events of a revelation character are permitted to enter the tax base; and (3) the death-completion rule is adopted to prevent tax avoidance.