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Transfers of Stock Pursuant to Post-Marital Property Settlements—A Taxable "Exchange" in Common-Law Jurisdictions

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TRANSFERS OF STOCK PURSUANT TO POST-MARITAL PROPERTY SETTLEMENTS — A TAXABLE "EXCHANGE" IN COMMON-LAW JURISDICTIONS

In 1954, a taxpayer entered into a voluntary property settlement with his wife in anticipation of divorce proceedings. In part, the agreement called for support payments to the wife and minor child in the amount of $550 per month. It further called for, as a "division in settlement of their property," an immediate transfer by the husband to the wife of 500 shares of DuPont stock.

Agreeing to accept this division in "full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy),"[1] the wife then instituted proceedings for divorce. The entire agreement was incorporated into the decree of the divorce court and the marriage was dissolved.

The laws of Delaware, where both parties were domiciled, provided that upon divorce the wife shall be entitled to such share of her husband's real and personal property as the court thinks reasonable.[2] As to rights of intestate succession, it provided that the wife shall be entitled to a share of her husband's personal estate "if the intestate is married at the time of his or her death."[3] It further declares that the "widow of any man" shall have rights of dower in all lands of which her husband was seised at any time during the marriage "unless she shall have relinquished her right of dower therein by her own voluntary act."[4]

Also pertinent to the transaction were certain sections of the Internal Revenue Code of 1954. Section 61 defines "gross income" as income "from whatever source derived" and includes specifically income from discharge of indebtedness.[5] Section 1001 directs that

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1 Davis v. United States, 82 Sup. Ct. 1190, 1191 (1962).

2 DEL. CODE ANN. tit. 13, § 1531 (1953).

3 DEL. CODE ANN. tit. 12, § 512 (Supp. 1960).

4 DEL. CODE ANN. tit. 12, § 901 (1953); *In re* Lamonica's Real Estate, 16 Del. Ch. 458, 462, 141 Atl. 315, 317 (1928): "[T]he dower right of a married woman is a valuable right or interest in the real estate of which her husband was seized during coverture, constituting an incumbrance on the husband's title and of which right she may not be divested except by her death before the husband or by her own voluntary act or deed."

5 INT. REV. CODE OF 1954, § 61(a)(12): "Section 61-Gross Income Defined. (a) General Definition. — Except as otherwise provided in this sub-

gain from the sale or disposition of property shall be computed by subtracting the adjusted basis from the amount realized.[6] Most important from the standpoint of marital property settlements is the statutory definition of "amount realized":[7]

> (b) Amount Realized.—The amount [of gain] realized from the sale or other disposition of property shall be the sum of any money received plus the *fair market value* of the property (other than money) received.

The Commissioner of Internal Revenue, treating the property settlement as an exchange of stock involving a taxable gain, notified the husband of a deficiency. After payment of the tax, the husband filed his claim for refund which, when disallowed, resulted in suit for its recovery. The Court of Claims, wherein the action was commenced, gave judgment to the taxpayer, holding the transaction non-taxable because of the impossibility of attributing a fair market value to the property received by him.[8] On petition for writ of certiorari, the case was taken to the Supreme Court for final adjudication.[9]

Held: The agreement must be treated as a taxable exchange. Since the wife had no rights of co-ownership in the property transferred to her by the husband, the agreement could not be given the non-taxability afforded a similar transaction in community property states. The "property" received by the husband was the release of the wife's claims against him, and because of the impossibility of attributing a fair market value to such "property," his realized gain must be determined by referring to the fair market value of the stock transferred.[10]

Owing to the complexity of the issue, a consideration of its

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title gross income means all income from whatever source derived, including (but not limited to) the following items: . . .
(12) Income from discharge of indebtedness."

[6] INT. REV. CODE OF 1954, § 1001(a): "Section 1001 — Determination of Amount and Recognition of Gain or Loss:
(a) Computation of Gain or Loss. — The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis . . . . "

[7] INT. REV. CODE OF 1954, § 1001 (b). (Emphasis added.)

[8] Davis v. United States, 287 F.2d 168 (Ct. Cl. 1961).

[9] Davis v. United States, *cert. granted,* 368 U.S. 813 (1961).

[10] Davis v. United States, 82 Sup. Ct. 1190 (1962). Other questions decided by the Court were the wife's basis for the property received and the deductibility of the wife's legal expenses incurred in the divorce proceedings on the return of the husband. However, this note will discuss only that part of the Court's decision dealing with the taxability of the transfer of stock pursuant to the marriage settlement.

past is warranted before its analysis. Although previous cases involved similar facts, their decisions are limited to narrower considerations than those found in *Davis.* As will be seen, a new and creditable argument was presented in *Davis,* not mentioned in the previous cases dealing with the same problem, in order to settle the question on which the lower federal courts had split.

The taxability of a post-nuptial property settlement first arose in 1940 in *Mesta v. Commissioner.*[11] In that case a wife amended a divorce libel originally brought for a divorce from bed and board "and for such alimony as her husband's circumstances will permit" to a libel for an absolute divorce, wherein no claim for alimony was made. In consideration for her amendment, the husband agreed to transfer to her a number of shares of appreciated stock, along with certain other personal property. The Board of Tax Appeals held the transaction not taxable due to the impossibility of determining the fair market value of the property received by the husband.[12]

While the appeal of the *Mesta* case was pending, *Halliwell v. Commissioner*[13] was decided by the Board. There the taxpayer had entered into an agreement with his wife whereby he would transfer to her for alimony and support "a lump sum, consisting of certain securities and cash" in exchange for the wife's release of all claims against him. The agreement was subject to the approval of the divorce court, and, when the divorce was awarded, it was found that the securities and cash were a reasonable portion of the husband's estate to be assigned to the wife in compliance with the terms of their agreement. The taxpayer was then directed to transfer the appreciated stock to his wife pursuant to the decree of the court. Relying on its holding in the *Mesta* case, the Board held that because of the impossibility of measuring the fair market value of the property received by the husband, there was no way to compute the amount realized by him on the transfer as the basis for his taxable gain.[14]

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[11] 42 B.T.A. 933 (1940).

[12] *Id.* at 940. "What is the measure of the value of the wife's right to maintenance and support? It is dependent upon many factors—the financial success or failure of the husband, his generosity, the thrift or acquisitiveness of the wife, the length of life of both parties, the rise and fall of markets. . . . We are of the opinion that the impossibility of evaluating the rights received by the husband constitutes an insurmountable obstacle to the application of section 22(e) in conjunction with section 111(b) . . . . "

[13] 44 B.T.A. 740 (1941).

[14] *Id.* at 746. "Our decision on the . . . question is controlled by *L. W. Mesta* . . . which differs in no material respect from the case presently before

Subsequently, however, the decision of the *Mesta* case was reversed by the Court of Appeals for the Third Circuit,[15] on which basis the Court of Appeals for the Second Circuit reversed the decision of *Halliwell*.[16] Both reversals were grounded upon the idea that they were the last step taken by the taxpayer by which he "obtains the fruition of the economic gain which has already accrued to him."[17] The *Mesta* court recognized that the "fair market value of the property . . . received by [the taxpayer] for the stock may be difficult to ascertain," but concluded that the gain must be computed by using the fair market value of the property *transferred* in accordance with "the practical assumption that a man who spends money or gives property of a fixed value for an unliquidated claim is getting his money's worth."[18]

It is to be noted that in both *Mesta* and *Halliwell* the contentions were presented that the agreements constituted no more than a division or partition of property between husband and wife. Indeed, the Board of Tax Appeals in both cases utilized that argument in holding the transactions non-taxable.[19] Unfortunately, however, in neither case can be found the argument that to recognize a taxable gain from such transactions would result in geographical disparity in the application of the tax laws, since a similar agreement in community property states would be a non-taxable division of property between co-owners. Such a contention would have substantiated the holdings of the Board, and might well have altered the courts' conclusions, at least in *Halliwell*. There the court recognized, even though to a limited extent, that the transaction could

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us." At 748: "In the present case, it is also impossible to evaluate the rights received by petitioner, . . . and thus to compute the amount realized by him on the transfer of the specified securities and the small amount of cash . . . . "

15 Commissioner v. Mesta, 123 F.2d 986 (3d Cir.), *cert. denied,* 316 U.S. 695 (1941), *rehearing denied,* 317 U.S. 704 (1942).

16 Commissioner v. Halliwell, 131 F.2d 642, 643 (2d Cir.), *cert. denied,* 319 U.S. 741 (1942): "In all essential respects the case is the same as Commissioner v. Mesta, 3 Cir., 123 F.2d 986. With that decision we agree."

17 Commissioner v. Mesta, 123 F.2d 986, 988 (2d Cir. 1941), quoting from Helvering v. Horst, 311 U.S. 112 (1940). Commissioner v. Halliwell, 131 F.2d 642, 643 (2d Cir. 1942): "His use of [the securities] to discharge his obligations of support to his wife and child was a disposition which enabled him to realize the enhancement in value which the securities sustained during his ownership of them."

18 Commissioner v. Mesta, 123 F.2d 986, 988 (3d Cir. 1941).

19 Halliwell v. Commissioner, 44 B.T.A. 740, 749 (1941); Mesta v. Commissioner, 42 B.T.A. 933, 941 (1940).

be called a "division of property."[20] Had the disparity issue been presented, we might have been left with more than the concise reliance on *Mesta.*

Thus, upon the authority of two federal courts the matter seemed well-settled, at least for a period of about eighteen years. Then, in 1960, in *Commissioner v. Marshman,*[21] the Court of Appeals for the Sixth Circuit, on a comparable set of facts, affirmed a decision of the Tax Court[22] in favor of the taxpayer. The court held the transaction non-taxable, not only because of the impossibility of measuring the fair market value of the property received by the taxpayer, but also because of the basic unfairness, contrary to the intent of Congress in drafting Section 111(b) of the Internal Revenue Code of 1939,[23] in attempting to measure the value of something given by the value of something received.[24]

With the law on this subject in a state of conflict, and further complicated by the decision of the Court of Claims in the *Davis* case,[25] which was in accordance with the decision in *Marshman,*[26] the Supreme Court in deciding *Davis* was faced with the task of resolving the issue once and for all.

In reaching its decision in *Davis,* the Supreme Court went one step further than the lower federal courts and divided the taxability of the transaction into two distinct questions: (1) Should a property settlement between a husband and wife pursuant to a divorce proceeding be classified as a taxable event at all, and (2) if so, what is to be the basis of the "property" received by the husband, *i.e.,* can his gain be measured by the fair market value of the property *transferred,* rather than the fair market value of the property received?[27] Such a distinction was made necessary by the policy

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[20] Commissioner v. Halliwell, 131 F.2d 642, 643 (2d Cir. 1942).

[21] 279 F.2d 27 (6th Cir.), *cert. denied,* 364 U.S. 918 (1960).

[22] Marshman v. Commissioner, 31 T.C. 269 (1958).

[23] INT. REV. CODE OF 1939, ch. 2, § 111(b), 53 Stat. 37 (now INT. REV. CODE OF 1954, § 1001(b)).

[24] Commissioner v. Marshman, 279 F.2d 27 (6th Cir.), *cert. denied,* 364 U.S. 918 (1960). See note 75 *infra* and accompanying text.

[25] 287 F.2d 168 (Ct. Cl. 1961).

[26] *Id.* at 174. "We think as did the court in Marshman . . . that the measurement of gain cannot be the fair market value of the property transferred. We also believe, as did the court in Marshman, that the measure of the value of the wife's right to maintenance and support was dependent upon so many uncertain factors that neither the taxpayer nor a revenue officer could do more than guess at it."

[27] See Davis v. United States, 82 Sup. Ct. 1190, 1191 (1962).

argument of the taxpayer that the Court should not inject geographical disparity into a system of nationwide taxation.

II.

The first question warranting consideration in determining whether the transaction constituted a taxable event under Section 1001(b) of the Internal Revenue Code of 1954 is whether the taxpayer received "money or property" as part of his "amount realized" on the sale or disposition of his own property. Apparently the Court regarded this determination as unimportant, or as evident from the facts and unworthy of elaboration. Although it speaks of the holdings in the lower courts on whether the taxpayer actually received *property* in exchange for his stock, it reserves its own solution until the latter part of its opinion. After the ultimate conclusion is reached, and the transaction is held to constitute a taxable event, the Court proceeds to resolve the "property" issue. Just as a release from a pre-existing debt or other obligation is valid consideration for the transfer of money or property in satisfaction thereof, we are told that the "property received" by the husband in this case was the "release of the wife's inchoate marital rights."[28] The agreement by Mrs. Davis to accept the stock in "full settlement and satisfaction of any and all claims and rights against the husband"[29] was the valuable property received in the exchange,[30] thus making the transaction taxable to the extent of the gain.

But, can it really be said in a situation involving tax consequences that one actually *receives property* by virtue of a release from a legal obligation? It might be argued that upon the execution of the release, the rights of the wife against the husband and the corresponding obligation of the husband are thereby extinguished, and thus the "property" never reaches the husband's hands. A waiver of rights by one should not freely be construed as a transfer and receipt of such rights by another. The rights of the wife and legal obligation of the husband, being extinguished by the release, should not be said to inure to the husband as *property received*, much less as his *amount realized*, for tax purposes.

In reaching its conclusion as to whether the situation should

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[28] *Id.* at 1194.

[29] See note 1 *supra* and accompanying text.

[30] The Court's reasoning is paralleled in Migdal, *The Lump Sum Divorce Settlement as a Taxable Exchange*, 8 U.C.L.A.L. Rev. 593, 595 (1961): "Moreover, the receipt of intangible economic benefit is sufficient to satisfy the property requirement," thus making the transaction taxable to the extent of the gain.

be classified as a taxable event, the Court was forced to realize that a decision in favor of the government would result in tax-law disparity between common-law and community-property jurisdictions,[31] an argument not propounded in either *Mesta, Halliwell,* or *Marshman.* However, the Court disposes of this argument and holds the transaction taxable by examining the interests of the wife under Delaware law and concluding that since such interests are not the equivalent of co-ownership per se[32] they are not deserving of the tax treatment afforded spouses in community-property states.[33]

The necessity of adherence to fact in application of the tax law can be appreciated, but the manner in which the Court disposes of the issue of disparity between common-law and community-property jurisdictions seems unjustifiable. Surely such a malignancy as geographical discrimination under the taxing statutes is worthy of more profound reasoning and extended discussion before it is made the law of the land. Not only does the Court attempt to minimize the issue, but ultimately disposes of it through the rationalization that "the facts of life are still with us."[34] Apparently it is ignoring the intent of Congress[35] in adopting the sweeping changes in the Revenue Act of 1948[36] in order to equalize the tax burden between the two jurisdictions, as well as its own holding when speaking of the estate tax in *Helvering v. Hallock:*[37] "[T]he importation of these distinctions and controversies from the law of property into the administration of the estate tax precludes a fair and workable tax system."

It is to be noted that counsel for the taxpayer was arguing not that the interests of the Delaware wife were the equivalent of co-

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31 "Although admittedly such a view may permit different tax treatment among the several States, this Court in the past has not ignored the differing effects on the federal taxing scheme of substantive differences between community property and common-law systems." Davis v. United States, 82 Sup. Ct. 1190, 1193 (1962).

32 "Delaware seems only to place a burden on the husband's property rather than to make the wife a part owner thereof." *Ibid.*

33 "The effectuation of these marital rights may ultimately result in the ownership of some of the husband's property as it did here, but certainly this happenstance does not equate the transaction with a division of property by co-owners." *Ibid.*

34 Davis v. United States, 82 Sup. Ct. 1190, 1193 (1962).

35 See note 65 *infra* and accompanying text.

36 *Compare* § 51(a) and (b) of INT. REV. CODE OF 1939, ch. 1, § 51(a) and (b), 53 Stat. 27, *with* § 303 of REVENUE ACT OF 1948, ch. 168, § 303, 62 Stat. 115.

37 309 U.S. 106, 118 (1940).

ownership, but only that they sufficiently resembled co-ownership to be afforded the same tax treatment, in view of Congress' intent of uniformity in tax law application.[38] In the typical community-property state, the husband and wife are deemed, during the marriage itself, "equal and present owners of the common property."[39] The wife acquires a present interest in one-half of the husband's property from the moment it is acquired by him,[40] and thus upon dissolution of the marriage the husband may transfer to her that one-half of the community property which was acquired by her at its original acquisition.[41] And since the transaction is merely a transfer of that property already owned, a division of property between co-owners, it gives rise to no taxable gain under the income tax statutes.[42]

But in *Davis,* the wife had rights of dower and intestate succession to personalty upon the death of her husband, coupled with rights of "reasonable share" to his real and personal property upon divorce.[43] It is conceded that the Court is correct in its statement that these rights do not "reach the dignity of co-ownership,"[44] but a closer examination and comparison may reveal sufficient similarities to justify equal tax treatment under the revenue laws.

That a wife in a community-property jurisdiction has a present, vested right (in common-law terminology) in one-half of her husband's property seems irrebuttable by the Court's own holding.[45]

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[38] Brief for Petitioner, pp. 9-13.

[39] 1 DEFUNIAK, PRINCIPLES OF COMMUNITY PROPERTY 271 (1943).

[40] "[H]er ownership and possession in half of these earnings and gains did not depend upon any mere physical fact of placing the earnings or gains in the husband's hands but related, just as the husband's ownership did, to the very inception of the right to such earnings and gains." *Id.* at 162.

[41] *Id.* at 658.

[42] Where "in exchange for a vested undivided one-half interest in the whole, each party receives a vested interest in the whole of one-half, obviously there would be no resulting taxable gain and no change in basis of any of the property by reason of the settlement." C. C. Rouse, 6 T.C. 908, 914, *aff'd,* 159 F.2d 706 (5th Cir. 1947). See Taylor and Swartz, *Tax Aspects of Marital Property Agreements,* 7 TAX L. REV. 19, 52-58 (1951); Wren, *Tax Problems Incident to Divorce and Property Settlement,* 49 CALIF. L. REV. 665, 687 (1961).

[43] See notes 2-4 *supra.*

[44] Davis v. United States, 82 Sup. Ct. 1190, 1193 (1962).

[45] Poe v. Seaborn, 282 U.S. 101, 111 (1930): "[I]t is clear the wife has . . . a vested property right in the community property, equal with that of her husband; and in the income of the community, including salaries or wages of either husband or wife, or both."

In many common-law states, however, dower is also regarded as a vested right.[46] Moreover, under statutes in some states the dower right vests completely upon divorce. At such time what may have been regarded as an inchoate interest becomes absolute, and the wife is entitled to dower in her husband's land to the same extent as if he were dead.[47]

Furthermore, in the absence of statute in certain states, a wife's dower rights are so secure that not even a divorce for her own misconduct will terminate them.[48] Delaware, on the other hand, provides that a wife's dower right can only be forfeited by killing her husband, her own adultery, or by her own voluntary act of relinquishment.[49] Thus it seems that a divorce in Delaware upon any other ground than the wife's adultery is insufficient to divest her of the dower rights she possesses in her husband's realty. It may be said, therefore, that the line between the solidarity of a wife's rights in a community-property state and those of a wife in Delaware, the jurisdiction determining the rights of the parties in the *Davis* case, seems very thin indeed.

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46 "A wife's inchoate right of dower is a vested right which vests at the time of marriage in property then owned by her husband. In property subsequently acquired by the husband this right vests at the time of the acquisition concurrently with the vesting of the title in the husband." Maryland Cas. Co. v. Lewis, 276 Ky. 263, 268, 124 S.W.2d 48, 50 (1939). See, *e.g.*, Flynn v. Flynn, 171 Mass. 312, 50 N.E. 650 (1898); Gerhardt v. Sullivan, 107 N.J. Eq. 374, 152 Atl. 663 (Ch. 1930); Class v. Strack, 85 N.J. Eq. 319, 96 Atl. 405 (Ch. 1915).

47 "[W]hen a divorce is decreed to the wife for the fault of the husband . . . she shall have dower in his real estate, to be recovered and assigned to her as if he were dead." McAllister v. Dexter & Piscataquis R.R., 106 Me. 371, 377, 76 Atl. 891, 894 (1910). See DEL. CODE ANN. tit. 13, § 1531 (1953); *cf.* Cunningham v. Cunningham, 2 Carter (Ind.) 233 (1850); Tatro v. Tatro, 18 Neb. 395, 25 N.W. 571 (1895). See generally 28 C.J.S. *Dower* §§ 47, 53 (1951).

48 "Dower is an estate in the land fixed by marriage and death of the husband. It is not dependent upon either the wife's conduct nor her residence, and . . . is not waived by her misconduct or abandonment of her husband." Swift v. Reasonover, 168 Tenn. 305, 308, 77 S.W.2d 809, 810 (1934); *accord,* Loughran v. Loughran, 292 U.S. 216 (1934); Lakin v. Lakin, 83 Mass. (2 Allen) 45 (1861); Cogswell v. Tibbetts, 3 N.H. 41 (1924).

49 DEL. CODE ANN. tit. 12, § 901 (1953); DEL. CODE ANN. tit. 12, § 908 (1953). DEL. CODE ANN. tit. 13, § 1531 provides that upon divorce the wife may be entitled to such share of her husband's real property as the court thinks reasonable. However, tit. 13, § 1532 provides that she shall forfeit any estate settled upon her in lieu of dower when the cause of the divorce is her own adultery. See notes 2-4 *supra* and accompanying text. *Cf.* Walter v. Walter, 136 A.2d 202 (Del. 1957); *In re* Lamonica's Real Estate, 5 Del. Ch. 458, 141 Atl. 315 (1928).

As to the right of intestate succession to personal property, the Court in *Davis* correctly points out that in Delaware the wife must survive the husband to share in his intestate estate.[50] But, considering the facts of the case, this portion of Delaware law must also be read with the statute pertaining to the wife's rights upon divorce. There we find that the wife is to receive that portion of the husband's real and personal estate as the court thinks reasonable, considering whether the divorce is being asked for the aggression of the husband or wife.[51] Again property rights of a "contingent" or "inchoate" nature vest completely upon a mere voluntary act of the spouses (the procurement of the divorce), and may be divided by judicial direction according to their respective guilt or innocence.

Comparing this to community property law, we find similar provisions:[52]

> [I]n a considerable number of the states, the statutes authorize the court to divide the community property between the spouses in such proportions as it shall, from the facts of the case, deem just and right. This allows the courts to take into consideration the respective situations of the spouses, as well as the situation of the children, and also allows the courts to consider the respective innocence and guilt of the spouses in deciding how to divide the community property.

On the one hand, then, we have a system of property law which makes the wife the present owner of one-half of the common property at the moment it is acquired. However, upon the institution of divorce proceedings, it is the court which determines the amount of her share, from a consideration of the factual situation. On the other hand, we have a system of property law, as in *Davis,* where although the rights of the wife are not "vested" in all cases, they can become vested by the mere institution of a divorce action. And here again it is the divorce court which may determine the extent to which these vested rights may be lessened or increased. In one system the wife acquires her rights at an earlier date than

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[50] "Her rights are not descendable, and she must survive him to share in his intestate estate." Davis v. United States, 82 Sup. Ct. 1190, 1193 (1962).

[51] "When a divorce shall be decreed for the aggression of the husband, the complainant shall be restored to all her real estate, and allowed, out of her husband's real and personal estate, such share as the court thinks reasonable; but if the divorce be for the wife's aggression, the court may restore the whole or a part of her real estate, and also such share of her husband's personal property as seems reasonable." DEL. CODE ANN. tit. 13, § 1531 (1953).

[52] 1 DEFUNIAK, *op. cit. supra* note 39, at 643.

in the other, but in both jurisdictions the rights of each are subject to alteration by the divorce court.

Furthermore, both systems generally allow spouses contemplating divorce or separation to enter into agreements providing for the disposition of their property. Here also their respective rights under the laws of either system may be changed or modified by voluntary act.

> In many of the [community property] states in which they can do so, they may, prior to separation or prior to the institution of divorce proceedings by one of the spouses, enter into a valid property settlement providing for the partition or disposition of the community property already acquired.[53]

Therefore, in a common-law jurisdiction, where the property settlement might also include satisfaction of the wife's right to inherit,[54] as it did in *Davis*, "the transaction would [likewise] seem to constitute a division of property from which no gain is realized."[55] Accordingly, there seems to be sufficient resemblance between the wife's rights under the two systems that, even though not identical, equal treatment under the tax laws would be justified. To counter the argument that the wife has an interest *ab initio* in her husband's property (acquired during coverture) in a community property state, it might be answered that

> the amount to which the wife is entitled by virtue of her property rights [in a common-law state] depends only upon the value of the husband's property; thus the wife shares the benefit of any appreciation in the property to an extent fixed by her dower or other statutory rights.[56]

Thus, noting the similarities between common-law and community property jurisdictions in respect to post-marital property settlements, one may wonder why the Court in *Davis* chose the road it did. To rest a decision on technical grounds, by holding that the wife's rights in her husband's property were not co-ownership

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[53] *Id.* at 658. 2 American Law of Property § 7.35 (1952).

[54] "The law is too well settled in this state to admit of dispute that husband and wife, in contemplation of a separation and divorce, may, by valid contract between themselves, settle and adjust all property rights growing out of the marital relation, including the wife's right of dower and claim for alimony, support, and maintenance." North v. North, 339 Mo. 1226, 1230, 100 S.W.2d 582, 584 (1927); see Fischer v. Leach, 124 Kan. 97, 258 Pac. 295, *cert. denied,* 276 U.S. 618 (1927); Young v. Watson, 3 Ky. Op. 210 (1869).

[55] Note, *Gains and Losses on Sales and Exchanges—Transfer of Appreciated Property in Divorce Settlement Results in No Taxable Gains,* 74 Harv. L. Rev. 1226, 1227 (1961).

[56] *Ibid.* See generally 28 C.J.S. *Dower* § 56 (1941).

per se, without an acceptable consideration of the resulting inequalities in its application, is to foster hostility to the tax laws. The Court concedes for a moment that "it would [not] be completely illogical to consider the shearing off of the wife's rights in her husband's property as a division of that property,"[57] but concludes by saying "we believe the contrary to be the more reasonable construction."[58] Possibly "the contrary" is the correct answer within its vacuum of the facts of *Davis*, but perhaps the Court "was more concerned with legal doctrine than it was with economic realities."[59] And in the light of history, the decision seems irreconcilable with Congress' attempt to eliminate geographical disparity for purposes of income, estate, and gift taxes.[60]

Prior to 1948, the Supreme Court and the lower federal courts had issued a series of decisions which resulted in income tax discrimination in favor of community property states.[61] The effect of these was various attempts by several state legislatures to uproot firmly embedded systems of common law,[62] as well as attempts by individuals to invent clever legal devices which would circumvent the application of the tax laws[63] in order to obtain the same advantages enjoyed by residents of community property states. In 1948, to put an end to the existing disorder surrounding income taxation, Congress evidenced its intent to have the tax law apply equally

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[57] Davis v. United States, 82 Sup. Ct. 1190, 1193 (1962).

[58] *Ibid.*

[59] Commissioner v. Harmon, 323 U.S. 44, 50 (1944) (Douglas, J., dissenting).

[60] See note 65 *infra* and accompanying text.

[61] Married persons in community property states were allowed to split their income so that each spouse would be liable for the tax on one-half the total income, whereas spouses in common-law states were liable for the tax computed on the aggregate of their combined income. See Poe v. Seaborn, 282 U.S. 101 (1930); Bender v. Pfaff, 282 U.S. 127 (1930); Hopkins v. Bacon, 282 U.S. 122 (1930); Goodell v. Koch, 282 U.S. 118 (1930); Helvering v. Campbell, 139 F.2d 865 (4th Cir. 1944); Commissioner v. Hart, 76 F.2d 864 (6th Cir. 1935); Helvering v. Hickman, 70 F.2d 985 (9th Cir. 1934).

[62] "After one false start, Oklahoma joined the community property group [already consisting of eight states] in 1945. Oregon, Michigan, Nebraska, and Pennsylvania were added to the list in 1947." *Equalization of Tax Burdens on Residents of Community Property and Common-Law States*, S. REP. No. 1013, 80th Cong., 2d Sess., 2 U.S. CODE CONG. SERV. 1184, 1186 (1948).

[63] "Chief among these devices are gifts, either outright or in trust, joint tenancies, and family partnerships. Confusion has resulted from attempts to use trusts, tenancies, and partnerships for such purposes, and the present state of the law and regulations on these points is most unsatisfactory." *Id.* at 1185.

throughout the nation by making vast changes in the then existing revenue laws.[64] The Senate Report on the Revenue Act of 1948 is illuminating:[65]

> Many states are waiting to see what Congress will do about the problem of geographical equalization. If the necessary action is not taken, there will be a flood of State legislation intended to produce the same results, but doing so in a manner which has most unfortunate consequences, not only for the taxpayer involved, but also for all the persons who must use or administer the property laws of the States which rush into the community-property system.
>
> Your committee believes that the best answer to the problem of geographical equalization is the splitting of the combined income of the husband and wife.... Income splitting will produce the same result in common-law States which now obtains in a community property State when the entire income of both spouses is community income.

Therefore, one wonders why the main issue in the *Davis* case was not the resulting disparity between the two jurisdictions, rather than that of the co-ownership per se of Mrs. Davis in her husband's property. The Court seems to dispose of the issue by circumventing it, and in deciding the question of whether the transaction constituted a taxable event, ignores what should have been the primary consideration in its determination. At any rate, what the Court did hold was that the rights of Mrs. Davis were not those of a co-owner,[66] and consequently the agreement could not be afforded the same non-taxability as a similar agreement in a community property state.[67] That the Court saw no need to further treat the "disparity" issue seems at least regrettable. Even though it could have tossed the entire solution into the lap of Congress by saying that the application of the revenue laws must be based on the dictates of the statute as well as present facts, it chose not to do so. Instead, our prejudices against tax-law discrimination are quelled by the statement that "the facts of life are still with us."[68]

III.

Having settled the question of whether the transaction was a taxable event at all, the Court then turned to the issue that was the basis of the dissension in the lower federal courts. With the

64 See note 36 *supra*.

65 *Equalization of Tax Burdens on Residents of Community Property and Common-Law States*, S. REP. No. 1013, 80th Cong., 2d Sess., 2 U.S. CODE CONG. SERV. 1184, 1186 (1948).

66 Davis v. United States, 82 Sup. Ct. 1190, 1193 (1962).

67 *Id.* at 1194.

68 *Id.* at 1193.

holdings of *Mesta* and *Halliwell,* courts directly opposed to those of *Marshman* and *Davis,* the question of the taxability of post-marital property settlements was ripe for final determination. Although the contention of geographical disparity was never presented in any of the lower courts, the Court of Claims in *Davis*[69] held the transaction non-taxable, as did the Court of Appeals in *Marshman*[70] because of the impossibility of attributing a fair market value to the "property" received by the husband in the exchange.

Contrary to what might be expected, these latter conclusions do not presuppose the recognition of *taxable* gain, but they do presuppose the recognition of *economic* gain. As the Supreme Court itself has said, "admittedly not all economic gain is taxable income."[71] Thus, even though it may be conceded that realization of economic gain may occur without the receipt of actual cash or property of monetary value, as where the "last step is taken by which [the taxpayer] obtains the fruition of the economic gain which has already accrued to him,"[72] we might draw a line of distinction by saying that only realized gain based on a measurable fair market value falls into the category of taxable gain.[73] It would seem to follow, then, that it was this impossibility of attributing a fair market value to the property received by the taxpayer that led two of the lower federal courts to treat it as a non-taxable gain, even though it might have involved a realized economic gain within the meaning of Section 1001(b).[74] In other words, economic gain, although realized, should not be held to be taxable

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69 Davis v. United States, 287 F.2d 168 (Ct. Cl. 1961). See note 25 *supra.*

70 "[T]he impossibility of evaluating the 'fair market value of the property (other than money) received' by the husband from the wife in the property settlement entered into between them, constitutes an insurmountable obstacle to the application of Section 22f [now Section 1001(a) and (b)]." Commissioner v. Marshman, 279 F.2d 27, 34 (6th Cir. 1960).

71 Helvering v. Horst, 311 U.S. 112, 115 (1940).

72 *Ibid.*

73 "[I]t is essential that property received have an exchangeable value, a market value, in order that it may be considered as income and taxable. . . . [I]t has frequently been held, or assumed, that no taxable income arises in respect of an exchange of property, unless the property received by the taxpayer had a market value at the time of the transaction." Annot., *Income Tax in Respect of Exchange of Properties,* 102 A.L.R. 6, 18 (1936). See cases collected at page 18.

74 *Cf.* Davis v. United States, 287 F.2d 168, 174 (Ct. Cl. 1961): "If the 'property' received by Davis had no fair market value, or if none has been shown, it may be economic gain but it is not taxable gain by reason of the express provision of section 1001(b)."

gain unless the economic gain has in itself a measurable fair market value upon which the tax can be assessed.

Furthermore, one federal court fortified its decision in holding that no taxable gain existed by precise adherence to the language of the statute:[75]

> We do not think that this problem is correctly solved by giving to those rights the value of the property which is given in exchange. Section 111(b) requires that the capital gain be measured by the fair market value of the property *received* by the taxpayer, not by the fair market value of the property *transferred* by the tax-in exchange for the property received. To say that the fair market value of the property received is the same as the fair market value of the property given up not only ignores realities, but is the use of a formula which is radically different from the well-established and well-recognized formula approved by the courts for determining fair market value.[76]

These arguments were rejected by the Supreme Court, however, on the theory that the husband and wife had negotiated an "arms-length" transaction, which was justification for the premise that they judged the rights relinquished by the wife as precisely equal to the value of the stock transferred by the husband.[77] To support its explanation, the Court cites three lower federal court cases[78] as examples of situations where the fair market value of "the two properties exchanged in an arms-length transaction are either equal in fact or are presumed to be equal."[79]

It is to be noted, however, that even though one of the cases cited was decided by the same court that decided *Marshman,* the results are not necessarily inconsistent. In each of the cases cited by the Court the transaction was of a general business nature, accomplished in a commercial setting, with a more readily iden-

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[75] INT. REV. CODE OF 1939, ch. 2, § 111(b), 53 Stat. 37 (now INT. REV. CODE OF 1954, § 1001(b)).

[76] Commissioner v. Marshman, 279 F.2d 27, 32 (6th Cir. 1960).

[77] "It must be assumed, we think, that the parties acted at arm's length and that they judged the marital rights to be equal in value to the property for which they were exchanged." Davis v. United States, 82 Sup. Ct. 1190, 1194 (1962).

[78] *Ibid.,* citing United States v. General Shoe Corp., 282 F.2d 9 (6th Cir. 1960) (land transferred to employee's retirement trust fund in exchange for improved employee relations and morale); International Freighting Corp. v. Commissioner, 135 F.2d 310 (2d Cir. 1943) (stock given to employees as a bonus for their past services); Philadelphia Park Amusement Co. v. United States, 126 F. Supp. 184 (Ct. Cl. 1954) (bridge transferred in exchange for a street railway franchise).

[79] Davis v. United States, 82 Sup. Ct. 1190, 1194 (1962), quoting Philadelphia Park Amusement Co. v. United States, *supra* note 78.

tifiable point of reference for valuation. Thus, even though the property received by the taxpayer may have been intangible in each case, it was more easily reduced to a dollar and cents value than the marital rights of the wife in *Davis*. The absence of a business atmosphere, coupled with the psychological and emotional factors involved in a divorce proceeding, would seem to necessarily negate the application of the arms-length test to determine the value of the "property" received.

"Fair market value" has been defined as "the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell."[80] Evidently the Court is not disturbed in attributing a fair market value to the release received by the husband by calling it an "arms-length" transaction. It proceeds to apply the test notwithstanding that a divorce proceeding is far from a commercial negotiation. It recognizes that divorce and property settlements are often plagued by emotion and tension,[81] as did the court in *Marshman*,[82] but falls short of saying that these, together with whatever premium the husband is willing to pay to have the marriage terminated, are sufficient to destroy the equality of values presumption. An even further consideration, making the applicability of the arms-length test at least doubtful in these post-nuptial property settlements, is that the

> valuation of the wife's claims by reference to the value of the property transferred requires that the property be transferred solely in exchange for the claims. However, the total value of the securities transferred in a lump sum marital settlement may not represent, or even approximate, the true value of the claims re-

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80 Commissioner v. Marshman, 279 F.2d 27, 32 (6th Cir. 1960). See, *e.g.*, *In re* Williams, 256 F.2d 217 (9th Cir. 1958); Fitts v. Commissioner, 237 F.2d 729 (8th Cir. 1956); Helvering v. Walbridge, 70 F.2d 683 (2d Cir. 1934); Metropolitan St. Ry. v. Walsh, 197 Mo. 392, 94 S.W. 860 (1906).

81 "To be sure there is much to be said of the argument that such an assumption is weakened by the emotion, tension and practical necessities involved in divorce negotiations and the property settlements arising therefrom." Davis v. United States, 82 Sup. Ct. 1190, 1194 (1962).

82 "Under such conditions [the emotional strains of a divorce settlement], values are lost sight of, concessions are made, one does not expect or insist upon getting his money's worth for what he gives up. Unfortunately, it is often the case that what a husband transfers to his wife in a so-called property settlement in a pending divorce action is not given merely in exchange for a release of alimony and dower rights, but also includes, without being so labeled, such additional amount as the husband may be willing to pay in order to have the marriage status terminated. . . . The value of what is given up is no criterion of the fair market value of the 'property' received." Commissioner v. Marshman, 279 F.2d 27, 32 (6th Cir. 1960).

> linquished, even though *some* gain is realized because property of *some* value is received in partial exchange therefor.[83]

An alternative method for evaluating the release of the support rights as "property" to the husband has been suggested, which, while requiring more effort, appears more realistic than ascribing to the entire lot of marital rights the total value of the property transferred:[84]

> The allocation between the value of W's support rights and her marital property rights is accomplished by deducting from the value of the total property transferred the value of her right to support. The value of her right to support has been measured by the Actuaries' or Combined Experience Table of Mortality with interest at four per cent per year . . . where chances of remarriage were not involved.
>
> If the property settlement for her support, however, is to terminate upon W's remarriage, this factor must also be taken into consideration in computing the present value of her support rights. . . . In such a reduction of the value of support rights by this remarriage factor, actuarial tables prepared by insurance companies handling workmen's compensation claims were approved.

The author further states that the value of the right to support may also be measured by a consideration of the circumstances at the time of the divorce or separation.[85] The question of valuation thereby becomes one of fact, the factual proof consisting of the showing of his income and station in life, as well as the circumstances of the wife. Moreover, such a factual determination may even be left to the Commissioner of Internal Revenue.[86]

Consequently, if the Supreme Court was seeking to prevent marital property settlements in common law states from escaping taxation, it could have employed either of these methods as a more acceptable formula in attributing a valuation to the property received by the husband. Even though such techniques would leave unanswered the value of the wife's dower rights, even a partially realistic approach is better than one which disregards the facts. At least the entire lot of marital rights released would not be lumped together for speculative judicial valuation.

To these arguments could be added the once-established rule of law, as utilized in the *Marshman* case,[87] that taxing statutes are

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[83] Note, *The Valuation of "Property Received" In a Marital Settlement Which Includes a Release of Marital Obligations*, 7 How. L.J. 64 (1961).

[84] BAYLY, TAX MANUAL FOR DIVORCE AND SEPARATION 228 (1953).

[85] *Id.* at 227.

[86] *Ibid.*, referring to ET 19, 1946-2 CUM. BULL. 166, 169 (1946).

[87] See note 76 *supra* and accompanying text.

to be strictly construed in favor of the taxpayer. "In case of doubt [taxing statutes] are construed most strongly against the Government, and in favor of the citizen."[88] This doctrine, however, has been substantially modified, in that:[89]

> It is the function and duty of courts to resolve doubts. We know of no reason why that function should be abdicated in a tax case more than in any other where the rights of suitors turn on the construction of a statute and it is our duty to decide what that construction fairly should be.

But even so, the Supreme Court is employing an unrestricted form of statutory construction, disregarding that duty of "fair interpretation," when, as in *Davis,* it unreservedly lifts the word "received" out of the statute and substitutes therefore its exact antonym, "transferred."[90]

However, the Court again justifies its conclusion through rationalization, by asserting that although accurate measurement of the fair market value is difficult, it is better to make a "rough approximation."[91] It is difficult to appreciate, in any case where property is sought to be subjected to taxation, why a rough approximation would ever be justified. But here we are told that otherwise the gain would either escape taxation altogether, or the burden would be unjustly shifted to the wife. Nevertheless, the opinion of the American Law Institute is to the contrary:[92]

> Since marital settlements, in a sense, are involuntary exchanges it seems undesirable to impose a tax at that time. However, all

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88 Gould v. Gould, 245 U.S. 151 (1917); see, *e.g.*, United States v. Merriam, 263 U.S. 179 (1923); Smietanka v. First Trust & Savings Bank, 257 U.S. 602 (1922); United States v. Field, 255 U.S. 257 (1921); Haiku Sugar Co. v. Johnstone, 249 Fed. 103 (9th Cir. 1918); Baltimore Talking Board Co. v. Miles, 280 Fed. 658 (4th Cir. 1908); Hubbard-Ragsdale Co. v. Dean, 15 F.2d 410 (S.D. Ohio 1926); Cleveland Provision Co. v. Weiss, 4 F.2d 408 (N.D. Ohio 1925).

89 White v. United States, 305 U.S. 281, 292 (1938); see Burnet v. Guggenheim, 288 U.S. 280, 286 (1933); Commissioner v. Morris, 90 F.2d 962 (2d Cir. 1937).

90 INT. REV. CODE OF 1954, § 1001(b) states that the "amount realized from the sale or other disposition of property shall be the . . . fair market value of the property (other than money) received."

91 Davis v. United States, 82 Sup. Ct. 1190, 1194 (1962).

92 I ALI FED. INCOME TAX STAT. § X257(a) at 368 (Feb. 1954 Draft). The proposed statute is entitled "Recognition of Gain and Loss on Transfer of Property In a Marital Settlement," and states:
(a) General Rule. No gain or loss shall be recognized with respect to property transferred in a marital settlement . . . .
(b) Definition of Marital Settlement. — "Marital settlement" means a transfer of property made pursuant to an ante-nuptial agreement,

property transferred in a marital settlement will retain its old basis, so that any potential gain of the transferred property (or potential loss) remains unchanged. . . . Recognizing gain or loss would require valuation of the transferred property, including the valuation of support rights. The suggested rule avoids the necessity for this valuation.

Finally, in examining *Davis,* one is led to the question of exactly what it was that the Court was evaluating when it spoke of the "arms-length" test. To what is it seeking to attribute the fair market value of the stock transferred by the husband? Or, more specifically, "does the *Davis* case cover only transfers of appreciated property in return for the release of support rights, or does it also include the transfer of property in satisfaction of the right to inherit?"[93]

Whether the Supreme Court in its evaluation of the property received by the husband is including all three rights of the wife mentioned in its statement of facts, whether it is eliminating the dower rights, or whether it is considering any one alone or any two together, are questions seemingly left to legal conjecture.

IV.

These and other questions arise to provoke the curiosity of tax and divorce lawyers as a result of the *Davis* case. Because the Supreme Court has unhesitatingly projected itself into so nebulous an area as the income tax consequences of marital property settlements in different jurisdictions, and because of the manner in which it disposes of the problems in *Davis,* the answers are at least vague.

As to which rights the Court was evaluating, the difficulty readily presents itself when we note that "the Court in referring to the release of the wife's inchoate marital rights apparently makes no distinction in the particular nature of those rights and would regard the transfer of property as a taxable event in either case".[94]

In its statement of the facts, the Court points out that the rights of the wife include intestate succession, dower, and reasonable share

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separation agreement, legal separation, divorce, or annulment of marriage, if the transfer was made because of the marital relationship or because of the obligation to support a minor child. *Id.* at 114.

93 *Comment* on Davis v. United States, CCH CURRENT LAW AND PRACTICE 783 (1962).

94 *Ibid.*

upon divorce.[95] However, the Court also states that the agreement called for "support payments to the wife and minor child *in addition* to the transfer of certain personal property to the wife."[96] (Emphasis added.) The Court of Claims describes this even further, showing that the support obligation called for a payment of $550 per month to the wife, and was contained in a paragraph quite separate from that calling for the transfer of the stock.[97] But in the remainder of its opinion, the Supreme Court refers only to the "wife's interest" or the "wife's rights,"[98] and in its discussion of fair market value states that the "property received" by the husband was the release of the wife's "inchoate marital rights."[99]

It might be contended that the issue of support rights is ruled out of the decision altogether because of the Court's statement that the satisfaction of such rights was *in addition* to the transfer of the stock.[100] On the other hand, if one is to conclude from the opinion that the Court is treating the agreement as a whole, *i.e.*, support rights, intestate succession rights, and dower rights, the result would not seem harmonious with the treatment of the community property question.

As previously stated, a wife has, in the community property states, an undivided interest in one-half of the husband's property instead of a right to inherit or rights of intestate succession.[101] Thus, if the opinion were construed to include a release from only support or alimony, the Court's handling of the community property issue would seem unnecessary, since a transfer of stock in an exchange involving the release of alimony or support claims in a community property jurisdiction would necessarily include the transfer of *some* of the stock in exchange for the alimony and support rights. Consequently, it could not be wholly classified as a division of the common property, and would also have to constitute a taxable event to the extent of the excess.[102] For example, if in a community property state the husband, concurrently with the division of

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95 Davis v. United States, 82 Sup. Ct. 1190, 1191 (1962).

96 *Ibid.*

97 Davis v. United States, 287 F.2d 168, 173 (Ct. Cl. 1961).

98 Davis v. United States, 82 Sup. Ct. 1190, 1193 (1962).

99 *Id.* at 1194.

100 *Id.* at 1191.

101 1 DEFUNIAK, PRINCIPLES OF COMMUNITY PROPERTY 271 (1943).

102 "It would therefore appear that a community property settlement, which does not constitute a true partition . . . will ultimately be held to constitute a taxable event." Taylor and Schwartz, *Tax Aspects of Marital Property Agreements*, 7 TAX L. REV. 19, 58 (1951).

property, secures a release from his wife of all claims for alimony and support against him, in exchange for which he transfers to her three-fourths of the community property, or other separate property of his own, the transaction would seem clearly to constitute a partially taxable event under the income tax statute.[103]

If, however, the opinion is to be limited to transfers involving a release of the wife's rights to inherit, the question then arises as to what happens in a jurisdiction where such inchoate rights are terminated upon divorce.[104] Clearly, if such rights are terminated by the divorce decree, the wife has nothing to transfer to the husband in exchange for the stock, and he therefore would receive no property in the exchange. Such a transaction would probably be treated, assuming no support rights are involved, as taxable only to the wife under the laws of gift taxes.[105]

Conversely, where the inchoate rights are terminated upon divorce, *and* the wife releases her husband from the obligation of support and alimony in exchange for his transfer to her of the stock, the "property" received by the husband would seem to be more readily measurable by a fair market value. As noted earlier, the court could attribute a value to such rights by taking into consideration the husband's station in life, the wife's life expectancy, the number of children, and the circumstances for which the divorce was granted.[106] Thus, no need would be present to resort to the market value of the stock transferred to determine the extent of

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103 "The cases which have dealt with unequal divisions of community property in divorce or separation agreements have held that any gain from such transactions will be fully recognized." *Id.* at 56. "[W]here there is an unequal division of the community property or where the husband transfers a large amount of cash to the wife for her share of the community, there is a taxable transaction." Wren, *Tax Problems Incident to Divorce and Property Settlement,* 49 CALIF. L. REV. 665, 687 (1961). See Long v. Commissioner, 173 F.2d 471 (5th Cir.) *cert. denied,* 338 U.S. 818 (1949); Rouse v. Commissioner, 159 F.2d 706 (5th Cir. 1947); Johnson v. United States, 135 F.2d 125 (9th Cir. 1943).

104 See, *e.g.,* Hamm v. Butler, 215 Ala. 572, 112 So. 141 (1927); Gwynn v. Rush, 143 Ark. 4, 219 S.W. 339 (1920); Seuss v. Schukat, 358 Ill. 27, 192 N.E. 668 (1934); Western States Finance Co. v. Ruff, 108 Ore. 442, 215 Pac. 501 (1923).

105 "To the extent that the husband transfers securities to his wife in a lump sum marital settlement which exceed in value the amount of the monetary claims relinquished by the wife, such excess would properly appear to constitute, for income tax purposes, a gift." Note, *The Valuation of "Property Received" In a Marital Settlement Which Includes a Release of Marital Obligations,* 7 How. L.J. 64, 70 (1961).

106 See note 85 *supra* and accompanying text.

the husband's gain, and the inequitable application of the "arms-length" test in a divorce settlement would be avoided.

If the argument that the Court is dealing with only the wife's rights to dower and intestate succession can be upheld, it would seem that the *Mesta* case is distinguishable. In *Mesta* the property was transferred by the husband in exchange for the partitioning of a tenancy by the entirety and for a release from alimony and support claims.[107] The partitioning of a tenancy by the entirety would seem to constitute even more of a division of property between co-owners than the transaction in the *Davis* case, thus leading to the conclusion that the only thing the *Mesta* court was evaluating was the release of alimony and support claims. Clearly, such a transaction would seem more capable of valuation than the one in *Davis,* for as stated previously, support rights may be evaluated by considering the facts surrounding the divorce proceedings.

Thus, the result of the *Mesta* case may be correct even though its reasoning may be disclaimed. By disposing of the test which the *Mesta* court used for valuation of the husband's "property" received, *i.e.,* the arm's-length test, we are still left with more realistic methods of evaluating the same property in order to arrive at the same conclusion of taxability. No justification can be found, therefore, for applying the arm's-length test in either *Mesta* or *Davis,* whether we consider the latter opinion as including all the claims released by the wife, or only those claims to dower and intestate succession. Such a technique, however applicable in commercial transactions, simply has no place in the taxation of post-nuptial property settlements.

The *Halliwell* case may also be distinguished. In *Davis,* the Supreme Court applied the arm's-length test in order to evaluate the worth of the "property" received by the husband, despite its own admissions as to the emotion and tension involved in such a transaction.[108] In the *Halliwell* case, however, it was the divorce court which determined the amount and value of the stock to be transferred by the husband in exchange for the wife's release.[109] It was left for the court to determine the extent to which the husband should pay in order for the exchange to be equal, in the light of the circumstances of the case.[110] The emotions, tensions, and extra-premiums paid by the husband, which prevent the fair application of the arm's-length test, were not involved.

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107 Commissioner v. Mesta, 123 F.2d 986, 987 (3d Cir. 1941).
108 Davis v. United States, 82 Sup. Ct. 1190, 1194 (1962).
109 Halliwell v. Commissioner, 44 B.T.A. 740, 743 (1941).
110 *Ibid.*

The same result, then, as reached by the *Halliwell* Court of Appeals, *i.e.*, holding the transaction taxable, can also be reached by disposing of the arm's-length test altogether. The amount and value of the "property" to be received by the husband, against which his tax would be assessed, and also that to be transferred to the wife pursuant to their agreement, was determined by a disassociated third party. No need was present, in order to arrive at a valuation, to resort to the inappropriate presumption, as did the Supreme Court in *Davis*, that the *parties* themselves adjudged their rights to be equal, a presumption which must be considered fallacious in view of the extraneous psychological factors permeating the transaction.

The "arm's-length" test itself will undoubtedly require close scrutiny in future marital property settlements. In community property situations and tenancies by the entirety, wherein the husband also seeks to extinguish the wife's claim to support or alimony, the application of the arm's length test to the entire lot of property transferred might be avoided by leaving it to the divorce court to determine such right, as in *Halliwell*,[111] or by computing their worth through either of the methods previously suggested.[112] As to other property settlements in common law states, however, the pattern is obscure. If unusual compulsion can remove a transaction from the common definition of fair market value,[113] it would seem that only the same is needed to take a property settlement out of the arm's length test. But since the Supreme Court in *Davis* decided that the emotion and tension involved therein were not sufficient for such removal, the extent required can only be left to speculation.

One may also wonder what the Court would do with the arm's-length test in a property settlement where the stock transferred had no readily ascertainable market value. For example, if the stock transferred were that of a closed corporation undergoing corporate reorganization, or part of a new issue not yet released, what would be the value of the "property" received by the husband in the exchange?[114] Would the Court be forced to treat such a situation as a non-taxable event?

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111 *Ibid.*

112 See notes 84 and 85 *supra* and accompanying text.

113 See, *e.g.*, Williams v. Commissioner, 256 F.2d 217 (9th Cir. 1958); Fraser Brick Co. v. Commissioner, 10 B.T.A. 1252 (1928); Acme Mills, Inc. v. Commissioner, 6 B.T.A. 1065 (1927); Albert M. Slater, 28 P-H Tax Ct. Mem. 486 (1959).

114 For examples of situations where stock has no readily ascertainable fair

The question also arises as to whether the husband would be allowed a deduction for losses sustained on the transfer of depreciated stock pursuant to such a marital settlement. Should he be allowed to use the market value of the stock transferred as the "amount realized" on the exchange, and thus deduct this amount from his adjusted basis? If the stock is transferred *prior* to the divorce decree, it is evident that the loss would be disallowed under Section 267.[115] However, if the stock is transferred after a decree absolutely dissolving the marital relationship, the results are not clear.

CONCLUSION

The question of the taxability of post-marital property settlements involving the transfer of appreciated stock has been answered by our highest tribunal. But the ramifications of its opinion are likely to extend considerably beyond what one might expect from only a cursory reading of this case. Through *Davis*, the Supreme Court has once again, as in the early thirties, applied the revenue laws in a manner which results in geographical discrimination. The ensuing disparity, as well as the intent of Congress to eliminate tax inequality between community property and common-law jurisdictions, has been minimized in order to achieve a result of questionable compatibility with the laws of one state. To be sure, the issues of the case must be considered through the facts, *i.e.*, the elements of ownership involved, but it is submitted that overriding these are basic principles of fairness and equality which necessarily underlie any system of effective taxation. Discrimination breeds hostility, but even more so when created with open indifference. The Court has, moreover, applied a method of valuation which, although workable to an uncertain extent in particular situations, defies equitable application in circumstances where excessive emotions and tensions predominate. The field of post-marital property settlements has no room for the application of the arm's length test. However, the Court has made its decision. Federal legislation can provide the remedy.

Bruce B. Graves, '64

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market value, see generally Champlin v. Commissioner, 71 F.2d 23 (10th Cir. 1934); Schoenheit v. Lucas, 44 F.2d 476 (4th Cir. 1930); O'Meara v. Commissioner, 34 F.2d 390 (10th Cir. 1929); Reynolds v. Durey, 9 F. Supp. 553 (N.D.N.Y. 1934); Ault & Wiborg Co. v. Commissioner, 17 B.T.A. 665 (1929); Parker v. Commissioner, 14 B.T.A. 1185 (1929).

[115] INT. REV. CODE OF 1954, § 267.