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Bernard P. Simons

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may be well to consider that a promise may be one to make a will, in determining the time when the rights of the third party beneficiary become unalterable without his consent. This is true, not because an exception should be made, but because such a consideration affords an opportunity to clearly see the consequences of such a rule.¹⁰³ Also, constructive conditions of exchange in bilateral contracts should not be applied as a matter of course, especially when unjust results may be reached. The fact that situations rarely arise where such conditions should not apply, is no justification to discard the reason why they exist.

A contract to make mutual wills in favor of third party beneficiaries is undependable as a device for disposition of property if the confusion that now exists continues.¹⁰⁴ An attempt has been made to help clarify the matter and show that a separation agreement to make mutual wills in favor of the children constitutes a bilateral contract in California. This contract may be rescinded by mutual consent of the contracting parties anytime before the beneficiary institutes a suit or changes position in reliance. The promises may or may not be dependent, depending on the circumstances of the case. An examination of California cases has been made to avoid an ill-founded application of stare decisis to support a contrary result.

Gerald Y. Sekiya*

¹⁰³ Compare Meislin, *Revocation of Contracts to Bequeath Benefitting Third Parties*, 44 VA. L. REV. 41 (1958). Professor Meislin urges an exception to the "vesting" rule of section 142 of the Restatement of Contracts when the contract involves a promise to make a will. Perhaps this conclusion is the result of a dislike for the rule of section 142, rather than a desire for special treatment of contracts to make wills.

¹⁰⁴ "The contract to devise and bequeath or, as we may call it more concisely, the contract to make a will is not among the devices favored by the bar for estate-planning purposes. But it is widely used by laymen; it has, perhaps for that reason, figured in a considerable amount of litigation; and it is, as pointed out by Sparks, an appropriate, and under certain circumstances the only available tool to achieve a number of legitimate ends." Rheinstein, *Critique: Contracts to Make a Will*, 30 N.Y.U.L. REV. 1224, 1225 (1955).

* Member, Second Year Class.

TAXABILITY OF TESTAMENTARY TRANSFER MADE FOR ADEQUATE CONSIDERATION

All estate¹ and inheritance² tax statutes provide that a transfer by will from a person who dies possessed of the property transferred, while a domiciliary of the state, is a taxable transfer.³ This all inclusive language has caused a number of

¹ An estate tax is a tax on what is left by the decedent and not on what comes to the beneficiaries or heirs. *United States v. Stewart*, 270 F.2d 894 (9th Cir. 1959).

² "The inheritance tax is not a tax on the property of the decedent but is an excise imposed on the privilege of succeeding to property upon the death of the owner." *Estate of Barter*, 30 Cal. 2d 549, 557, 184 P.2d 305, 309 (1947).

³ E.g., CAL. REV. & TAX. CODE § 13601; D.C. CODE ANN. § 1601 (1961); MASS. GEN. LAWS ch. 65, § 1 (1965); N.J. STAT. ANN. § 54: 34-1 (1965).

state courts to consider whether a testamentary transfer, supported by adequate and full consideration, is to be subject to a death tax. The Supreme Court of California faced this question for the first time in *Estate of Vai*.⁴ The court held, with Chief Justice Traynor dissenting, that to the extent a testamentary transfer was supported by full consideration, it was not includible in decedent's gross estate for computing the death tax. The supreme court thus overruled the decision of the district court of appeals in *Estate of Grogan*.⁵

Prior Judicial Interpretation in California

*Estate of Grogan*⁶ was the first case in California to consider this question. There, a husband and wife entered into a property settlement agreement which was later incorporated into a decree of divorce. Under this agreement, the husband agreed to create a testamentary trust, the income from which was to be paid to and become the separate property of his wife during her life. At her death, the unexpended portion of the corpus was to go to their minor child. In consideration for this promise, the wife renounced her right to inherit from her husband.

When the husband died an inheritance tax was imposed on the trust fund created by his will. In opposing the tax, the wife contended that the bequest operated merely to fulfill an obligation created by the property settlement agreement; and, therefore, did not constitute a transfer within the meaning of section 2 of the Inheritance Tax Act.⁷ The court, however, upheld the tax, saying:

The reason for such transfer is not taken into consideration. The *result* is all that is considered; that is, the transfer itself. . . . The statute here does not provide for a tax because someone has a *right* arising out of a debt or otherwise, but only when a *transfer* of property is brought about by means of a will is a tax imposed. *It is a tax on the vehicle carrying the right, rather than a tax upon the right itself.* It is in effect a declaration of law that when a will is used as a means of conveyance of property a tax must be paid for this privilege.⁸

The *Grogan* case was somewhat restricted by *Estate of Rath*,⁹ decided fourteen years later. There, a husband and wife entered into a written agreement whereby the wife agreed to will her separate property to her husband in the event he survived her. The husband agreed, in turn, to make a will devising such portion of said property as he did not consume in his lifetime to his wife's two nephews. The husband died five months after his wife, leaving by his will the real estate, which was the subject of the agreement, to his wife's two nephews. The California Supreme Court held that the property was not includible in the husband's gross estate for computing the inheritance tax. The court expressly distinguished *Estate of Grogan*,¹⁰ as well as certain New York decisions,¹¹ saying:

⁴ 65 A.C. 139, 52 Cal. Rptr. 705, 417 P.2d 161 (1966).

⁵ 63 Cal. App. 536, 219 Pac. 87 (1923). This case is criticized in Note, 12 CAL. L. REV. 233 (1923).

⁶ *Ibid.*

⁷ CAL. REV. & TAX. CODE § 13601. This section provides "A tax shall be, and is, hereby imposed upon transfer of any property . . . by will."

⁸ 63 Cal. App. at 544, 219 Pac. at 90. (Emphasis added.)

⁹ 10 Cal. 2d 399, 75 P.2d 509 (1937).

¹⁰ *Estate of Grogan*, 63 Cal. App. 536, 219 Pac. 87 (1923).

¹¹ *In re Howell's Estate*, 255 N.Y. 211, 174 N.E. 457 (1931); *In re Kidd's Estate*,

Said decisions are to the effect that a transfer made by will is taxable although in pursuance of a contract, in payment of a debt, or for services rendered. Said decisions had reference to a situation where the testator is disposing of his own property, not of property held by him in trust for others, as to which his will is a mere conduit of title.¹²

By distinguishing *Grogan*, *Rath* limited the decision to allowing a deduction where the testamentary transfer is of property held in trust by the testator. This means that where A promises B to devise B's property to C, the testamentary transfer from A to C is not a taxable transfer at A's death. Nevertheless, *Grogan* still seemed to remain authority for the imposition of an inheritance tax at A's death where A promises B to devise A's property to C.

Grogan was further limited by *Estate of Belknap*.¹³ In *Belknap*, a husband and wife entered into a property settlement agreement. In partial settlement of all the wife's property rights in his estate, the husband agreed to direct his executor by his will to purchase a 20,000 dollar annuity bond for his wife. The husband so provided in his will. The court, holding that the annuity bond purchased by the executor was not taxable, said:

The contract having been made for a valuable consideration as a complete settlement of all property rights, which rights were approved and awarded by the terms of the interlocutory decree from which no appeal was taken, it was enforceable regardless of the provision of the will. The transfer of interest in the property was therefore made by the contract before the will was executed, and the wife was entitled to exemption from inheritance taxes on the annuities.¹⁴

Estate of Vai

The Supreme Court of California had an opportunity to evaluate *Belknap* and *Rath* when it heard *Estate of Vai*.¹⁵ Giovanni and Tranquilla Vai had cared for their incompetent daughter, Madeline, for twenty-seven years until January, 1953, when marital discord ensued. After filing a separate maintenance action, Tranquilla entered into a property settlement agreement with Giovanni.¹⁶

The community assets of Giovanni and Tranquilla exceeded 1,000,000 dollars when the property settlement agreement was executed. In consideration for Giovanni's promise to provide for Madeline's lifetime care, and to hold Tranquilla harmless from this obligation, he received by far the majority of the community property. Tranquilla received only a parcel of improved real estate valued at 150,000 dollars,¹⁷ 26,000 dollars in cash, an automobile, an assured lifetime in-

188 N.Y. 274, 80 N.E. 924 (1907); *In re Gould's Estate*, 156 N.Y. 423, 51 N.E. 287 (1898).

¹² 10 Cal. 2d at 407, 75 P.2d at 513. (Emphasis added.)

¹³ 66 Cal. App. 2d 644, 152 P.2d 657 (1944).

¹⁴ *Id.* at 657, 152 P.2d 664.

¹⁵ 65 A.C. 139, 52 Cal. Rptr. 705, 417 P.2d 161 (1966).

¹⁶ Following the execution of the property settlement agreement, the separate maintenance action was abandoned. Therefore, the agreement could not have been incorporated into a court decree as in *Belknap*.

¹⁷ Although not directly related to the scope of this article, a very interesting problem is raised by the decision of the United States Supreme Court in *United States v. Davis*, 370 U.S. 65 (1966) as to whether a federal income tax is due upon the transfer of improved real estate. In *Davis* the Court approved an income tax on a transfer

come of 6,000 dollars per year after taxes and freedom from the community obligations.¹⁸

The property settlement agreement provided that Giovanni was to support and maintain Madeline during his life; and, that he would create a testamentary trust to provide for her lifetime support.¹⁹ By his will, Giovanni left substantially his entire estate in trust; the income directed to be distributed to Madeline during her life.

Giovanni's executors estimated the cost of supporting Madeline at 2,500 dollars per month. Capitalized by Madeline's life expectancy, this represented 515,341.56 dollars as of the date of Giovanni's death. The executors claimed that this amount should be treated as a non-taxable transfer.

The court rejected the *Grogan* test of looking only to the transfer itself and not to the reasons behind it. The majority adopted the modern view that in determining whether a transfer is subject to an inheritance tax, the realities of substance should control the niceties of form.²⁰ The court looked beyond the vehicle used to carry out the transfer, and examined the motives for it. To the extent that the transfer was supported by adequate and full consideration, the majority concluded it was simply a means of fulfilling the testator's contractual obligation.

Suppose the testator had not provided for Madeline in his will, but, instead

of appreciated property by a husband to his wife pursuant to a property settlement agreement. Under the law of Delaware, where the husband and wife were domiciled, the husband is deemed to own all the "community" property subject to his wife's right upon divorce to a reasonable share. In dividing their property, the husband transferred certain shares of stock to his wife. The court held that the difference between the fair market value of the shares and the original cost to the husband was subject to taxation as a capital gain. Under § 61(a) of the Internal Revenue Code of 1954, an income tax is due on "gains derived from dealings in property." The court held that this section was designed to tax the economic growth of the shares.

In California, a wife has a vested one-half interest in all community property; therefore, when the husband conveys to her the fee simple in certain real estate in exchange for his freedom from his legal obligations, a sale is transacted. An economic benefit inures to the husband, and seemingly this benefit is subject to taxation under § 61(a). For an excellent discussion of the *Davis* case and its impact in community property states, see Note, 10 U.C.L.A.L. Rev. 425 (1963).

¹⁸ After Giovanni's death, Tranquilla brought an action to rescind the property settlement agreement on the ground that Giovanni had fraudulently concealed part of the community assets at the time the agreement was made. The California Supreme Court, in *Vai v. Bank of America*, 56 Cal. 2d 329, 15 Cal. Rptr. 71, 364 P.2d 247 (1961), held that Tranquilla could rescind the agreement, and that she was entitled to relief because of the constructive fraud of Giovanni. After this decision, Tranquilla entered into a stipulation agreement with the executors of Giovanni's estate whereby she received \$500,000 for the decedent's fraud. Under this settlement, Tranquilla waived all of her rights under the property settlement agreement except Giovanni's promise to provide for Madeline's lifetime support and care. Brief for Appellant, p. 15, *In re Estate of Vai*, 237 A.C.A. 901, 47 Cal. Rptr. 227 (1965).

¹⁹ Brief for Appellant, p. 8, *In re Estate of Vai*, 237 A.C.A. 901, 47 Cal. Rptr. 227 (1965).

²⁰ See *Kelly v. Woolsey*, 177 Cal. 325, 170 Pac. 837 (1918); *Estate of Stevens*, 163 Cal. App. 2d 255, 329 P.2d 337 (1958); *In re Hyde's Estate*, 92 Cal. App. 2d 6, 206 P.2d 420 (1949).

devised all his property to others. What contractual rights would Madeline have had? It is well established in California, as in the majority of jurisdictions, that the daughter could have enforced the contract between her parents by an action for quasi-specific performance.²¹ In his dissenting opinion in *Vai*, Chief Justice Traynor relies on *In re Kidd's Estate*²² for the proposition that any recovery obtained by the daughter through an action for quasi-specific performance would be subject to an inheritance tax. However, the court in *Vai*, by overruling *Estate of Grogan*,²³ impliedly disapproved of the holding in the *Kidd* case,²⁴ thus removing the possibility that a person would be relieved of tax consequences simply by performing his contractual obligations. This may cause the court's decision in *Vai* to have a very significant effect. To the extent a testamentary transfer is supported by full consideration, it is not includible in the transferor's gross estate for computing the state inheritance tax. It is seemingly immaterial whether the transfer is effected by the testator's will or by the judicial enforcement of a third party beneficiary contract.

California Statutory Provisions

The legislature has made it quite clear that every transfer by will is subject to an inheritance tax.²⁵ Moreover, no exception has been provided for a testamentary transfer, even if it is supported by an adequate and full consideration. Therefore, the court in *Vai* violates the generally recognized rule that "deductions are matters of legislative grace, and one seeking a deduction must show that he comes clearly within the terms of the statute allowing it."²⁶

When Giovanni Vai signed the property settlement agreement, the California Administrative Code provided:

A transfer by will is subject to the Inheritance Tax Law even though made pursuant to an agreement between the transferee and the decedent for an adequate and full consideration in money or money's worth which was received by the

²¹ "A contract to make a will cannot be specifically enforced because 'in the lifetime of a party all testamentary powers are in their nature revocable and after his death it is no longer possible for him to make a will. Courts of equity have adopted a remedy equivalent to a specific performance by compelling those upon whom the legal title had descended to convey to the beneficiary under the contract on the ground that they hold as trustees for the beneficiaries. . . .' This practice has developed what is termed the quasi-specific performance theory." *Sonnicksen v. Sonnicksen*, 45 Cal. App. 2d 46, 53, 113 P.2d 495, 499 (1941); 2 WILLISTON, CONTRACTS, §§ 347, 356, 370 (3d ed. 1959).

²² 188 N.Y. 274, 80 N.E. 924 (1907).

²³ 63 Cal. App. 536, 219 Pac. 87 (1923).

²⁴ Cited with approval in *Estate of Rath*, 10 Cal. 2d 399, 407, 75 P.2d 509, 513 (1937); *Estate of Grogan*, 63 Cal. App. 536, 539, 219 Pac. 87, 88 (1923).

²⁵ CAL. REV. & TAX. CODE § 13601: "A transfer by will or the laws of succession of the state from a person who dies seized or possessed of the property transferred while a resident of this state is a transfer subject to this part." CAL. REV. & TAX. CODE § 13304: "'Transfer' includes the passage of any property, or any interest therein, or income therefrom, in possession or enjoyment, present or future, in trust or otherwise." CAL. REV. & TAX. CODE § 13401: "An inheritance tax is hereby imposed upon every transfer subject to this part." (Emphasis added.)

²⁶ *Markwell's Estate v. Commissioner*, 112 F.2d 253 (7th Cir. 1940); *Empire Trust Co. v. Commissioner*, 94 F.2d 307, 310 (4th Cir. 1938).

decendent. In such case, the transferee takes from the decedent under the will and not by virtue of the agreement.²⁷

The majority of the court quickly passed over this provision saying that it did not "represent a correct interpretation of legislative intent."²⁸ Giving full effect to the clarity of the statutory provisions,²⁹ it seems obvious that this administrative provision gives the proper interpretation to the legislature's intention. The court does great violence to the statutory language in reaching its conclusion.³⁰

Alternative Solution

The court could have reached the same result by other means doing no violence to the clear language of the statutes. The transfer to the incompetent daughter was actually from the wife and not from the husband. Under the property settlement agreement, the wife agreed to transfer a substantial part of her share in the community property to her husband. He agreed, in turn, to create a testamentary trust to provide for their incompetent daughter's lifetime support and maintenance. Thus, to the extent the wife renounced her share in the community property, the trust corpus represented property held by the husband in trust for the daughter. Following the *Rath* case, the court could have allowed an exemption for a testamentary transfer of property held in trust by the testator.

A second alternative method of reaching the same conclusion would have been to rely on section 13983 of the California Revenue and Taxation Code, which provides: "Debts of a decedent owed by him at the time of his death are deductible from the appraised value of the property included in any transfer subject to this part made by the decedent." At the time of his death, the husband was indebted to his daughter in a sum equal to the amount necessary for her lifetime support and maintenance. The daughter was a creditor beneficiary under the property settlement agreement, and possessed a valid claim against her father's estate.³¹ The court, however, chose a more direct means of reaching its holding.

²⁷ CALIFORNIA ADMINISTRATIVE CODE, TIT. 18, Regs. 13601-03(a).

²⁸ *In re Estate of Vai*, 65 A.C. 139, 52 Cal. Rptr. 705, 711, 417 P.2d 161, 167 (1966).

²⁹ "Unless the contrary appears, statutory words are presumed to be used in their ordinary and usual sense, and with a meaning commonly attributable to them." *Burnet v. Brooks*, 288 U.S. 378, 391 (1933). See *Estate of Letchworth*, 201 Cal. 1, 255 Pac. 195 (1927).

³⁰ The court's holding that the property passed to the daughter through the will and not through the contract also does violence to the eleventh paragraph of Giovanni's will: "During the entire term of this trust the whole title, both legal and equitable, in fee, to the trust estate is and shall be vested in the trustee (named in the will) as such title in the trustee is necessary for its due execution of this trust, and no interest therein is vested in any beneficiary hereunder. The interest of the beneficiary is personal only, consisting of the right to enforce the due performance of the trust." Brief for Respondent, p. 4, *In re Estate of Vai*, 237 A.C.A. 901, 47 Cal. Rptr. 227 (1965). (Emphasis added.)

³¹ RESTATEMENT, CONTRACTS § 133(1)(b) (1932): "Where performance of a promise in a contract will benefit a party other than the promisee, that party is . . . a creditor beneficiary if no purpose to make a gift appears from the terms of the promise in view of the accompanying circumstances and performance of the promise will satisfy an actual or supposed or asserted duty of the promisee to the beneficiary . . ." *Anderson v. Calaveras Cent. Mining Corp.*, 13 Cal. App. 2d 338, 57 P.2d 560 (1936).

Correctness of the Vai Decision

The court's holding in *Estate of Vai* places California in a minority position. The great majority of courts which have considered statutes almost identical to section 13601 of the California Revenue and Taxation Code have reached decisions contrary to the *Vai* case.³² They have held that a testamentary transfer, otherwise subject to the inheritance tax, will not be excluded from the decedent's gross estate even if made pursuant to a contract supported by full consideration.³³

The minority view, now adopted by California, is easily justified and seems to be the answer the legislature would give were the question presented to it. The reason for this conclusion is that the result of such testamentary transfers, when made for full value, can in no way defeat the statutory purpose of an inheritance tax; since the estate is not depleted in value, it is merely changed in form.³⁴ In exchange for the property devised, the testator has received other property which is included in his taxable gross estate. To prevent the imposition of an inheritance tax on the mere form of the transfer, the court should examine the effect and operation of the property settlement agreement under the circumstances existing at the time the contract is executed. If such an examination discloses that the decedent received full consideration in money's value, then the transfer is merely an exchange of assets; his estate is not reduced and no tax is avoided.

Legal Obligation of Support as Adequate Consideration

The district court's dicta in *Estate of Vai*³⁵ raises the question whether a parent's legal obligation to reasonably support an incompetent adult child is adequate consideration, for taxation purposes, for the promise to support the child. This question has not been decided in California; however, the State Controller's office in the past has rejected all claims for deduction based on such ground.³⁶ "If the duty of a parent to support his child is adequate consideration to exempt from taxes the transfers made to such child, then there would never be any gift or inheritance tax on the property or transfers to his dependent child."³⁷

The federal courts, in determining whether to include property within the decedent's gross estate in computing the federal estate tax, have disapproved of the *Grogan* test that form controls substance.³⁸ Instead, they have held that

³² The following cases have held such transfers taxable: *Slyder v. District of Columbia*, 187 F.2d 217 (D.D.C. 1951); *State v. Mollier*, 96 Kan. 51, 152 Pac. 771 (1915); *Clarke v. Treasurer & Receiver Gen.*, 226 Mass. 301, 115 N.E. 416 (1917); *State ex rel. March v. Probate Court*, 168 Minn. 508, 210 N.W. 389 (1928); *Carter v. Craig*, 77 N.H. 200, 90 Atl. 598 (1914); *In re Gould's Estate*, 156 N.Y. 423, 51 N.E. 287 (1898); *Sheppard v. Desmond*, 169 S.W.2d 788 (Tex. Civ. App. 1943). *Contra*: *Schroeder v. Zink*, 4 N.J. 1, 5, 71 A.2d 321, 325 (1950).

³³ Cases cited note 32 *supra*.

³⁴ *Schroeder v. Zink*, 4 N.J. 1, 5, 71 A.2d 321, 325 (1950).

³⁵ 237 A.C.A. 901, 911, 47 Cal. Rptr. 227, 233 (1965).

³⁶ Interview on September 23, 1966 with Mr. Milton D. Harris, head of the San Francisco office of the Inheritance and Gift Tax Division of the State Controller's office.

³⁷ Brief for Respondent, p. 14, *In re Estate of Vai*, 65 A.C. 139, 52 Cal. Rptr. 705, 417 P.2d 161 (1966).

³⁸ See *Chase Nat'l Bank v. Commissioner*, 225 F.2d 621 (8th Cir. 1955); *Helvering v. United States Trust Co.*, 111 F.2d 576 (2d Cir. 1940).

where a parent fulfills his legal obligation to provide for his child's reasonable support, the amounts so paid (or put into a trust for that purpose) are exempt from the federal estate tax because the transfer is supported by full and adequate consideration.³⁹ This is based on the sound reasoning that the parent is fulfilling an obligation that would otherwise be imposed upon the government. This reasoning has been restricted to those situations in which the state has imposed a legal duty on the taxpayer. The same view should be adopted by the California courts, since our statutes provide that a parent has the legal duty to reasonably support a minor and a mentally incompetent child. This statutory duty is designed to fulfill an obligation that would otherwise fall upon the state. The federal courts have recognized the fulfillment of this obligation to be exempt from taxation, and so should the California courts when the question is presented to them.

Tax Consequences

Gift Tax

The decision in *Estate of Vai* raises the question whether a gift tax can be successfully imposed on the transfer to the daughter. By holding that the testamentary transfer was supported by full consideration to the extent that the wife's renounced share of the community property was of equal value to the trust corpus, the Supreme Court precluded the imposition of a gift tax upon the decedent. However, as discussed above, it is arguable that the real transfer was from the wife to the daughter. If this can be successfully established, and a gift tax is imposed on the transfer, can the wife obtain a tax deduction to the extent that the trust fulfills her legal duty to support the incompetent daughter?⁴⁰ The California gift tax law does not expressly cover this problem. Moreover, the California Revenue and Taxation Code sections that are nearest in point lack judicial construction and application.

California Revenue and Taxation Code, section 15106 provides:

Where property is transferred for less than an adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration is a gift.

A similar provision is found in the Internal Revenue Code of 1954.⁴¹ In applying the federal provision, the federal courts have held that the discharge by a parent of his legal obligation to provide for the support of his child is deemed adequate and full consideration in money's worth.⁴² By fulfilling his obligation, the parent is saving the state and federal governments the expense of providing such support. For this reason, the California courts should follow the federal courts, holding such transfers to be nontaxable.

California Revenue and Taxation Code section 15105 apparently provides that support transfers are not subject to the gift tax. This may be implied from the

³⁹ *Ibid.*

⁴⁰ In an interview on November 15, 1966 with Mr. Milton D. Harris, *supra* note 39, he stated that his office is presently bringing a claim against Mrs. Tranquilla Vai for a gift tax on her transfer to the incompetent daughter.

⁴¹ INT. REV. CODE of 1954, § 2512(b).

⁴² INT. REV. CODE of 1954, § 2512(b); *Hooker v. Commissioner*, 174 F.2d 863 (5th Cir. 1949); *McDonald Trust*, 19 T.C. 672 (1953).

section's definition of a "donor" as an "individual who transfers property to another with a donative intent." Although the desire to benefit one's child is a definite motive behind most of the support transfers, such motive is not necessarily illustrative of a donative intent. Rather, it shows the transferor's interest in fulfilling his legal obligation of support. In the *Vai* case, for example, the surrounding circumstances and the action for fraudulent concealment of community property show that the wife did not renounce her share for a donative reason. She intended to discharge her legal obligation of supporting her incompetent daughter after the husband's demise.

It seems unlikely that the California legislature intended to impose a gift tax where the transferor confers on the transferee benefits normally associated with support, such as the care and maintenance of a minor or an incompetent. This is especially true in view of the interpretation given by the federal courts to an identical statutory mandate.⁴³

If the California courts follow the above interpretation of sections 15105 and 15106 of the California Revenue and Taxation Code, a transfer made in fulfillment of a parent's legal obligation of support will not be subject to a state gift tax. This means that neither a state inheritance nor gift tax will be imposed on testamentary transfers for money's value.

Income Tax

If a transfer for money's worth is exempt from an inheritance and a gift tax, will there be a federal or state income tax liability? The California Revenue and Taxation Code,⁴⁴ and the Federal Internal Revenue Code of 1954,⁴⁵ provide that if, pursuant to the terms of the trust, income is used to discharge a settlor's legal obligation of support, the income so used is taxable to the settlor. Thus, an income tax lies where a trust is established to fulfill a parent's legal obligation of supporting his minor or incompetent child.

Impact of the Vai Decision

If the California courts follow the federal courts in holding that a transfer in discharge of a legal obligation of support is not a taxable gift, then the decision of *Estate of Vai*⁴⁶ will affect the amount of revenue coming into the state treasury. It would exempt transfers in discharge of a parent's duty to support his child from any gift or inheritance tax. The only tax that could be imposed would be an income tax on the amount of income used each year to discharge the legal duty of reasonable support. The resulting loss of revenue to the state is seen by the situation in the *Vai* case. The daughter will receive 30,000 dollars per year for her support; the state income tax on this sum is only 800 dollars.⁴⁷ At the time of her father's death, she was thirty-one years old. Estimating her life

⁴³ INT. REV. CODE 1954, § 677; Treas. Reg. § 1.662(a)-4 (1955).

⁴⁴ CAL. REV. & TAX. CODE §§ 17001(15), 17791.

⁴⁵ CAL. REV. & TAX. CODE §§ 17253, 17255; and Treas. Reg. 39.12(x)-(1)(b)(1) allow a limited deduction for medical expenses of the taxpayer's children to the amount exceeding 5% of the adjusted gross income for the taxable year; but not to exceed \$1,250 per year.

⁴⁶ 65 A.C. 139, 52 Cal. Rptr. 705, 417 P.2d 161 (1966).

⁴⁷ CAL. REV. & TAX. CODE § 19200.

expectancy to be seventy, the state will receive only 31,200 dollars. However, an inheritance tax on 515,000 dollars is over 50,000 dollars.⁴⁸ Thus, there will be a sizeable reduction in the amount of revenue coming into the state treasury.

The impact of the *Vai* decision will depend on the extent to which estate planners can utilize it for tax saving purposes. Suppose X contracts with Y, for Y to perform services for X, in consideration for which X agrees to transfer by will an agreed sum of money to Y. So long as the reasonable value of the services rendered is equal to the amount provided in X's will for Y, there will be neither an inheritance tax nor a gift tax due. However, such a transfer will be looked upon as money earned by Y, and the entire sum transferred will be taxable as income. The income tax would be greater than either the inheritance or the gift tax. Thus, it appears that the income tax consequences would make such a device impractical.

The impact of the court's holding in *Estate of Vai*⁴⁹ is seemingly limited to transfers which fulfill a taxpayer's legal obligation of reasonable support. As to mentally incompetent adults, the legal obligation is imposed primarily upon the incompetent's spouse.⁵⁰ However, in the absence of a spouse, the obligation falls upon the incompetent's father, then his mother, and finally his children.⁵¹ As to minors, the father is primarily responsible for their support;⁵² and the mother becomes liable upon her husband's death or his inability to fulfill the obligation without her financial assistance.⁵³ A testamentary transfer by either of the persons named above, in fulfillment of their legal obligation of reasonable support, should incur neither an inheritance nor a gift tax. Although this is very likely to result in a decrease of revenue to the state treasury, it is a just result since the state is saved the expense of providing for the maintenance and support of those unable to provide for their own care.

Under the holding of *Estate of Vai*, a testamentary transfer for full value is exempt from the state inheritance tax. If the California courts accept the logical view that the fulfillment of a legal obligation of reasonable support is adequate and full consideration, a testamentary support trust will be exempt from the state inheritance and gift taxes. It is urged that the California courts follow the lead of the federal courts and recognize such transfers as being nontaxable.

Bernard P Simons*

⁴⁸ CAL. REV. & TAX. CODE §§ 13307, 13404.

⁴⁹ 65 A.C. 139, 52 Cal. Rptr. 705, 417 P.2d 161 (1966).

⁵⁰ CAL. WELFARE & INST'NS CODE § 5077.

⁵¹ CAL. WELFARE & INST'NS CODE § 5077.

⁵² CAL. CIV. CODE §§ 196, 205.

⁵³ CAL. CIV. CODE §§ 196, 205.

* Member, Third Year Class.