Florida Law Review

Volume 34 | Issue 5 Article 2

September 1982

Conforming Section 2039 to the Goals of Estate Tax

James W. Colliton

Follow this and additional works at: https://scholarship.law.ufl.edu/flr

Part of the Law Commons

Recommended Citation
James W. Colliton, *Conforming Section 2039 to the Goals of Estate Tax*, 34 Fla. L. Rev. 693 (1982).
Available at: https://scholarship.law.ufl.edu/flr/vol34/iss5/2

This Article is brought to you for free and open access by UF Law Scholarship Repository. It has been accepted for inclusion in Florida Law Review by an authorized editor of UF Law Scholarship Repository. For more information, please contact kaleita@law.ufl.edu.

CONFORMING SECTION 2039 TO THE GOALS OF ESTATE TAX

JAMES W. COLLITON*

INTRODUCTION

Internal Revenue Code section 2039[1] originated in the massive tax law revision that became the 1954 Code. In enacting section 2039 Congress sought to tax payments received by a decedent's beneficiaries as a result of his employment. Although its application is not limited to payments made as part of an employment agreement, the main purpose of section 2039 is to impose the estate tax on payments made to beneficiaries under employment agreements.[2] Although this purpose is worthwhile, the section's specific provisions have led to decisions inconsistent with either its legislative history or the general goals of estate tax law.

Under section 2039(b), an annuity or other payment purchased by the decedent's employer and payable to the decedent's beneficiary is included in the decedent's estate if the arrangement arose from the decedent's employment and satisfies the other requirements of section 2039.[3] The estate also includes the value of annuities or other payments to beneficiaries purchased by the decedent but excludes those purchased by non-employer third parties. If the decedent paid only part of the purchase price of the "annuity or other payment," his estate includes the proportionate part. Section 2039(c)[4] excludes payments to

*Associate Professor, DePaul University College of Law; A.B., 1966, Stanford University; J.D., 1973, University of California, Hastings College of the Law; LL.M., 1977, Georgetown University Law Center.

I would like to thank Gayl Hansen for her assistance in preparing this article.

1. I.R.C. § 2039 (1976 & Supp. III 1979).

2. *See* H.R. REP. No. 1337, 83rd Cong., 2d Sess. 90 (1954), *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS 4017, at 4117 [hereinafter cited as H.R. REP.]; S. REP. No. 1622, 83d Cong., 2d Sess. 123 (1954), *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS 4621, 4756-57 [hereinafter cited as S. REP.]. *See also* Estate of Bahen v. United States, 305 F.2d 827 (Ct. Cl. 1962); Estate of Beal v. Commissioner, 47 T.C. 269 (1966), *acq.* 1967-2 C.B. 1; Estate of Fusz v. Commissioner, 46 T.C. 214 (1966), *acq.* 1967-2 C.B. 2; Estate of Barr v. Commissioner, 40 T.C. 227 (1963), *acq. in result,* 1978-1 C.B. 1. *See generally* Bittker, *Estate and Gift Taxation Under the 1954 Code: The Principal Changes,* 29 TUL. L. REV. 453, 470-71 (1955); Kramer, *Employee Benefits and Federal Estate and Gift Taxes,* 1959 DUKE L.J. 341; Pincus, *Estate Taxation of Annuities and Other Payments,* 44 VA. L. REV. 857 (1958); Wolk, *The Pure Death Benefit: An Estate and Gift Tax Anomaly,* 66 MINN. L. REV. 229 (1982); Note, *The Generic Estate Taxation of Employee Death Benefits Beyond the Ambit of Section 2039,* 1971 WASH. U.L.Q. 585; Comment, *Internal Revenue Code Section 2039—Estate Taxation of Employee Death Benefits in Nonqualified Retirement Plans,* 52 TUL. L. REV. 343 (1978); Comment, *The Baptism of Section 2039—A New Look at Estate Taxation of Employee Death Benefits Under Nonqualified Plans,* 10 U.C.L.A. L. REV. 619 (1963).

3. I.R.C. § 2039(b) (1976).

4. *Id.* § 2039(c) (1976 & Supp. III 1979). Section 2039(c)'s exclusion of payments to beneficiaries under qualified retirement plans has been generally criticized by commentators be-

Published by UF Law Scholarship Repository, 1982

a decedent's beneficiaries arising from a qualified retirement plan. Section 2039, therefore, generally requires inclusion of annuities or other payments to beneficiaries purchased by the decedent or his employer under non-qualified plans.

For an annuity or other payment not arising from a qualified retirement plan to be included in a decedent's estate under section 2039, three conditions must be met. First, a beneficiary must only receive an annuity or other payment if he survives the decedent. Second, the annuity or other payment must be made under a contract or agreement other than life insurance. Finally, a separate annuity must have been payable to the decedent before his death.

Conditions often arise that, although apparently satisfying these requirements, do not create the traditional joint and survivor annuities Congress sought to address in section 2039. These unanticipated situations, coupled with the section's poor drafting, create both confusion and litigation concerning the section's scope. This confusion has forced conclusions inconsistent with either the purpose of section 2039 or the general goals of estate tax law.

The requirement that the decedent have a right to receive some annuity or other payment before death causes the confusion.[5] This article maintains that the pre-death payment requirement is unnecessary from a policy point of view and leads to conclusions that are difficult to justify. Section 2039's legislative history and development, as well as problems caused by the predeath right-to-payment requirement, shows those cases conforming to the legislative intent underlying section 2039[6] are inconsistent with the basic purposes of estate tax law. In contrast, those cases reaching conclusions con-

---

cause it allows payments that are clearly compensation for the decedent's work to pass tax free to beneficiaries. *See, e.g.*, A.L.I. FEDERAL ESTATE AND GIFT TAXATION, RECOMMENDATIONS AND REPORTERS' STUDIES 15-16 (1969); S. SURREY, W. WARREN, P. MCDANIEL & H. GUTMAN, FEDERAL WEALTH TRANSFER TAXATION 470-71 (3d ed. 1977); Bittker, *supra* note 2, at 470-71; Kramer, *supra* note 2, at 394-96; Pincus, *supra* note 2, at 870-71. The IRS has ruled that benefits accruing under a qualified employee's retirement plan cannot be considered together with benefits accruing under a nonqualified survivor's income benefit plan for purposes of determining the includibility of the value of the survivor's benefits in a decedent's gross estate under § 2039. Rev. Rul. 76-380, 1976-2 C.B. 270, 271. Because of this ruling, a decedent may receive a retirement annuity under a qualified plan until his death, have a death benefit paid under a non-qualified plan, and have no estate tax inclusion. This allows significant amounts of property to be passed tax free and provides planning opportunities. *See generally* Wolk, *supra* note 2, at 234-35.

5. Section 2039(a) provides that:

> The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement . . . (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death, or for any period which does not in fact end before his death.

I.R.C. § 2039(a) (1976).

6. *See, e.g.*, Estate of Schelberg v. Commissioner, 612 F.2d 25 (2d Cir. 1979); Estate of Fusz v. Commissioner, 46 T.C. 214 (1966), *acq.* 1967-2 C.B. 2.

sistent with basic estate tax principles stretch section 2039 beyond Congress' apparent intent.[7] Finally, this article demonstrates these problems could be avoided by amending section 2039(a) and eliminating the pre-death payment requirement.

HISTORY OF SECTION 2039

Congress enacted section 2039 in 1954 to deal with problems that had arisen under the 1939 Code, which had no counterpart to the section. The legislative history shows that before the enactment of section 2039, although the value of joint and survivor annuities purchased by the decedent were clearly includible in the gross estate, it was unclear whether that type of annuity was included when purchased in whole or part by decedent's employer.[8] Congress therefore enacted section 2039 to include such annuities in decedent's gross estate to the extent of contributions made by him or his employer through an nonqualified benefit plan.[9] The legislative history shows that taxation of joint and survivor annuities was Congress' primary concern in enacting section 2039.

Before section 2039, courts often excluded employers' payments made to the decedent's beneficiaries arising from the decedent's employment.[10] In cases litigated under the 1939 Code, pension plans typically allowed employers discretion to refuse to pay retirement annuities to the employee or his spouse.[11] If employees contributed to the plan, their rights were limited to the return of payments.[12] The plans frequently allowed employees to elect a smaller annuity for life in return for the employer's agreement to pay an annuity to the employee's surviving spouse.[13] When the employees elected payment to a surviving spouse, the government would contend the decedent had made a

---

7. *See, e.g.,* Silverman v. United States, 333 F. Supp. 1120 (W.D. Pa. 1971); Estate of Bahen v. United States, 305 F.2d 827 (Ct. Cl. 1962); Estate of Beal v. Commissioner, 47 T.C. 269 (1966), *acq.* 1967-2 C.B. 1.

8. H.R. REP., *supra* note 2, at 90.

9. *Id.*

10. *See generally* Kramer, *supra* note 2, at 348 n.19; Pincus, *supra* note 2.

11. *See, e.g.,* Dimock v. Corwin, 19 F. Supp. 56-58 (E.D.N.Y. 1937), *aff'd,* 99 F.2d 799 (2d Cir. 1938), *aff'd sub nom,* United States v. Jacobs, Ex'r, 306 U.S. 363 (1939); Estate of Salt v. Commissioner, 17 T.C. 92, 97 (1951), *acq.* 1952-1 C.B. 4; Estate of Miller v. Commissioner, 14 T.C. 657, 661 (1950), *non acq.* 1950-2 C.B. 6; Estate of Stake v. Commissioner, 11 T.C. 817, 820-21 (1948), *acq.* 1949-1 C.B. 3. Realistically, employers had to make payments to deceased employee's beneficiaries because refusal to make such payments would cause employees to feel they had been unfairly treated. *See generally* Kramer, *supra* note 2, at 348-50; Pincus, *supra* note 2; Wolk, *supra* note 2.

12. Employees were often required to make contributions. *See, e.g.,* Estate of Miller v. Commissioner, 14 T.C. 657, 658 (1950), *non acq.* 1950-2 C.B. 6; Estate of Stake v. Commissioner, 11 T.C. 817, 822 (1948), *acq.* 1949-1 C.B. 3; Illinois Merchants Trust Co. v. Commissioner, 12 B.T.A. 818, 819 (1928), *acq.* VIII-1 C.B. 22 (1929).

13. *See, e.g.,* Libbey v. United States, 147 F. Supp. 383, 384 (N.D. Cal. 1956); Estate of Davis v. Commissioner, 27 T.C. 378, 380 (1956); Estate of Howell v. Commissioner, 15 T.C. 224, 226 (1950), *acq.* 1953-1 C.B. 4; Estate of Twogood v. Commissioner, 15 T.C. 989, 990 (1950), *aff'd,* 194 F.2d 627 (1952), *acq.* 1953-1 C.B. 6.

transfer taking effect at death under section 811(c) of the 1939 Code and its predecessor sections.[14]

Although the government persisted in litigating section 811(c) cases,[15] courts often refused to include the annuities in the decedent's estate.[16] These decisions rested on the theory that the decedent had no interest in the property passing to the beneficiary and therefore had transferred nothing.[17] The leading case of *Dimock v. Corwin*[18] typifies the reasoning applied under the 1939 Code. In *Dimock,* the decedent had the power to designate beneficiaries to receive death benefits, although the company reserved the right to withdraw or modify the annuity plan at its discretion.[19] Because the court held the decedent had only an expectancy and not a property interest in the amounts paid to his widow,[20] designation of the beneficiary did not amount to a transfer of property.[21]

---

14. Int. Rev. Code of 1939, ch. 3, § 811(c), 53 Stat. 121 (currently I.R.C. §§ 2035-37). *See, e.g.,* Glen v. Hanner, 212 F.2d 483, 484 (6th Cir. 1954); Libbey v. United States, 147 F. Supp. 383, 384 (N.D. Cal. 1956); Dimock v. Corwin, 19 F. Supp. 56, 60 (E.D.N.Y. 1937) (property transfer under § 411(c), predecessor of § 811(c)), *aff'd,* 99 F.2d 799 (2d Cir. 1938), *aff'd sub nom.* United States v. Jacobs, Ex'r, 306 U.S. 363 (1939); Estate of Davis v. Commissioner, 27 T.C. 378, 379 (1956); Estate of Howell v. Commissioner, 15 T.C. 224, 227 (1950), *acq.* 1953-1 C.B. 4; Estate of Higgs v. Commissioner, 12 T.C. 280, 281-82 (1949), *rev'd,* 184 F.2d 427 (3d Cir. 1950); Estate of Stake v. Commissioner, 11 T.C. 817, 822 (1948), *acq.* 1949-1 C.B. 3; Estate of Nevin v. Commissioner, 11 T.C. 59, 62 (1948), *acq.* 1949-1 C.B. 3.

15. *See, e.g.,* Libbey v. United States, 147 F. Supp. 383 (N.D. Cal. 1956); Dimock v. Corwin, 19 F. Supp. 56 (E.D.N.Y. 1937), *aff'd,* 99 F.2d 799 (2d Cir. 1938), *aff'd sub nom.,* United States v. Jacobs, Ex'r, 306 U.S. 363 (1939); Estate of Howell v. Commissioner, 15 T.C. 224 (1950), *acq.* 1953-1 C.B. 4; Estate of Miller v. Commissioner, 14 T.C. 657 (1950), *non acq.* 1950-2 C.B. 6; Estate of Stake v. Commissioner, 11 T.C. 817 (1948), *acq.* 1949-1 C.B. 3.

16. *See, e.g.,* Glenn v. Hanner, 212 F.2d 483, 484 (6th Cir. 1954); Libbey v. United States, 147 F. Supp. 383, 385 (N.D. Cal. 1956); Molter v. United States, 146 F. Supp. 497, 501 (E.D.N.Y. 1956); Dimock v. Corwin, 19 F. Supp. 56, 60 (E.D.N.Y. 1937), *aff'd,* 99 F.2d 799 (2d Cir. 1938), *aff'd sub nom.,* United States v. Jacobs, Ex'r, 306 U.S. 363 (1939); Estate of Howell v. Commissioner, 15 T.C. 224, 231 (1950), *acq.* 1953-1 C.B. 4; Estate of Miller v. Commissioner, 14 T.C. 657, 665 (1950), *non acq.* 1950-2 C.B. 6; Estate of Stake v. Commissioner, 11 T.C. 817, 826 (1948) (only amounts contributed by decedent includible), *acq.* 1949-1 C.B. 3; Illinois Merchants Trust Co. v. Commissioner, 12 B.T.A. 818, 827 (1928), *acq.* VIII-1 C.B. 22 (1929).

17. *See, e.g.,* Kramer, *supra* note 2, at 348 n.19; Bittker, *supra* note 2, at 470.

18. 19 F. Supp. 56 (E.D.N.Y. 1937), *aff'd,* 99 F.2d 799 (2d Cir. 1938), *aff'd sub nom.,* United States v. Jacob's Ex'r, 306 U.S. 363 (1939).

19. 19 F. Supp. at 58.

20. *Id.* The district court quoted G.C.M. in support of its conclusions. This G.C.M., published before the widespread adoption of retirement plans, stated: "[I]t is clear that the decedent's interest in the death benefit prior to his death was nothing more than an expectancy, which is not a property right and, therefore, not includible in his gross estate under section 302(a) as amended." *Id., quoting* G.C.M. 17817, 1937-1 C.B. 281, 282.

The government tried to retreat from this reasoning in a subsequent opinion, arguing *Dimock* should not be followed: "[T]he employee, at the time of his death, is in possession of such rights as constitute property . . . provided that prior to the employee's death the employer has not withdrawn the right of the employee to designate a beneficiary, and has not eliminated all death benefits." G.C.M. 27242, 1952-1 C.B. 160, 160-61. Although the government reversed its position, courts continued to follow the *Dimock* reasoning. *See, e.g.,* Estate of Howell v. Commissioner, 15 T.C. 224, 227-31 (1950), *acq.* 1953-1 C.B. 4.

21. 19 F. Supp. at 60. The court stated:

The *Dimock* court applied traditional property law analysis in deciding whether the decedent's beneficiary had received property. The court gave weight to the possibility that under some circumstances, no payment at all would be made to a beneficiary.[22] The court also reasoned that the right to nominate could not be assigned, sold, or levied upon to satisfy a judgment.[23] In addition, if the decedent became bankrupt, his right to nominate would be of no value to creditors.[24]

Although one may disagree with the *Dimock* court's conclusion, whether an employer's annuity benefits should be included in a decedent's estate clearly depended on the existence of a property transfer. As a result of decisions following *Dimock*'s expectancy and transfer analysis,[25] employers were able to make payments to surviving spouses of deceased employees who were invariably executives of corporate employers. These payments were not taxed, although they clearly compensated the employee for services rendered under the employment agreement.[26]

Section 2039 apparently resulted from congressional belief that these employer payments were sufficiently similar to property owned by the decedent at death to be included in his estate.[27] The basic purpose of section 2039 was

---

> [D]uring his life [the decedent had], only the right to render it possible for [decedent's wife] to receive a grant from the . . . [company], and that this did not constitute property of his . . . and that the act of naming her as the repicient of the death benefit was not a transfer of property by him to her.

Id.

22. *Id.* at 59.

23. *Id.*

24. *Id. Dimock* clearly illustrates the artificial reasoning courts have used in dealing with death benefits to employees' beneficiaries:

> Here nothing may be payable, if the named beneficiary predeceases the annuitant, but since a payment did accrue, because the annuitant named a surviving beneficiary, that result is to be traced not to a transfer of anything from [the decedent] to his wife, but to the circumstance that the annuity which he had enjoyed became extinct through his death, and a new relation came into existence between the company and [the decedent's wife].

Id. This statement demonstrates a lack of understanding that the surviving spouse's relationship to the deceased's employer arose directly from the decedent's employment. Under such arrangements the payments realistically are part of the employee's total compensation for services rendered and are recognized as such by all concerned. To treat the spouse's payments as somehow new and separate from the employee's pay and employment relationship ignores economic reality.

25. *See, e.g.*, Estate of Salt v. Commissioner, 17 T.C. 92 (1951), *acq.* 1952-1 C.B. 4.

26. *See generally* Kramer, *supra* note 2, at 349-50 (benefits not a result of generosity but payment for services).

27. The estate tax has a number of sections requiring inclusion of property not owned outright by the decedent, but which the decedent controlled or retained an interest. *See* I.R.C. § 2036 (1976 & Supp. III 1979) (dealing with transfers with retained life estates); *id.* § 2037 (1976) (transfers taking effect at death); *id.* § 2038 (revocable transfers and transfers where the decedent retained the power to alter or amend); *id.* § 2040 (1976 & Supp. III 1979) (joint interests); *id.* § 2041 (1976) (powers of appointment); *id.* § 2042 (life insurance). Under all of these sections the decedent either holds substantial control over the property or retains

reasonable: to include in a decedent's estate of property that was in reality part of the wealth accumulated before his death. Although sparse, the section's legislative history indicates that Congress was primarily concerned with inclusion of beneficiary annuities purchased either solely by the decedent's employer or jointly by the decedent and his employer.[28]

Section 2039 requires inclusion in the estate if the annuity or other payment was payable to the decedent, or the decedent had the right to receive such payment during his life.[29] Congress obviously patterned this section after section 2036,[30] which pertains to transfers with retained life estates. Section 2039's language is almost identical to that of section 2036,[31] although Congress' purpose in using similar language is unclear. The retention of a life interest is the key concept of section 2036 and the very reason for its existence. A decedent who has transferred property but retained a life interest has in reality made a transfer logically taxable as though he owned the property in its entirety until death. The retained life interest language of section 2036 neatly effectuates this thinking. Section 2039, however, addresses the entirely different problem of a decedent whose beneficiaries receive payments after his death under a retirement plan. While section 2036 depends upon the retained life interest concept, the pre-death payment requirement does not effectuate any policy of section 2039. It may have come into existence merely because of a misguided desire for symmetry between the sections or because most annuity contracts provide for pre-death payments.

The Department of the Treasury first attempted to define section 2039's

---

a large enough interest before death to render it reasonable for Congress to require inclusion of the property in the estate.

28. According to the Senate Committee Reports section 2039 requires inclusion:

> [I]f under the contract or agreement an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death . . . . [T]he provisions of this section apply not only to cases where an annuity was payable to a decedent but also to contracts or agreements under which a lump-sum payment was payable to the decedent or the decedent possessed the right to receive such a lump-sum payment in lieu of an annuity.

S. REP., *supra* note 2, at 469-70. *See also* H.R. REP., *supra* note 2, at A314.

29. I.R.C. § 2039(a) (1976).

30. *Id.* § 2036 (1976 & Supp. III 1979).

31. *Id.* § 2036(a) states:

> The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death — (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

scope in regulations adopted in 1958.[32] Regulation section 20.2039-1(a) notably does not limit the section's application to joint and survivor annuities. Rather, the regulation requires inclusion of any annuity or other payment receivable by a surviving beneficiary under certain agreements or plans to the extent of contributions by the decedent or his employer.[33] Regulation section 20.2039-1(b) further carries out this broad interpretation[34] by providing:

> The term "annuity or other payment" as used with respect to both the decedent and the beneficiary has reference to one or more payments extending over any period of time. The payments may be equal or unequal, conditional or unconditional, periodic or sporadic. The term "contract or agreement" includes any arrangement, understanding or plan or any combination of arrangements, understandings or plans arising by reason of the decedent's employment. An annuity or other payment "was payable" to the decedent if, at the time of his death, the decedent was in fact receiving an annuity or other payment, whether or not he had an enforceable right to have payments continued. The decedent "possessed the right to receive" an annuity or other payment if, immediately before his death, the decedent had an enforceable right to receive payments at some time in the future, whether or not, at the time of his death, he had a present right to receive payments.[35]

The section 2039 regulations effectively extend the section's scope beyond Congress' major concern of traditional joint and survivor annuities. This broad interpretation of section 2039 is reasonable if one considers only the section's specific language. Section 2039(a)'s vague reference to an annuity or

---

32. T.D. 6296, 1958-2 C.B. 432.

33. Treas. Reg. § 20.2039-1(a), T.D. 7416, 1976-1 C.B. 274, 275. The regulation states that:

> A decedent's gross estate includes under 2039(a) and (b) the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under certain agreements or plans to the extent that the value of the annuity or other payment is attributable to contributions made by the decedent or his employer.

Id.

34. The broad regulatory interpretation of section 2039 by may not be consistent with the narrower purposes discussed in the section's legislative history. *See* S. REP., *supra* note 2, at 123-24; H.R. REP. No. 2543, 83d Cong., 2d Sess. 74, *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS 5280, 5335-36. The regulations, however, may be defended as rational because they appear consistent with the statute's language and with the general purposes of the estate tax law. In any event, the taxpayers did not challenge the regulations' validity in early cases. *See* Estate of Bahen v. United States, 305 F.2d 827, 835 (Ct. Cl. 1962) ("firmer legal basis provided by the Regulations"). *See also* Estate of Beal v. Commissioner, 47 T.C. 269, 271-72 (1966), *acq.* 1967-2 C.B. 1, where the Tax Court stated:

> The purpose of this section, which is new in the 1954 Code, was to clarify prior law as to whether a joint and survivor annuity . . . to which both the decedent and his employer made contributions, is includible in the decedent's gross estate. . . . However, the broad language of the section goes beyond the precise situation which served as the initial impetus for congressional action in this area.

Id. (Citing H.R. REP. No. 1337, 83d Cong., 2d Sess. 90 (1954)).

35. Treas. Reg. § 20.2039-1(b)(1) (1958). *See infra* notes 100-04 and accompanying text.

other payment payable to the decedent before his death can be broadly interpreted. On the other hand, the legislative history demonstrates that Congress' main purpose in enacting section 2039 was to include the value of annuities arising from traditional retirement plans, in contrast to the broad application adopted by the regulations.[36] Even though traditional arrangements were clearly most important to Congress, it is unclear whether Congress intended to include only traditional retirement plans under the section. Courts have been forced, therefore, to interpret a statute given broad scope by regulations and narrow scope by its legislative history.[37]

DEVELOPMENT OF SECTION 2039 UNDER *Bahen v. United States*

The first case decided under section 2039 was *Estate of Bahen v. United States*,[38] a comprehensive and well reasoned opinion that has greatly influenced the development of case law. The decedent, Bahen, was an executive who had rights under two compensation plans his employer established.[39] The Court of Claims adopted the regulations' broad interpretation of section 2039 and included the beneficiary's payments in Bahen's estate.

The first plan that Bahen participated in was the Deferred Compensation Plan, adopted by the company for forty of its high executives and officers. Under this plan, the company paid a stated sum in sixty equal installments to the employee's surviving widow and children.[40] The payments would have been made whether the employee died before or after retirement.[41] If the employee became totally incapacitated before retirement, however, the payments would be paid to him in sixty equal installments with his widow and children receiving unpaid installments at his death.[42] The decedent also participated in a Death Benefit Plan, adopted a year before the Deferred Com-

36. Taxpayers have not challenged the regulations as being overbroad and the regulations have been accepted as valid in a number of cases. *See, e.g.*, Estate of Schelberg v. Commissioner, 612 F.2d 25 (2d Cir. 1979); Estate of Bahen v. United States, 305 F.2d 827 (Ct. Cl. 1962).

37. *See* Estate of Beal v. Commissioner, 47 T.C. 269, 271-72, *acq.* 1967-2 C.B. 1 (1966).

38. 305 F.2d 827 (Ct. Cl. 1962).

39. *Id.* at 828. Cases under § 2039 typically causing problems deal with high executives of large corporations such as Bahen, who worked for the Chesapeake and Ohio Railway Company. *See, e.g.*, Estate of Schelberg v. Commissioner, 612 F.2d 25, 27 (2d Cir. 1979) (IBM); All v. McCobb, 321 F.2d 633, 634 (2d Cir. 1963) (Standard Oil Co.); Gray v. United States, 278 F. Supp. 281, 282 (D.N.J. 1967) (Socony Mobil Oil); Estate of Beal v. Commissioner, 47 T.C. 269, 269 (1966), *acq.* 1967-2 C.B. 1 (Western Electric); Estate of Barr v. Commissioner, 40 T.C. 227, 228 (1963), *acq. in result*, 1978-1 C.B. 1 (Eastman Kodak Co.). The other major type of case presenting problems involves executives and owners of closely held businesses. *See, e.g.*, Estate of Wadewitz v. Commissioner, 339 F.2d 980, 981 (7th Cir. 1964); Silberman v. United States, 333 F. Supp. 1120, 1121-22 (W.D. Pa. 1971); Kramer v. United States, 406 F.2d 1363, 1364 (Ct. Cl. 1969). Interestingly, low and middle level employees are not represented in the cases, showing that the issues discussed here seem to apply only to executive employees, whether employed by large or small businesses.

40. 305 F.2d at 828.

41. *Id.*

42. *Id.* at 828-30.

pensation Plan, that covered all company employees with more than ten years of service who died while employed.[43] Under this plan, the company would pay a sum equal to three months' salary to the employee's widow or to the guardian of any minor children surviving the decedent.[44]

After Bahen's death, the company paid three months' salary to his widow under the Death Benefit Plan and sixty monthly payments under the Deferred Compensation Plan.[45] The government asserted that these amounts should have been included in the estate under section 2039 and other sections.[46] The Court of Claims first upheld the Treasury Regulations stating unless they violate the statute sought to be implemented, such regulations must be accepted.[47] With regard to the Deferred Compensation Plan, the court concluded the plan was a form of contract or agreement as required by the statute. The court reasoned, "[a] compensation plan unilaterally adopted by the employer, but made irrevocable and communicated to the employee, falls directly within [the statutory] definition, at least where the employee continues in the company's service after the adoption of the plan."[48]

The *Bahen* court's rationale follows the Treasury Regulations[49] and has been adopted in other cases.[50] The decision reasonably concluded there was a contract or agreement under these facts since benefits under such plans are part of both the employee's compensation and the employment agreement, regardless of whether the employer and the employee specifically negotiated the benefit terms. The employer clearly does not provide such pay benefits as gifts or fringe benefits.

The next and more difficult question the court considered was whether there was an annuity or other payment payable to the decedent *before* his death under the Deferred Compensation Plan.[51] The court held the decedent's right to have $100,000 paid in sixty equal installments if he became incapacitated was such an annuity under the regulations' broad definition.[52] The Court of Claims reached this conclusion even though Bahen had never received any disability payment and his rights were contingent upon becoming disabled.[53]

---

43. *Id.* at 828.

44. *Id.* at 834-35.

45. *Id.* at 828-29.

46. *Id.*

47. *Id.* at 829. Even though the taxpayers did not challenge the section 2039 regulations as overbroad, such an argument would have been reasonable because of legislative history.

48. *Id.* at 830.

49. *See* Treas. Reg. § 20.2039-1(b)(1)(ii) (1958) (§ 2039 applies to agreements under which decedent possessed right during life to receive payments).

50. *See, e.g.*, All v. McCobb, 321 F.2d 633, 635-36 (2d Cir. 1963).

51. 305 F.2d at 830. Under the Deferred Compensation Plan, the Court of Claims decided that there was a contract or agreement. The Plan also clearly involved an annuity payable to the beneficiaries in the 60 payments to Bahen's wife. The critical issue therefore was whether there was an annuity or other payment to Bahen before his death. *Id.*

52. *Id.* at 831.

53. *Id.* The court stated: "The Regulations make clear that, in circumstances like these, the decedent's interest in future benefits, even if contingent, is sufficient." *Id.*

Section 2039 also required inclusion of the three months' salary paid to the decedent's widow under the Death Benefit Plan, even though there was no annuity or other payment payable to the decedent under this plan standing by itself.[54] After first rejecting the idea that unpaid salary could be the necessary annuity or other payment,[55] the court decided that the possibility of disability payments under the Deferred Compensation Plan satisfied the lifetime payment requirement for both plans.[56] In reaching this conclusion, the court relied on the regulations' requirement that employee benefit plans are to be read together.[57] The court upheld this requirement, stating that although the evidence failed to indicate the plans were part of one scheme, "the statute and the Regulation can establish a prophylactic across-the-board rule applicable to all cases, regardless of the purity of motivation in a particular instance."[58]

Bahen is significant because it considered several of section 2039's major interpretative problems. First, although the taxpayers did not raise the issue, the *Bahen* court upheld both the section 2039 regulations' broad interpretation of annuity or other payment.[59] Second, the case determined a contingent right, while not a traditional annuity, may be a pre-death annuity or other payment for section 2039 purposes. Third, *Bahen* concluded that benefit plans may be read together.[60] This results in inclusion of post-death benefits if there are contingent lifetime rights under another plan. *Bahen* therefore resulted in inclusion even though the two plans in question did not resemble a traditional retirement annuity plan, regardless of whether they were read together or separately.

Bahen's facts raised some of the most difficult problems in interpreting section 2039 because it did not involve a traditional survivor's annuity. The *Bahen* court's holding must be measured not only against section 2039's wording and legislative history but also against the general purposes and scope of estate tax law. *Bahen*'s result is consistent with those general purposes. The decedent was an executive of a large corporation that agreed to make payments to his beneficiaries as deferred compensation for his services to the corporation. Treating the value of the payments as includible property is comparable to considering the payments as property clearly owned by the decedent at death. Such property reasonably should be included in the decedent's estate.

Organizations do establish benefit programs such as in *Bahen* to compensate

---

54. *Id.* at 835.

55. *Id.* at 834-35. *See also* Estate of Schelberg v. Commissioner, 612 F.2d 25, 31 (2d Cir. 1979) (disability payments too dissimilar to annuities); Eichstedt v. United States, 354 F. Supp. 484, 491 (N.D. Cal. 1972) (same); Silberman v. United States, 333 F. Supp. 1120, 1126 (W.D. Pa. 1971) (payment in form of compensation for services); Kramer v. United States, 406 F.2d 1363, 1366 (Ct. Cl. 1969) (wages are not annuities).

56. 305 F.2d at 835.

57. *Id.*; Treas. Reg. § 20.2039-1(b)(2), ex. (6) (1958). *See infra* notes 100-04 and accompanying text.

58. 305 F.2d at 835 n.16.

59. *Id.* at 835. *See also* Treas. Reg. § 20.2039-1(b) (1958).

60. 305 F.2d at 835. *See* Treas. Reg. § 20.2039-1(b)(2), ex. (6) (1958).

employees for their services.[61] They establish these plans recognizing the market place's economic realities, which require compensation and incentives to keep executives productive and content. The benefits paid to Bahen's widow clearly were not gifts from the company, but were compensation for the decedent's work. The decision simply includes in his estate compensation for employment paid to a beneficiary. This result is fully consistent with the purposes of the estate tax.

It is difficult, however, to reconcile *Bahen*'s conclusion with the legislative history of section 2039. The committee reports clearly show that the section is primarily concerned with the inclusion of amounts paid under traditional retirement plans.[62] While section 2039 does use the broad term "other payment" with respect to the requirement of payments during the decedent's life, it is unclear whether Congress intended to include highly contingent payments such as those in *Bahen*.[63]

An early case, *Estate of Wadewitz v. Commissioner*,[64] considered whether the estate includes an amount forfeitable by the decedent's action before death, but vested in the decedent's beneficiaries after death.[65] This question arises when an employee has the right to have payments made to a surviving beneficiary, but the employee may forfeit the right by a voluntary act such as competing with his employer or resigning. In *Wadewitz*, the decedent had been president of a company that agreed, among other things, to make payments to certain beneficiaries for a specified period after decedent's death.[66] His rights were to be forfeited if he competed with the company during his lifetime, but the company had no other right to withhold the benefits.[67] The Seventh Circuit concluded that the decedent's rights should be included in the estate because his right to payments was entirely within his control through the decision not to compete. Thus "he possessed an enforceable, nonforfeitable right to future payments."[68]

Wadewitz clearly held that a contingent, forfeitable right satisfies section 2039 if the decedent completely controls the contingencies. In other words, when an employer promises that a beneficiary will receive payments, section 2039 requires inclusion if the right can be lost only by the employee's actions, assuming that the arrangement meets other section 2039 requirements. If the decedent has the power to control distribution to his beneficiaries, and no one other than the decedent has that power, it is reasonable to treat the decedent as the absolute owner of the right and to include its value in his estate. Treat-

61. *See generally* Kramer, *supra* note 2.

62. *See supra* note 2 and accompanying text.

63. *See* Estate of Schelberg v. Commissioner, 612 F.2d 25, 29 (2d Cir. 1979) (disability payments too contingent to warrant inclusion in gross estate). *See also* All v. McCobb, 321 F.2d 633, 635-36 (2d Cir. 1963) (following *Bahen*'s decision of reading two employee benefit plans together and finding a contract agreement).

64. 339 F.2d 980 (7th Cir. 1964).

65. *Id.* at 982. This issue was a problem under the 1939 Code. *See generally* Pincus, *supra* note 2, at 864.

66. 339 F.2d at 981-82.

67. *Id.* at 982 & n.2.

68. *Id.* at 983.

ing such a right as the equivalent of the decedent's property is consistent with the purposes of estate tax law.

In 1966 the Tax Court considered in depth the major question of whether salary earned but unpaid at death was an annuity or other payment payable to the decedent.[69] In *Fusz v. Commissioner,*[70] the decedent and his employer, a corporation owned in part by the decedent, entered into an employment agreement providing for certain payments to the decedent's wife upon his death. Although the agreement provided that Fusz's regular salary and the payments to his wife were consideration for his services, no post-employment benefits were payable to Fusz or to anyone else. When Fusz died and the corporation made the agreed payments to his widow, the government argued that the payments should be included in his estate under section 2039.[71] The Tax Court had to determine whether to classify the unpaid salary as a pre-death annuity or other payment for section 2039(a) purposes.

The Tax Court in *Fusz* refused to accept the government's contention that the payments should be included, holding instead that "the phrase 'other payment' is qualitatively limited to post-employment benefits which, at the very least are paid or payable during decedent's lifetime."[72] In concluding that compensation being paid to a working employee could not be an annuity or other payment, the Tax Court observed that the government's argument would require adopting two different meanings of the statutory language, "annuity or other payment." The court determined that current compensation cannot be simultaneously "payable to" and "receivable by" both the decedent and a beneficiary and therefore concluded: "Respondent's construction would convert 'an annuity or other payment was payable to the decedent' into '*any payment* was payable to the decedent. . . .' "[73] This analysis is puzzling because section 2039 does not require that only one payment or annuity be made to the decedent and his spouse. Indeed, the statute specifically provides for inclusion if the decedent and the beneficiary each receive either an annuity, or in the alternative, any other payment.

While the Tax Court's reasoning in *Fusz,* based on the history of section 2039, is attractive, it is difficult to reconcile with the underlying purposes of the estate tax. Generally, estate tax is imposed when the decedent either owned the property at death or had some substantial interest in the property justifying inclusion.[74] In *Fusz,* the decedent's spouse received payments arising from an employment contract and paid as consideration for the decedent's services. This property's exclusion is inconsistent with the goal of the estate tax.[75] Realistically the payments to beneficiaries are consideration for services

69. This issue had previously been considered in *Bahen* where the Court of Claims held that unpaid salary was not an annuity or other payment. 305 F.2d at 384-85.

70. 46 T.C. 214 (1966), *acq.* 1967-2 C.B. 2.

71. *Id.* at 215.

72. *Id.* at 218.

73. *Id.* at 217.

74. *See* H.R. REP., *supra* note 2, at 90.

75. It is difficult to distinguish payments to beneficiaries from regular salary earned but unpaid at death. The unpaid salary is clearly includible in the decedent's estate.

and should be treated the same as previously paid wages already deposited in a bank.

Even though *Fusz* may be inconsistent with general estate tax theory, it appears consistent with section 2039's purposes and history. Neither the section, its legislative history, nor the regulations discusses unpaid wages. Example four in the legislative history does imply that unpaid wages are a pre-death payment by stating section 2039 applies to: "A contract or agreement entered into by the decedent and his employer under which at decedent's death, prior to retirement or prior to the expiration of a stated period of time, an annuity or other payment was payable to a designated beneficiary if surviving the decedent."[76] Because the example does not describe an obvious pre-death annuity or other payment, the government argued it must be unpaid salary. The Tax Court reasonably rejected the government's contention by pointing out that the legislative history focuses upon situations quite different than the unpaid salary encountered in *Fusz*.[77]

While section 2039 arguably should have required inclusion under the *Fusz* facts, the Tax Court nonetheless reached a reasonable conclusion. Clearly Congress was primarily concerned with traditional retirement arrangements and gave no specific attention to whether unpaid salary could be the necessary pre-death payment. The government's reliance on example four is misplaced because the example makes no specific reference to unpaid salary and probably reflects, at most, a drafting oversight in the committee reports.[78] Situations in which a decedent has accrued unpaid salary at death are so common that it is very unlikely Congress would require inclusion by the indirect means the government asserted in *Fusz*. In any event, the Tax Court's *Fusz* conclusions have become well-established and neither regular salary payments[79] nor payments under wage continuation plans[80] cause section 2039 inclusion.

Later cases have adopted the *Bahen* and *Fusz* reasoning, although sometimes reaching contrary conclusions on the facts. Some cases have followed the *Bahen* approach of reading different plans together in deciding whether the

76. H.R. REP., *supra* note 2, at A315. *Accord* S. REP., *supra* note 2, at 470.

77. The court cited the conference committee report in support of its conclusion:

> This amendment amends section 2039 of the House bill by revising subsection (a) so as to make it clear that the provisions of section 2039 apply not only to cases where an annuity was payable to a decedent but also to contracts or agreements under which a lump-sum payment is payable to the decedent or the decedent possesses the right to receive such a lump-sum payment in lieu of an annuity.

H.R. REP. No. 2543, 83d Cong., 2d Sess. 74, *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS at 5335.

78. The fact that such an oversight occurred, however, shows that Congress was mainly concerned with the requirement of a payment to a beneficiary rather than with the pre-death payment. *See* Pincus, *supra* note 2, at 866-67.

79. *See* Kramer v. United States, 406 F.2d 1363, 1366 (Ct. Cl. 1969); Estate of Siegel v. Commissioner, 74 T.C. 613, 619 (1980).

80. *See, e.g.,* Estate of Schelberg, 612 F.2d 25, 29 (2d Cir. 1979); Eichstedt v. United States, 354 F. Supp. 484, 491 (N.D. Cal. 1972); Silberman v. United States, 333 F. Supp. 1120, 1126 (W.D. Pa. 1971); Kramer v. United States, 406 F.2d 1363, 1366 (Ct. Cl. 1969); Rev. Rul. 183, 1977-1 C.B. 274, 275.

annuities or other payments required for 2039 purposes exist.[81] Other cases have followed *Bahen* and *Fusz* by determining that section 2039 applies only to post-employment payments and does not require inclusion if the payments are essentially salary or salary continuation payments.[82]

The *Fusz* conclusion that unpaid salary is not a pre-death payment to the decedent raises the question of how to treat disability payments. An employee typically has the right to receive payments if he becomes ill.[83] If these payments are viewed as salary for a current employee, then they are similar to the unpaid wages in *Fusz* and do not satisfy section 2039(a)'s pre-death payment requirement. On the other hand, if the payments are viewed as post-employment benefits, assuming section 2039's other requirements are met, the value of the payments passing to a beneficiary will be included.

In *Kramer v. United States,*[84] the Court of Claims dealt with the decedent-owner of a business who had agreed with his company that if he became disabled, payments would be made to him during his lifetime in return for his services as an advisor and counsellor. In that role, he was to assist the officers and employees in formulating plans and programs for the business.[85] The government contended this was a retirement arrangement giving Kramer the post-employment benefit *Fusz* requires.[86] The court held, however, that the payments were essentially a substitute for salary, not an annuity or other payment as defined in *Fusz.*[87] In *Kramer,* as in *Fusz,* an employer made payments to the decedent's beneficiaries as compensation for the decedent's services,[88] without inclusion of the payment in the decedent's estate. This value was excluded despite decedent's irrevocable contractual right to substantial payments. Once again, careful attention to section 2039's requirements allowed a decedent to pass substantial amounts of property tax free.[89]

81. *See* All v. McCobb, 321 F.2d 633, 636 (2d Cir. 1963); Eichstedt v. United States, 354 F. Supp. 484, 492 (N.D. Cal. 1972); Gray v. United States, 278 F. Supp. 281, 284 (D.N.J. 1967); Estate of Beal v. Commissioner, 47 T.C. 269, 272 (1966), *acq.* 1967-2 C.B. 1.

82. *See supra* cases cited at notes 79-80.

83. Eichstedt v. United States, 354 F. Supp. 484, 492 (N.D. Cal. 1972); Silberman v. United States, 333 F. Supp. 1120, 1126 (W.D. Pa. 1971); Kramer v. United States, 406 F.2d 1363, 1366-67 (Ct. Cl. 1969); Estate of Siegel v. Commissioner, 74 T.C. 613, 624 (1980); Rev. Rul. 77-183, 1977-1 C.B. 274, 275.

84. 406 F.2d 1363 (Ct. Cl. 1969).

85. *Id.* at 1364-65.

86. *Id.* at 1366. *See also* Estate of Siegel v. Commissioner, 74 T.C. 613, 619-20 (1980). This line of cases shows how the law in general, and particularly tax law, becomes complex. Initially, § 2039 required inclusion if there is a pre-death annuity or other payment. *Fusz* then held unpaid salary did not satisfy this requirement and there must be a post-employment benefit. The court in *Kramer* added consideration of whether disability payments were post-employment benefits. This step-by-step series of questions and answers moved the courts from simply looking for a pre-death annuity or other payment under the statute to deciding whether a disability plan provides post-employment benefits. It is therefore not surprising that tax law developed into a technicality-ridden legal nightmare.

87. 406 F.2d at 1367-68.

88. *Id.* at 1364. According to the court, the company agreed to make the payments because "it was essential to the Company to have the benefit of Mr. Kramer's services . . . ." *Id.*

89. *See also* Estate of Siegel v. Commissioner, 74 T.C. 613 (1980). In *Siegel,* the Tax Court applied similar reasoning in refusing to include the value of payments to the decedent's

AN ALTERNATIVE TO *Bahen*:
Schelberg v. Commissioner

After section 2039 was enacted in 1954, the law under it developed in a predictable and consistent manner, based largely on the initial reasoning of *Bahen*. In 1979, however, the Second Circuit in *Schelberg v. Commissioner*[90] threw doubt on much of the previous analysis. Written by Judge Friendly, the *Schelberg* opinion is a carefully drafted and reasoned examination of section 2039's language, purposes and case law development.

Schelberg was an employee of International Business Machines Corporation, which maintained a variety of employee benefit plans.[91] One plan, the Group Life Insurance Plan, included an unfunded and uninsured survivor's income benefit providing for monthly payments to specified survivors.[92] Under this plan, Schelberg was to receive no payments before death. Read by itself, therefore, the Group Life Insurance Plan did not satisfy section 2039's requirement of a pre-death payment to the decedent.

IBM also had a Sickness and Accident Plan entitling all full-time employees to receive full salary while absent from work for a specified period because of sickness or accident.[93] In addition, IBM had a Disability Plan providing payments for totally disabled employees with no reasonable expectation of becoming able to work. The Disability Plan called for payments only after the sickness and accident payments had expired. At the normal retirement date, an employee receiving disability benefits would receive retirement benefits under IBM's general retirement plan. Only 393 employees out of a total of 150,000 were receiving benefits under the Disability Plan.[94] It was therefore quite unlikely that Schelberg or any other individual employee would receive benefits under the Disability Plan. When Schelberg died he was not, in fact, receiving benefits under any of the plans although at his death his wife began receiving the survivor's benefit.[95]

The decedent had both the right to have his beneficiary receive the survivor's annuity and the highly contingent right to receive disability benefits under certain circumstances.[96] The value of the survivor's annuity therefore could be included under section 2039 only by reading the plans together and by designating the contingent disability payments an annuity or other payment to Schelberg. The *Schelberg* facts are similar to *Bahen*'s, and are unlike the traditional annuity arrangements that are the main focus of section 2039.

The government argued under regulation section 20.2039-1(b)[97] that the

children under section 2039. The Tax Court held the payments were not post-employment benefits and therefore were not includible under the *Fusz* reasoning. *Id.* at 620.

90. 612 F.2d 25 (2d Cir. 1979).

91. *Id.* at 27.

92. *Id.* The Group Life Insurance Plan also provided for life insurance that was not at issue in the case.

93. Payments were available for up to 52 weeks in any two year period. *Id.*

94. *Id.* at 28.

95. *Id.*

96. *Id.* at 28-29.

97. Treas. Reg. § 20.2039-1(b) (1958).

Disability Plan and the survivor's benefit should be considered together.[98] If both plans were read together, the contingent disability payments would meet the statutory requirement of an annuity or other payment to Schelberg, while the survivor's benefit would be the necessary annuity or other payment to a beneficiary. The contract or agreement would be satisfied because the employer communicated both plans to the employees as part of an employment arrangement.

The *Schelberg* court first considered whether the contingent disability payments could be read together with the survivor's benefit. Regulation 20.2039-1(b) provides "the term 'contract or agreement' includes any arrangement, understanding or plan, or any combination of arrangements, understandings or plans arising by reason of decedent's employment."[99] Example six of the regulation section states "all rights and benefits" the employee or others receive because of employment are to be construed together in determining section 2039's applicability and that "[t]he scope of section 2039(a) and (b) cannot be limited by indirection."[100] The court interpreted these regulation provisions to mean the Commissioner could consider "any combination" of arrangements resulting from the decedent's employment.[101] The court reasoned, however, the "mere possibility" of employee benefit from such a plan would not necessarily satisfy section 2039(a)'s requirements, unless the plan also creates survivor's benefits.[102] After acknowledging the Commissioner's right to read plans together in determining whether there should be section 2039 inclusion, the court concluded that the decedent's rights under the Disability Plan were "too dissimilar in nature from an 'annuity or other payment' and too contingent to meet the conditions of section 2039(a)."[103] The *Schelberg* analysis accordingly requires a determination of whether payments to the decedent are similar to annuities or other payments.[104]

The payments in *Schelberg* were next analyzed in light of the congressional

---

98. 612 F.2d at 28.

99. Treas. Reg. § 20.2039-1(b) (1958).

100. *Id.* § 20.2039-1(b)(2), ex. (6) states:

> The employer made contributions to two different funds set up under two different plans. One plan was to provide the employee, upon his retirement at age 60, with an annuity for life, and the other plan was to provide the employee's designated beneficiary upon the employee's death, with a similar annuity for life. Each plan was established at a different time and each plan was administered separately in every respect. . . . The value of the designated beneficiary's annuity is includible in the employee's gross estate. All rights and benefits accruing to an employee and to others by reason of the employment . . . are considered together in determining whether or not section 2039(a) and (b) applies.

Id.

101. 612 F.2d 25, 28, *quoting* Treas. Reg. § 20.2039-1(b) (1958).

102. 612 F.2d at 28.

103. *Id.* at 29.

104. *Id.* The court here misstates the question. The issue is not whether the rights are *similar* to an annuity or other payment but whether the rights *are* an annuity or other payment. The court apparently meant to determine whether the rights are similar to the traditional annuities Congress focused upon in enacting § 2039.

intent expressed in the legislative history. The court concluded Congress intended the section to deal only with a joint annuity, not the whole gamut of possible employer/employee arrangements.[105] This conclusion was supported by pointing out that the instant situation did not represent the classic situation of joint and survivor annuity presented by the examples used in the legislative history. Although the term "other payment" is literally broad, Congress was clearly referring to payments in the nature of annuities that would be includible in the estate if made to the survivor.[106]

The court concluded that *Schelberg*'s facts should not lead to inclusion under section 2039, because the contingency of qualifying for payments under a disability plan should not be considered a pre-death annuity or other payment for section 2039 purposes.[107] The court added that such an interpretation would be contrary to the congressional intent.[108] Distinguishing *Bahen* on its facts, the court stated the benefits there were more similar to the joint and survivor annuities with which section 2039 was concerned. In addition, the Second Circuit hinted that it might have decided *Bahen* differently.[109] In general, the *Schelberg* court simply refused to require inclusion of payments arising from situations far removed from the traditional annuity arrangement.

Schelberg questions the reasoning reflected in the majority of cases decided under section 2039. It essentially rejects *Bahen*'s view that a contingent payment to a decedent is a sufficient pre-death annuity or other payment when occurrence of the contingency is unlikely.[110] This view has subsequently been approved outside the Second Circuit as recently demonstrated by *Estate of Van Wye v. United States*.[111] Under similar facts,[112] the Sixth Circuit relied on

---

105. *Id.* The court stated:

> Both text and context show that [section] 2039 was conceived as dealing only with the problem of what in substance was a joint annuity, although to be sure in all its various ramifications, not with the whole gamut of arrangements under which an employee, his employer or both may create benefits for the employee's survivors.

Id.

106. *Id.*

107. *Id.* at 33. The court stated:

> [T]o consider a deceased employee[']s potential ability to have qualified at some future time for payments under a plan protecting against total and permanent disability . . . as meeting the condition in section 2039(a) that there must be a contract or agreement under which the decedent received or be entitled to receive "an annuity or other payment", is such a departure from the language used by Congress, read in the light of the problem with which it was intending to deal, as to be at war with common sense.

108. *Id.*

109. *Id.* at 34. Estate of Wadewitz v. Commissioner, 339 F.2d 980 (7th Cir. 1964) was distinguished because the payments in question arose from a single unitary plan. 612 F.2d at 33. The court distinguished Gray v. United States, 410 F.2d 1094 (3d Cir. 1969) on the ground that "[t]he decedent's rights to payments were thus not conditional upon such unlikely events as total disability, but merely survival until retirement age." 612 F.2d at 33.

110. 612 F.2d at 33. The court noted that contingency attributed to Schelberg had been exercised by only a quarter of one percent of IBM employees. *Id.*

111. 686 F.2d 425 (6th Cir. 1982).

112. *Id.* at 426-27. Mr. Van Wye, a decedent, received sickness and accident benefits

Schelberg to reject the Commissioner's attempt to treat disability and survivor benefits under separate plans as a single annuity under section 2039.[113] Quoting Judge Friendly's opinion, the court agreed the decedent's contingent, future right to disability payments while alive were analogous to continued wages and therefore not within the ambit of "annuity as other payment," under the *Schelberg* analysis.[114] In *Schelberg*'s wake, therefore, a sharp division of authority exists on the question of what pre-death interest causes section 2039 inclusion.

While *Schelberg*'s application of section 2039 appears consistent with the section's language and legislative history, it is unclear what effect, if any, Congress intended the section to have when specifically applied to this situation. At a minimum, *Schelberg* demonstrates that the section is difficult to apply in situations beyond those Congress clearly considered. *Schelberg*, however, does not appear consistent with the general purposes of estate tax. The transfer of property the decedent either owns or has substantial rights in is generally subject to estate tax. Stepping back from section 2039's technicalities, *Schelberg* involves an employee of a large corporation whose widow received payments from the employer after her husband's death. The payments resulted from the decedent's work as an executive and were clearly compensation very similar to a salary. Realistically, in this sort of plan both the employer and the employee consider such benefits compensation for the employee's services and plan accordingly.[115] *Schelberg* effectively treats the widow's payment as property not owned substantially by the decedent at death, which is inconsistent with the reality of these compensation plans. Retirement and death benefit plans are not gifts in any sense of the word but are clearly payments for services. In a real economic sense, the decedent owns the benefits at death; to treat them in any other manner contradicts reality.

Recommendations to Harmonize Section 2039 With Estate Tax Goals

The state of the law under section 2039 is quite unsatisfactory with re-

which, if he had survived, could have commuted to disability benefits. A survivor plan allowed the widow one percent of decedent's final monthly salary times years of service. *Id.* at 426. As did *Schelberg*, *Van Wye* distinguished *Bahen* on its facts, finding the plan there had allowed the widow to receive the disability benefits after decedent's death. Such a plan can be considered a joint annuity within the scope of § 2039. *Id.* at 427 n.2.

113. *Id.* at 427. As the court stated: "We need not tarry long with the question presented here for the *Schelberg* case . . . is directly on point and appears to be clearly correct." *Id.*

114. *Id.* The court agreed with Judge Friendly that Congress did not intend "annuity or other payment" to include wages or sickness and accident payments. Here the disability payments would reflect sickness and accident rather than retirement benefits. *Id. quoting* Schelberg v. Commissioner, 612 F.2d 25, 31 (2d Cir. 1979).

115. This sort of plan often arises from hard bargaining between employees and management, typically for the benefit of high executives of large corporations or the owners of smaller businesses. In either situation, all involved parties understand when the employer agrees to make payments to a survivor he gives up something of value and the employee receives something of value. The parties create agreements to make such payments after careful consideration of the financial and business employment realities and the payments are clearly not gifts or casual fringe benefits to the employee.

spect to employee compensation plans that are not traditional joint annuities. The well-established line of cases starting with *Bahen* reached conclusions consistent with the general estate tax but difficult to reconcile with the statute's language and legislative history. *Bahen* required inclusion even though the decedent's pre-death rights were highly contingent. *Fusz* and *Bahen* established the principle that an unpaid salary does not satisfy the pre-death payment requirement. These conclusions, while consistent with the section's history and language, allow part of a decedent's wealth to pass to beneficiaries tax free. *Schelberg* re-examined the section's purpose and rejected the *Bahen* analysis. Although apparently consistent with the history and specific purposes of section 2039, the *Schelberg* decision allowed property to pass untaxed. These decisions therefore leave the law in an unsatisfactory state.[116]

The underlying problem is that section 2039 is poorly drafted. Specifically, the pre-death annuity or other payment required by section 2039(a) results in conclusions that are irreconcilable with both the section's purpose and general estate tax principles. Because of this analytical conflict, some courts, such as that in *Bahen,* have been forced to stretch section 2039's coverage beyond congressional intent to reach a conclusion consistent with general estate tax purposes. Other courts following *Fusz* and *Schelberg* view the requirement narrowly and thus deny inclusion. This narrow reading may be consistent with the section's history, but it allows property the decedent actually owns to pass tax free. These inconsistencies result not from a failure of judges, but from a failure of drafters.

This dilemma could be solved by simply eliminating the pre-death payment requirement from section 2039.[117] If this were done, the value of an

116. Professor Kramer presented an example of how unequal treatment can result from the pre-death payment requirement:

> Under an employee benefit plan, an employee is entitled to a lump sum payment equal to one-half the amount credited to his account under the plan upon reaching retirement at sixty years, and may designate beneficiaries to receive the other half at his death, after retirement; if he dies before retirement, the entire amount in his account is paid his beneficiary. Two employees, *A* and *B*, each irrevocably designate their wives and children as beneficiaries. *A* dies one day before his sixtieth birthday. Since he had a "right" at his death to the payment of one-half of his benefit, the entire lump sum payment to his beneficiary is included in his gross estate under section 2039. *B* dies one day after his sixtieth birthday. Since he no longer had any "right" to any payment at all (having received his one-half before death) and is no longer receiving any payment, the lump sum paid his beneficiary is not taxable under section 2039. And it is hard to see how it can be taxed under any other section of the Code, unless *B*'s designation of the beneficiary was made in contemplation of death within three years of his death. *B* had no life interest, no reversion, no power over or in the benefit paid the beneficiary. Why should *B* receive such favored treatment over *A* here? Do we want to penalize *A* because he died younger than *B* — this, indeed, is a queer philosophy!

Kramer, *supra* note 2, at 369-70. *See also* Pincus, *supra* note 2, at 865-68.

117. So amended, § 2039(a) would read: "The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent)."

annuity or other payment to a beneficiary would be included in a decedent's taxable estate if it arose from a contract or agreement. The effect would be simply that if a decedent entered into an agreement with his employer for payment to beneficiaries after the employee's death, the value of the payments would be included in his estate. Section 2039 would then require inclusion of compensation for the decedent's services that is realistically his property.[118]

This amendment to section 2039 would have several effects. The value of payments to beneficiaries under traditional retirement annuity plans would continue to be included in the decedent's estate because these plans consistently have a post-death payment to beneficiaries. Thus, the legislative history of section 2039 and purposes of the estate tax would be upheld. In addition, the *Bahen* result would be unchanged since that case clearly involved an annuity or other payment to a beneficiary under a contract or agreement. *Fusz,* on the other hand, would not be decided in the same way under an amended section 2039. The court would require inclusion of the annuity or other payment because it arose from an agreement requiring a post-death payment. *Schelberg*'s facts would also require inclusion because once again there was an agreement for payments to beneficiaries. These results would be consistent with the aims of estate tax since the payments were property the decedent earned through his employment.[119] If there had been no pre-death payment requirement, the analytical struggle of both the Tax Court and the Second Circuit would have been unnecessary, and *Schelberg*'s facts would have required inclusion with little judicial difficulty.[120]

Since Congress has shown no particular interest in revising section 2039, however, courts will be forced to apply the law as it now stands. Although not flawless, *Bahen* represents a better application of section 2039 than *Schelberg* and should be followed. While *Bahen*'s reasoning cannot be easily reconciled with section 2039's legislative history,[121] it does not necessarily contradict congressional intent. *Bahen* does appear consistent with both the section's specific

---

118. Suggestions for this amendment have been made previously. *See* A.L.I., *supra* note 4, at 46; G. COOPER, A VOLUNTARY TAX? 97 (1979); Dodge, *Substantial Ownership and Substance Versus Form: Proposals for the Unification of Federal Estate and Gift Taxes and for the Taxation of Generation-Skipping Transfers,* 1976 U. ILL. L.F. 657, 701-02 (1976); Kramer, *supra* note 2, at 389-96. Most recently, Dean Wolk examined the treatment of "pure" or "naked" death benefits, benefits paid on the death of a decedent who had no lifetime benefit. Wolk, *supra* note 2, at 278. He concluded pure death benefits should be taxable, even though they are not now taxable under §§ 2033, 2035, 2037, 2038 or 2039. He then proposed elimination of the pre-death payment requirement from 2039 to cause inclusion of these benefits. *Id.* He also asserted that the IRS's current attempt to tax pure benefits as gifts is inappropriate. *Id.* at 264-77.

In 1958 Meyer Pincus recognized that the pre-death payment requirement caused problems, stating it "[s]hould play no part in the taxation of benefits payable to employee beneficiaries. The employment relationship alone would seem sufficient to justify a tax, since that relationship is the generating source and provides the motive for the payment of benefits to the decedent's family." Pincus, *supra* note 2, at 870.

119. *See infra* note 124 and accompanying text.

120. Indeed, the answer would have been clear under the Code and *Schelberg* probably would not have been litigated.

121. See *supra* text accompanying note 62.

wording and the Treasury Regulations promulgated under it. *Bahen* requires inclusion of property that logically should be taxed to the decedent. In contrast, *Schelberg* reaches a conclusion inconsistent with the purposes of estate tax law, and therefore it is a less preferrable approach.

Schelberg's analysis is also weak because it recreates conceptual problems section 2039 was intended to solve. Specifically, one reason for enacting section 2039 was to eliminate the necessity of determining whether a property interest passed to a surviving beneficiary.[122] Before the section's enactment, if the rights received on the decedent's death were not "property," their value could not be included in the decedent's estate. *Schelberg*'s analysis resurrected this determination with all its problems. The *Schelberg* court's concern that the decedent's rights under the Disability Plan were highly contingent and unlikely to occur[123] was similar to pre-section 2039 analysis concerning whether a decedent's rights were vested.[124] If *Schelberg* is followed, it will be impossible to predict without litigation whether a decedent's pre-death rights are substantial enough to satisfy the statutory requirements. Avoiding this unpredictability originally prompted section 2039's enactment.[125]

The *Bahen* analysis, on the other hand, has the advantage of creating predictability. If the decedent has any pre-death rights to an annuity or other payment, even if highly contingent, that element of section 2039 is satisfied. In view of the fact that the pre-death right requirement is unnecessary from a policy viewpoint, *Bahen* reaches the best result.[126]

Conclusion

Section 2039 requires that an annuity or other payment be payable to both the decedent before death and to his beneficiary after death, and further, that these payments must arise from a contract or agreement. The most serious problems involve the threshold payment-before-death requirement. Differing interpretations of this requirement, best shown by the conflict between *Bahen*

---

122. *See supra* note 17 and accompanying text.

123. 612 F.2d at 33.

124. *See, e.g.,* Howell v. Commissioner, 15 T.C. 224, 227-31 (1950), *acq.* 1953-1 C.B. 4.

125. *See generally* Kramer, *supra* note 2; Pincus, *supra* note 2.

126. Since it was decided, *Bahen* has been cited in 27 later decisions and in six Private Letter Rulings and Revenue Rulings. Although it would be unreasonable to assume Congress recognizes every decision on an issue, *Bahen* is of sufficient importance and notoriety Congress must have been aware of it. While the doctrine of congressional re-enactment is not overwhelmingly persuasive, it does reflect a common sense affirmation of the *Bahen* approach. *See* Jones v. Liberty Glass Co., 332 U.S. 524 (1947) (holding the doctrine of legislative acquiescence is at best an ancillary tool in interpreting ambiguous provisions). After all Congress has never been reluctant to change tax law when it disapproves of judicial application. *See, e.g.,* James v. United States, 366 U.S. 213 (1961). Prior to its decision in *James,* the Supreme Court had ruled in Commissioner v. Wilcox, 327 U.S. 404 (1946), that money taken by embezzlement did not constitute income. When fifteen years passed without congressional adoption of the Court's definition of income, the Justices reversed the *Wilcox* holding. 366 U.S. at 221. The Court took note that congressional reports indicated the statutory definition of income would remain intact. *Id.* at 222. *See also* United States v. Byrum, 408 U.S. 125 (1972); I.R.C. § 2036(b) (1976 & Supp. III 1979).

and *Schelberg*, exist because section 2039's literal requirements cause decisions that are contrary to the basic purpose of estate tax law.

The major purpose of the estate tax is imposition of tax on the transfer of the decedent's property.[127] Before section 2039's enactment, a number of cases considered whether payments from an employer to a decedent employee's beneficiary were sufficiently vested to require inclusion under the 1939 Code.[128] Congress intended section 2039 to eliminate this confusion by requiring inclusion of payments that could reasonably be considered the decedent's property.[129] Later cases applying section 2039 focused on the section's specific requirements without reconciling their results with estate tax law.

Section 2039's application to a traditional joint annuity fulfills the basic goal of estate tax. In such cases, a beneficiary receives payments that have been arranged as part of the employee's compensation. These benefits are equivalent to paid wages and should be treated as property the decedent owned at death.[130] Inclusion in the decedent's estate of traditional survivor's annuities is reasonable and consistent with the basic structure of estate tax and section 2039.

The development of the law under section 2039 through decisions inconsistent with either general estate tax principles or the section's apparent legislative purpose demonstrates the section was poorly drafted. These conflicting interpretations could be solved by the repeal of section 2039(a)'s pre-death annuity or other payment requirement. Repealing this requirement would result in the inclusion of both survivors' benefits under traditional retirement plans, as Congress intended, and benefits similar to those in *Bahen, Fusz* and *Schelberg*, as required by the principles of estate tax law. Absent such an amendment, the *Bahen* analysis provides the better approach for courts to follow, since it carries out general estate tax principles.

---

127. *See* C. LOWDNES, R. KRAMER & J. MCCORD, FEDERAL ESTATE AND GIFT TAXES 26 (3d ed. 1974).

128. *See supra* note 17 and accompanying text.

129. See *supra* text accompanying note 27.

130. However, it should be noted that Congress has chosen to exclude compensation paid after the decedent's death if the payments arose under a qualified plan. I.R.C. § 2039(c) (1976 & Supp. III 1979). Exempting such payments has been criticized on policy grounds. *See supra* note 4. The Treasury Department attempted to convince Congress in 1969 that § 2039(c) should be repealed but was unsuccessful. UNITED STATES TREASURY DEP'T TAX REFORM STUDIES & PROPOSALS BEFORE THE HOUSE COMM. ON WAYS & MEANS, 91st Cong., 1st Sess. 363-64 (Comm. Print 1969).