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Death Benefit Payments To Widows Of Deceased Corporate Employees — Gift Or Income?

Poyner v. C.I.R.¹

Upon the death of its president and majority shareholder, and pursuant to resolutions giving recognition to past services rendered, the corporation, in 1956, transferred to the president's widow a Cadillac and cash valued at $9910.05 as a continuation of the decedent's salary. The payments were not made pursuant to any "contract, plan, policy, practice or understanding made or in effect prior to the Decedent's death."² The corporation was under no obligation to pay any additional compensation, and it apparently derived no benefit from the payment. The widow had performed no services for the corporation. Upon these facts, the Tax Court found that the payments were not, as contended by the widow, excludible from gross income under Section 102(a) of the Internal Revenue Code of 1954³ as gifts, but rather that they constituted taxable income under Section 61⁴ subject only to the $5000 death benefit exclusion of Section 101(b)⁵. On appeal to the Fourth Circuit, Chief Judge Sobeloff, ruled that the decision below must be vacated and remanded so that certain

²Supra, n. 1, 290. This note is limited to consideration of voluntary death benefit payments. It is well settled that payments made pursuant to a contract or other legal obligation are taxable as additional compensation for the decedent's services. See Flarsheim v. United States, 62 F. Supp. 740 (E.D. Mo. 1945) aff'd. 156 F. 2d 105 (8th Cir. 1946); Estate of Arthur W. Davis, 52,238 P-H Memo T.C. (1952); I.T. 3972, 1949-2 Cum. Bull. 15. Cf. Florence E. Carr, 28 T.C. 779 (1957) (Nonacq.), IRS appeal dismissed (nolle pros.) (1958).
³§ 102. Gifts and inheritances

"(a) General Rule. — Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance." All references hereafter made to the Code and to statutory sections refer to the Internal Revenue Code of 1954 or sections thereof, unless otherwise indicated.
⁴§ 61. Gross income defined

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

(1) Compensation for services...
"

⁵§ 101(b) Employees' death benefits.

"(1) General rule. — Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee.

(2) Special rules for paragraph (1).—

(A) $5000 limitation. — The aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed $5000."
additional factors not covered by the parties in their stipulation in the Tax Court could be considered.

The controversial distinction between gift and income has had a long and turbulent history. The Internal Revenue Service has by no means maintained a consistent position in the area of widow's payments, but it was the issuance of a 1950 ruling which gave rise to judicial controversy which has continued until the present day. To counter the Commissioner's contention that such payments were in consideration of the deceased officer's services, the widow-taxpayer argued that the transfers were mere gifts and therefore not taxable. In the numerous cases over the years, the widows were consistently successful. Finally, in 1958, the Commissioner announced his capitulation by

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6 The first officially reported case before the Board of Tax Appeals related to this problem. John H. Parrott, 1 B.T.A. 1 (1924).

7 On the particular problem of corporate payments to the widows of deceased officers and employees, the government first stated its position in T.D. 2090, 16 Treas. Dec. Int. Rev. 259 (unpublished) (1914), and in O.D. 1017, 5 Cum. Bull. 101 (1921), both of which ruled that such payments were nontaxable gifts. In 1939, the Commissioner issued I.T. 3329, 1939-2 Cum. Bull. 153, which, while reiterating this position, stated the payments would be classed as gifts so long as the widow had rendered no services. This appeared to be no more than a crystallization of Regulation 118, § 39.22(a)-2, promulgated under the 1939 Code, which provided gift treatment where no services had been rendered to the corporation. However, intended or not, I.T. 3329 shifted the emphasis from lack of services by anyone to the payor (corporation) to lack of services by the recipient (widow). This shift was noted by the Tax Court in Louise K. Aprill, 13 T.C. 707 (1949) (Nonacq.) which cited I.T. 3329 and found a gift because no services had been rendered by the widow in return for the payments. Then, in 1946, the Fifth Circuit handed down a decision in Varnedoe v. Allen, 158 F. 2d 467 (1946) cert. den. 350 U.S. 821 (1947), holding that there was no necessity that services be rendered by the payee; a payment would be taxable as long as the payor was one to whom services had been rendered. With this decision in hand, the Commissioner issued I.T. 4027, 1950-2 Cum. Bull. 9, which revoked O.D. 1017 and modified I.T. 3329 and held that payments to the widow of a deceased employee in consideration of services rendered by the employee would be taxable to the widow even though she herself had rendered no services.

8 For an excellent comprehensive coverage of the area, see Pelisek, Tax Treatment of Payments to the Widows of Corporate Officers and Employees, 44 Marq. L. Rev. 16 (1960). Some of the factors given varying degrees of consideration by the courts in deciding whether or not a gift was intended are: (a) whether the death benefit was measured by the decedent's salary; (b) whether payment was to the widow or to the estate; (c) whether the corporation has realized any benefit from the payment; (d) the wording of the corporate resolution authorizing the payment; (e) whether the resolution has been submitted to the shareholders, or merely passed on by the Board of Directors (on the theory that only the shareholders may give away corporate assets); (f) whether the payment has been charged as an expense on the corporate books and/or deducted on the tax return; (g) testimony of corporate directors, officers and shareholders; and (h) past practices of the corporation. See also Groh, Voluntary Payments to an Employee's Widow, 36 Taxes 333 (1958).

9 See Pelisek, supra, n. 3, footnotes 20 & 21.
declaring that he would no longer litigate cases involving voluntary payments to widows by their deceased husbands' employers arising under the 1939 Code.

Under the Internal Revenue Code of 1954, litigation became temporarily diverted into a new area. A 1951 amendment to the 1939 Code had exempted contractual death benefit payments from taxation to the extent of $5000. However, the analogous provision of the 1954 Code removed the requirement that the payments be made pursuant to contract; i.e., voluntary death benefits now became subject to the $5000 exclusion. It was contended by the Internal Revenue Service that § 101(b) was intended to cover all payments to widows, voluntary or contractual, including those that would have been classified as fully exempt gifts under Sec. 102(a) of the 1954 Code. There was a small measure of judicial support for this view. However, such a contention had no logical foundation; it produced the anomaly of a taxable gift — a direct contradiction of Sec. 102. The courts, when specifically required to rule on the point, held, apparently without exception, that Sec. 101(b) did not supersede Sec. 102(a); that if a death benefit payment was in reality a gift, it would be completely exempt from taxation. In view of these developments, the Commissioner, in 1962, announced that he would no longer contend that the exclusion for a payment received by a widow from her deceased husband's former employer is limited to $5000 where the payment otherwise qualifies as a gift.

The end of the controversy concerning Section 101(b) signaled a return to the basic issue of whether a particular death benefit payment was actually a gift to the widow

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*Rev. Rul. 58-613, 1958-2 Cum. Bull. 914. It will be noted, however, that the ruling leaves the Revenue Service free to litigate cases involving dividends or where there existed clear evidence that the payments were intended as compensation.

*1939 I.R.C., § 22(b)(1)(B), added by § 302(a), Revenue Act of 1951.

*Supra, n. 5.

*The new provision contained a second change from the 1951 Code in that the maximum exclusion under § 101(b) became $5000 per employee, without regard to the number of employers or beneficiaries, whereas, under the old § 22(b)(1)(B), each employer could pay $5000 in non-taxable benefits to each (if more than one) beneficiary. Under § 101(b), if benefits over $5000 are paid to several beneficiaries, the exclusion must be apportioned among them.


or additional compensation for the deceased employee's services. This meant that all the cases decided under the 1939 Code became applicable to disputes arising under the 1954 Code, since the same issues were involved, and since the latter Code made no other changes in the widow's tax status.\(^\text{17}\)

The confused state of the law and the lack of any universal guidelines to be applied in properly defining the nature of a gift gave rise to a review of the situation by the Supreme Court in the now famous case of *Commissioner v. Duberstein*.\(^\text{18}\) Two separate cases were being considered by the Supreme Court in this opinion: *Commissioner v. Duberstein*: Duberstein, an officer of Corporation A, was given a Cadillac by the president of Corporation B. Although it was a gratuitous transfer, Duberstein stated that he probably would not have received the car were it not for the fact that he had supplied B with names of potential customers. Corporation B deducted the cost of the car on its tax return. The Tax Court, finding no intention to make a gift, held that the car was income to Duberstein. The Sixth Circuit reversed.\(^\text{19}\) The Supreme Court reinstated the holding of the Tax Court, on the ground that such holding could not be found to be "clearly erroneous."

*Stanton v. U.S.*: Stanton, a church employee, was given $20,000 upon his resignation. Although there was conflict as to the circumstances under which he was leaving, and as to the feeling toward him at that time, a church resolution said that the payment was a gratuity in appreciation of services. The District Court found a gift, but the Second Circuit reversed.\(^\text{20}\) The Supreme Court here remanded the case to the lower court for more adequate findings of fact.

The Supreme Court in *Duberstein* rejected a test proposed by the government that "[g]ifts should be defined as transfers of property made for personal as distinguished from business reasons,"\(^\text{21}\) on the grounds: (a) that it would

\(^\text{17}\) Frankel v. United States, *supra*, n. 15, aff'd. 302 F. 2d 666 (8th Cir. 1962). Judge Donovan stated at p. 778 of the District Court opinion: "It is . . . clear that the determination of the problem of gift versus compensation in cases of this kind is not affected by the 1954 Code, since Section 102 appeared in the 1939 Code in the same form."


\(^\text{19}\) 265 F. 2d 28 (1959).

\(^\text{20}\) 268 F. 2d 727 (1959).

\(^\text{21}\) *Supra*, n. 18, 284, footnote 6. Business reasons were any that established a proximate causal relationship between the payment and the performance of services, the conduct of a business, or the production of income. Personal reasons were considered motivations other than business reasons.
be going beyond the requirements of the cases before the Court, (b) that it is based on maxims of experience rather than principles of law, (c) that the conclusion that a payment is or is not a gift must be derived from a consideration of all the factors in each case, and (d) that the governing principles have already been spelled out in previous Supreme Court opinions. The Court noted that the legal definition of a gift has been developed by judicial interpretation, and it then restated the more important principles of law to be applied. The Court stated that an objective inquiry, and not the donor's characterization of his action, is determinative of whether or not a payment is actually a gift. The proper criterion is one that inquires into the basic reason for the payor's action.

The approach was taken that the issue is one of fact for determination on a case-by-case basis, and that, as a consequence, there must exist only a limited scope of appellate review. Any fears of undue uncertainty or excessive litigation, said Justice Brennan, must be quieted by the Congress, and not by the courts. The Court has been firmly criticized for its "excessive deference to the triers of facts."

The first Tax Court case to be decided after Duberstein was Poyner v. C.I.R. (titled in that Court, Estate of Pier-

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22 "[T]he statute does not use the term 'gift' in the common-law sense, but in a more colloquial sense. This Court has indicated that a voluntary executed transfer of his property by one to another, without any consideration or compensation therefor, though a common-law gift, is not necessarily a 'gift' within the meaning of the statute. For the Court has shown that the mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift. . . . And, importantly, if the payment proceeds primarily from 'the constraining force of any moral or legal duty,' or from 'the incentive of anticipated benefit' of an economic nature, . . . it is not a gift. And, conversely, '[w]here the payment is in return for services rendered, it is irrelevant that the donor derives no economic benefit from it.' . . . A gift in the statutory sense, on the other hand, proceeds from a 'detached and disinterested generosity.' . . . 'out of affection, respect, admiration, charity or like impulses.' . . . And in this regard, the most critical consideration, as the Court was agreed in the leading case here, is the transferor's 'intention.' . . . 'What controls is the intention with which payment, however voluntary, has been made.'" (Citations omitted). Supra, n. 18, 285-286.

23 "Where a jury has tried the matter upon correct instructions, the only inquiry is whether it cannot be said that reasonable men could reach differing conclusions on the issue. . . . Where the trial has been by a judge without a jury, the judge's findings must stand unless 'clearly erroneous' . . . 'A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.'" (Citations omitted). Supra, n. 18, 290, 291.

24 Griswold, Of Time and Attitudes, 74 Harv. L. Rev. 81, 88-89 (1960). Dean Griswold calls this opinion "[T]he failure of 'the maturing of collective thought,' as well as of the unfortunate enlargement of the function of the jury or other finder of the facts."
Judge Raum proclaimed that the *Duberstein* opinion "went a long way toward bringing the problem back into proper focus, thereby clarifying and developing the law in this troublesome area." Citing the legal principles espoused in *Duberstein*, the Tax Court found that the widow's payment was income, not gift, and that the issue was one of fact, not of law. It was held to be significant that the corporate resolution authorizing the payment spoke in terms of "recognition of services" and "continuation of salary." The opinion also stated that it was not necessary to refer to the pre-*Duberstein* cases any longer.

On appeal to the Fourth Circuit, Judge Sobeloff vigorously challenged the Tax Court's ruling. His view was that the following factors considered by the Tax Court in pre-*Duberstein* cases are still timely:

1. the payments had been made to the wife of the deceased employee and not to his estate;
2. there was no obligation on the part of the corporation to pay any additional compensation to the deceased employee;
3. the corporation derived no benefit from the payment;
4. the wife of the deceased employee performed no services for the corporation; and
5. the services of her husband had been fully compensated."

The Court asserted that *Duberstein* does not destroy the value of the old cases as precedent; that, when considering these criteria in similar factual situations, the Tax Court had always found a gift to be present, and that, but for *Duberstein*, would have done so in this case. Little significance was attached to the language used in the corporate resolution. However, the Tax Court decision was not reversed, but, rather, was vacated and remanded so that consideration could be given to those factors which

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25 *35 T.C. 65 (1960).*
26 *Id.,* pp. 70-71. Judge Kern, dissenting, took the view that was eventually adopted by the Fourth Circuit on appeal. He stated that unless *Duberstein* created new law, the Tax Court should be bound by its previous decisions that payments under these circumstances constituted gifts. *Duberstein*, he contended, being so factually different, could not be deemed to create new law in the area of widow's benefits.
28 Poyner, *supra*, n. 1, 291.
have become important since *Duberstein* and on which the record was silent.

The significance of Judge Sobeloff's remand in the Fourth Circuit can be more readily appreciated when it is realized that all of the Tax Court cases decided subsequent to the Tax Court's consideration of *Poyner*, but prior to the *Poyner* appeal, followed the Tax Court's conclusion in that case. Since then, no Tax Court opinions have issued in this area, so that it is entirely possible that the stage may be set for a hasty retreat by the Tax Court to its pre-*Duberstein* position.

Other of the Tax Court "income decisions" have met a fate similar to that of *Poyner*. Just two weeks after the Fourth Circuit's decision, the Sixth Circuit reversed without remand the holding in *Kuntz' Estate v. C.I.R.*9 The only significant factual difference between *Poyner* and *Kuntz* was that in the latter, directors and an officer of the corporation testified as to intent to make a gift. Perhaps this explains the refusal to remand, as done in *Poyner*. The Eighth Circuit added its voice and reversed the Tax Court decision in *Olsen's Estate v. C.I.R.*,8 expressly relying on the Sixth Circuit's decision in *Kuntz*.

The district courts, barring unusual factual situations, have continued, even in the light of *Duberstein*, to find excludable gifts. Rejecting the Tax Court's interpretation of *Duberstein*, the district courts have found *Duberstein* applicable only from a procedural standpoint; i.e., that the issue is one of fact requiring case-by-case analysis and a limited scope of review. The Eighth and Tenth Circuits have affirmed this position.83

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83 300 F. 2d 671 (8th Cir. 1962) rev'g T.C. Memo 1960-247.


84 United States v. Frankel, 302 F. 2d 606 (8th Cir. 1962) aff'g. 192 F. Supp. 776 (Minn. 1961); U.S. v. Kasynski, 284 F. 2d 143 (10th Cir. 1960) aff'g. 6 AFTTR 2d 6060 (Colo. 1960).
Repudiation seemed imminent for the Commissioner's view that *Duberstein* has had the effect of re-interpreting the standards to be used in deciding the proper classification of widow payments. In fact, the only two post-*Duberstein* district court cases that have found widow's payments to be income rejected the Commissioner's view of *Duberstein*, and cited the case only as reiterating the bare principles that intent of the donor is the governing criterion and that this is a factual question to be handled on a case-by-case basis. It is submitted that the Commissioner is, in fact, in error in his view of *Duberstein*'s effect. As stated in *Kuntz*, *Duberstein* really has no application in the area of widow's payments because, (a) the taxpayer had rendered services for which he wasn't compensated, (b) the transferror was obligated in a moral sense, and (c) the transferror might be anticipating further services from the taxpayer.

In June of 1962, the apparent trend toward uniformity seemed to be cast aside when the Third Circuit Court of Appeals, affirming two Tax Court decisions, found for the Commissioner. *Duberstein* was relied on only as authority for application of the "clearly erroneous" standard of appellate review. There is, perhaps, factual justification for the differing results reached in the Third Circuit as compared to those reached in the Fourth (*Poyner*), Sixth (*Kuntz*) and Eighth (*Olsen*) Circuits. In one of the Third Circuit decisions, the payor-corporation followed normal payroll procedures (Forms W-2, withholding, etc.) in its handling of the widow's payments; in the other case, there were a sufficient number of additional facts relied on by the Tax Court below to reach the conclusion that additional compensation was intended, so that the Appeal Court, applying limited review, could not hold that the lower court decision was clearly erroneous. However, it is to be noted that the Third Circuit had in the record be-

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34. *Gaugler v. United States*, 204 F. Supp. 493 (S.D.N.Y. 1962); *Hein v. United States*, ..., F. Supp. ..., (E.D. Wis. 1962) 62-2 USTC ¶ 9564. These cases may be distinguished from the other district court cases cited in n. 32 in that, in the Gaugler and Hein cases, a voluntary death benefit plan creating a moral obligation was found to exist at the decedent's death. This had the effect of making the death benefit a type of "fringe" compensation, and of evidencing an intent, other than purely donative, on the part of the corporation. See, *Simpson v. U.S.*, 261 F. 2d 497 (7th Cir. 1958), cert. den. 359 U.S. 944 (1959).

In addition, in Hein, there was a direct statement by a corporate officer that the payments were not intended to be gifts.

35. *Supra*, n. 30, 552.

fore it those very factors, the lack of which impelled Judge Sobeloff in *Poyner* to remand.\(^7\) Perhaps, had the record been as complete, *Poyner* would have been decided in a manner similar to the Third Circuit decisions.

The Commissioner, possibly because of the new lease on life granted by the Third Circuit, requested certiorari in *Kuntz, Olsen*, and *Frankel*. On the other hand, a similar request was made by the taxpayers in *Smith* and *Martin*. However, the Supreme Court has declined to rule in this area.\(^8\) Effectively, this means that, unless and until Congress decides to legislate, the law will remain on a case-by-case basis. The apparently conflicting results reached by the various courts serve to point out the factual nature of the question. However, the overwhelming weight of the court decisions over the past years has shown that, under normal circumstances, payments to widows have been, and will probably continue to be, treated as gifts. It is not inconceivable that, faced with this fact, the Commissioner will be limited to attack only in special situations (voluntary benefit plan, dividend circumstances, etc.), and ultimately, will issue an acquiescing ruling similar to that issued in regard to cases under the 1939 Code.\(^9\)

Such a disposition of the matter would seem equitable in the light of the passage of the Revenue Act of 1962. Much of the contention in this area results from the fact that corporations were taking deductions for the same payments that were going tax-free to the widows. It would appear that the very factors which would necessitate gift treatment by the widow,\(^40\) should also serve to deny a corporate deduction through failure of the payment to qualify as an ordinary and necessary business expense.\(^41\) Unfortunately, this question has never been fully resolved by the courts.\(^42\) However, Section 4(a)(1) of the 1962 Act,

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\(^7\) The *Poyner* opinion mentioned (a) the widow's stock holdings in the company, and (b) the company's knowledge, or lack of it, concerning her financial needs. In a footnote, the opinion cited the *Smith* and *Martin* decisions in the Tax Court as considering these factors. See, *supra*, n. 1, 292.

\(^8\) *.... U.S. ....* (1962).


\(^40\) See *supra*, n. 8.

\(^41\) However, Chief Judge Thomsen, in a factually-dominated opinion holding that certain payments constituted gifts to the widow, set forth dictum to the effect that: "The fact that the payments were made in recognition of the services rendered to the corporation by the decedent does not require that they be treated as income by the widow, even if it permits their deduction by the corporation as ordinary expenses." *Corasaniti v. United States ...., F. Supp. ....* (D. Md. 1962).

\(^42\) This is perhaps due to the fact that rarely are both the corporate deduction and the widow's treatment of the income item before the same
which becomes Section 274(b) of the 1954 Code, denies a deduction to the payor for any business gift in excess of $25.00 per recipient. As a result, a corporation will not be able to deduct any payment which the widow-payee may exclude as a gift under Section 102 of the Code. This factor could weigh heavily in any decision by the Commissioner to limit litigation in this area.

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court at the same time. One exception, however, was Cooper's Estate, T.C. Memo 1961-154 (1961). There, the Tax Court found that the payments "were not gifts to the widow, but were intended as additional compensation for services previously rendered by the decedent. Such payments therefore were not excludable from income in the hands of the widow as gifts, and they were deductible by the corporation." It seems implicit in this wording that Judge Raum considered the same factors in arriving at both conclusions. The opinion went on to state that, "We do not reach the possible question whether the corporation might in any event deduct the payment even if they should be held to be gifts."

"Gift" is defined, in the context of this section, as any item excludable under § 102 which is not excludable under any other section. This means that an employer's payment to the widow of a deceased officer which is excludable from her income as a gift under § 102 would be deductible by the employer only to the extent of $25.00, whereas, if the payment is excludable under § 101(b) as a death benefit, § 274(b) does not apply to it. Committee Report (Revenue Act of 1962) — § 4, C, 3.