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TAX TREATMENT OF PAYMENTS TO THE WIDOWS OF CORPORATE OFFICERS AND EMPLOYEES

FRANK J. PELISEK*

The tax consequences of payments by a corporation to the widow of a deceased officer or employee is a problem of concern to every practitioner who represents corporate clients. This is especially true of those representing small closely knit corporations where this problem most often arises. Initially involved is the narrow distinction between the broad definition of income\(^1\) and the limited exclusion provided for gifts.\(^2\) A further complication has been created by the varied interpretation of the exclusion provisions of Sec. 101(b).\(^3\) Tax practitioners initially believed that Sec. 101(b) had put to rest the Commissioner-widow controversy and had made the 1939 Code cases on the subject obsolete. Subsequent events have shown the error of this initial reaction. For that reason the following includes a review of the authority on this subject under the 1939 Code as well as the current code.\(^4\)

*Associate Michael, Spohn, Best & Friedrich, Milwaukee; L.L.B. Wisconsin, 1958.

\(^1\) Int. Rev. Code of 1954.

"SEC. 61. GROSS INCOME DEFINED.
(a) General Definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

1. Compensation for services, including fees, commissions, and similar items;

7. Dividends;

11. Pensions;


"SEC. 102. GIFTS AND INHERITANCES.
(a) General Rule.—Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance."

\(^3\) Int. Rev. Code of 1954.

"SEC. 101. CERTAIN DEATH BENEFITS.
(b) Employees' Death Benefits.—
(1) General Rule.—Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee.

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

\(^4\) The entire subject of gifts is presently under close scrutiny by the courts. At
TAX TREATMENT OF WIDOWS

TREATMENT OF PAYMENTS IN THE HANDS OF THE WIDOW UNDER THE 1939 CODE

Although the Internal Revenue Service has within the past several years closely scrutinized voluntary payments to widows of corporate officers, its earlier pronouncements on the issue were directly contrary. In 1914 the Treasury Department determined, under the provisions of the Revenue Act of 1913, that

When the monthly salary of an officer or employee is paid for a limited period after his death to his widow in recognition of the services rendered by her husband, no services being rendered by the widow, it is held that such payment is a gratuity and exempt from taxation under the income tax laws.5

This initial position was reaffirmed in 19216 and again in 1939.7 Under the broad protection of the 1939 ruling, many employers began to voluntarily pay allowances to widows of deceased officers and employees in recognition of past services. This rash of activity in the area after the Commissioner's announcement in I.T. 3329 was due to the emphasis of the Treasury on the question of whether the recipient had rendered any service to the paying organization. Prior to this announcement the emphasis had, since 1920, been on the question of whether services had been rendered to the payor.8

least three cases involving taxation of alleged gifts were before the United States Supreme Court during the October, 1959 term. See Kaiser v. United States, 262 F. 2d 367 (7th Cir. 1959), cert. granted 359 U.S. 1010 (1959), aff'd.—U.S.—., 80 S.Ct. 1204 (1960); Duberstein v. Comm., 265 F. 2d 28 (6th Cir. 1959, cert. granted 361 U.S. 923 (1959), aff'd.—U.S.—., 80 S.Ct. 1190 (1960); and Stanton v. United States, 268 F. 2d 727 (2nd Cir. 1959, cert. granted, 4 L. Ed. 239 (1959), remanded—U.S.—., 80 S.Ct. 1192 (1960). Involved in these cases were the tax status of union strike benefits (held to be gifts), items given to non-employee who furnished leads to customers (held to be income), and voluntary payments to retiring manager of church real estate (remanded for further proceedings). During the argument of these cases the Government proposed a standard test that would apply to all future gift cases in the following terms: "Gifts should be defined as transfers of property made for personal as distinguished from business reasons." The Court refused to adopt this broad test. Instead it declared that each gift case must be decided on its own facts with the controlling question one of intent. "We take it that the proper criterion, established by decision here, is one that inquires what the basic reason for his (the donor's) conduct was in fact—the dominant reason that explains his (the donor's) action in making the transfer. Further than that we do not think it profitable to go."

6 O.D. 1017; 5 Cum. Bull. 101 (1921). "... a corporation paid to the widow of a deceased officer a certain amount equal to the salary he would have earned in two months. The payment was without consideration, a gratuity voted as a compliment to the deceased. It is held that the payment does not constitute taxable income."
7 I.T. 3329, 1939-2 Cum. Bull. 153. "When an allowance is paid by an organization to which the recipient has rendered no service the amount is deemed to be a gift or gratuity and is not subject to Federal income tax in the hands of the recipient."
8 Treas. Reg. 45, Art. 32. "... so-called pension awarded by one to whom no services had been rendered are mere gifts or gratuities and are not taxable...." See also Treas. Reg. 111, §29.22(a)-2.
ous that the test of I.T. 3329 was much easier to satisfy. In almost all cases the widow of a deceased officer or employee would not have rendered any service to the paying corporation. However, under the earlier regulations, it could have been argued that services had been rendered to the corporation by the deceased husband and that the voluntary payments were for those services.

In shifting the emphasis in this area from the benefit to the corporation, to the activity of the recipient, the Treasury undoubtedly had considered the language of the United States Supreme Court in *Bogardus v. Commissioner*. There the question before the Court was the tax status of payments made by former stockholders of a corporation to employees of the corporation through the medium of a new corporation which had taken over a portion of the old corporation’s property. The Court found that the payments were intended as gifts by the payors and were to be treated as such for tax purposes. In conclusion the Court noted:

Some stress is laid on the recital to the effect that the bounty is bestowed in recognition of past loyal services. But this recital amounts to nothing more than the acknowledgment of an historic fact as a reason for making the gifts. A gift is none the less a gift because inspired by gratitude for the past faithful service of the recipient.

Such a great number of employers began to rely on the broad *Bogardus* and I.T. 3329 test that the Commissioner, in 1950, felt forced to reverse his position and return to the test of the former regulations. This was done through I.T. 4027 which declared that “payments made by an employer to the widow of a deceased officer or employee, are includible in the gross income of the widow for Federal income tax purposes.” The release claimed that I.T. 3329 contained a fundamental error in the placing of emphasis on the lack of services by the recipient. It stated:

Thus, the essential factor is whether services were rendered to the employer, not as indicated in I.T. 3329, supra, whether services were rendered by the recipient.

Since there had been substantial reliance by employers on the prior ruling it was necessary for the Commissioner to make I.T. 4027 applicable only to payments received after January 1, 1951.

In addition to the potential loss of revenue resulting in employer’s reliance on I.T. 3329, a further motivation for the Commissioner’s reversal of position may have been the initial Tax Court decision directly involving the question of voluntary payments to widows. In

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9 302 U.S. 34 (1939).
10 Id. at 44.
12 Id. at 10.
Aprill, the directors of a corporation voted to continue the salary of its deceased president by paying such amount to his widow "in recognition of the services rendered by Mr. Aprill to this corporation..." The Commissioner attempted to tax these payments to the widow on a two-pronged theory. One, that the payments were merely for the prior services of the deceased husband (the position of I.T. 4027) and, two, that the payments were dividends to the widow, who was a substantial stockholder in the corporation. The Court noted that under either theory the controlling question would be the purpose which motivated the corporation in making the payments. The Court further noted that although the corporate resolution referred to the payments in terms of recognition for the deceased husband's prior services and the corporation deducted the payments as salary expense (which the Commissioner subsequently disallowed), these facts were satisfactorily explained by the desire of the corporation to comply with I.T. 3329. The Commissioner's contention of a dividend was dismissed as totally unsupported by the facts.

Within a year the Commissioner published I.T. 4027. Thus the battle lines were drawn between the Tax Court directives in Aprill, and the Commissioner's position in I.T. 4027. The subsequent history of the controversy clearly indicates that the Commissioner has been the loser.

Almost five years elapsed between the announcement of I.T. 4027 and the decision in Estate of Arthur W. Hellstrom where the Tax Court directly met and disregarded the Commissioner's position. During that period four other cases were decided by the Tax Court without mention of the 1950 ruling. In each of these interim cases the Court found the payments to be gifts. Although I.T. 4027 was ignored in these cases, it was Hellstrom which dealt the knockout punch to that directive. There the corporation paid to the widow of the deceased president of the corporation, the balance of his annual salary for the year of his death by a resolution indicating the payment was "in recognition of the services" of the deceased. This amount was taken as a salary deduction by the corporation. The Commissioner

14 24 T.C. 916 (1955).
15 Alice M. MacFarlane, 19 T.C. 9 (1952); Ruth Hahn, 13 T.C.M. 308 (1954); Estate of Ralph W. Reardon, 14 T.C.M. 577 (1955), and Marie G. Haskell, 14 T.C.M. 788 (1955).
16 It should be noted that the Commissioner, in order to be consistent with his announcement in I.T. 4027, acquiesced in Aprill and MacFarlane, since the payments there involved were made prior to January 1, 1951. See 1950-2 Cum. Bull. 1 and 1953-1 Cum. Bull. 5. The Commissioner has not acquiesced in any subsequent case despite his recent announcement that he would not litigate cases in this area involving 1939 Code years unless peculiar facts were involved. See Rev. Rul. 58-613, 1958-2 Cum. Bull. 914; T.I.R. 87, August 25, 1958.
17 See also Rodner v. United States, 149 F. Supp. 233 (S.D.N.Y. 1957) for a subsequent direct rejection of I.T. 4027.
relied solely on his 1950 announcement in attempting to tax the widow on the payments. The Court directly overruled I.T. 4027 in stating:

... We, however, do not ascribe the far-reaching effect to that ruling which he does. We understand his ruling to mean that if the amounts paid to a deceased employee's widow were not a gift, but were payment for his past services, they constitute ordinary income to the widow. The respondent, obviously, cannot by administrative ruling tax as ordinary income a payment which the payor made and intended as a gift.\(^{18}\)

In addition the Court refused to attach any significance to the fact that the amount of the payments were determined by the deceased's salary or that the corporation claimed the payments as a salary deduction.

From *Hellstrom* and the prior cases came the controlling facts necessary to classify the payments as gifts. These briefly stated are:

1. Payment made directly to widow and not to estate of deceased
2. No obligation on part of corporation to make payments
3. Corporation derives no benefit from payments
4. Widow performed no services for corporation
5. Services of deceased previously fully compensated.

These controlling facts have become tests applied in varying degrees to all of the cases in this area decided subsequent to *Hellstrom*.\(^{19}\) Each of these tests, of course, is merely a tool in arriving at the question of intent which all of the cases clearly recognize as controlling. However, the intent of a corporate board of directors is difficult if not impossible to ascertain without extrinsic aid. It is this aid which the above noted facts provide.

Cited below are the decisions on this issue decided in favor of the widow in those of the Tax Court\(^{20}\) in proposed deficiency cases and those of the District Courts\(^{21}\) in refund suits. An examination of these

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\(^{18}\) *Supra* note 14 at 919.

\(^{19}\) All of the decided cases recognize that the question of the intent to make a gift is one of fact. For this reason summary judgment will not normally be granted for the taxpayer even if all of the tests are met. See Packard v. United States, 179 F. Supp. 508 (S.D.N.Y. 1959); Peters v. Smith, 221 F. 2d 721 (3rd Cir. 1956), reversing 123 F. Supp. 711 (E.D.Pa. 1954), *But see*, Nixon v. United States, 57-2 U.S. Tax Cas. ¶9982 (D.C.Tenn. 1957) where the court ordered a directed verdict for the widow.

\(^{20}\) *Tax Court Cases:*


\(^{21}\) *District Court Cases:*

cases reveals significant attitudes taken by the courts in this area which will be of value in future litigation under the current interpretation of Sec. 101(b). Initially it should be noted that the amount of the payment has never troubled the courts in determining the existence or non-existence of a gift.\(^{22}\) Amounts vary from under five thousand dollars\(^{23}\) to over sixty thousand dollars.\(^{24}\) The form in which the payments are made also appears to be of little consequence.\(^{25}\) In almost all of the cases the payments bore some relationship to the salary of the deceased officer or employee. A payment based solely on salary would appear at first glance to imply that it was intended as additional compensation. However it is submitted that the use of the salary in the making of such payments is merely a measuring device and should not be determinative or even considered in concluding whether or not the payments are gifts. Although the amount of payment is not directly considered, on several instances, the courts have mentioned the fact that the widow was in need, as contributing to the existence of a gift.\(^{26}\)

One of the controlling factors mentioned in *Hellstrom* is that the payments were made directly to the widow and not to the estate of the deceased. However, even this position has now been relaxed by the Tax Court. In *Estate of Frank J. Foote*,\(^{27}\) the payment involved


22 See Graybar Electric Co., 29 T.C. 818 (1958), *aff'd*. 267 F. 2d 403 (2nd Cir. 1959) where the death benefits were held to be purchase of the stock of the deceased officer, and Standard Asbestos Mfg. and Insulating Co., *supra* note 20, where a portion of payments were found to be designed to encourage widow to hold her stock in the corporation.


25 See Rodner v. United States, *supra* note 17 where payment was in lump sum and Louise K. Aprill, *supra* note 13 where twenty-seven monthly payments were made.

26 Estate of Albert W. Morse, *supra* note 20; Simpson v. United States, 261 F. 2d 497 (7th Cir. 1958); and Baur v. United States, *supra* note 21.

27 *Supra* note 20.
was made to the estate of the deceased and the court still found the payment to be a gift, noting:

... The gift here was made to the estate because it was recognized by the donor corporation that thus it would 'result in benefit and comfort to all members of his family who were remembered by him under his will.' To us this is the same as if the payment had been made directly to the widow or other beneficiary. The interposition of the estate is without meaning otherwise than to ensure that the benefits of the payment would surely inure to those whom the corporation acting through its board of directors thought the deceased would want to benefit, ... 28

Despite the decision in Foote, it would appear that safety dictates that the payment be made directly to the widow if gift status is sought.29

Also a factor which the courts have declared to be of importance is that the corporation received no benefit from the payment. Ignored by the case authority appears to be the intangible benefit received whenever a payment of this type is made. Certainly the morale of the other executives is elevated by the prospect that their widows will also receive payments, or at least that consideration will be given to such payments upon their death.30

A consideration mentioned in Hahn31 was that the resolution authorizing payment had not been submitted to the stockholders, but had merely been adopted by the Board of Directors. The Commissioner argued that this indicated the payments were additional compensation, since as a matter of corporate law, only the stockholders may make gifts while the Board may pass on compensation. The court indicated that this was a factor which was indicative of the intent of the corporation, but found it to be of "lesser importance."32 The Commissioner has apparently not advanced this theory in subsequent cases.33

It could be assumed that the actual language used by the corporate Board of Directors in authorizing payments to the widow, would be a valuable aid in ascertaining the exact intention of the Board. The courts have, however, virtually ignored the wording of the resolution

28 Id. at 550; compare Bausch's Estate, 14 T.C. 1433 (1950), aff'd. 186 F. 2d 313 (2nd Cir. 1951); Brayton v. Welch, 39 F. Supp. 537 (Mass. 1941); Estate of Edgar O'Daniel, 10 T.C. 631 (1948), aff'd. 173 F. 2d 966 (2nd Cir. 1949).

29 Note that in other areas of the 1954 Code, preferential treatment is given for direct payments as opposed to payments to an estate. See Int. Rev. Code of 1954, §2039(c) and §2042.

30 See for recognition of this benefit, Simpson v. United States, supra note 26.

31 Supra note 15.

32 Id. at 310.

33 See Moore v. Keystone Macaroni Co., 370 Pa. 172, 87 A. 2d 295 (1952); Annot., 29 A.L.R. 2d 1256 (1953), and Dwyer v. Tracey, 118 F. Supp. 289 (N.D.Ill. 1954). Involved in each of these cases was the question of director's liability for payments of gifts to the widow or family of a deceased officer. In each the court found such payments to be an ultra vires act.
in resolving the ultimate question of the presence of a gift. In one recent case the language of the resolution was phrased in terms of additional compensation. In addition the corporation treated the payments as salary expense and even deducted withholding taxes on them. The Court, in spite of this clear manifestation of intent on the part of the corporation, found the payments to be a gift. Normally the resolutions in the litigated cases followed the language of I.T. 3329 and indicated that the payments were made “in recognition of the services rendered” by the deceased. Representative of this type of resolution is that reported in *Hellstrom*:

RESOLVED, that in recognition of the services rendered to this corporation for many years by Arthur W. Hellstrom, its founder and late president, and in conformity with the policy of this corporation to make reasonable provision for the surviving dependents of its deceased officers and employees, although it is under no obligation so to do, this Board of Directors does hereby authorize and direct the Treasurer of this corporation to pay monthly to Selma M. Hellstrom, the surviving wife of said Arthur W. Hellstrom, a sum equal to his last salary per month, said monthly salary to continue until this Board of Directors shall require the reduction or discontinuance of such payments.

Variations of this type of resolution which state that the payments are “in consideration of the services rendered” by the deceased have also won the approval of the courts, as have other like variations.

Closely allied to the form of the resolution authorizing payment, as an indication of intent, is the treatment of the payments upon the books of the corporation. Here again the courts have virtually ignored the corporate treatment of the payments. In a number of the

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34 Nixon v. United States, supra note 19.
35 Compare Estate of Charles J. Ginsburg, 17 T.C.M. 472 (1958), aff’d. 271 F. 2d 511 (6th Cir. 1959), where the minutes of the directors indicated that the payments were to be gratuities although the resolution itself mentioned “recognition of services.” The court noted the other circumstances surrounding the payments and found them to be additional compensation.
36 See Ruth Hahn, supra note 15; Estate of Maycann, supra note 20; Jackson v. Granquist, supra note 21; Marie G. Haskell, supra note 15; Bankston v. United States, supra note 21; Citizens Fidelity Bank & Trust Co. v. United States, supra note 21; Harriet B. Campbell v. United States, supra note 21; Estate of Hellstrom, supra note 14, and Louise K. Aprill, supra note 13.
37 *Supra* note 14 at 918.
38 Slater v. Riddell, supra note 21; Jones v. Squire, supra note 21, and Allinger v. United States, supra note 21. See also Estate of Hellstrom, supra note 14 at 918 for a destruction of the distinction between “in recognition” and “in consideration.”
39 Greenburg v. United States, supra note 21 “grateful recognition of the untiring efforts and exceptional services”; Carley v. United States, supra note 21 “recognition of efforts and appreciation thereof”, and Estate of Albert W. Morse, supra note 20 “in view of the long years of services.”
40 The question of the ability to deduct the payments will be discussed infra. The discussion here is merely to indicate the effect, on the existence of a gift, of the treatment given to the payments by the corporation.
cases decided in favor of the taxpayer, the corporation has deducted the payments as salary expense. Of special note is Morse, where the corporation originally claimed the payments as general expense. However, when the corporate return was audited and the expense disallowed, the corporation claimed in its protest that the payments were salary and that the only question which could be raised by the Commissioner was the reasonableness thereof. The court recognized the conflict of position between the widow and the corporation (in which the widow was a 50% stockholder), but held that the payments were intended as gifts. Other corporations, giving some recognition to the doctrine of intent, have claimed the payments as some other form of current operating expense. Since payments of this type are valid deductions in most instances, it would seem that the proper method of deducting payments of this type would be as a general expense under an account headed "Payments to Widow."

Rather than rely on the manifestations of intent shown by the corporate resolution authorizing the payments and the accounting treatment of the payments by the corporation, the courts appear inclined to rely on the testimony of directors as to what they intended to accomplish at the time of the resolution. Several of the cases indicate that this testimony was received and considered by the court. The use of this type of evidence is shown by the following statement of the Tax Court in Maycann:

... Respondent's argument that the board of directors was of the opinion that decedent had been receiving a $5,000 bonus in addition to his stated salary at the time they acted on the payment to the widow may well be true, but all of the four directors who were living at the time this case was tried testified unqualifiedly that they intended by their resolution of November 10, 1950, to make a gift to the widow. One of the directors, Roy McDonald, who was also a stockholder, also testified that if the payments voted to Bernice had been intended as a dividend, he would have insisted on his and his wife's share.

Although there appears to be little logic in the courts accepting this type of evidence, and rejecting totally, or at least giving little con-

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41 See Ruth Hahn, supra note 15; Slater v. Riddell, supra note 21; Elizabeth R. Matthews, supra note 20; Bounds v. United States, supra note 21; Nixon v. United States, supra note 21; Estate of Albert W. Morse, supra note 20, and Standard Asbestos Mfg. and Insulating Co., supra note 20.
42 Estate of Albert W. Morse, supra note 20.
43 Carley v. United States, supra note 21; Ethel Mann, supra note 20; Estate of Maycann, supra note 20; Rodner v. United States, supra note 21; Estate of Foote, supra note 20; Friedlander v. United States, supra note 21; Jones v. Squire, supra note 20, and Estate of Hellstrom, supra note 14.
44 See Linoff v. United States, supra note 21 and Friedlander v. United States, supra note 21, for an example of such treatment.
45 Estate of Maycann, supra note 20; Rodner v. United States, supra note 21; Hardy v. United States, supra note 21, and Estate of Morse, supra note 20.
46 supra note 20 at 86.
sideration to, the position taken in the resolution itself and on the books of the corporation, it must be remembered that the ultimate question is one of intent. The direct testimony of those who authorized the payment would seem to be better evidence of this than the mechanical treatment of the payments or the wording of a resolution.\textsuperscript{47}

In many of the instances where payments to widows of corporate officers or employees have been made, small closely-held corporations are involved. Upon the death of the husband, his widow often becomes a substantial stockholder. In such instances the Commissioner has attempted to attack the widow's payments as dividends. Here again he has met with almost universal defeat. The argument was first made in \textit{Aprill}, where it was summarily rejected. This has also been its fate in most of the subsequent cases.\textsuperscript{48} The attitude of the Tax Court is indicated in \textit{Marie Haskell}, where that body noted the substantial stock holdings of the widow, but found this fact not to be controlling:

The only circumstance that gives us pause is the fact that petitioner and her daughter together owned a controlling stock interest in the Company and respondent has suggested on brief that the payments were in the nature of a distribution of corporate earnings. We think this suggestion is negatived by the facts of record. Dividends were paid when warranted by earnings, and in substantial amounts. There is no evidence to show that mother and daughter took concerted action with respect to the payments and so far as the record goes, petitioner did not participate in any of the corporate action pursuant to which the payments were made.\textsuperscript{49}

The Commissioner has, however, not been without some success on his dividend argument. In \textit{Ruth T. Lengsfield, et al.}\textsuperscript{50} the facts revealed a closely knit family, where the less fortunate individual members had always received aid from the family as a unit, through a family business corporation. The particular payments in dispute were payable from the surplus of the corporation. The facts also revealed that payments to widows of deceased family members had often been made in the past. The court found that the payments were in the nature of a dividend to the recipient and were thus, of course, taxable to her. The unusual fact situation in \textit{Lengsfield} distinguishes it from the average case in this area, and its holding has not given the Com-

\textsuperscript{47} In other aspects of the gift v. income controversy, the treatment of the payments by the corporation has also been held not to control. See Stanton v. United States, \textit{supra} note 4; Wallace \textit{et al} v. Commissioner, 219 F. 2d 855 (5th Cir. 1955); Nickelsburg v. Commissioner, 154 F. 2d 70 (2d Cir. 1946), and Thomas v. Commissioner, 135 F. 2d 378 (5th Cir. 1943).

\textsuperscript{48} See Bounds v. United States, \textit{supra} note 21, \textit{rev'd} on another point in 262 F. 2d 876 (4th Cir. 1958); Bankston v. United States, \textit{supra} note 21, and Friedlander v. United States, \textit{supra} note 21.

\textsuperscript{49} \textit{Supra} note 15 at 789.

\textsuperscript{50} 14 T.C.M. 1024 (1955), \textit{aff'd}. 241 F. 2d 508 (5th Cir. 1957).
missioner any basis for attacking subsequent cases on a dividend theory.

Although most of the decided cases in this area have resulted in victory for the taxpayer, the Commissioner has not been totally without success, although it has been in limited areas. Payments made under a legal, moral or statutory obligation have been consistently held to be includible in the income of the widow or like beneficiary.\textsuperscript{51} These payments, of course, would, under the 1954 Code, be subject to the $5,000 exclusion of Sec. 101(b). This rule is applied even in cases where the amount of the payment is in the discretion of the payor.\textsuperscript{62} The burden of proof to show the absence of an obligation is, of course, on the taxpayer.\textsuperscript{53}

Even though no fixed obligation exists, the past practice of the corporation may give rise to obligations by implication and result in the taxation of the benefits so received. Such a case is Simpson v. United States.\textsuperscript{54} There the corporation made payments to widows of corporate executives four times during the period from 1928 to 1947, pursuant to a resolution of the Board of Directors adopted in 1910. Prior to the death of the instant taxpayer's husband, the corporation had revised the 1910 resolution to provide for payments to widows of specific officers and directors, although the resolution stated that no director should receive any vested rights by reason thereof. The corporation treated the payments in a special salaries account. The District Court nonetheless held that a gift was intended, but the Seventh Circuit reversed on the basis that a plan had been established prior to the death of taxpayer's husband and that services had been rendered to the corporation by the deceased under the plan. Thus the payments were taxable to the widow. In at least partial conflict with Simpson is the ruling in Allinger v. United States.\textsuperscript{55} There two officers, owning majority interest in a corporation informally, agreed that upon the death of either of them, the corporation would pay one year's salary of the deceased to his widow. After the death of one officer, the corporation resolved to pay the agreed amount "in consideration of


\textsuperscript{52} Anna E. Curtis, supra note 51.

\textsuperscript{53} Estate of Charles J. Ginsburg, supra note 35.

\textsuperscript{54} Supra note 51.

\textsuperscript{55} Supra note 21.
past services.” The Court found the payments to be a gift, despite the existence of the informal agreement, which was reasoned to be of no effect since it was merely the act of two officers and was not binding on the corporation. *Allinger* can be technically distinguished from *Simpson* on the fact that no plan was present by corporate act, although a complete reading discloses that the basic attitudes of the two cases are conflicting. There are numerous cases such as *Allinger* where the fact that the corporation had previously made like payments did not in itself create a plan. In each of these cases, payments to the widow were considered on an individual basis. In all of them the payments were held to be gifts.56

It is also relatively clear that payments of compensation which are earned at the time of the decedent’s death, but are not paid to either his estate or his widow until after death, are income in respect to a decedent and as such are includible in the recipient’s gross income.57 Included in this category are accumulated leave pay,58 profit-sharing benefits,59 earned termination pay,60 unpaid life insurance renewal commissions,61 and continued retirement compensation.62 However, the question of whether a normal bonus, normally paid by an employer after the death of an employee, constitutes income in respect of a decedent is not entirely clear. In *Estate of O’Daniel*,63 the amount of the regularly paid corporate bonus which the employee would have received if he had been living was paid to his estate after his death. The employee, if living, would have had no enforceable claim to such bonus and hence his estate certainly had none. The bonus was held to be income with respect of a decedent and taxable to the estate of the deceased as recipient. However, in the recent case of *Standard Asbestos Mfg. and Insulating Co.*,64 the Tax Court, in a like factual situation, found that post death payments, made to the widow of the deceased president of the corporation, were made without obligation on the part of the corporation and were gifts, not includible in the gross income of taxpayer.65 Perhaps these two cases can be distinguished by the fact that in *O’Daniel* the payment was made to the estate while in *Standard Asbestos* it was made directly to the widow.

59 *United States v. Ellis*, 264 F. 2d 325 (2nd Cir. 1959).
60 *Estate of Arthur W. Davis*, supra note 51.
63 *Supra* note 28.
64 *Supra* note 20.
65 See also *Alice M. MacFarlane*, supra note 15, and *Elizabeth R. Matthews*, supra note 20.
However, as previously indicated, the Tax Court has recently ignored any such distinction. It should be noted that although Standard Asbestos was taken on appeal to the Eighth Circuit, it was by the taxpayer on another point with no cross-appeal by the Government on the bonus issue. Thus, the current law is that bonus payments made without obligation on the part of the payor, even though based upon activities of the deceased during his lifetime, constitute tax-free gifts.

The authorities have, with minor variations, consistently followed the factual test set forth in Hellstrom. These have been previously noted and will not be repeated. However, a recent case has restated in a varied form, the factors to be considered in determining the existence of a voluntary payment to the widow. This Court indicates the following considerations: (1) the existence of a plan or policy in the past of making similar payments; (2) the adequacy of the past compensation of the deceased officer or employee; (3) the absence of a personal relationship or close family ties between the payor and the recipient; (4) the extent to which personal affection motivated the payment; and (5) the statements and conduct of the donor. These factors indicate a more perceptive approach to the problem of truly determining intent than those noted in Hellstrom. Their strict application would have defeated gift status in several of the cases previously decided in favor of the widow. The writer lists them here by way of summary of the factual pattern which the taxpayer must satisfy in future cases of this type.

Payments Under the 1954 Code

Until the adoption of Sec. 302 of the Revenue Act of 1951, there were no statutory provisions directly involving death payments by employers. The cases excluding voluntary death payments had based this exclusion solely on the provisions of the Code pertaining to gifts. Section 302 of the 1951 Act amended Sec. 22(b)(1) of the 1939 Code which related to the taxation of the proceeds of life insurance. The amendment provided for a $5,000 exclusion for payments received pursuant to a contract from an employer, by the beneficiaries of an employee by reason of his death. Five thousand dollars could be received tax free from each employer of the deceased. The obvious purpose of this legislation was to equalize the

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66 Estate of Frank J. Foote, supra note 20.
67 Supra note 20.
68 A special factor of importance to Wisconsin practitioners in this area has been noted by Judge Tehan in Friedlander v. United States, supra note 21. There both the corporation and the widow filed the requisite Wisconsin gift tax forms and the widow paid the required gift tax. This was taken to be an indication that a gift was intended.
69 Estate of Arthur W. Hellstrom, supra note 14.
70 Packard v. United States, supra note 19.
TAX TREATMENT OF WIDOWS

TAX TREATMENT OF THE PROCEEDS OF A LIFE INSURANCE CONTRACT PAID UPON THE DEATH OF AN EMPLOYEE AND A PAYMENT DIRECTLY BY THE EMPLOYER UNDER THE SAME CIRCUMSTANCES.

The Sec. 22(b)(1) exclusion was not construed by the Commissioner as having any relation whatsoever to gratuitous payments, as indicated by the regulations promulgated under it. They provided that the payments must be pursuant to an enforceable written contract between the employer and the deceased employee, or an established plan providing for payments to all employees or special classes of employees.\textsuperscript{72}

Basically the revision of this section in the 1954 Code eliminated the requirement that the payments must be made under a contract of the employer, to qualify for the $5,000 exclusion. In addition, the 1954 Code limited each deceased employee to a single $5,000 exclusion and contained other qualifications on the exclusion which are not relevant to this discussion. Thus, as presently constituted, Sec. 101(b) provides for an exclusion from gross income, not exceeding $5,000, of voluntary death benefits paid to the estate or the beneficiaries of a deceased employee. At first glance it would appear that under this section all gratuitous payments made to a widow of a deceased employee exceeding $5,000 would be taxable income to her. A closer look, however, indicates that this was not the intent of the 1954 revision.

As indicated above, payments made under a legal or moral obligation, or under a non-contractual plan, do not qualify for gift status. Under Sec. 22(b)(1) these payments also did not qualify for the $5,000 exclusion and were fully taxable. Thus, gifts were totally exempt; payments under a written contract or an established plan were exempt to the extent of $5,000; and payments between these two extremes were fully taxable. Congress was faced with this senseless situation when they considered the 1954 revision. Their solution was the elimination of the contractual requirement, thus placing non-contractual payments on an equal footing with those made under contract. Nothing in the legislative history indicates any intention on the part of Congress to place gratuitous payments under the limitations of Sec. 101(b). Rather, the Committee Reports indicate that Congress intended to liberalize the exclusion rules rather than to restrict them by bringing under their scope payments which had been judicially determined to be totally exempt from tax. The House Ways and Means Committee noted that

Present law provides a special exclusion of up to $5,000 for payments by an employer to beneficiaries of a deceased employee. Under existing law, however, this exclusion is available

\textsuperscript{72} Treas. Regs. 118, §39.22(b)-(1)(2)(c).
only where the employer is under a contractual obligation to pay the death benefits.

Restricting the exemption to benefits paid under a contract discriminates against those who receive benefits where this contractual obligation does not exist. To avoid this problem your committee's bill extends this exclusion to death benefits whether or not paid under a contract.73

This hardly sounds like a radical departure from existing judicial authority74 which would be present if the $5,000 limitation were meant to apply to payments in the form of gifts. Certainly any attempt to include previously tax exempt items within this limitation would have been specifically expressed.

It should be noted that the Committee report makes reference to "this exclusion", thereby indicating that not all tax exempt income was considered. This conclusion is further supported by the final form of Sec. 101(b)(2)(A) which states that the limitation applies to amounts excludable under Sec. 101(b). It does not attempt to apply the limitation to amounts excludable under other provisions of the Code and no reason appears for such application. Also note the fact that the general exclusion under Sec. 101(b) applies to amounts received by the estate or the beneficiaries of an employee. Clearly the widow is not the estate and hence the Commissioner must bring her within the meaning of beneficiaries of the employee. This requires a strained interpretation of that phrase. It must be remembered that these same provisions now apply to payments under contract. Considering this, it appears that the far more logical interpretation of beneficiary is the person designated by the employee to receive death benefits under his contractual rights. A further point worthy of consideration is contained in Sec. 101(f). That subsection states that Sec. 101 only applies to amounts received by reason of the death of an employee after the effective date of the 1954 Code. Until such time, the provisions of Sec. 22(b)(1) of the 1939 Code are indicated to apply. This is a further, clear indication that Sec. 101 is the successor to Sec. 22(b)(1) and not to Sec. 22(b)(3) under which the gratuitous payments to widows were excluded. On the basis of the above comments on the legislative history of Sec. 101 and that statute itself, it is submitted that Congress had no intent to tie together Secs. 101 and 102 of the Code and make the $5,000 limitation of Sec. 101 apply to the totally tax exempt gift of Sec. 102. Intended rather was the elimination of discrimination between payments under contract and those under non-contractual obligations.

This interpretation has been adopted in the only case on this issue

74 Both Louise K. Aprill, supra note 13, and Alice M. MacFarlane, supra note 15, were decided prior to 1954 revision deliberations.
decided under the 1954 Code. There, confronted with a factual situation similar to the many cases decided under the 1939 Code, the Court found that the entire amount of the payments to the widow were a non-taxable gift. In rejecting the Government's argument that the limitation of Sec. 101(b)(2)(A) applied, the Court noted in its conclusions of law:

It is clear that the purpose of the latter section (section 101(b)) of the 1954 Code is to eliminate the requirement that certain employee death benefits must be paid pursuant to a contractual obligation in order for such benefits to qualify for a $5,000 exclusion from gross income.

The Court also directly held that Congress did not intend to change Sec. 102(a) by enacting Sec. 101(b).

Standing against Reed is the dicta contained in two 1939 Code cases. In Rodner the Court went so far as to note that its interpretation of the 1954 Code was in conflict with the Committee Reports, but stated that Congress was not aware of the law and hence the reports should be rejected. With due respect to the Court it is submitted that it was in error regarding the awareness of the lawmakers. Congress certainly recognized that under prior law all contractual payments were taxable and subject to the exclusion, but that not all non-contractual payments were non-taxable. As indicated previously, several types of non-contractual payments were subject to tax, but were not given the benefit of the $5,000 limitation. It was these types of payments which Congress clearly intended to grant equal treatment with contractual payments. The dictum in Bounds stands. Without a statement of the reasoning of the Court, it must be assumed that it

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75 Reed v. United States, supra note 21.
76 Id. at 209.
77 Rodner v. United States, supra note 21, and Bounds v. United States, supra note 21.
78 Rodner v. United States, supra note 21 at 237:

"The Internal Revenue Code of 1954 (not applicable here) changed this. Section 101(b), 68A Stat. 26, quoted in the margin, eliminates the provisions limiting to contractual death benefits the application of the $5,000 exemption. To me the effect of this would seem to be to withdraw the complete exemption that gratuitous death benefits had enjoyed and to substitute an exemption up to $5,000. In the complete revision effected by the 1954 Code the general language exempting gifts is controlled by the particular language of section 101(b) limiting the exemption of death benefits to $5,000. Gifts in general are exempt but gifts in the form of death benefits are taxable insofar as they exceed $5,000. "That does not seem to have been the view of the Senate Committee on Finance of a subsequent congress, however. In the Report referred to, p. 14, the Committee deals with this very change and says 'The exclusion is * * * made available regardless of whether the employer has a contractual obligation to pay the death benefits.' That language is certainly that of some one who thinks that the new provision extends a boon instead of a burden to the recipients of gratuitous death benefits. With the utmost respect, I believe that the Committee's view of the prior law was a misinterpretation."
was made on the basis of the same superficial glance at the problem as made in Rodner. Of the three decisions Reed, is clearly the proper interpretation of the effect of the limitation contained in Sec. 101(b)(2)(A). The only provision applicable to gratuitous payments under the 1954 Code is Sec. 102. The limitation of Sec. 101(b)(2)(A) does not apply and all amounts so received by the widow are tax exempt to her.

**Deduction Allowed to Employer**

I.T. 3329, in addition to providing tax-free status for the recipient of voluntary payments to widows of corporate officers or employees, also indicated that such payments were deductible by the corporation as a business expense. This position was in conformity with the then existing regulations and was not altered by the Commissioner's 1950 change of position regarding the tax status of such payments in the hands of the widow. The deductibility of the payments by the corporation was not affected. However, the language of the prior regulations does not appear in the regulations under the trade or business expenses section of the 1954 Code. This is due to the Commissioner's announcement that deductions for payments of this type must now be under the deferred compensation section of the Code rather than the business expense section. The Commissioner's intention in shifting the deductibility of widow's payments from Sec. 162 to Sec. 404 is not to deny the corporation a deduction, but rather to make the deduction available only in the year when the payments are actually made. Under Sec. 162, an accrual-basis taxpayer could accrue the entire amount of the authorized payments in a single year even though the payments were, in fact, to be made over a subsequent period of years. The Commissioner appears warranted in making the shift.

79 1939-2 Cum. Bull. 153. "[P]ayments made by a corporation under such circumstances not in excess of decedent's salary are properly deductible by the payor corporation as ordinary and necessary business expenses."

80 Treas. Regs. 101, §23(a)-9.


82 Treas. Regs. 118, §39.23(a)-9. "When the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, such payments may be deducted."


85 Rev. Rul. 54-625, 1954-2 Cum. Bull. 85 held that payments of this type were deductible under Sec. 23(a), Int. Rev. Code of 1939, which is now Sec. 162, Int. Rev. Code of 1954. However, this was modified by Rev. Rul. 55-212, 1955-1 Cum. Bull. 299 which required that such deductions be claimed under Sec. 23(p) rather than Sec. 23(a). This former section is now Sec. 404, Int. Rev. Code of 1954. Regarding this subject Treas. Reg. §1.404(a)-12 provides: "Similarly, if amounts are paid as a death benefit to the beneficiaries of an employee (for example, by continuing his salary for a reasonable period), and if such amounts meet the requirements of Section 162 or 212, such amounts are deductible under Section 404(a)(5) in any case when they are not deductible under the other paragraphs of Section 404(a)."
However, the section he is attempting to apply relates to a plan deferring compensation. It is, of course, his theory that voluntary payments to a widow are additional compensation to the deceased employee. He further reasons that the payments, after the death of the employee, were merely deferred pursuant to a plan. But this position has not been sustained by the only apparent case in which it was raised.

In Champion Spark Plug Co., the board of directors of an accrual-basis taxpayer resolved to pay voluntarily to a former employee or his widow, thirty thousand dollars over a period of thirty months. The Commission conceded that the payments were ordinary and necessary business expenses, but claimed that they were subject to Sec. 23(p) of the 1939 Code and were deductible only when actually paid. The Court found that the payments were not additional compensation made pursuant to any informal plan, but were merely gratuitous payments made to provide for a fatally ill, former employee in a time of financial hardship. It thus concluded that the provisions of Sec. 23(p) did not apply and the entire amount was deductible at the time it became an unconditional obligation of the company. A non-acquiescence has been issued by the Commissioner and it can be assumed that he will continue to press his theory that these payments are to be treated as deferred compensation.

It has long been recognized that post-death payments made pursuant to an employment contract are deductible by the corporation, subject to the normal reasonable compensation rules. As indicated previously, regulations allowing this deduction contained the provision that the payments be for a "limited period." This was defined by the Tax Court in I. Putnam, Inc. to be a period of two years, and hence, as a general rule, a deduction was allowed for only such period. The appearance of Rev. Rul. 54-625 noted the Commissioner's abandonment of the "limited period" concept and the substitution therefor of a test of "reasonableness." The ruling allowed payment of one year's salary over a period of twelve years on the theory that the total amount to be paid was reasonable. Despite this change in emphasis, it is submitted that payments limited in amount to two years' salary

86 Sec. 404(a)(5).
88 The question of whether or not the payments were income to the recipient was not present.
90 See Seavey & Flarsheim Brokerage Co., 41 BTA 198 (1940).
91 Treas Reg. 118, §39.23(a)-9.
93 See McLaughlin Gromley King Co., 11 T.C. 569 (1948); William H. Swan and Sons, Inc., 14 T.C.M. 105 (1953), and Bleichroeder, Bing & Co., Inc., 12 T.C.M. 117 (1953).
would be allowable as reasonable.\textsuperscript{95} It should be noted that by adopting the reasonableness test for payments to widows, the Commissioner is again attempting to equate such payments to the compensation paid to living employees where this test has always been applied.

At least some indication of the Tax Court's current attitude toward the issue of deductibility is shown by \textit{Fifth Avenue Coach Lines, Inc.}\textsuperscript{96} There the widow of the deceased corporate president received payments for a period of five years, equal in amount to the deceased's salary for thirty-one months. The Court found the payments to be in part as additional compensation to the deceased, in part as gratitude for past services and in part as an aid to the widow. It then noted that "to be deductible the payments need not be in the nature of additional compensation,"\textsuperscript{97} but need only be reasonable in amount and concluded that the payments for the five years in dispute were ordinary and necessary business expense. Thus in effect the Court found a partial gift and nonetheless allowed the deduction. The Commissioner has acquiesced in that portion of the decision which allows the deduction for payments for past services, but he has apparently refused to acquiesce in that portion allowing the deduction of payments not for such services.\textsuperscript{98}

Normally the questions of whether a payment is deductible to the payor and includible in the income of the recipient are not present before the Court at the same time. In addition, in many of the cases where the widow was involved, the Commissioner had allowed the deduction to the corporation without contest. \textit{Fifth Avenue Coach Lines, Inc.}\textsuperscript{99} goes as far as any case authority in sustaining the deduction and excluding the payments from income. Apparently the Tax Court actually sees no inconsistency in such treatment,\textsuperscript{100} although it had at least noted this position in an earlier case.\textsuperscript{101} However, it is extremely unlikely that the commissioner will allow this question to be settled without a stronger fight. In view of his consistent losses in attempting to

\textsuperscript{95} Note W. D. Haden Co., 5 T.C.M. 250 (1946) where a deduction was totally disallowed because the resolution authorizing payments did not limit their duration.
\textsuperscript{96} 31 T.C. 1080 (1959).
\textsuperscript{97} Id. at 1096.
\textsuperscript{99} \textit{Supra} note 96.
\textsuperscript{100} In the argument in the United States Supreme Court in Duberstein v. Commissioner, \textit{supra} note 4, the Government contended that the concept of a gift was inconsistent with a payment's being deducted as a business expense. In commenting on this the Court noted that this factor as well as others were: "evidentiary inferences relevant to a factual determination on the totality of circumstances in the case: it is doubtless relevant to the over-all inference that the transferor treats a payment as a business deduction..." Thus the Court recognized that treatment of the payments as deductible expenses had a bearing on the intent of the payor but that it was not controlling. The Court refused to accept the Government's contention that deductibility and gift status were totally inconsistent.
\textsuperscript{101} See Estate of Albert W. Morse, \textit{supra} note 20.
tax the payments in the hands of the widow, he may now place greater attention on the deduction by the corporation. Despite the Commissioner’s reluctance to agree with the *Fifth Avenue Coach Lines* doctrine, it is submitted that this case is correctly decided and that a deduction of a truly gratuitous payment is proper if limited to a reasonable amount.

**Conclusion**

From the above discussion, the writer believes that it is proper to conclude that the controversy over the tax status of voluntary payments to widows of corporate officers or employees, both as to the employer and the widow, has not ended. However, it is submitted that the controversy in the future should be limited to the application of a particular set of facts to well established rules of law. Assuming that the *Reed* case properly expresses the law as to the effect of Sec. 101(b)(2)(A), and this writer believes that it does, it can be seen that the factual tests established under *Aprill* and the succeeding cases will still control. Gratuitous payments will continue to be totally nontaxable to the widow if the standard facts are present. If the factual tests are not met, the payments will not be given gift status, but they may nonetheless qualify for the $5,000 exclusion of Sec. 101(b). In addition, it is submitted that the gratuitous payment constitutes a deduction to the employer if the payments are limited to a reasonable amount. However, in this area, corporate taxpayers can anticipate increasing resistance from the Commissioner.