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TAXING SALES OF LIFE INTERESTS

A STUDY OF THE ADVANTAGES OF CONFUSION

RICHARD KILCULLEN*

PROLOGUE

Shortly after the firing in the Pacific stopped for a time there was a
halcyon period in Tokyo when chocolate bars and cigarettes were supplied
in profusion and were worth their weight, if not in gold, at least in silk,
lacquer, ivory and assorted wares. And one ration day in the post exchange
a soldier was heard to say with sincere feeling—"Look what that fool is
doing with his chocolate bar—he's eating it."

Which is not entirely irrelevant. At least during the present halcyon
period (pending final word) any ex-life tenant might well say—"Look what
that fool is doing with his life estate—he's enjoying it."

The struggle of the tax collector with the law of property began in all
probability on the first occasion when a taxpayer sought to utilize that law
to reduce his taxes. On the whole, the collector has been waging a suc-
cessful if uphill struggle. He has succeeded in taxing income to the person
who earns it, even though that person has by assignment created a valid
legal right in someone else to receive it. He has also succeeded in taxing
the income from property to the person who is, by and large and all things
considered, its real owner even though that real owner has created valid
rights in others to receive the particular income in question. He has suc-
cceeded in many cases in disregarding state court decisions establishing prop-
erty rights either on the ground that those decisions were collusively ob-
tained or that they were irrelevant to the question of tax burden since the
imposition of the tax in question was determined not by property rights
but by some other accepted tax standard. In some cases he seems even
to have established a separate and different "federal property law," though
what such a thing would be is hard to imagine.

So far, however, he has failed to disturb the basic premise that the
income of property is taxable to the owner of the property and that a trans-

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2. Helvering v. Clifford, 309 U.S. 112 (1940); Helvering v. Horst, 311 U.S. 112
   (1940); Helvering v. Eubank, 311 U.S. 122 (1940); Comm'r v. Tower, 327 U.S. 280
   (1946); Lusthaus v. Comm'r, 327 U.S. 293 (1946).
   (1947); James S. Reid, 6 T.C. 438 (1846).
5. Craig v. United States, 161 F.2d 1022 (3d Cir. 1947), affirming 69 F. Supp. 229
   (W.D. Pa. 1946). For a discussion of this subject see The Commissioner Unbound:
   Waning of State Property Decrees and Emergence of a Control Criterion in Federal
   Taxation, 61 HARV. L. REV. 1033 (1948).
fer of property results in a shift in the tax burden with respect to the income on the property transferred.

In the transfers of life estates the area of the tax collector's success touches directly the area of his failure. The results are strange and fascinating in themselves. They may also indicate the necessity for some fundamental revision in tax concepts.

The problem starts with the death of a man (or woman) of substance who desires that certain of his next-of-kin receive for life the income on his property and that others, at some future time, have the property itself. Since the Sixteenth Amendment authorized a tax only on income, the revenue acts since 1913 have taxed only that and in particular have expressly exempted from the burden of the tax imposed, property received by bequest, devise, or inheritance—a—which is where the problem begins.

I—THE GOOD OLD DAYS

(a) The Bequest Theory.

One Anthony N. Brady died in 1913. By his will he divided his estate into six parts and as to one part provided that it should be held in trust and that so much of the income as might be necessary for the support and maintenance of his granddaughter should be paid to her. He further provided that until his granddaughter reached twenty-one (or died earlier) so much of the income as was not necessary for her support should be paid over in equal shares to the taxpayer and another. The taxpayer protested the imposition of an income tax on the moneys he received and, after payment, sued to recover it on the ground that the payments were a bequest exempt from income tax. In *Gavit v. Irwin*, a New York District Court after appropriate references to the difference between fruits and trees and crops and land sustained the taxpayer's position. The Court in its opinion stated that the taxpayer had not received "property" from which he derived income. On the contrary, the only "property" he received was the income itself. In answer to the Government's argument that the plaintiff had received a "right" to those payments which right constituted property, the Court held that in view of the temporary and uncertain nature of the payments to the plaintiff it would be "unreasonable" to call such a right "property." To remove any doubt as to the correctness of its decision the Court added: "If the will had provided that the income of this one-sixth of the Brady estate, during the first year after his death, should be paid to the plaintiff, and the income thereafter appropriated to the support of his granddaughter so far as necessary, and the balance accumulated for her benefit, would anyone contend that the payment to the plaintiff in the one year was income within the meaning of the Act of 1913?"  

6. Revenue Act of 1913, § 111 B. From the first, income from the property was excluded from the exemption. The section first appeared in its present form in the Revenue Act of 1942, see note 15 infra.


8. Id. at 648.
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year at a time the Court without difficulty reached the term of the granddaughter's minority.

From the vantage point of 1951 the rhetorical nature of the Court's inquiry has an heirloom quality, and even four years later, in 1925, the Supreme Court (Sutherland and Butler, J.J. dissenting) took only a few paragraphs to brush aside the judgment of the lower court and sustain the tax. But while the argument that a bequest of income (whether from a specific fund or charged on the general assets of the estate) should escape income taxation in the hands of the recipient seems today too naive to be seriously put forward, reflection discloses that the successful imposition of such tax lays the foundation for future troubles for the tax collector. The courts have rejected the notion that an income beneficiary receives a tax-free bequest of income. Have they then necessarily established that such a beneficiary receives a right which, whatever its nature, is a species of property and that it is the income from that property which is taxed? Such a theory makes that tax easy since Section 22(b) (3) (and earlier comparable provisions) while exempting property acquired by gift, bequest, devise, or inheritance specifically exempts from the exemption the income from such property. Such a theory also establishes, however, the existence in the hands of a recipient of "property" for which he may subsequently have to be given credit.

(b) The Return of Capital Theory.

The Supreme Court's decision in Irwin v. Gavit did not begin to try the taxpayers' ingenuity or the Court's appreciation of the ingenuity. The First, Second, and Eighth Circuit courts all agreed that while a bequest of income was taxable to the ordinary recipient, the Supreme Court could not have intended that a widow who accepted such a bequest in lieu of her

9. Irwin v. Gavit, 268 U.S. 161 (1925). The Court did not, however, say absolutely. This apparently the Third Circuit then required. Four years after the decision in Irwin v. Gavit that court held that an income bequest for the life of one other than the recipient "might have been income" in the hands of the recipient but was a legacy and hence not taxable in the hands of the recipient's legatee. Dobbins v. Comm'r, 31 F.2d 935 (3d Cir. 1929). It is doubtful whether any taxpayer today would spend good money in an effort to obtain a similar decision.

10. Section 22(b) (3), as amended by the Revenue Act of 1942, also denies exemption to a "gift, bequest, devise, or inheritance . . . of income from property." This may not solve the problem. Unless such a gift, devise, or bequest, constitutes income within the Sixteenth Amendment, it is not subject to tax whether or not included in the statute. In fact, the amendment was not intended to change the then existing law according to the House Committee Report: "Under existing law, the value of property acquired by gift, bequest, devise, or inheritance, but not the income therefrom, is excluded from gross income by the provisions of Section 22(b) (3) of the Code. This section has been construed as not requiring exclusion from gross income of amounts received under a gift, bequest, or devise of a right to income from property. [citing Irwin v. Cavit]. This construction of the existing law is now written into the bill for the sake of clearness." H.R. Rep. No. 2333, 77th Cong., 1st Sess. 425 (1942). In general, as will be seen, the cases consider the taxation of an income beneficiary as the taxation of income derived from property. The question whether there is a difference between "property" producing income and a "right" to income is discussed in connection with the F. S. Bell and Widener cases infra.
statutory right to a share of the principal of the estate should be similarly
treated. Where a widow surrendered her right to share in the principal
of the estate in exchange for income payments for her life, she had, accord-
ing to those courts, purchased an annuity at a cost equal to the value of
her statutory share and accordingly (under the then law) was entitled to
receive back her cost before paying any taxes on the amounts received.
This was a noble effort and while somewhat hard on non-widow (or
widower) beneficiaries, at least mitigated the lot of one fortunate class of
beneficiaries. It ran afoul, of course, of the idea, steadily gaining currency,
that rights of dower and curtesy, whether by common law or statute, were
not the equivalent of money or money's worth for tax purposes. When the
question reached the Supreme Court that Court again required little space
to dispose of it. The Court stated simply: "When she makes her election
the widow decides to accept the benefits of the will with the accompanying
rights and liabilities. In no proper sense does she purchase an annuity. For
reasons satisfactory to herself, she expresses a desire to occupy the position
of a beneficiary and we think she should be so treated."

(c) The Exhaustion Theory.

The most ingenious theory (and though unsuccessful in its pure form
the one with which we will in one way or another be most concerned) was
that which admitted the taxability of the income received but urged a cor-
responding offset for shrinkage or exhaustion of the life interest. If, as we
said above, the income beneficiary is taxed on the theory that he derives
income from "property," then what he receives by bequest is a valuable prop-
erty which by the time of his death is valueless. What could be fairer,
therefore, than to allow such a beneficiary to write off each year the amount
by which the property declines in value, an amount roughly equivalent to
the income he receives? While this theory never had the success of the others it was in 1921 thought sufficiently dangerous to make advisable
the enactment of what is now Section 24(d).

11. Allen v. Brandeis, 29 F.2d 363 (8th Cir. 1928); United States v. Bolster, 26
F.2d 760 (1st Cir. 1928); Warner v. Walsh, 15 F.2d 367 (2d Cir. 1926); see George
D. Widener, 8 B.T.A. 651 (1927).
13. Id. at 370.
14. It was urged unsuccessfully in Codman v. Miles, 28 F.2d 823 (4th Cir. 1928)
and George D. Widener, 8 B.T.A. 651 (1927). The Widener case is an example of
one of the most persistent cases of optimism on record.
15. "Holders of Life or Terminable Interest . . . Amounts paid . . . as income to
the holder of a life or terminable interest acquired by gift, bequest, devise, or inheritance
shall not be reduced or diminished by any deduction for shrinkage (by whatever name
called) in the value of such interest due to the lapse of time . . ."
H.R. REP. No. 350, 67th Cong., 1st Sess. 177 (1939), explains the amendment
as follows: "Under existing law persons receiving by gift, bequest, devise, or inheritance
a life or other terminable interest in property, frequently capitalize the expected future
income, set up the value of this expectation as corpus or principal, and thereafter claim
a deduction for exhaustion of this so-called principal on the ground that with the passage
of time the "principal" or corpus is gradually shrinking or wasting. This section ex-
plitly provides that no such deduction shall be recognized."
While Section 24(d) denies certain life tenants who enjoy their property the right to offset against the income they receive the annual decline in the value of their "property," it neither denies nor affirms the existence of a property or the fact of a decline in value. The denial of a deduction for the exhaustion of life interests acquired by "gift, bequest, or inheritance," confirms that such interests, where acquired for value are "property" subject to exhaustion and suggests that denial of an exhaustion deduction to a purchaser for value might render unconstitutional a tax on the full income received.\textsuperscript{16}

II—THE GOOD NEW DAYS (OR WHO WON IRWIN V. GAVIT).

PROLOGUE

The Supreme Court decisions in \textit{Irwin v. Gavit} and \textit{Helvering v. Butterworth} and the statutory help of Section 24(d) might be thought to have disposed of any substantial problem raised by bequests of income.\textsuperscript{17} The difficulty has been that not all recipients of income bequests have been content to sit and enjoy them. On occasions their restless natures, their inability to get along with other beneficiaries, their unwillingness to gamble on living out their expectancies, or their need for money, has led them to give away, or more often to sell, the interest that they have received. The new problems created by such gifts or sales and the results at which the courts have arrived in attempting to solve those problems makes it pertinent to ask who really won \textit{Irwin v. Gavit}.

Flushed with his success in taxing to the earner earned income assigned, the Commissioner attempted in the \textit{Blair}\textsuperscript{18} case similarly to tax to a donor the income of property he had given away. In that case the life beneficiary of a trust assigned a percentage of her interest to another. The Supreme Court held that a life estate, even an equitable life estate as here, was property, that the income of property was taxable to the owner thereof, and accordingly that the assignee and not the assignor was taxable on the income on that part of the life estate that was assigned. It is probable that the Commissioner had picked the \textit{Blair} case with great care. It involved an equitable, rather than a legal, estate and a partial, rather than an entire, assignment; it also involved a spendthrift trust, permitting the Commissioner to argue that the assignment itself was by the terms of the trust invalid. Having picked the case with such care, the effect of an adverse decision was, of course, all the more damaging. With a victory in the \textit{Blair}

\textsuperscript{16} This assumes that the deductions allowed for depreciation and depletion are based on constitutional grounds rather than fair play. There could well be a difference, constitutionally speaking, between purchased and inherited property since the latter does not "cost" the recipient any part of his capital. Such a distinction is theoretical of course; it is not reflected in the statute which gives an inheritor the same "basis" as a purchaser on which to compute not only gain or loss but depreciation and depletion. The specific provision of Section 24(d) provides no ground for distinguishing the two bases in other situations and for other purposes.

\textsuperscript{17} Pure sports like \textit{Dobbins v. Comm'r}, supra note 9, notwithstanding.

\textsuperscript{18} \textit{Blair v. Comm'r}, 300 U.S. 5 (1937).
case the Commissioner could have gone on to transfers of legal life estates and, perhaps, of other forms of property, at least where the transfers were within a family group. Having lost the Blair case the Commissioner in effect established for the taxpayers’ benefit the privilege of splitting up interests in trust property at will.

While the Commissioner did succeed in the Schaffner case in placing some limits on the extent to which taxpayers can successfully divide up trust income, he cannot be said to have made any headway against the Blair doctrine. The Blair case is, of course, a perfect corollary to the theory suggested above as the rationale of Invin v. Gavit. If the income beneficiary is taxed because he derives income from property that he has received by bequest, then he has property which he can assign and, except as affected by such matters as retained control or unreality, he can shift the tax burden on trust income as easily as he can shift the tax burden on the dividends he receives on shares of United States Steel.

This, however, is only by way of introduction. Blair permits a taxpayer, including an income beneficiary, to shift the burden of his taxes; but such a shift costs the taxpayer his loss of the income. Our present concern is with the sale of a life estate for value, where we come much closer to the taxpayer’s promised land.

(a) The Nature of the Sale.

The Tax Court has three times had the problem of determining the tax on a life beneficiary who sells his interest for an amount roughly equivalent to its actuarial value. It has once held for the taxpayer and twice for the government. In both cases where it held for the government it has been reversed by the Circuit Courts. In all these cases the arguments and counter-arguments center, expressly or implicitly, around the Blair and Hort cases.

In Blair, as we have seen, the life beneficiary of a trust made a partial assignment of his life interest. He was held to have transferred property on the income of which he was no longer to be taxed. In the Hort case the taxpayer acquired by devise real property which was subject to a fifteen-year lease at an annual rental of $25,000. Five years later the lessee paid the taxpayer $140,000 in cancellation of the lease. The taxpayer claimed a loss of about $20,000 being the difference between the amount received and the discounted value of the payments to become due over the term of the lease. The Supreme Court denied the loss and held, on the con-

20. The recent Circuit Court decisions in Farkas v. Comm’r, 170 F.2d 201 (5th Cir. 1948) and Hawaiian Trust Co. v. Kanne, 172 F.2d 74 (9th Cir. 1949) and the references by those courts to the Clifford regulations indicate that in general assignments of more than ten years’ income will probably be governed by Blair, and assignments of lesser fractions by Schaffner.
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trary, that the $140,000 received was ordinary income since it was an anticipation of future income payments. "The cancellation of the lease involved nothing more than relinquishment of the right to future rental payments in return for a present substitute payment and possession of the leased premises. Undoubtedly it diminished the amount of gross income petitioner expected to realize, but to that extent he was relieved of the duty to pay income tax. Nothing in Section 23(e) indicates that Congress intended to allow petitioner to reduce ordinary income actually received and reported by the amount of income he failed to realize." 22

The Commissioner argues that the Hort case is exactly applicable to the sale by a life tenant of his life interest since such a sale does no more than anticipate the income which such life tenant could expect to receive over a determinable period of years, i.e., his life expectancy. The taxpayer argues on the other hand that under the ruling of the Blair case a life tenant is the owner of property, that as such owner not only can he assign it (as in Blair) but he can sell it, and that if he can sell it then, like any other property owner, he realizes gain or loss in the amount of the difference between the proceeds and the basis of the property. 23

In Sayres P. Harman, 24 the Tax Court had to deal with a legal life estate in real property. The life tenants joined with the remaindernen in selling the property to third persons. The Court, without reference to the Hort case, held that the taxpayer life tenants had realized a deductible loss in the difference between the proceeds and the basis of their life interests. Both the Commissioner and the taxpayer seemed primarily concerned with the question whether the loss was sustained by the taxpayer or by the executors. The only real attack made by the Commissioner on the right to a loss as such was based on Section 24(d). This was dismissed by the Court as applicable only to a claim by a life tenant enjoying the property for an exhaustion deduction. "It should not," said the Court, "be extended by judicial interpretation to cover the case of a loss sustained by the life tenant upon the sale of property acquired by inheritance." 25 Three judges dissented in the Harman case on the authority of Irwin v. Gavit, stating that "the sale of a life estate is but the anticipation of that taxable income." 26

In both the Bell and McAllister 27 cases, one decided before and one after the Harman case, the Tax Court held that the matter was covered by the Supreme Court's decision in the Hort case. Since by the time of the McAllister decision the Bell case had been reversed by the Eighth Cir-

22. Hort v. Comm'r, supra note 21 at 32.
23. The question of basis receives separate treatment below; for the present we can assume it is approximately the actuarial value of the life estate at the time of sale computed with reference to the value of the entire property at the time of death.
24. 4 T.C. 335 (1944).
25. Id. at 344. See discussion of Section 24(d) in note 15 supra.
26. Id. at 348.
27. Estate of F. S. Bell, 46 B.T.A. 484 (1942); Beulah Eaton McAllister, 5 T.C. 714 (1945).
cuit Court; the Tax Court distinguished that decision on the ground that the taxpayers there had "sold" their life interests while in the McAllister case the life tenant had merely "surrendered" her interest to the remainderman. Since in both the Bell and McAllister cases the "sale" or "surrender" was made to the remainderman, the distinction, based at most on the words used in the contract, is thin. Again, in the McAllister case three judges dissented on the ground, among others, that the majority decision was inconsistent both with the Harman case and the Circuit Court's opinion in Bell.

It will probably be best for our purposes to look in some detail at the majority and dissenting opinions in the McAllister case in the Second Circuit. This is the most recent statement on the subject and as full a treatment as we have of both sides of the question.

Judge Clark, with whom Judge Swan agreed, held that the question raised was answered by the Supreme Court's decision in the Blair case, the continuing authority of which, as the Court pointed out, had been recognized in Schaffner. Since the transfer of a fee interest would unquestionably have been a capital transaction, the Court saw no reason for treating differently the transfer of a lesser estate. The Hort case was held inapplicable since it involved merely the surrender of a contractual right to future rental payments in return for an immediate lump sum; the statute expressly taxes rent and the consideration received for cancellation was held by the Supreme Court to be a substitute for rent as it fell due.

The Court cited with favor the Eighth Circuit's decision in the Bell case and the Tax Court's decision in the Harman case, as well as a District Court decision to the same effect. It rejected the argument of the Commissioner (and the Tax Court) that the Bell case was distinguishable as a sale while here the life tenant merely "surrendered" her interest to the remainderman. Since the sale in the Bell case was also to the remainderman the Court considered the situations identical, stating: "There surely cannot be that efficacy in lawyer's jargon that termination, or cancellation, or surrender carries some peculiar significance for laymen whose counsel have chanced to use them." To the argument that the Blair case involved a different question, i.e., a transfer without consideration, the Court replied that a transfer for value should, if anything, be favored. While admitting

28. Bell's Estate v. Comm'r., 137 F.2d 434 (8th Cir. 1943).
29. It is difficult to explain the divergent results in the three cases since each was reviewed by the full court. In the Harman case, the interest involved was a legal as opposed to an equitable interest that was involved in Blair. Also, the sale in Harman was to a third person, but that would seem important only if all sales to remaindermen were to be considered "surrenders" or "extinguishments" of the life interest, and the majority in McAllister recognized Bell as a "sale." Equally difficult to understand is the absence of any reference to the Hort case in either the majority or dissenting opinions in Harman and the apparent failure of the Commissioner to urge it.
32. Supra note 30 at 236.
that there may be difficulty in drawing a line between Hort and McAllister, the Court quotes from the Supreme Court’s opinion in the Schaffner case:

“Nor are we troubled by the logical difficulties of drawing the line between a gift of an equitable interest in property for life effected by a gift for life of a share of the income of the trust and the gift of the income or a part of it for the period of a year as in this case.”

The Court concludes: “The distinction seems logically and practically to turn on an anticipation of income payments over a reasonably short period of time and an out and out transfer of a substantial and durable property interest such as a life estate at least is.”

The majority opinion is a good statement of the arguments for the taxpayer but it raises a number of questions. Not the least of these is the correctness of the text urged by the Court for distinguishing the Hort and McAllister cases—that of separating short time anticipations of income payments from out and out transfers of durable property interests. After all the lease in the Hort case was for a fifteen-year term of which ten years were cancelled. Ten years would appear to be the present breaking point between the Blair and Schaffner cases and could quite easily exceed the life expectancy of a life tenant who sells his life interest. Will an eighty-year-old life tenant be held to have anticipated income and a forty-year-old life tenant be held to have sold a capital asset?

Unfortunately for our peace of mind, when we come to the dissenting opinion, again a reasoned statement for the opposition, we find ourselves bothered by at least as serious questions. Judge Frank is apparently disturbed that a life tenant who “frustrates” a testator’s wishes should fare better tax-wise than one who does not, and it may be this feeling which prompts him to say that he “is not at all sure” that the Bell case in the Eighth Circuit was correctly decided.

What is hardest to accept in his opinion, however, is his reliance upon the term “surrender” used in the McAllister agreements. The transfer of a life estate to a remainderman will in the normal case result in a merger of the two interests so that the erstwhile remainderman becomes the fee owner. Such a result is accomplished equally effectively by a paper called a “sale” or a paper called a “surrender.” To make tax consequences turn on which term is used does seem, as the majority suggest, to attribute too much efficacy to legal jargon. A transfer of property for money should be a sale under Section 117 unless the consequent extinguishment of the property transferred makes it something else. In either event, it should be what it is, whatever the term used to describe it in the legal instruments.

Despite this bad beginning Judge Frank’s opinion at one point comes very close to what is the essence of the problem. Emphasizing that the Blair case did not involve the question of gain or loss but rather the right

33. 312 U.S. 579, 583.
34. 157 F.2d 235, 237.
to tax to one person the income actually received by another (on the theory that the assignor has received "non-material satisfactions" through his right to control the disposition of the income), Judge Frank attacks the alleged capital nature of the McAllister transaction. He calls attention to the fact that the Supreme Court in the Hort case, where again the argument was made that the lease was "property" and inherited property at that, stated that "property" and "capital" were not necessarily synonymous either under the Revenue Act or in common usage and that the mere fact that a life estate is property does not mean that it is a capital asset within the definition of Section 117. He points out that the purpose of Section 117 is to provide favorable treatment to the disposition of a capital investment and that this is far from permitting favored treatment to the anticipation of future installments of income.

Having come this close to a logical basis for attacking the taxpayer's claim of a capital loss, he then unfortunately proceeds to hold the Hort rule applicable for the reason that in this case the life estate was "surrendered." He even suggests that perhaps where there is a sale, as in the Bell case, "furtherance of sales of such interests falls within the intention of Section 117."

In disposing of a similar argument by the Commissioner the majority opinion states: "More rationally to accept the respondent's contention we ought frankly to consider the Blair case as overruled." More accurately perhaps, following Judge Frank's suggestion, we should consider Blair inapplicable. Either view seems preferable to a theory which results in taxing the life tenant in McAllister and not taxing the life tenant in Bell.

As is apparent, we are in these cases and in the problems they present paying the penalty for taxing an income beneficiary as the recipient of income derived from property that he has inherited. A priori, we could be persuaded by Judge Frank's suggestion that in the McAllister, as in the Hort case, what the life tenant receives is an anticipation of future income payments and that such anticipations should be identically treated. We can even reconcile the Blair case to this proposition if, as he suggests, we explain that case by saying that where income is transferred for a substantial period, and certainly where it is transferred for the entire life of the assignor (i.e., the entire period for which it is payable) the non-material satisfactions received by the assignor through this one final disposition are not sufficient to support the taxation of the income to him. (On the other hand, when such dispositions are for short periods and therefore capable of being frequently repeated, a tax is justified.)

But this still leaves us with the necessity of finding a basis for Irwin v. Gavit consistent with our present aims. Section 22(b)(3) in its present

35. Id. at 241.
36. Id. at 237.
form provides it (by taxing bequests of income as well as the income on bequests), if such does not violate constitutional requirements by taxing as income what is in effect capital. It seems unlikely that in its present mood the Supreme Court would find such taxation unconstitutional.

The difficulty with all this is, of course, that the Blair case does not say what Judge Frank takes it to say, or at least it does not say only that, even assuming that the theory of "non-material satisfactions" is implicit in the Blair decision. The Blair case also said that a life interest was "property" and that, on the facts presented, the "property" had been transferred. While "property" and "capital" may not always be synonymous, what logical or statutory basis have we for saying that "property" which can be "transferred" by gift either can not be "sold" or if "sold" is not a "capital asset" under Section 117? On its face the Blair opinion says that a life interest is "an equitable interest in the corpus," a "present property alienable like any other," and a "right, title, and estate in and to property." As such, it is difficult to see on what basis a transfer of such interest should be treated differently from the transfer of a larger interest, such as a fee. It is not quite enough to say that the Blair case was not concerned with Section 117, and that "property" can have different meanings in different contexts. There must still be some reason in the new context for the new meaning, and, it is suggested, a better reason than that of punishing a life tenant for "frustrating" the testator's intention.8

We shall try a little later to determine whether, all things considered, the McAllister case should have been so decided, and, if so, whether some statutory change is called for. Since, however, we must look first at several other matters, it is appropriate to call attention here to the fact that the Hort and McAllister cases are not as parallel as they at first appear, and, accordingly, that the decision in the one does not furnish a clear guide to the decision in the other.8

In both cases the taxpayer received a lump sum payment roughly equivalent to the discounted value of the income he might have expected to receive over a term of years. But there the similarity ends. In the Hort case the taxpayer recipient was the owner of the fee. Upon receiving the cancellation payment he had both the property, discharged of the lease obligation, and the anticipated income. The lessee, the holder of the lesser estate which

37. Particularly as the life tenant in Blair, being a spendthrift trust beneficiary, was at least equally guilty on that score.

38. It is interesting, if unprofitable, to speculate on the extent, if any, to which the courts may have been influenced by the fact that any life estate is traditionally a greater property than any term for years. An analogous bit of confusion is found in Estate of Johnson N. Camden, 47 B.T.A. 926 (1942). The taxpayer who owned the fee, sold a life estate therein to her husband and executed a deed to him for life with remainder (sic) to herself. She claimed and was allowed a loss in the amount of the difference between the price paid by her husband and the actuarially computed value of the life estate at the time of sale. The discussion in the opinion turned almost entirely on whether the transaction was a "lease" and the consideration "prepaid rent" or a "sale and conveyance" of an estate in the property.
was "sold" or "surrendered" or "extinguished" was not the recipient but the payor of the "anticipated income." He ended up without either property or money; he had not sold or surrendered his interest for money; he had paid to get rid of it. In the McAllister case, it was the life tenant, the holder of the lesser estate, the estate which was to be "sold" or "surrendered" who was currently receiving income and who received the questioned payment. In that case the ultimate fee owner paid money to enlarge his estate. The life tenant received money in exchange for the sale or surrender of hers. The recipient of the money in the Hort case ended up with a larger property and money. In the McAllister case she ended up with no property or money. There is good reason to think of a sale or exchange in one case and a surrender or extinguishment in the other.

Nor are the cases more analogous if it is argued that the "property" involved in the Hort case was not the land itself but the lease. For again the person receiving the payment is the person whose estate is at the same time enlarged. The person who ends up without an interest is not the payee but the payor. Put otherwise, the payor does not acquire a right but escapes an obligation.

It would thus seem that the Hort and McAllister cases can be validly distinguished on the very ground of surrender versus sale which Judge Frank uses to connect them and distinguish them from the Bell case. The owner in the Hort case did not transfer by sale or otherwise his right to receive the rental payments. Such a sale or transfer would necessarily have involved continuing in someone the right to the use of the property for the period of the lease. Instead, he freed the property from such continuing obligation (leaving himself free to rent it the next day) while at the same time receiving a substantial part of the payments which he would have received had the obligation continued. He cannot, therefore, be said to have exchanged a right to future payments for a present payment since by the transaction he relieved himself of the obligation charged upon the land.

All of this is not to say that the McAllister case is right and the Hort case is wrong. It is only to say that there is no necessary conflict between the two, merely to indicate that the problem is not as simple as Judge Frank would have us think, to point out that the real difficulties are different from those he touches on.

(b)—The Question of Basis (or Button, Button, Who Has the Button).

In the dissenting opinion in the Harman case,39 Judge Murdock, as stated above, based his brief argument entirely upon Irwin v. Gavit, stating that the sale of a life estate is nothing but the anticipation of future taxable income and that any loss is, at most, the loss of anticipated income which would have been subject to tax if received. That argument could, of course,
have as well been based on Hort. This dissent would have been more persuasive had it stopped there. It goes on to include two rather extraordinary statements. The first is that it is inconsistent with Irwin v. Gavit to allow a life tenant to base any deduction upon the sale of his property where, as here, he has acquired that property by devise without paying out any cost for it. The second is that even if the taxpayers are entitled to a basis for gain or loss, the basis should be determined in accordance with the regulations: "Thus the life estate which is sold is a shorter estate than the life estate which was acquired at the death of the father. The life tenant has enjoyed a part of it. The Regulation takes this into consideration and is the most satisfactory solution for this difficult question which has come to my attention."

On the first point we are back again to the question whether the basis of the decision in Irwin v. Gavit is the legatee's acquisition of income producing property. If, as we believe, that is the prevailing theory for Irwin v. Gavit, is there any reason for saying that although the life tenant acquired property by inheritance he has no basis for that property which he can use in computing gain or loss? It is true that if the life tenant keeps and enjoys his life estate, Section 24(d) denies him the right to an annual deduction; but there is nothing in that section, or in any other section of the Code, to suggest that the provisions of Sections 111, 112, and 113(a)(5) are not applicable to the realization of gain on a life interest acquired on the death of another. It could well be argued that the existence of Section 24(d) is proof that such a basis exists and is in other situations available for use by the life tenant.

This brings us to Judge Murdock's second point. He states that if the life tenants are entitled to a basis it should be the basis provided in the Regulations. Apparently it does not surprise him that the Regulations should provide a basis for persons, in his opinion, not entitled to one. As a matter of fact, the Treasury's Regulations and Rulings not only provide a basis but also specifically provide that a life tenant realizes capital gain or loss on the disposition of his life estate, computed in accordance with the basis so provided. This brings us to the question of basis and to the final beautiful absurdity.

Section 29.113(a)(5)-1(b) of Regulation 111 provides a uniform basis (fair market value) for all property acquired at death or by reason of death, whether the interest of the taker was, at the time of death, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise. Section 29.113(a)(5)-1(f) provides that upon the disposition of his interest by a life tenant or remainderman, gain or loss is determined by comparing the proceeds with that part of such uniform basis properly allocable to the life estate or the remainder, adjusted as of

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40. Whether the correct one or not has not yet been determined; see discussion infra.
the date the disposition takes place. Simply put, the underlying property in which the life tenant and the remainderman have their respective interests is valued at its fair market value as of the date of the decedent's death. If the question is then important (as it might be under a statute requiring allocation of the estate tax) the value of the life estate and the remainder are computed actuarially on the basis of the life tenant's age at that date. If, however, the remainderman or life tenant subsequently sells his interest, the actuarial computation must be redone on the basis of the life tenant's age at that date of sale. Although the basis of the underlying property remains constant, the life tenant's basis for his life interest will decrease each year and the remainderman's basis will increase each year. If the market value of the underlying property also remained constant, a sale at market value by life tenant or remainderman would theoretically result in neither gain nor loss. Presumably, it is this result which prompted Judge Murdock to call this Regulation "the most satisfactory solution for this most difficult question which has come to my attention."

Supplementing the Regulations, I.T. 207641 sets out in more detail the method of determining basis of property inherited by life tenant and remainderman prior to 1913. While this I.T. failed to provide for a reallocation as of the date of sale, I.T. 391142 was published in 1948 to explain the earlier ruling and to set out by description and example the proper method of reallocating. Interestingly enough, I.T. 3911 uses as its example the sale by a life tenant of his interest and, after adjusting the uniform basis for depreciation and reallocating the basis between the life tenant and remainderman as of the date of sale, states: "A's (the life tenant's) basis . . . when subtracted from $12,000 (the proceeds of the sale of his life interest) shows a taxable gain to A of $481.45." If Judge Murdock really believed that this is "the most satisfactory solution for this difficult question," it is odd that he did not base his opinion upon it, rather than upon the fact that the life tenant is not entitled to any basis, a result which makes the ruling a very confusing bit of surplusage.

The question of basis, even assuming the correctness of the McAllister decision, is not to be answered, however, merely by reference to I.T. 3911. In both the Bell and McAllister cases the Circuit Courts remanded to the Tax Court since the parties were not in agreement as to the life tenant's basis. It is not stated what the dispute was, nor can it be readily guessed since in both cases the life tenants actually determined gain or loss on a basis for the life interests computed as of the date of sale, i.e., in strict accordance with the Regulations.

The Harman case makes no specific reference to the question of reallocating the uniform basis between life tenant and remainderman as of the date of sale, but, in fact, computes the life tenant's basis as of the date

of death despite the fact that the sale did not occur until fourteen years later. The same result was reached in First National Bank & Trust Co. in Macon, also without discussion. There the life tenant had apparently reallocated as of the date of sale but had also revalued the underlying property as of the date of sale before making the reallocation. The Court in its opinion refused to impose a delinquency penalty, apparently on the theory that the method used by the life tenant was understandable, if wrong, but determined a small capital gain by allocating the date of death value of the underlying property between life tenant and remainderman as of the date of death.

On the present law, i.e., the McAllister and Bell cases, we may assume that a life tenant who inherits and then sells his interest realizes a capital gain or loss as if he had sold any other capital asset. It is too early to say precisely what his basis is but quite clearly it is that part of the uniform basis actuarially allocable to the life estate either as of the date of death or as of the date of sale. What then of the other parties to the transaction?

The remainderman under the Regulations above quoted acquires a basis for his interest as of the date of death, which basis increases with each year of the life tenant’s life until upon the life tenant’s death it equals the uniform basis for the underlying property. While not entirely clear, it is probable that if he sells his interest as such before the life tenant’s death he will have a basis no greater, certainly, than the basis of the remainder interest actuarially determined as of the date of sale.

What happens when the remainderman purchases the interest of the life tenant? He could have a basis equal to the sum of the then actuarial basis of the remainder and the purchase price of the life interest. If so, his basis would presumably increase each year until the life tenant died, at which time it would equal the uniform basis for the fee plus the purchase price of the life interest. However, since the life estate normally merges in the fee there are at least two other possibilities. The first is that with the life estate gone the remainderman is immediately entitled to the full uniform basis and therefore has a basis equal to that uniform basis plus his cost for the life interest. The second, obvious from the first, is that he acquires the uniform basis only, since what he has is the underlying property and that property can, under 113(a) (5) have only one basis in his hands.

43. Subra note 31.
44. Fidelity & Columbia Trust Co. v. Comm’r, 90 F.2d 219 (6th Cir. 1937); Hueett v. Burnet, 64 F.2d 705 (D.C. Cir. 1933); William H. Slack, 36 B.T.A. 105 (1937); CCM 14350, CB XIV-1, 197.
45. What treatment would be given in that case to the remainderman’s payment to the life tenant? If McAllister is right and the life tenant has sold a capital asset then the remainderman has bought one. In that case, presumably his payment would be a non-deductible capital expenditure (analogous to expenditures to quiet title) regardless of what his basis thereafter may be. Where two bases are available (here inheritance and purchase) there is apparently no constitutional need for basis to reflect cost. Compare the acquisition by one corporation of the stock of another and subsequent liquidation of the subsidiary. If McAllister is wrong the remainderman could make a strong argument.
When the life tenant sells to a third person the answer is clear enough. In that case, there is no merger, and the third person has a cost for his property in the price that he pays for it.46

Since Section 24(d) denies an exhaustion allowance only to those who acquire those interests by bequest, devise, or inheritance, there is nothing to prevent a purchaser from claiming an annual deduction based upon his vendor's life expectancy.47

Let us assume a sale to a third person for $10,000 of an inherited life estate in property with a uniform basis of $30,000. Let us assume further that the basis is to be reallocated as of the date of sale, and that the basis for the life estate as so reallocated is $10,000, and for the remainder $20,000. The life tenant who sells his interest for $10,000 realizes no gain or loss since he has a $10,000 basis for his interest. The purchaser who has paid $10,000 for the interest is entitled to an annual offset against the income he receives which will, in time, give him full tax utilization of his cost. The remainderman, on the life tenant's death, will have a basis of $30,000 for the property which he can offset against the proceeds of any future sale. Among the three they have had the use, tax-wise, of $50,000. The original value of the property was $30,000 and the additional investment $10,000, a total of $40,000. Does the availability as an offset against taxable gain of an additional $10,000 indicate some material error in the tax doctrines that produced it?

III—Toward Good Future Days

Having come to the conclusion that the results reached by the present cases, at least taken in the aggregate, are wrong, the first question is what results are desired and the second question is how those results can be achieved. To answer these questions requires a re-examination of the correctness of the various ideas that have led to the present results and primarily to a re-examination of what a life interest in property really is.

Judge Disney, writing the dissenting Tax Court opinion in the McAllister case, favored the taxpayer, on the authority of the Harman case and the Circuit Court's decision in Bell, and suggested:

"The majority opinion is obviously based upon some idea of fear that the petitioner should not be allowed her original base because she has enjoyed the income from the life estate from acquisition to date of sale. The answer is, first, that base in property is not affected or adjusted by the mere receipt of income therefrom; and, second, if there should be adjustment of the base because of lapse of time, it is the function of Congress, and not of this Court, to provide the adjustment."

for a deduction since the life tenant is then taxed on anticipated income (even though the income would have come in normal course from the property and not the remainderman). 46. Elmer S. Keitel, 15 B.T.A. 903 (1929); Floyd M. Shoemaker, 16 B.T.A. 1145 (1929); H. Edward Wolfe, 7 T.C. 717 (1946). 47. See cases in note 46 supra.
This statement is very difficult to understand. As mentioned at page 24, above, the life tenant in that case herself redetermined her basis as of the date of sale. More than that, the majority opinion does not refer to the question of interim receipt of income and proceeds entirely on the theory of an anticipatory receipt of taxable income, rather reluctantly distinguishing the Bell and Harman cases as cases of sale rather than surrender.

The dissenting opinion (unless based on off-the-record discussion) might, however, be rewritten along the following lines:

"The majority erred in refusing to allow the life tenant any basis. They argued that since by statute the life tenant is not allowed a deduction for the decline in the value of her life estate between acquisition and sale (roughly equivalent in amount to the income she has received) it must be that she has no basis for that interest and hence nothing to apply against the proceeds of a sale.”

If that is what the Judge meant, it is, of course, true as far as it goes. The majority opinion does deny the life tenant any basis for her property. Logically, it must go further and deny the existence of the “property” itself or at least its “capital” nature since even zero basis property can be a capital asset.

This would seem to be the case. The majority opinion in the Bell case, again by Judge Opper, states:

"It is not open to question that the interest of a life tenant limited to the right to receive income is taxable in full as such. The question we have to decide is whether the price paid in one sum for that interest, arrived at by the parties for all practical purposes by computing the present value of a life estate for the life of a person of the age of the life tenant, can be made to partake of the nature of capital and the gain limited as if a capital transaction had taken place by the mere process of concentration and anticipation. We do not think it can. . . . Here transfer of the life estate, consisting only of the right to receive the income, should not be thought of as a diminution of capital merely because the income is lumped together and collected in a single payment.”

The Court goes on to add that since the life tenant would not be allowed a deduction for the shrinkage of her estate it is not unfair to deny her a basis for all other purposes stating: “It is not as though they had bought the life interest, and thus had a cost basis of that right by virtue of the purchase. Such basis in the trust corpus as might otherwise have existed has been transferred to the trust . . . or to the remainderman.”

Those judges who constituted the majority of the Tax Court in the Bell and McAllister cases were of the opinion that, where a life tenant is entitled merely to receive the income of property, what he receives in installments or in a lump-sum payment is income in his hands. (The effort in the McAllister opinion to distinguish the Bell case seems to be made in

49. Id. at 489.
reluctant deference to the reversal of the Bell case in the Circuit Court.) While the references in the opinion are to “basis” and to the justice of denying any “basis” to such a life tenant, the taxation of the amounts received as ordinary income (rather than capital gain in the full amount) has the effect of, and is apparently intended to be, a denial of the existence of any “property,” or at least any property capable of “sale or exchange.”

The question whether the Tax Court had anything particular in mind in referring to life tenants whose interests consist solely in a “right to receive income” would appear to be answered in the Camden case. In that case the fee owner of real estate sold a life interest therein to her husband for roughly its then actuarial value. She claimed and was allowed a small capital loss on the sale. Referring to its previous opinion in the Bell case the Court stated: “[That case] involved trusts set up by the petitioners, under which there was a life estate consisting only of the right to receive income for life, which right was later transferred to the remaindermen. Both Irwin v. Gavit, 268 U.S. 161, and Maas v. Higgins, 312 U.S. 443, cited in the Bell case, are pointedly limited to situations where the life estate consists ‘only of the right to receive income’ and our opinion in the Bell case is so limited.”

Perhaps the fullest discussion by the Tax Court of the problem with which we are now concerned is in a very early opinion, George D. Widener. In that case the recipients of trust income, notwithstanding the Supreme Court’s holding in Irwin v. Gavit, opposed the taxation to them in full of such income. The Court in rejecting all the various arguments of the taxpayers, stated:

The present situation is squarely within Irwin v. Gavit. . . . While it may be, so far as the Court’s opinion discloses, that no attempt was made by Gavit to establish a value of the expectancy at death, claiming rather that all distributions were in themselves the bequest, nevertheless the reasoning of the opinion gives no warrant for the belief that the decision would have been at all different if such valuation had been fixed in the record. . . . The taxpayer argued that the periodic receipts by him were but the realization of his bequest and hence exempt, and the court held that they were entirely income. The court recognized that the expectancy constituted an interest in the fund itself, and since it had long been recognized . . . that such interest was property of value subject to death duty . . .
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we are compelled to believe that the decision in the Gavit case was reached in the full light of that established law.

We may pass the question whether in a true sense this “right to receive income” is capital—whether the capital, if any, is not represented only by the interest in the fund which produces the income—whether it is not subversive of the entire concept of income to say in turn that a gratuitous right to receive it is capital and hence the realization upon that right is recovery of capital. There is a point of revolt against the tyranny of logic. But suppose it is capital, wherein is it impaired or diminished? It persists in full force. It begins at death as a right to receive income from, and thus an interest in, the fund, and continues throughout in as great a measure as it began. To be sure, the lapse of time affects the probable number of future payments, but how can this change the nature of the payments as income when received? Suppose they were to go on forever, would they be more capital because of longer expectancy or less capital because beyond the formula of valuation.

The second question then arises, whether this income is a bequest and hence within the exemption of Section 213(b) (3). This, as already stated, is in our opinion answered in Irwin v. Gavit, supra, to the effect that the income itself is not the bequest, which in our opinion carries with it the decision that the income is not to be limited by reason of a valuation given to the right to receive it. The Supreme Court in the Gavit case said that that exemption provision “assumes the gift of a corpus and contrasts it with the income arising from it, but was not intended to exempt income properly so-called simply because of a severance between it and the principal fund.”

Furthermore, while the section exempts the value of bequests, it carefully provides that the income from the bequest is not exempt. Hence, as we have seen, the distributions are the income from the petitioners' interest in the fund and are, as such, expressly removed from the exemption.

What has been said is sufficient to demonstrate that the distributions are income under the Constitution as well as under the statute, and that Congress was therefore authorized by the Sixteenth Amendment to tax it as it did. It is apparent from the quotations above that the Tax Court has spent twenty years struggling with a problem it believes Irwin v. Gavit created. Since at the time Irwin v. Gavit was decided what is now Section 22(b) (3) spoke only of taxing the income from property received by bequest (and not, as now, of taxing bequests of income), the Tax Court, and in general the circuit courts as well, have proceeded on the theory that Irwin v. Gavit assumed the receipt by the life tenant of “property” which produced the income taxed to him, and accordingly those courts have been plagued by the question what it is a life tenant has besides the income he receives. In the Bell and McAllister cases a life tenant whose interest consists only of a right to income from a fund was held to have a “right” but, a right which was not “property” in the sense of “capital.” However, where the life tenant

54. Id at 659-662.
was entitled to the use of land, as in the Harman and Camden cases, a majority of the Court was not willing to deny the existence of "capital" in his hands. The Widener case suggested an even further distinction—that a life tenant's "property" is not the "right" to receive income but is a separate "right," i.e., an interest in the fund, and that it is this second right which produces the income the life tenant receives under the first right.

The moral of all this would seem to be that the answer to our problem is not to be reached through abstract discussions of "rights," "property," and "capital." Rather it is to be reached through deciding first where we want to go and second what is necessary to get there.

The first goal would seem to be the taxation to a life tenant of the full amount of the income he receives, without offset for "capital" or deduction for "shrinkage." This result has been achieved by Irwin v. Gavit, Helvering v. Butterworth, and Section 24(d). None of these seem threatened by reversal or by attack on constitutional grounds. Since we have found that the justification of this result on the theory that the life tenant owns "property" or "capital" leads to undesirable results, we are justified in asking whether such an assumption is necessary to the result or even implicit in it.

The Committee Report on the amendment of Section 22(b) (3) by the Revenue Act of 1942 states that the addition of language specifically taxing bequests of income is merely a restatement for purposes of clarification of the law established in Irwin v. Gavit. The Supreme Court in Irwin v. Gavit said that "income properly so-called" should not escape tax merely because it is severed in ownership from the property that produced it. Can it not be assumed therefore that Irwin v. Gavit held proper and constitutional a tax on income received by reason of some testamentary disposition or law of inheritance, even though the recipient received nothing besides the income that would classify as a bequest? Cannot the income be identified with the right to receive it without thereby holding the income to be an exempt bequest? It is true that under some state statutes the life tenant may be required to pay part of the estate tax just as in other situations the donor of a life interest might be required to pay a gift tax, but consistency among income, estate, and gift taxes has never been required. The fact is, or at least can be said to be, that the income which the recipient receives, while not in itself a bequest, is earned by property in which he has no "capital" interest.

It is suggested that this approach accomplishes the end desired with

55. The interests of contingent remaindermen and vested remaindermen subject to divestment present more difficulty and, of course, are less salable. Perhaps each should be given an allocated part of the uniform basis on the sale of his interest even though some contingent remainderman who has not sold his interest may later come into possession and thereby become entitled, under Section 113(a)3, to the full uniform basis. In the alternative, such remaindermen could be denied any basis on a sale of their interest as not yet having any capital interest in the property. In either event, a purchaser coming into possession should have cost only as his basis.
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respect to taxation of the life tenant without the unfortunate results presently observed on the “property” or “capital” theory. Its constitutionality would not seem open to serious question and it is equally consistent with the language in Irwin v. Gavit even if that language in the past has not been so interpreted.

The second mainstay of the “property” theory is, of course, the Blair case which holds that a life tenant has such a “property” as will carry with it on transfer the tax burden on the income which the transferee thereby becomes entitled to receive. That this case need not be a barrier to the denial of any “capital” interest in the life tenant is suggested both in the Hort case and in Judge Frank’s dissenting opinion in McAllister. While it is true that the Schaffner case does not attempt to overrule Blair, it is equally consistent with the theory that Blair does not more than establish that a life tenant who transfers his whole interest does not thereby receive such non-material satisfactions as justify the continued taxation to him of the income he no longer receives. If that is the only necessary holding of the Blair case, the references to the life tenant’s “property” interest are no more than an unfortunate choice of language—the “property” referred to not being, in any true sense, “capital” that can be sold and exchanged and depreciated and otherwise made use of for tax benefit.

If we can go so far, it is submitted that we have solved our problems. The life tenant is no longer the owner of a capital asset. Not only has he no right to a return of capital or to a deduction for shrinkage but he has no basis to offset against the proceeds of a sale or in fact any property subject to sale or exchange. What he has is a right which is no more than an enforceable expectation of periodic income. He can enforce that expectation for his own benefit, in which case he will be taxed in full on the income he receives. He can assign his right to enforce his expectation to another, in which case either he or his assignee will be taxed in full on the income the assignee receives (the tax burden depending on whether, in view of the period and other circumstances of the assignment, the life tenant has received such non-material satisfactions as justify a continued tax upon him with respect to the income received by his assignee). He can also anticipate his income either by surrendering it to the remainderman, or assigning it to a third person, for a consideration. In either case he will be taxed upon the lump sum received since that sum amounts to no more than an earlier receipt of the payments which he otherwise expected.

It is suggested that this is the result which the majority in the Bell and McAllister cases in the Tax Court wished to achieve, though handicapped in the first by the property concept and in the second by that and the Circuit Court’s reversal of their earlier opinion. It is also submitted that the efforts of that Court to distinguish between life tenants whose interest consists only of a right to receive income and other life tenants is not only unnecessary but unjustified. Whether the life tenant’s enforceable expecta-
tion relates to the continued use of physical property or to the continued receipt of income should not affect its "capital" nature. In either event it is an expectation that can be either enjoyed or assigned and, if assigned, assigned either gratuitously or for a consideration. If enjoyed, there will be no tax not because it is property bequeathed but because the law does not so far impose an income tax upon the constructive rental value of property which, by reason of fee ownership or some lesser right or expectation, one is permitted to use and enjoy. Similarly, if the right is assigned there may be a gift tax on its value but there will be no income tax on the assignee. If, however, the assignment is for value, the life tenant should be considered as having received ordinary income since he has no property, no capital asset, to transfer. He has in that case put his right or expectation to a profitable use much as a fee owner might rent instead of occupying his land. He has by his act produced what is very like rental income, even though received in a lump sum.

We will examine in a moment the question of basis, particularly whether, as might first appear, part of the original basis of the property has disappeared or been lost under the proposal made. First, however, it is appropriate to consider whether the proposal made handicaps or makes difficult a fair treatment of one who purchases a life interest in property. Clearly such a purchaser should have a capital status and basis for what he acquires. He should be able by way of depreciation deductions or otherwise to make tax use of his cost. Is it illogical to hold that an interest for the life of another acquired for value is a capital asset while the same interest in the hands of the original holder did not have such character? It is submitted that it is not and that there are on the contrary many situations where the expenditure of money will create a capital asset for tax purposes. It is further submitted that logicality is not the final criterion and that this inconsistency, if it exists, could well be suffered if it produces equitable results for both types of holders of life interests.

Turning then to the question whether on this proposal, a part of the original basis for the property has disappeared, it is submitted that the proper answer has been suggested by the Tax Court in the Bell case—that the full basis presently exists either in the hands of the trustees or in the hands of the remainderman.

It has long been settled, that after the life tenant's death, the remainderman has as his basis the full uniform basis for the property. While life tenants were content to sit and enjoy their interests, no harm was done by dividing the basis for the property, while the life tenant was alive, between the life tenant and remainderman on either a fixed or annually changing ratio. Even when both joined in a sale there was no improper loss of revenue. As we have seen, however, allowance of a basis to a life tenant for purposes of a sale of his life interest alone creates an absurd result since
it does not cut off the increase in the remainderman’s basis on the life tenant’s death.

It is suggested that the remainderman be given the full uniform basis as of the date he acquires his remainder interest. It is true that he can thereby obtain a capital loss by a prompt sale of his interest. But his purchaser should in that case have only his cost as his basis not only for the remainder interest but for the property itself when it comes to him at the life tenant’s death. He has bought, not inherited. There is no reason for his participation in the uniform basis since his low basis merely reflects his low cost (which in turn reflects the fact that he had to wait to obtain possession of the property).

The interposition of trustees does not result in any further difficulty. They have full basis for the property. The remainderman has full basis for his interest. But again if a purchaser buys the remainder interest, his cost basis need not be increased on acquisition of the property from the trustees since he still takes as purchaser and not as legatee.

It is suggested that what has been proposed will solve the mathematical basis problem with which we are now faced. It is suggested that it will also solve the discrepancy that now exists in the tax treatment of a life tenant who enjoys his property and one who “sells” it. It will no longer be wasteful for a life tenant to eat his chocolate bar.

It is also suggested that what is proposed could be accomplished not only within the present statutory provisions but within the necessary authority of the existing Supreme Court decisions. In view, however, of the various ways in which the problem can arise and in view of the possibility that inconsistent or antagonistic results will be reached by different courts at different times on different aspects of the problem, it would seem preferable to amend the Code to provide specifically that amounts received on the sale, surrender, or other disposition of an inherited life interest, legal or equitable, in real or personal property, are taxable as ordinary income without deduction for the value of such interest when received, and to amend the present Regulations with respect to a remainderman’s basis for his remainder interest.

56. With the possible exception of a contingent remainderman coming into possession after another contingent remainderman has sold his interest.