DISCHARGES OF LEGAL OBLIGATIONS, SECTION 2036
AND CONSIDERATION IN ESTATE AND GIFT
TAXATION

JOEL E. NEWMAN*

I. Introduction

Under present law, a finding that trust assets are being applied in dis-
charge of the settlor's legal obligations can have the effect of including the
trust corpus in the taxable estate under section 2036 of the Internal Re-
venue Code,¹ or it can have the effect of excluding the trust corpus from the
taxable estate as a transfer for full and adequate consideration.² The courts
have not defined the concept of "discharges of legal obligations" in the
same way for purposes of inclusion as they have for exclusion. If they did,
as they should, then the two effects would always cancel out. Therefore,
the concept of "discharges of legal obligations" is functionally unneces-
sary to the estate and gift tax system, and should be discarded. This article
will discuss how the concept is supposed to work, how it has actually de-
veloped, and how and why it should be discarded.

A. Section 2036

Before 1976, a differential structure of estate and gift tax rates and
exemptions made it highly preferable to transfer assets by lifetime gifts
rather than transferring those same assets to the same people through the
estate at death.³ Tax consequences notwithstanding, however, most people
preferred to transfer assets through their estates, so that they could enjoy
those assets throughout their own lives. Therefore, the tax goal was always
to effect a transfer of assets which was complete enough so that it would
be taxed as a gift rather than taxed through the estate, but to retain
enough control over the assets so that the donor could continue to enjoy
them for the rest of his life. As a result, much of the law in the estate and
gift tax area deals with the question of when a transfer will be complete

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* Assistant Professor of Law, Wake Forest University School of Law; A.B. (1968) Brown
University, J.D. (1971) University of Chicago. I am indebted to Professor David Shores of the
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¹ See notes 22-52 infra and accompanying text. See also Schneider, The Inter-Vivos
Trust for a Minor: Its Estate Tax Aspect, 28 Taxes 825 (1950); 133-2d T.M., Retained Life
Interests, II C (2). Hereinafter, references to sections without further description will be to
the Internal Revenue Code of 1954. "1939 Code" will refer to the Internal Revenue Code of
1939.

² See notes 53-61 infra and accompanying text.

94-455, §§ 2001(a)(1) and 2001(b)(1), respectively, 90 Stat. 1520; I.R.C. §§ 2052 and 2521, as
repealed by, Tax Reform Act of 1976, Pub. L. No. 94-455, §§ 2010(e)(4) and 2505(d)(3),
respectively, 90 Stat. 1520.
enough to be taxed as a gift, and the corollary question of when a present transfer will be incomplete enough so that the transferred assets will be included in the estate despite the transfer.\(^4\)

The Tax Reform Act of 1976,\(^4\) by unifying the rate structure,\(^4\) makes it much less preferable to structure a transfer as a gift rather than a bequest. There are still advantages, however, to the gift tax.\(^7\) Therefore, although the incentives are lower, the same goals are present.

One of the principal maxims of the law in this area is that transactions which have the same practical effect must have the same tax effect. Otherwise, form would conquer substance. For example, if A wills Blackacre to B, A will have the possession and enjoyment of Blackacre for his life, and B will have it at A's death. Similarly, if A transfers Blackacre to B now, but retains a life estate, then A will have possession and enjoyment for his life, and B will get it at A's death. There are differences, to be sure, but they are outweighed by similarities. Because in practical terms a transfer with a retained life estate is the same as a testamentary transfer, they should be taxed the same way. In fact, in either case, the entire value of Blackacre will be included in the taxable estate; a transfer with a retained life estate is not a complete enough transfer to avoid the inclusion of the transferred assets. This concept is codified in section 2036(a)(1), which provides in part:

The value of the gross estate shall include the value of all property . . . of which the decedent has at any time made a transfer . . . under which he has retained for his life . . .

(1) the possession or enjoyment of, or the right to the income from, the property . . .

In the garden variety transfer with a retained life estate, the transferor himself has the rights to the enjoyment of the property or the income from the property. What if the transferor did not retain the right to enjoy the property himself, but did retain the right during his life to transfer the right of enjoyment of the property to his creditors in discharge of his legal obligations? Such a transfer would function, for all practical purposes, in the same way as a transfer with a retained life estate. Allowing the transferor to use the transferred property to discharge his obligations is a significant, though indirect, mode of "possession or enjoyment." In fact the right so to transfer releases other assets that the transferor otherwise would have had to apply toward the discharge of those obligations. Therefore, whether trusts assets are enjoyed by the settlor or his creditors, the practical effect is the same, and the transaction should be taxed in the same way. In fact,

\(^4\) See, e.g., I.R.C. §§ 2035-2038 and 2511.
\(^7\) One advantage of the gift tax is the annual exclusion of I.R.C. § 2503(b). Another is the avoidance of a transfer tax on the market appreciation that may accrue to transferred assets between the date of the gift and the date of the donor's death.
when transferred assets are applied toward the discharge of a legal obligation of the transferor, these transferred assets are included in the taxable estate. The applicable language is found in regulation section 20.2036-1(b)(2), which expands upon the meaning of the phrases “possession or enjoyment” and “right to the income,” as found in section 2036(a)(1):

use, possession, right to income, or other enjoyment of the transferred property is considered as having been retained by or reserved to the decedent to the extent that the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent, or otherwise for his pecuniary benefit. The term “legal obligation” includes a legal obligation to support a dependent during the decedent’s lifetime.

B. Consideration

One way of describing the operation of section 2036 is to say that a taxpayer will not be allowed to deplete the amount of his taxable estate by transferring assets out of his estate during his life in such a way that the transfer is practically the same thing as a testamentary transfer. However, if the transfer was done in such a way that the taxpayer’s taxable estate was not depleted, then it would not matter. For example, if a transferor transferred assets with a retained life estate, but did so in exchange for an equivalent cash payment, then the transfer would not deplete his estate at all. In fact, if those transferred assets were included in his estate, the initial transfer would be taxed, and the cash payment, if not otherwise expended, would also be taxed to his estate. To avoid this double taxation, section 2036(a)(1) provides that transfers with retained life estates will not be included in the taxable estate in the case of a “bona fide sale for an adequate and full consideration in money or money’s worth.” This “consideration exception” is also found in sections 2035, 2037, 2038, 2041, 2043, and in the gift tax statutes. Clearly the phrase “adequate and full consideration in money or money’s worth” cannot have the same meaning that consideration has in contract law. A peppercorn may be good consideration for a contract, but it would not prevent the depletion of an estate. What is required, in the words of regulation section 20.2043-1(a), is that “the price must have been an adequate and full equivalent reducible to a money value.”

What about the discharge of a legal obligation? Such a discharge would clearly furnish consideration for a contract, but that is not enough. However, such a discharge, if it reduces the liabilities on the balance sheet of the transferor, must thereby increase his net worth. Any increase in net worth would tend to prevent the depletion of the estate. Therefore the discharge of legal obligations is that sort of consideration to which the consideration exception in section 2036 applies.

* See A. Corbin, Corbin on Contracts § 136 (1952).
* See C. Lowndes, R. Kramer & J. McCord, Federal Estate and Gift Taxes, chs. 14,
We are left with a dilemma. A transferor transfers assets in trust, with the assets of the trust to be applied in discharge of his legal obligations. Conceptually, according to the section 2036(a)(1) and regulation section 20.2036-1(b)(2), the assets of the trust should be included in his estate, for his transfer is tantamount to a transfer with a retained life estate, which is tantamount to a testamentary transfer. However, the very fact that makes the trust assets includable in his estate should make them excludable as well. The fact that the transferor's legal obligations are being discharged means that the transfer in trust is not depleting the estate. Therefore, the trust assets should be excluded from the estate pursuant to the consideration exception. Conceptually, then, when transferred assets are to be applied toward the discharge of a legal obligation of the transferor, section 2036 pulls the assets into the taxable estate, but the consideration exception pulls them back out. Do these two effects of discharges of legal obligations in fact cancel out? If they do cancel out, is it not inappropriate to keep these opposing provisions in the law? If they do not cancel out, why not?

In fact, they do not cancel out; what is more, they are not even mentioned in the same breath. With but two exceptions, the cases hold that transferred assets applied toward a discharge of a legal obligation will be included in the estate pursuant to section 2036 fail to mention the consideration exception. Similarly, cases holding that a discharge of a legal obligation is consideration for purposes of the estate and gift tax statutes fail to mention section 2036. An examination of the two cases which do recognize both consequences of discharges of legal obligations, Estate of McKeon v. Commissioner and National Bank of Commerce v. Henslee, gives rise to a theory that “discharge of legal obligation” is defined in different ways for purposes of section 2036 and for the consideration exception. This difference should explain why the two consequences rarely occur in the same case.

II. McKeon and Henslee

In McKeon, the decedent, pursuant to a separation agreement, transferred stock in trust to his wife for the support and maintenance of herself and the couple's minor children. The wife accepted the trust in full satis-


Exclusions of transfers for full and adequate consideration from the taxable estate pursuant to I.R.C. §§ 2035-2038 and 2041, allowance of deductible claims contracted for full and adequate consideration pursuant to I.R.C. § 2053, and exclusions of transfers from taxable gifts to the extent of the consideration received pursuant to I.R.C. § 2512 will hereinafter be referred to collectively as the “consideration exception.”

10 See cases cited notes 22-52 infra.
11 See cases cited notes 53-61 infra.
12 25 T.C. 697 (1956).
faction of the husband’s obligation to support the family. The Tax Court held that the transfers in trust were includable in the decedent’s estate, being in discharge of the husband’s legal obligation.

The court went on to discuss the consideration exception then found in section 811(i)(b) of the 1939 Code. As to the children, the court found that the discharge of the husband’s legal obligation to support them was adequate and full consideration. Therefore, the court reduced the taxable estate by that portion of the trust corpus which was necessary to provide enough income to support and maintain the children until they became adults, no longer legally dependent on their parents.

As to the wife, the court noted that section 812(b) of the 1939 Code provided in part:

For the purposes of this subchapter, a relinquishment of dower, curtesy . . . or other marital rights in the decedent’s property or estate, shall not be considered to any extent a consideration in “money or money’s worth.”

The court declined to go along with published treasury rulings, and held that the phrase “other marital rights” included support rights. On that basis, the court held that money paid in discharge of the husband’s support obligations toward his wife was not adequate and full consideration. Therefore, the court refused to make any further reduction in the decedent’s taxable estate.

Henslee, unlike McKeon, involved a support trust for the child of a broken marriage, but not the wife. In Henslee, the decedent, pursuant to a separation agreement, established a trust for the support of his daughter who was to remain in his custody. The court held that the corpus of the trust was includable in the decedent’s estate pursuant to section 302(c) of the Revenue Act of 1926 (the predecessor of section 2036), citing Helvering v. Mercantile-Commerce Bank & Trust Co., a case involving the discharge of a legal obligation. As to the consideration exception, the Henslee court distinguished McKeon because, in McKeon and four of the cases cited therein, the settlor of the trust did not have custody of the minor children, while in Henslee, the decedent did have custody. The court in Henslee commented that it is impossible for one who has custody of a minor child to effect an absolute discharge of his obligation to that minor child. Reasoning that nothing less than an absolute discharge could be adequate and full consideration, the court found the consideration excep-

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15 See Commissioner v. Weiser, 113 F.2d 486 (10th Cir. 1940); G.D. McDonald Trust v. Commissioner, 19 T.C. 672 (1953), aff’d sub. nom., Chase Nat’l Bank v. Commissioner, 225 F.2d 621 (8th Cir. 1955); Hooker v. Commissioner, 10 T.C. 388 (1946), aff’d, 174 F.2d 893 (5th Cir. 1949); Estate of Phillips v. Commissioner, 36 B.T.A. 762 (1937). In the only other case cited on this issue in McKeon, Converse v. Commissioner, 5 T.C. 1014 (1945), aff’d, 163 F.2d 131 (2d Cir. 1947), the government had conceded the issue raised in Henslee.
tion to be inapplicable, and included the full trust corpus in the decedent’s estate.

In *McKeon*, the discharge of the husband’s obligation to support his divorced wife was enough of a discharge for inclusion in the estate pursuant to section 2036, but not enough for exclusion pursuant to the consideration exception. In *Henslee*, the discharge of the husband’s obligation to support the children was enough of a discharge for section 2036, but not for the consideration exception. Can the same discharge be treated in different ways for the purposes of section 2036 and for the consideration exception? Perhaps it can.

In section 2036, the function of the discharge of obligation concept is to cover the fact situations practically comparable to the possession and enjoyment of property in the retained life estate. The function is a conceptual one; it is more crucial to show that the discharge was a mode of “possession and enjoyment” than it is to show that the discharge was specifically beneficial to the transferor, in a way that can be measured on his financial statements. In contrast, the consideration exception is much more oriented toward hard data. It is imperative that the consideration be “adequate and full,” meaning that the consideration coming in furnish an economic equivalent to the property transferred out. The only way to prove this equivalence is to require that the consideration be reducible to a money value.

This difference between the soft, conceptual approach, as it were, of section 2036, and the hard data approach of the consideration exception is borne out by the distinctions raised in *McKeon* and *Henslee*. In *McKeon*, the discharge of the marital support obligation was held not to be full and adequate consideration, precisely because “the release of these rights does not constitute consideration in money or money’s worth.” However, the discharge of the obligation did constitute sufficient possession and enjoyment of the funds so expended for section 2036. Thus, the hard data requirement of the consideration exception was not satisfied, though the more conceptual “possession or enjoyment” requirement of section 2036 was.

*Henslee* can be read similarly. According to *Henslee*, only a discharge which can be specifically valued will do for the consideration exception; only a discharge which is absolute can be valued. Therefore, since it was impossible for a settlor to effect an absolute discharge of the legal obligation to a child as long as that child remained in his custody, what discharge there was had to be insufficient for the consideration exception. Again, even the less-than-absolute discharge in *Henslee* was sufficient evidence of possession and enjoyment for section 2036.

The inference, then, from *McKeon* and *Henslee* is that, for the purpose of the consideration exception, discharges of legal obligations must be absolute discharges, and must be measurable in money or money’s worth.

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"25 T.C. at 707."
However, for the purpose of section 2036, a lesser standard can be applied. This inference is reinforced by analyzing the contrasting fact patterns in which most of the discharge of legal obligation cases arise. By far the great majority of these cases arise in the family context—trusts for the support and maintenance of spouses and children. Of these family cases, all of the cases applying the consideration exception arose in the context of separation and divorce. With the exception of McKeon, Henslee, and one other atypical decision, none of the family cases applying section 2036 involved separation and divorce. Separation and divorce are the difference.

Only upon separation and divorce can one spouse lose custody of the children to the other. Only upon loss of custody can that spouse's legal obligation to the children be reducible to money's worth, and be discharged absolutely. During the marriage, in contrast, the obligation to one's children is much more profound than a merely money debt. No mere money expenditure, although admittedly applied toward the discharge of that obligation, can reduce that obligation in absolute terms.

Similarly, as to the spouse, one's obligations to one's spouse during marriage transcend dollars and cents. They cannot be valued; nor can they be discharged absolutely. Upon separation and divorce, the courts are forced to put dollar values on these obligations, and they can be discharged absolutely. Every authority but McKeon views the discharge of the post-marital legal obligation to support one's spouse as sufficient for the consideration exception. No authority has held the same before separation and divorce. Therefore, in the family cases, only upon separation and divorce will it be possible for a discharge of legal obligations to meet the higher standards which have been posited for the consideration exception. Accordingly, the fact that in the family cases the consideration exception is only applied in the context of separation and divorce supports the inference of a more rigorous, dollar-oriented standard for the consideration exception than for section 2036.

Up to this point, the analysis has proceeded from the basis of what may be mere happenstance, the conformity of a simplistic set of fact categories with a set of suggested definitions. However, if the proposed analysis is valid, it must be supported, or at least not refuted, by the holdings and

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19 See Estate of Pardee v. Commissioner, 49 T.C. 140 (1967). In Pardee, the support trust was created while the couple was happily married. A subsequent divorce decree, however, made reference to the prior trust and provided that the husband could, in his discretion, make support payments pursuant to the decree out of the income generated by the prior trust.

20 See cases cited notes 22-25 infra.

discussions in the cases themselves. The family cases on section 2036 and
on the consideration exception will be discussed with this in mind.

III. Section 2036: Family Cases

Since none of the family cases applying section 2036 involve divorce and
separation, none of them involve an absolute, measurable discharge. Since
this factor is universally absent, it would be surprising if any of the cases
found its absence significant. In fact, none do. Instead of turning upon the
absoluteness of the discharge, the section 2036 cases turn upon two other
factors. One line of cases holds that it must be virtually certain that the
assets will be applied in discharge of the obligation. Section 2036 will apply
only when the settlor has a legal right pursuant to the terms of the trust
indenture to force the trustee to apply assets toward the discharge of his
obligation. Too much discretion on the part of the trustee, and, in some
cases, too much discretion in the beneficiary as to how the money will be
spent, will defeat section 2036 includability. The other line of cases would
view the certainty of application as immaterial. Crucial in these cases are
the intention of the settlor to discharge his legal obligations, and the pow-
ers of the trustee to apply the assets toward such a discharge, whether or
not it was in fact so applied.

The discharge of legal obligation cases began not with section 2036 and
its estate tax predecessors, but with the income tax. In Douglas v.
Willcuts, 22 a husband placed stock in trust with directions that a fixed
amount per year of the trust income be distributed to the wife, with the
excess income going back to him. It was stipulated that the trust was
established in settlement of the wife’s marital rights, with a view toward
divorce. The Court held that all of the income of the trust was taxable to
the husband, commenting, “income was received by a taxpayer when,
pursuant to a contract, a debt or other obligation was discharged by an-
other for his benefit.” 23 Based upon the precedents cited by the Douglas
Court, it is clear that the Court was taxing the income to the husband on
the theory of constructive receipt.

Shanley v. Bowers, 24 another income tax case, framed an issue that
would be faced by all subsequent courts. In Shanley, the taxpayer put an
income interest in trust. Twenty-five thousand dollars was to be paid
annually to his wife, and the remainder was to be paid to those creditors
holding certificates of participation in trust. The trust was to end when all
such certificates of participation were paid in full. The trust was not estab-
lished pursuant to a separation or divorce. The court commented,
“[c]ertainly a man must be able to make his wife a gift, if he wishes,
without affecting his marital duty. No authority has been cited for the
theory that every gift by a husband to his wife must be presumed to be in

22 296 U.S. 1 (1935).
23 Id. at 9.
24 81 F.2d 12 (2d Cir. 1936).
discharge of it." The court, finding no evidence of any intention that the trust was to discharge the taxpayer's marital obligation, held that the $25,000 per year from the trust which was paid to the wife was taxable to the wife. Thus, Shantley v. Bowers raised the issue of which intra-family transfers were in discharge of family obligations, and deemed the crucial factor to be the intention of the grantor.

In Helvering v. Mercantile-Commerce Bank & Trust Co., the issue was faced for the first time in an estate tax context. The decedent conveyed assets to a trust with the income to go to his wife for family expenses and for her own maintenance and support. The decedent's intentions were ambiguous, so the Board of Tax Appeals focused upon another factor. The wife had used part of the trust income to support her brother, a man to whom the decedent had no legal obligation. Therefore, the Board of Tax Appeals found, "[t]he use of the income was not limited to the discharge of his legal obligations." On that basis, it was held that the trust was not includable in the decedent's taxable estate.

The Board of Tax Appeals was espousing the theory that it must be shown with certainty that the income would be applied in discharge of the legal obligation before section 2036 would apply—that a factual showing that the income could be applied otherwise would defeat includability. The Eighth Circuit reversed, commenting that:

It would also pervert the meaning and render administration impracticable to read into the section a burden upon the Commission to segregate out of the income some dollars thereof which may not have been applied to a legal obligation of the decedent and to reduce the taxable corpus proportionately.

The court then held, on the basis of Douglas v. Willicuts, that the trust was includable.

Four years later, the certainty of application test, rejected by the Eighth Circuit, was accepted by the Third Circuit. In Commissioner v. Douglass' Estate, the decedent established a trust for the benefit of his four minor children with power in the trustees, in their sole discretion, to apply the income to the support, maintenance and education of the children. The Commissioner included one quarter of the trust corpus in the decedent's estate because, at his death, the decedent was legally obligated only to the one child of the four who was still a minor. The court rejected Mercantile-Commerce as not binding, and held that, since there was total discretion vested in an independent trustee, there was no certainty whatsoever that any of the trust income would be applied toward the discharge

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25 Id. at 15.
26 111 F.2d 224 (8th Cir.), cert. denied, 310 U.S. 654 (1940).
28 Id. at 1239.
29 111 F.2d 226.
30 143 F.2d 961 (9th Cir. 1944).
of the obligation. Therefore, the decedent had retained nothing during his lifetime, and there was no inclusion in his estate. Douglass, therefore, was the first in the line of cases requiring virtual certainty that the trust income would be applied to the discharge of the legal obligation.

In that same year, in Helfrich's Estate v. Commissioner,\(^\text{31}\) the decedent created a trust for each of his four children, with himself and his wife as trustees. During the lifetime of the trustees, the trust income was to be paid to or on the order of the trustees. Upon the death of the trustees, the trust income was to be paid to or on the order of the beneficiaries. The court found that the trust agreement was completely ambiguous as to how the trust income was to be applied. Therefore, there was no certainty that the trust income would be applied in discharge of the settlor's obligations. However, the trustees did apply some of the trust income to pay for his children's college tuition. The court noted that the payment of the children's college tuition was evidence that the trustees had the power to apply the trust income in discharge of the obligation to support the children. For the Helfrich court, this power was enough, notwithstanding the total absence of certainty as to the application of the trust income.

Thus, the lines were drawn. Some jurisdictions aligned themselves squarely on one side or the other,\(^\text{32}\) and others straddled the fence, supporting their decisions with reasons from both sides.\(^\text{33}\) The certainty of application cases continued, mostly focusing upon the presence or absence of a legal right on the part of the settlor to enforce the application of the trust assets to the discharge of his obligations.\(^\text{34}\) Many cases refined their analy-

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\(^{31}\) 143 F.2d 43 (7th Cir. 1944).

\(^{32}\) For those circuits applying the certainty of application test see Richards v. Commissioner, 375 F.2d 997 (10th Cir. 1967); Commissioner v. Douglass' Estate, 143 F.2d 961 (3d Cir. 1944). For those circuits applying the power and/or intention tests see Commissioner v. Dwight's Estate, 205 F.2d 298 (2d Cir.), cert. denied, 346 U.S. 871 (1953); Helvering v. Mercantile-Commerce Bank & Trust Co., 111 F.2d 224 (8th Cir.), cert. denied, 310 U.S. 654 (1940); First Nat'l Bank v. United States, 211 F. Supp. 403 (M.D. Ala. 1962).

\(^{33}\) The Fourth Circuit's position is based on both lines of authority. See Colonial-American Nat'l Bank v. United States, 243 F.2d 312 (4th Cir. 1957). The Tax Court decisions have relied on different lines of authority. For those cases based on the certainty of application tests see Estate of Mitchell v. Commissioner, 55 T.C. 576 (1970); Estate of Chrysler v. Commissioner, 44 T.C. 55 (1965), rev'd on other grounds, 361 F.2d 508 (2d Cir. 1966). For a case based on the power and intention test see Estate of Prudowsky v. Commissioner, 55 T.C. 890 (1971), aff'd per curiam, 465 F.2d 62 (7th Cir. 1972). For those cases based on both lines of authority see Estate of Perdee v. Commissioner, 49 T.C. 140 (1967); Estate of Lee v. Commissioner, 33 T.C. 1084 (1960); Estate of Sherman v. Commissioner, 9 T.C. 594 (1947). The Seventh Circuit has also relied on different lines of authority. See Wishard v. United States, 143 F.2d 704 (7th Cir. 1944) (holding based on certainty of application test); Helfrich's Estate v. Commissioner, 143 F.2d 43 (7th Cir. 1944) (holding based on power and intention tests.).

\(^{34}\) Cases holding the trust corpus includable in the estate are: Richards v. Commissioner, 375 F.2d 997 (10th Cir. 1967); Estate of Chrysler v. Commissioner, 44 T.C. 55 (1965), rev'd on other grounds, 361 F.2d 508 (2d Cir. 1966); Estate of Lee v. Commissioner, 33 T.C. 1084 (1960). Cases holding the trust corpus not includable in the estate are: Colonial-American Nat'l Bank v. United States, 243 F.2d 312 (4th Cir. 1957); Commissioner v. Douglass' Estate, 143 F.2d 961 (3d Cir. 1944); Wishard v. United States, 143 F.2d 704 (7th Cir. 1944); McCul-
sis to an inquiry into the amount of discretion in the trust instrument. Relevant factors included discretion inferred from ambiguous purpose clauses in the trust, the practical control exercised by the settlor over a subservient trustee and even the discretion in the beneficiaries to use the funds for other than the discharge of the settlor's legal obligations to them.

The cases not requiring certainty of application tended to focus either on the intention of the grantor to discharge his obligation, or the power of the grantor to discharge his obligations. In the intention cases, sometimes the intention was apparent; sometimes it had to be inferred by the court. In both Estate of Flynn and Estate of Sessoms, the intentions were apparent. When the stock of closely held corporations was placed in trust, the courts found that the primary intention for the creation of the trusts was to keep the stock in the control of the families. The fact that the trust income was applied in discharge of the settlors' obligations to support their families was only incidental. Therefore, with the requisite primary intention lacking, section 2036 was held to be inapplicable.

In Colonial-American National Bank v. United States, Estate of Sherman, and Estate of Burr, the intentions had to be inferred. In each of these cases, the settlors of support trusts continued to make expenditures for the support and maintenance of the beneficiaries after the creation of the trust. The courts reasoned that, if the settlors had truly intended their support trusts to discharge their support obligations, they would have stopped making any other expenditures toward the discharge of those obligations. From the fact that the settlors did not stop these other expenditures, the courts inferred that the settlors could not have intended to discharge the obligations by creating the trusts. Therefore, section 2036 was again held to be inapplicable.

Other cases ignored the intention of the grantor and focused on mere power. In First National Bank v. United States, the taxpayer, relying on


31 243 F.2d 312 (4th Cir. 1957).

32 9 T.C. 594 (1947).


Columbia-American National Bank v. United States,44 pointed out that, since the husband had continued to provide for his wife out of his own funds after the creation of the support trust, it could not have been his intention to provide for her solely from the trust. The court rejected this argument, and held that, since the trust income could have been applied in discharge of the legal obligation, intention notwithstanding, the trust was includable.

Even more striking is Estate of Pardee v. Commissioner,45 in which the trust indenture provided explicitly that the settlor's trust was "not intended by him to discharge any legal obligation he may owe to any beneficiary hereunder and that he will continue to discharge all such obligations from his own funds."46 In spite of this specific statement that the trust was not intended to be applied in discharge of any obligation, the court included the trust. Since $500 of a total trust corpus of $681,425 was in fact used in discharge of an obligation, the power was there. Intention notwithstanding, that power was enough. The trust corpus was includable to the extent of the obligation, which the court valued at $171,428.57.47

One other category of cases fits in with this line of authority. These cases all involve trusts created under Uniform Gift to Minors Acts. More often than not, the discretion of the settlor/trustee under these Acts to pay out the income or to accumulate it until the beneficiaries reach the age of 21 has led to the inclusion of the trusts pursuant to sections 2036(a)(2) and 2038.48 This discretion in the settlor/trustees would clearly be too much for inclusion under the certainty of application line of authority. Yet, a number of decisions have held that the power of the settlor/trustees to apply trust income in discharge of their legal obligations to support their children makes these trusts also includable pursuant to section 2036(a)(1).49

Those section 2036 cases which do mention absoluteness and measurability of the discharge do not require a great deal of compliance. In Commissioner v. Estate of Dwight,50 the decedent established a trust for the benefit of his wife and children. The court commented:

Having furnished his wife with this income the husband had in part at least discharged his legal obligation of supporting her. (ci-

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44 243 F.2d 312 (4th Cir. 1957).
45 49 T.C. 140 (1967).
46 Id. at 141.
47 Id. at 150.
50 205 F.2d 298 (2d Cir.), cert. denied, 346 U.S. 871 (1953).
tations omitted) The existence of the income from the trust would certainly have been a pro tanto defense in any suit for support brought by his wife. . . . Nor do we see why it should matter that the decedent’s full obligation to support may not have been discharged. . . .

It is apparent, then, that the section 2036 family cases require neither absolute discharges nor measurable discharges, but turn instead on such relatively extrinsic factors as certainty of the application of the assets toward the discharge, the intention of the grantor, and the power to apply the assets toward the discharge. When the extent of the discharge is mentioned, something less than an absolute discharge, measurable in money’s worth, will be sufficient.23 Therefore, the section 2036 marital cases are at least not inconsistent with the distinction suggested by McKeon and Henslee.

IV. Consideration: Family Cases

In the family context, it has been claimed that the discharge of the husband’s obligation to support his wife and minor children constituted full and adequate consideration pursuant to section 2036(a)(1),24 sections 2036(a)(2) and 2038,25 2053,26 and sections 2033 and 203728 of the estate tax

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23 205 F.2d at 301.
24 But cf. Estate of Lindsay, Tax Ct. Mem. Dec., (P-H) ¶ 52,154 (1952) (trust not includable). Lindsay relied in part on the following finding: “The evidence fails to show the amount or the use of the income for any year or that it actually relieved the petitioner to any extent of his obligation to support and maintain his minor child. Id. at 52,157 (emphasis added).
25 For cases where adequate consideration was found see United States v. Past, 347 F.2d 7 (9th Cir. 1965); Estate of O’Nan v. Commissioner, 47 T.C. 648 (1967); Estate of Glen v. Commissioner, 45 T.C. 323 (1965); Estate of Keller v. Commissioner, 44 T.C. 851 (1965) (adequate consideration found as to wife’s interest only).
26 For cases in which consideration was found see Leopold v. United States, 510 F.2d 617 (9th Cir. 1975); Helvering v. United States Trust Co., 111 F.2d 576 (2d Cir. 1940) (adequate consideration as to children’s interest only); Smith v. United States, 277 F. Supp. 583 (M.D. Fla. 1967); Estate of Davis v. Commissioner, 440 F.2d 896 (3d Cir. 1971); Estate of Nelson v. Commissioner, 47 T.C. 279 (1966), rev’d on other grounds, 396 F.2d 524 (5th Cir. 1968); D.G. McDonald Trust v. Commissioner, 19 T.C. 672 (1953), aff’d sub. nom. Chase Nat’l Bank v. Commissioner, 225 F.2d 621 (8th Cir. 1955).
27 For cases where consideration was found see Estate of Iversen v. Commissioner, 552 F.2d 997 (3d Cir. 1977); Sherman v. United States, 462 F.2d 577 (5th Cir. 1972); Beecher v. United States, 280 F.2d 202 (3d Cir. 1960); Commissioner v. Weiser, 113 F.2d 486 (10th Cir. 1940); Estate of Hartshorne v. Commissioner, 48 T.C. 882 (1967), aff’d, 402 F.2d 592 (2d Cir. 1968), (consideration for only part of the trust); Estate of Phillips v. Commissioner, 36 B.T.A. 762 (1937) (consideration as to children’s share only).
For divorce and separation cases where no consideration was found see Markwell’s Estate v. Commissioner, 112 F.2d 263 (7th Cir. 1940); Meyer’s Estate v. Commissioner, 110 F.2d 867 (2d Cir. 1940); Levering v. United States, 318 F. Supp. 215 (S.D. N.Y. 1970); Chemical Bank N.Y. Trust Co. v. United States, 249 F. Supp. 450 (S.D.N.Y. 1966); Chase Nat’l Bank v. Hickey, 90 Am. Fed. Tax Rep. 1685 (N.D.N.Y. 1942); Estate of Ottmann v. Commissioner, 12 T.C. 1118 (1949).
laws and section 2512 of the gift tax laws. Many issues in these cases go wide of the mark of defining what sort of consideration, and what sort of discharge of an obligation, is sufficient to trigger the consideration exception. As to those cases dealing directly with the question of consideration, there is little to add. Those dealing with the support of children generally hold that, if the children were minors at the date of the transfer, so that the discharge obligations were legal ones and not just moral ones, the consideration is adequate. Those cases dealing with the support of spouses invariably deal with the argument that was virtually resolved by E.T. 19.

This argument centered around the language now found in section 2043(b), which provides:

> For purposes of this chapter, a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent’s property or estate, shall not be considered to any extent a consideration “in money or money’s worth.”

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For cases involving antenuptial agreements where no consideration was found see Commissioner v. Bender, 125 F.2d 796 (6th Cir. 1942); Sutton, Tax Ct. Mem. Dec. (P-H) ¶ 73,211 (1973), aff’d per curiam, 535 F.2d 254 (4th Cir. 1974); Estate of Ellman v. Commissioner, 59 T.C. 367 (1972); Estate of Pollard v. Commissioner, 52 T.C. 741 (1969); Estate of Myers, Tax Ct. Mem. Dec. (P-H) ¶ 68,209 (1968); Central Union Trust Co. v. Commissioner, 24 B.T.A. 296 (1931).


25 For cases of divorce and separation where consideration was found for a transfer to the grantor’s wife see Spruance v. Commissioner, 60 T.C. 141 (1973); Estate of Fabrikanth v. Commissioner, 39 T.C. 714 (1963); Tarrago v. Commissioner, 11 T.C. 1016 (1948); McLean v. Commissioner, 11 T.C. 543 (1948); Judson, Tax Ct. Mem. Dec. (P-H) ¶ 47,050 (1947); Ledyard, Tax Ct. Mem. Dec. (P-H) ¶ 46,071 (1946); Converse v. Commissioner, 5 T.C. 1014 (1945). For cases of divorce and separation where consideration was found for a transfer to the grantor’s children see Rosenthal v. Commissioner, 205 F.2d 505 (2d Cir. 1953); Hooker v. Commissioner, 10 T.C. 888 (1948), aff’d, 174 F.2d 863 (5th Cir. 1949).

For cases where consideration was not found see Merrill v. Fahn, 324 U.S. 308 (1945) (divorce and separation transfer to wife); Rosenthal v. Commissioner, 205 F.2d 505 (2d Cir. 1953) (divorce and separation transfer to children); Commissioner v. Greene, 119 F.2d 383 (9th Cir. 1941) (transfer to incompetent dependent); Wiedemann v. Commissioner, 26 T.C. 565 (1956) (divorce and separation transfer to children); Mitchell v. Commissioner, 6 T.C. 159 (1946) (divorce and separation transfer to wife). See Proposed Regs. § 25.2512-8.

26 See, e.g., Commissioner v. Estate of Watson, 216 F.2d 941 (2d Cir. 1954) (claim founded on divorce decree and not on agreement); Lasker v. Commissioner, 138 F.2d 889 (7th Cir. 1943) (claim founded on antenuptial agreement); Commissioner v. Bristol, 121 F.2d 129 (1st Cir. 1941) (claim founded on antenuptial agreement); and I.R.C. § 2516.

27 See cases cited notes 53-58 supra. But cf. Leopold v. United States, 510 F.2d 617 (9th Cir. 1975) (trust held partially includable). Leopold raised an issue as to whether the obligation to minor children can ever be discharged. The court answered that it can only be discharged in exceptional circumstances, when the termination of affections between parent and child make the child no longer the natural object of the parent’s bounty.

28 See note 14 supra.
The issue was whether or not the phrase "other marital rights in the decedent's property or estate" included support rights.

E.T. 19 concluded that "other marital rights" did not include support rights, and therefore support rights could be treated as consideration. It reasoned as follows:

The gift tax is supplementary to the estate tax. It taxes, to a large extent, transfers *inter vivos* which deplete the estate that the donor would otherwise leave at death. Taxability, therefore, under the gift tax of other than commercial transactions is said to be determined by, and to the extent of, absence of financial benefit to the transferor. (citations omitted)

Under a decree of divorce or legal separation a husband's duty to support a divorced wife (alimony) customarily lasts only during the joint lives of the parties or until the divorced wife remarries. (citations omitted) The fulfillment, therefore, of this obligation by the husband merely amounts to the liquidation of a presently existing obligation, the satisfaction of which does not have the effect of diminishing or depleting the husband's estate to any greater extent than the payment of other existing legal obligations. On the other hand, a transfer to a wife under such a decree in settlement of inheritance rights is a present transfer of what would otherwise constitute a major portion of the husband's estate on death.41

The argument in E.T. 19 and the family cases applying the consideration exception focuses on the problem of estate depletion and the concurrent requirement that consideration be reducible to money's worth. This same focus is apparent in the virtual requirement of divorce and separation in these cases—that only an absolute, measurable discharge will satisfy the consideration exception. Therefore, the family cases applying the consideration exception are consistent with the distinction suggested by *McKeon* and *Henslee*.

V. Non-Family Cases

The family cases on discharge of obligations follow a consistent, if not totally rational pattern. Non-divorce trusts are includable pursuant to section 2036, as long as they fulfill whatever certainty, intention, or power requirements which that jurisdiction imposes on that day; divorce support trusts, if they are includable, come right out again pursuant to section 2043. The non-family cases, however, raise disturbing questions and inconsistencies with this pattern.

A. *Section 2036*

Two cases have been found in which a discharge of a non-family obliga-

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41 1946-2 C.B. at 168.
tion led to section 2036 includability. Estate of Hooper is essentially consistent with the family cases. In Hooper, the decedent, heavily in debt, transferred substantially all his property and his right to his salary in trust with the income to be expended for, first, the support and maintenance of his wife and children, secondly, the premiums on his insurance policies so that the insurance proceeds could be used to pay his debts, and finally if there was any excess, to pay his debts. The court held that both the decedent's obligations to support his wife and children and his obligations to pay his debts were legal obligations and that were being discharged by the creation of the trust. Therefore, the trust was included in his estate.

The consideration exception was not raised in Hooper, probably because it was inapplicable. The discharge of family obligations was certainly not consideration. The discharge of the money debts, on the other hand, would have been consideration if it had been effected. However, the discharge was not effected until the death of the decedent gave rise to the insurance proceeds. Therefore, since there was no discharge, of the money debt at the time of the decedent's transfer, the transfer was not made for consideration. However, since the debt still existed at the death of the decedent, the debt was a deductible claim against the estate. Here, the deductible claim cancelled out the section 2036 inclusion just as effectively as the consideration exception.

The other case is not consistent with the family cases. In Estate of Hays v. Commissioner, the decedent placed mortgaged real estate in trust for the benefit of his children. The settlor/trustee had full discretion to disburse income to the children and/or to apply the income in payment of the mortgage on the trust property. The Commissioner argued that the power to pay off the mortgage debt was a discharge of an obligation, within the meaning of section 2036. The taxpayer argued that, when the real estate was transferred to the trust, the settlor remained only secondarily liable on the mortgage. Therefore, it was the trust, and not the settlor, which was deriving the primary benefit from the reductions in the mortgage balance. The Tax Court noted that the settlor had presumably already enjoyed the benefits of the original loan proceeds, and held that section 2036 applied.

On appeal, the Fifth Circuit reversed. It held that the decedent's secondary liability on the mortgages was so remote that its discharge did not lead to the dignity of a section 2036 discharge. The court noted:

It is not a general or indefinite benefit but a pecuniary benefit that is necessary for a transaction to constitute a reservation of income, and in this case no pecuniary benefit resulted to the decedent by

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41 In Estate of Low, 2 T.C. 1114 (1943), aff'd per curiam, 145 F.2d 832 (2d Cir. 1944), the Commissioner's argument under § 2036 failed when the court found that there was no legal obligation.
42 41 B.T.A. 114 (1940).
43 181 F.2d 189 (5th Cir. 1950).
44 12 T.C. 210, 215 (1949).
the trustee’s payment of the mortgage notes. A pecuniary benefit means an increase in one’s net worth by the receipt of money or property. The payment of the mortgage notes did not and could not increase the decedent’s net worth.68

In requiring an increase in the decedent’s net worth, and in rejecting an increase too remote to be valued, the Hays court was using the same test for a section 2036 discharge that has been used for discharges pursuant to the consideration exception. Perhaps Hays can be limited to is own special facts.67 However, the pattern of the family cases was clearly not followed.

B. Consideration

Outside of the family context, there is only one factual situation in which the discharge of an obligation has been held to trigger the consideration exception. That situation is the settlement of a dispute. These cases have arisen pursuant to the gift tax68 and pursuant to section 2036(a)(1).69 The settlement of a dispute is perhaps not technically a discharge of a legal obligation since, when the disputes are settled before adjudication by a court, the existence and extent of the legal obligation remains merely speculative. Yet that speculative nature of the obligation is precisely what is so striking about these cases. The discharge of a speculative, unliquidated claim, clearly not measurable in money’s worth, has still been held to be full and adequate consideration. Indeed, in Beveridge v. Commissioner70 the Commissioner made exactly this argument, that since “petitioner had made the transfer ‘to secure the release of unproven claims which had no ascertainable value in money or money’s worth,’ she received nothing in return and hence the entire amount transferred should be deemed a gift.”71 The court in Beveridge noted that the case was analogous to the family cases, and quoted Commissioner v. Mesta,72 a separation case: “A man who spends money or gives property of a fixed value for an unliquidated claim is getting his money’s worth.”73

68 181 F.2d at 171.
69 Hays is in apparent conflict with Commissioner v. Blumenthal, 296 U.S. 652 (1935), a “Clifford Trust” pledged assets case in which the Supreme Court reversed the Second Circuit per curiam, and found the income taxable to the grantor without considering whether the grantor’s liability was primary or secondary, and without considering whether or not the encumbrance was simultaneous with the transfer in trust. In the income tax area, however, Hays was followed in Edwards v. Greenwald, 217 F.2d 632 (5th Cir. 1954).
71 See United States v. Righter, 400 F.2d 344 (8th Cir. 1968); Council v. United States, 302 F. Supp. 1315 (N.D. Miss. 1969); Estate of Friedman, 40 T.C. 714 (1963).
72 10 T.C. 915 (1948).
73 Id. at 917-18.
74 123 F.2d 986 (3d Cir. 1941).
75 10 T.C. at 988.
These dispute cases allow the taxpayer to stipulate that the value of an unmeasurable, unliquidated claim is equal to the value of the property exchanged in settlement of that claim. If these cases are valid, then all of the settlers in the non-divorce section 2036 cases should be allowed to stipulate that the value of their equally unmeasurable support obligations is equal to the amounts paid into the corpus of the support trust in discharge of these obligations.\textsuperscript{71} If this stipulation were accepted, then the discharge of non-divorce family obligations, though still not absolute, would be measurable. If they are measurable, perhaps they should all trigger the consideration exception. Again, the non-family consideration cases break the pattern of the family cases, just as did \textit{Hays} with respect to section 2036.

VI. Conclusions

\textit{McKeon} and \textit{Henslee}, and the coincidence of contrasting fact patterns in the section 2036 family cases and the consideration exception family cases, suggest that there are two definitions of income in discharge of a legal obligation. For purposes of the consideration exception, only an absolute, measurable discharge will suffice. For purposes of section 2036, these requirements are unnecessary. These two definitions are not contradicted by the holdings of the family cases.

Yet, the problems are apparent. First, a review of the section 2036 family cases shows that, although they consistently ignore any requirements of absoluteness and measurability, the consistency stops there. There are at least two conflicting lines of authority as to the requirements for income in discharge of a legal obligation within the meaning of section 2036.\textsuperscript{72} Predictability is lowered further by the fact that some circuits take more than one line at a time.\textsuperscript{73} Thus, the system of requiring absolute, measurable discharges for the consideration exception but not for section 2036 has not left us with a predictable, workable body of law.

Secondly, once we leave the family cases and consider other applications of the doctrine, the pattern falls apart. Precedents exist for requiring a measurable discharge for section 2036,\textsuperscript{74} and for not requiring one for the consideration exception.\textsuperscript{75} These precedents are no less logical than the family cases, and there is no apparent reason for treating family and non-family cases differently.

Finally, the present formulations are inelegant and unclear. It is a cardinal rule of legal drafting that the same word or phrase must mean the

\textsuperscript{71} One could argue that it is considerably easier to accept the parties' valuation when it is made at arm's length, as in the dispute cases, than when it is not made at arm's length, as in the § 2036 family cases.

\textsuperscript{72} See notes 22-52 \textit{supra} and accompanying text.

\textsuperscript{73} See note 33 \textit{supra}.

\textsuperscript{74} See note 64 \textit{supra}.

\textsuperscript{75} See notes 68 and 69 \textit{supra}.
same thing every time it is used. 79 The same should be true whether it applies to statutory phrases or case law concepts. The concept of discharge of legal obligations, wherever it appears in the estate tax system, should mean the same thing. Since the gift tax is in pari materia with the estate tax, the meaning of the concept should be the same there as well.

The present state of affairs, therefore, is unworkable. For the sake of consistency, either an absolute, measurable discharge should always be required for all purposes, or it should never be required. It is submitted that eliminating the requirement of an absolute, measurable discharge across the board would not work. First, any system that operates on money values to the extent that the tax system so operates should avoid items not reducible to money values, if at all possible. Secondly, it was the vacuum created by the absence of this requirement that led to the multiple lines of authority and resultant confusion in the section 2036 cases as they now stand.

The only remaining alternative is to require an absolute, measurable discharge for both section 2036 and the consideration exception. Is this alternative feasible? Consider its application in the case of a man with sufficient funds in a savings account to pay an annuity of $6,000 a year for fifteen years. Assume that the man set aside these funds in trust to pay $6,000 a year for the support and maintenance of his six-year-old child, until she becomes legally independent at age 21. No court or legislature would have fixed the amount of his obligation to his child. Therefore, the creation of the trust would not discharge the obligation in a measurable way. The transfer is a depletion of the estate, without measurable consideration, and therefore should be taxed. Pursuant to the suggested alternative, the sums would not be included in the man’s estate pursuant to section 2036 because there would be no absolute discharge of his obligation to his child as long as the family remained intact. However, since the discharge would not be absolute, the establishment of the trust would be a transfer not for adequate consideration, and a gift tax would be payable. 80 Since the gift tax rates and estate tax rates are now unified, 81 there would be no difference in tax between the estate tax payable under the present case law and the gift tax payable under the suggested alternative.

Assume that the same man had marital difficulties, and obtained a divorce. Assume further that the divorce required him to pay $6,000 a year for fifteen years to his six-year-old child who will not be in his custody.

79 See R. Dickerson, The Fundamentals of Legal Drafting $ 2.3(1.) (1965); H. Weihofen, Legal Writing Style 16 (1961); Hohfeld, Some Fundamental Legal Conceptions as Applied in Judicial Reasoning, 23 Yale L.J. 16, 28-29 (1913).

80 Holding such transfers to be taxable as gifts would not make all transfers between spouses taxable as gifts. Most of those transfers, such as buying groceries, paying the mortgage, etc., would be discharges of present obligations. Clearly, present, as opposed to future, marital obligations can be discharged absolutely — therefore, the consideration exception would exempt such transfers from the gift tax.

81 See notes 5 and 6 supra.
Here, value judgments aside, the man has suffered a misfortune analogous to having committed a tort in which he was at fault. A legal obligation has arisen where no measurable obligation existed before. Nothing of monetary value has been obtained in exchange for the new obligation. The divorce obligation for child support, therefore, is a net loss to the estate; funds applied against this obligation should not be taxed. Pursuant to the suggested alternative, if the man transferred his savings account to a trust in discharge of the obligation, there would be no gift, for the transfer would be for adequate consideration. Were the man to survive the fifteen year period, both the trust and the obligation would be zero. Were the man to die during the fifteen year period, the remaining trust corpus at his death would be includable in his estate by virtue of section 2036, but reduced to zero by virtue of the consideration exception. If the man were merely to withdraw funds from his bank account as needed to make payments pursuant to the divorce decree, without setting up a separate trust, there would be no inclusion in his estate pursuant to section 2036, and no reduction of his estate pursuant to the consideration exception. However, at the time of his death, any amount remaining in this savings account would be cancelled out by a deductible claim of equal amount. Therefore, no matter what was done, either the amount of the obligation or the assets transferred in discharge of that obligation would come out of the taxable estate, but not both. The ultimate net taxable estate would be the same no matter how the obligation was handled.

What if only the income from trust assets were applied in discharge of an obligation, leaving the corpus intact? Assume the same divorced man, with the same child support obligation of $6,000 annually for fifteen years. This time, however, assume that the man has $100,000 earning him six per cent interest. If the man were to die before making any child support payment, the $100,000 would remain in his estate, but it would be reduced by a deductible claim. Pursuant to Table B of regulation section 20.2031-10(f), the amount of the claim would be the value of an annuity of $6,000 for fifteen years, or about $58,000. The man would pay a tax on the remaining $42,000.

Assume that the man put the $100,000 in trust, with the annual income of $6,000 payable to his child in discharge of his child support obligation for fifteen years, with the remainder going to his mistress. Pursuant to Table B of the regulation, the remainder would be valued at about $42,000. Since the transfer of the remainder would be a completed gift, the man would pay a gift tax immediately on the $42,000 remainder interest.

If the man were to die within fifteen years, then, pursuant to the suggested alternative, the corpus of $100,000 would be included in his estate, but it would be reduced by the consideration received by virtue of the discharged obligation—i.e., $58,000.\[2\] Then, pursuant to section 2001, the

\[2\] See Estate of Pardee, 49 T.C. 140 (1967); United States v. Allen, 293 F.2d 916 (10th Cir.), cert. denied, 368 U.S. 944 (1961).
tax payable would be a tentative tax on the balance of $42,000, minus the
gift tax payable on the remainder of $42,000. Thus, the result would be no
additional tax at the estate level, with a tax on only the gift of the $42,000
remainder interest. Therefore, the tax result is the same.\footnote{This man's support trust enjoys, perhaps, a tax advantage over the man who leaves
his money in the bank and pays the $8,000 each year when it comes due. If this second
man were to die within the 15 years, he would have the $100,000 corpus included in his estate,
but reduced by a claim of some lesser amount than $88,000. Every payment he made would
reduce that claim. Therefore, this second man would pay an estate tax on some amount larger
than the $42,000 on which the first man paid his gift tax. It should be noted, however, that
this possible inequity is present both under present law and under the suggested alternative.
Therefore, it results from something extrinsic to the presence or absence of the concept of
discharges of legal obligations.}

It would appear then, that requiring an absolute discharge both for
section 2036 and for a consideration exception would do justice across the
board in the estate and gift taxes. It would, however, make the effect of
the discharge of an obligation moot. Every time there is a discharge which
is included under section 2036, it will be cancelled out by the consideration
exception. In view of this analysis, it is submitted that this cancellation
would be a good thing. If an obligation is truly discharged during life, then
that very discharge will increase the net worth of the taxable estate. There-
fore, additional inclusions in the estate as a result of the discharge of the
obligation would be unnecessary.\footnote{Note that, in Estate of McKeon, 25 T.C. 697 (1956), the amount of the trust attributable
to the husband's obligation to support his wife was taxed once under § 2036, and taxed
again to the extent that the net worth of the estate was increased by the discharge of this
obligation.} Conversely, if transferred assets are
applied toward a discharge which is not absolute and measurable, then
that transfer would be taxable as a gift. Accordingly, the use of the concept
of discharges of legal obligations is unnecessary to protect the estate and
gift tax revenues.

One might argue that the use by the grantor of the income to discharge
his legal obligations is still that sort of "possession or enjoyment" tantam-
ount to his reservation of a life estate in the transferred property.\footnote{But cf. Estate of Holmes, 326 U.S. 480, 486 (1946) ("enjoyment" connotes substantial
present economic benefit rather than technical vesting of the estate).} As
such, the transfer would be a substitute for the testamentary transfers that
furnish the staple diet of the estate taxation scheme, and should be taxed.
Such an argument, however, is founded upon tradition and nothing more.
With the unification of the gift and estate tax rates, the same tax revenue
will be generated with or without the use of this concept of discharges of
legal obligations. In view of the enormous inconsistencies and confusion
created by the concept of the discharge of legal obligations in the estate
and gift taxes, and its total lack of impact upon the federal fiscal posture,
the concept should be removed from the estate and gift tax scheme, and
relegated to the junk heap of ideas whose time has gone.
FACULTY—SCHOOL OF LAW

ROBERT E. R. HUNTLEY, A.B., LL.B., LL.M.
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ROY L. STEINHEIMER, JR., A.B., J.D.
  Dean and Professor of Law
WILLIAM MCC. SCHILDT, B.A., LL.B.
  Assistant Dean and Assistant Professor of Law
LAWRENCE D. GAUGHAN, B.A., J.D., LL.M.
  Professor of Law
ROGER D. GROOT, B.A., J.D.
  Professor of Law
LEWIS H. LA RUE, A.B., LL.B.
  Professor of Law
ANDREW W. McTHENIA, JR., A.B., M.A., LL.B.
  Professor of Law
WILFRED J. RITZ, A.B., LL.B., LL.M., S.J.D.
  Professor of Law
JAMES W. H. STEWART, B.S., LL.B., LL.M.
  Professor of Law
JOSEPH E. ULRICH, A.B., LL.B.
  Professor of Law
FREDERIC L. KIRGIS, JR., B.A., LL.B.
  Visiting Professor of Law
THOMAS H. SPONSLER, B.A., J.D., LL.M.
  Visiting Professor of Law
JAMES M. PHEMISTER, B.S., J.D.
  Associate Professor of Law
BENJAMIN M. VANDERGRIFT, A.B., J.D.
  Associate Professor of Law
MARK H. GRUNEWALD, B.A., J.D.
  Assistant Professor of Law
NATHAN G. OSTROFF, B.A., LL.B.
  Assistant Professor of Law
ANNE UNVERZAGT, B.A., M.A.T., J.D.
  Assistant Professor of Law
ROBERT M. CAMPBELL, A.B., LL.B.
  Adjunct Professor of Law
EDWARD S. GRAVES, A.B., M.A., J.D.
  Adjunct Professor of Law
BARBARA B. KENNEY, A.B., M.D.
  Adjunct Professor of Law
LOUISE P. MOORE, B.A., A.M.L.S., J.D.
  Adjunct Professor of Law
THOMAS C. SPENCER, B.A., LL.B.
  Adjunct Professor of Law
WILLIAM W. SWEENEY, A.B., LL.B.
  Adjunct Professor of Law
JAMES C. TURK, B.A., LL.B.
  Adjunct Professor of Law
HENRY L. WOODWARD, B.A., LL.B.
  Adjunct Professor of Law