CAPITAL RETURNS ACCRUING TO A SURVIVING SPOUSE AS TAXABLE INCOME

Warwick Potter Scott †

Rich American testators, while still alive, seldom regard their wives as merely convenient household chattels of which the *raison d'être* ceases upon the death of its owner. In this they defy the age-old fashion of at least some of their European friends. The average American desires, in the event of being survived by his wife, that the latter shall not, after the sad occasion, be constrained to reduce radically the scale and standard of living to which she had been accustomed in his life. He wishes, nevertheless, that the corpus of his estate shall remain intact for the issue of his body who are to carry on his name after her death. He is confronted (if a Pennsylvanian)[1] by his wife's absolute right to one-third (at least) of all his property, real and personal, unless she elects to take under the will. He visualizes his death: *eo instanti,* one-third of all his estate will become her capital.

He decides to buy her off; and by his will bequeaths to her a life estate or gift of the income of his estate sufficiently large and attractive to induce her to elect to take under the will and to pay, as the price of this annuity, the surrender of her capital. Thus the capital return which she has purchased with her capital permits the maintenance of her former standard of living; and he on his part has achieved his underlying purpose of preserving the corpus of his estate for his issue.

These social observations merely point the practical importance of the vital problem of tax law to which this article is addressed. The several Circuit Courts of Appeals of the United States, as well as the Supreme Court, have made it unmistakably clear that where a testator bequeaths all or part of the income of his estate to his widow for life and where the widow elects to waive her statutory interest in her husband's estate and to take under his will, the payments of income from the testamentary trust to the widow are not income to the widow within the meaning of the income tax laws but are return premiums of capital as in the case of return premiums

† A. B., 1923, Harvard University; Litt. B., Oxford University; L. L. B., 1927, University of Pennsylvania; Associate Editor, University of Pennsylvania Law Review, 1926-27; member of Pennsylvania Bar; author of leading article on the Pennsylvania Sci. Fa. Act, (1931) 79 U. of Pa. L. Rev. 306.

[1] The scope of this article is not confined to Pennsylvania. What is said applies equally to all states of the Union where the state statute or the common law right of dower or curtesy gives to a surviving spouse the right to elect to take absolutely a fixed portion of the estate of the decedent spouse in lieu of such benefits as may be provided by the decedent's will. Pennsylvania is taken merely as typical of the situation in most states. The Pennsylvania statute gives to the survivor the right to take absolutely one-half of all real and personal property if there is one child or none, and one-third if there are two children or more. Act of June 7, 1917, P. L. 429.

upon a purchased annuity. Of this there is no doubt whatever; nor do the taxing authorities now contend the contrary.

The principle is perhaps best stated in the case of *Warner v. Walsh*,[2] in which a widow elected to accept a testamentary annuity for life in lieu of her statutory rights. The court said:[3]

> " . . . what we have here is, in fact and in legal effect, the purchase of an annuity, in no way differing from an annuity purchasable by the widow from an insurance company, with the proceeds of her statutory rights in the estate, except only that in such a purchase she would have an unsecured obligation, whereas here the obligation is secured by the income and principal of the trust fund. That such a relinquishment of dower rights is a purchase of the will provision is well and long established. Burridge v. Beabyl, 1 Pere Wms. 127 (1710); Isenhart v. Brown, 1 Edw. Ch. (N. Y.) 413 (1832); Requa v. Graham, 187 Ill. 67, 58 N. E. 357, 52 L. R. A. 641 (1900). That a purchased annuity, even if income, is exempt as and to the extent that it is a return of premiums paid therefor; that is, until the purchase price shall have been returned, is determined by the express provisions of the acts above cited, as construed by the Bureau of Internal Revenue."

In *United States v. Bolster*[4] a widow elected to accept in lieu of her statutory rights the entire net income of a testamentary trust. Citing with approval the *Warner* case, the court said:[5]

> "The federal income tax laws recognize the legal status of the taxpayer as created by local law, and fix the taxes in accordance with such law. By the General Laws of Massachusetts (Chapter 191, § 15), as well as under the earlier statutes, a surviving husband or wife may refuse to accept the provisions of a will and take his or her statutory share in the corpus of the estate as if the deceased had died intestate. When the surviving husband or wife accepts the provisions of the will, whether or not such provisions are expressly declared to be 'in lieu of such statutory rights,' the survivor is in the position of one who sells property to the estate, and acquires the legal status of 'a purchaser for a valuable consideration.'
>
> "In Pollard v. Pollard, 1 Allen 490, 491, speaking for the Supreme Judicial Court of Massachusetts, Chief Justice Bigelow said:
>
> > 'The bequest in this case to the widow of the testator is made in express terms in lieu of dower, and on condition that she relinquishes all her right and title thereto.
> >
> > 'A wife cannot be deprived of her dower except by her own consent. Therefore, when she accepts a provision in her husband's will as a substitute for this existing legal right, the law regards her as standing in the light of a purchaser for a valuable consideration, and entitled to receive the whole of the sum given by the

[2] 15 F. (2d) 367 (C. C. A. 2d, 1926).
[3] At 368.
[4] 26 F. (2d) 760 (C. C. A. 1st, 1928).
[5] At 761-762, 763.

will, for which she has relinquished her life estate in one-third of the testator's real estate, in preference to other legatees, who, being only objects of the bounty of the testator, and not having any legal claim on his estate, are regarded as volunteers, and are not allowed to take until the widow has received the full amount of the bequest to her.' . . .

"Under the principles announced by the Supreme Judicial Court of Massachusetts, we think that, in the case before us, the payments made to Sarah A. Davenport during the years in dispute represented 'purchase money' or 'installment payments' by the estate in consideration for her share in the corpus of the estate. We think, then, that she was a 'purchaser for value.' . . .

"In the case at bar the local law gave Sarah A. Davenport the status of a 'purchaser for value.' The federal income tax law recognizes that status. We think it clear that she was not liable for the payment of any of the taxes in dispute; . . .

"While in the Warner case the court had before it an annuity, the provision relating to the annuity was made expressly in lieu of statutory rights of the beneficiary in the estate; we think the principles announced in that case are controlling in the case before us, . . ."

In no case is the reason for the rule made clearer than in *Allen v. Brandeis*,[6] where the analogy to a purchased annuity is vividly drawn in the following language:

"It is freely conceded, if the widow had taken the amount of her interest in the estate, and with that sum had purchased an annuity of $50,000.00 per annum for a period of years, such annuities, when paid to her, would not have been taxable to her under the law, for the laws above referred to so provide. In legal effect, is that not precisely what was done in this case? She took her property by her acquired under the laws of the state, turned the same over to her husband's estate under an agreement she should receive as the purchase price of her interest $50,000.00 per annum from the estate, that is to say, her invested capital was the value of her interest in her husband's estate, to wit, $483,727.79. By the expenditure of this sum, the same being her own money, she purchased an annuity of $50,000 per annum from those representing her husband's estate to be paid out of that estate. Clearly, in such case, under the law, she should not be required to pay any income tax on the annual payments received until her capital investment in the annuities shall have been returned to her."[7]

The theoretical basis of the doctrine of capital recoupment is stamped with the approval of the Supreme Court of the United States by the opinion in *Burnet v. Logan*,[8] in which the taxpayer had surrendered certain shares of stock in exchange for the right to receive annual payments in amounts to

[6] 29 F. (2d) 363 (C. C. A. 8th, 1928).
[7] At 364.
[8] 283 U. S. 404, 51 Sup. Ct. 550 (1931).

depend upon the amount of ore periodically removed from a mine. The value of the stock surrendered had been fixed as of March 1, 1913. Without further noting the factual ramifications of the case, suffice it to state that the controversy arose as of 1921 and that the capital investment had not yet, as of that date, been recouped by the taxpayer. The following quotations from the opinion of the Court are self-explanatory:

> "The transaction was not a closed one. Respondent (taxpayer) might never recoup her capital investment from payments only conditionally promised. Prior to 1921 all receipts from the sale of her shares amounted to less than their value on March 1, 1913. She properly demanded the return of her capital investment before assessment of any taxable profit based on conjecture." [9]

In the same case the taxpayer had inherited the right to similar payments against shares which had been originally surrendered by the taxpayer's mother in 1916 but of which the value had not been fixed. As to these the Court said:

> "Some valuation—speculative or otherwise—was necessary in order to close the estate. It may never yield as much, it may yield more. If a sum equal to the value thus ascertained had been invested in an annuity contract, payments thereunder would have been free from income tax until the owner had recouped his capital investment. We think a like rule should be applied here. The statute definitely excepts bequests from receipts which go to make up taxable income. See *Burnet, Commissioner v. Whitehouse,* 282 U. S. 818, (April 13, 1931)." [10]

The law of Pennsylvania is precisely to the same effect, as an examination of the decisions will readily show.[11]

Since the highest courts of the United States and of this commonwealth have established beyond peradventure that the payments of income *of her husband's estate* which the widow receives under her husband's will are not income *to her* (until the aggregate equals the capital which she has paid for them) but are a return of the capital with which she purchased the said payments by waiving her statutory right to her said capital, it is difficult to see how any tax upon the income *of the widow* can be made to reach directly or indirectly these particular payments. Irrespective of the wording or intent of any income tax statute of the United States or of any state, and irrespective

---

[9] At 413, 51 Sup. Ct. at 552.

[10] At 413, 51 Sup. Ct. at 553.

[11] "It is true that her acceptance under the will must be regarded as an acceptance in lieu of dower, and so to be taken as a purchase for a valuable consideration . . ." Appeal of Kline, 117 Pa. 139 at 148, 11 Atl. 866 at 868 (1887).

"She had surrendered her rights under the intestate law in accepting these provisions, and was therefore a purchaser for value of the testamentary provisions in her favor." *In re* Denis's Estate, 169 Pa. 493 at 498, 32 Atl. 436 at 439 (1895).

". . . the widow, by accepting the provisions of the will in lieu of dower, is a purchaser for value . . ." *In re* Taylor's Estate, 175 Pa. 60 at 64, 34 Atl. 307 (1896).

of the income tax amendment of the United States Constitution or of any state constitution, it seems quite clear that that which is finally adjudged by the courts of last resort to be, by its inherent nature, capital and *not* income, cannot be reached by any *income* tax statute or constitutional provision.

It would seem to follow that if an income tax statute expressly purported by its very terms to tax what is not income but a capital return or recoupment the statute would be to that extent meaningless and unconstitutional.

Happily, however, no such statute exists. The statutory provision which the government has chosen as the vehicle for its considered attempt to tax as income of a widow (if not directly then indirectly) that which it is conceded is in fact a recoupment of her capital is section 219 of the *Revenue Act* of 1924 [12] of which the relevant portions provide:

> "Sec. 219 (a) The tax imposed by . . . this title shall apply to the income of estates or of any kind of property held in trust, including . . .
>
> "(2) Income which is to be distributed currently by the fiduciary to the beneficiaries . . . ;
>
> "(b) Except as otherwise provided . . ., the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that . . .
>
> "(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries . . . but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not."

It will be noted from the most scrupulous reading of the above statutory provisions that no difficulty is presented whatsoever. Testamentary trustees find in it the most simple and unequivocal directions as to how they shall act with regard to the "net income of the estate or trust". Let us eliminate all doubt, even of an absurd nature, as to the plain meaning of the above quoted words by following step by step the normal approach of testamentary trustees to the question of income tax.

First of all, at the conclusion of the taxable year they must determine exactly how much net income has been produced to the estate by their management. When this has been determined they turn to the will, by which they are empowered to act, to verify the testamentary direction as to what

[12] 43 STAT. 275, 26 U. S. C. A. § 960 (1928). This section is re-enacted, as quoted, in the Revenue Act of 1926, 44 STAT. 819, 26 U. S. C. A. § 960 (1928).

they are to do with the net income of the estate. From the will it appears that the entire net income of the estate is to be "distributed currently" during her lifetime to the widow of the testator. The trustees note that they have so distributed the entire net income currently to the widow during the taxable year. The trustees are, of course, not interested in the individual income tax return which the widow files. They are concerned only with the "income of the estate or trust". They do not even know whether the widow is a confirmed and deliberate income tax evader or whether she prepares her return with the aid of her banker or lawyer with whom the trustees have no connection whatever.

Confining their attention, therefore, strictly to the "net income of the estate or trust", they read in the above statute:

> "There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries . . ."

They note that the remaining clause (also above quoted) of the statute is not concerned with the "net income of the estate or trust" but touches only the "net income of the beneficiaries" and they, therefore, rightly dismiss it from further consideration. The widow's personal banker or lawyer can take care of that; and it is no concern of the testamentary trustees of her husband's estate that under the principle of the *Warner, Bolster* and *Allen* cases, her personal adviser will be able to treat as a return of the *capital of the widow* the payments received as *income of the estate or trust* until the said payments in the aggregate equal the value of the widow's statutory right in her husband's estate as of the date of his death; which right, being capital belonging to her, was waived and paid over in consideration of the benefits provided by the will.

It is hardly necessary to point out that if the latter clause of the statute, which is addressed to the individual's income and not to that of the estate, had been couched in language susceptible of interpretation as a condition subsequent of the preceding clause, the trustees might perhaps properly take it into consideration; since such is not the case the eventuality need not be considered.

It will thus be obvious that the meaning of the statute as above discussed does not depend upon any niceties of statutory construction nor upon the time-honored rule of construction that tax statutes, in the event of ambiguity, must be construed against the taxing authority and in favor of the taxpayer. The plain words of the Act make it quite unnecessary for the widow to call to her assistance such secondary defenses.

In the face of the foregoing, the Department of Revenue, in pursuit of its proper purpose of collecting as much revenue as possible, has published two rulings since the decision of the *Bolster, Warner* and *Allen* cases. By one of these rulings,[13] the department declares that payments made to the widow prior to her recovery of the value of her statutory interest "may not be deducted in computing the net income of the trust, as only those distributions of income by an estate or trust which, under the taxing statutes, 'shall be included in computing the net income of the beneficiaries', are allowable as deductions in computing the net income of the estate or trust."

In other words, the department by its ruling, which is supposed to be in the character of interpretation and not of legislation, expressly denies to the statute the only meaning of which the statute is susceptible. It is a piece of constructive legislation by an administrative department to which, unfortunately, the legislative powers of Congress have not been deputed by the Constitution.

By an earlier ruling [14] it is provided that after the widow has recovered the value of her dower interest "she is treated as any other income beneficiary".

These two rulings taken together complete the symmetrical scheme which the department has legislated into existence and by the same token the rulings purport to revoke the Act of Congress, of which the only possible meaning has already been noted and with which the two said departmental rulings are necessarily inconsistent.

The question was directly raised judicially before the Board of Tax Appeals in the case of *Butterworth et al., Trustees, v. Commissioner.*[15] In an opinion which has already attracted considerable attention the Board unanimously ruled that under the above quoted Act of 1924 the trustees of a testamentary trust, of which income was payable to the testator's widow who had elected to take under the will, were not entitled to deduct, in computing the net income of the estate or trust, the amount of the income of the estate or trust for the taxable year which was to be distributed currently by the fiduciary to the widow prior to the recovery by the widow of the value of her statutory interest.[16]

The *Butterworth* opinion (unlike the ruling first cited above [17]) does not attempt to read the last clause of the pertinent statutory provision as a

[13] I. T. 2506, VIII—2 Cum. Bull. 129, 130 (1929).
[14] I. T. 2480, VIII—2 Cum. Bull. 141 (1929).
[15] 23 B. T. A. 838 (1931).
[16] A hasty reading of the opinion in the Bolster case, *supra* note 4, might suggest that there was color of authority for the Butterworth decision, *supra* note 15, in the following *dictum:* "We think that the government must look to the trustee for its taxes, and that the trust would clearly be taxable upon this income, if it were not expressly exempt because of its charitable character." As was pointed out, however, in the briefs of counsel in the Butterworth case (which the writer has had the great privilege of seeing) the last sentence *must* refer to the trust income after the termination of the life estate of the widow, because, under the facts of the Butterworth case, that is the income which is expressly exempted because of its charitable character. However, the Board of Tax Appeals in the Butterworth decision quite properly does not rely upon or advert to the *dictum* in question.
[17] *Supra* note 13.

condition subsequent of the earlier clause (since obviously the language is in fact not conditional). On the contrary, the Board expressly bases its decision upon the earlier clause standing by itself and without reference to the latter clause. The Board said in part:

> "It is also argued by the petitioners that the last clause of section 219 (b) (2), which provides that the amounts deducted by the trustees shall be included in the income of the beneficiary, is directed solely to the beneficiary and has no bearing on the preceding part of the section which gives the deduction to the trustee. We have indicated in our discussion so far that our decision is not rested on the last clause of section 219 (b) (2) but is based on the preceding part under which the trustees claim the deduction . . ." [18]

In thus resting its decision *solely* upon the earlier clause the Board happily narrows the issue and makes simpler the task of condemning the conclusion reached.

After citing with approval the *Warner, Bolster, Allen* and similar decisions, and the Pennsylvania cases of like import, the Board correctly states that the said decisions "consider the situation from the standpoint of the widow". The Board then points out (as was pointed out in the initial paragraph of this article) that just as the widow, by surrendering her capital, purchases for herself an annuity, so the testator, by the testamentary provision creating the trust for the benefit of his widow, offers to purchase from his widow for his estate the surrender of the portion of capital to which she has a statutory right upon the testator's death. By electing to take under the will she accepts his posthumous offer and thereby sells to the estate her statutory capital share. It is impossible to place too much stress upon the importance of understanding that the price which she receives in exchange for her surrender of capital is the right to receive, during her lifetime, "the income of the estate or trust".

It is respectfully submitted that it was the failure to grasp this one point that was the cause of the mistaken decision of the Board.

The Board conceives that because the "income of the estate or trust" becomes a capital return in the hands of the beneficiary it cannot be deducted. This, it is submitted, is the plainest example of *non sequitur*. After pointing out upon the undoubted authority of *Burnet v. Whitehouse* [19] that "the statute taxes to a beneficiary only 'income paid as such' ", the Board again becomes guilty of a *non sequitur* by directly continuing "and in our opinion contemplates the deduction by the trustee only of income paid as such to a pure [*sic*] beneficiary . . .".[20]

---

[18] Butterworth *et al.* v. Commissioner, *supra* note 15.
[19] 282 U. S. 818, 51 Sup. Ct. 22 (1931).
[20] Butterworth *et al.* v. Commissioner, *supra* note 15.

It is submitted that the words of the Act of 1924 make it too plain for argument that the purity of the beneficiary has nothing to do with the matter. The opinion of the Board makes very plain the cause of the Board's misconception of the words of the Act; for, in quoting the Act in the opinion in two separate places, the Board replaces by asterisks the words which are the most important of all. In discussing the very foundation upon which the case must turn the Board asserts that the statute "taxes trust income primarily to the *trust* but it allows the trustee to deduct the 'income * * * which is to be distributed currently by the fiduciary to the beneficiaries' ".[21] From this it seeks to infer that since under the *Warner, Bolster* and like cases the disputed payments are not "income" but are capital return to the beneficiary, they are not deductible as currently distributable "income of the estate or trust". Referring to the same line of cases the Board says again in the following paragraph:

> "In view of the authorities quoted as to the status of the widow who takes a bequest in lieu of dower, we think there is no doubt that the amounts paid to her in this case are not 'income * * * distributed * * * to the beneficiaries' and there is no room for application of the rule urged." [22]

It is already obvious that the key-words ("of the estate or trust") of the whole question should have been included in place of the asterisks which immediately followed the word "income" in the two quotations.

It would appear that the Board is guilty of the ancient error of failing to note *whose* income is being talked about in the earlier clause of the statute upon which alone the Board avowedly bases its opinion,[23] as the words omitted by the Board in its quotations from the statute clearly show the earlier clause deals expressly only with the "income of the estate or trust" and the latter clause deals expressly only with the "net income of the beneficiaries". Since the language of the statute shows, and the opinion of the Board expressly admits, that the two clauses are independent of each other (the Board's opinion being avowedly based solely on the earlier one) there is really nothing more to be said.

While it is submitted that the above considerations are conclusive it is fitting to point out that what the Board considers an obstacle to the permission of the deduction, is in reality no obstacle at all. The Board feels that because the payments of the income ("of the estate or trust") to the widow is merely carrying out a "convention or contract" arising from the acceptance by the widow of the offer made on behalf of his estate by the testator, it is for that

[21] *Ibid.*

[22] *Ibid.*

[23] See, for example, the words of Judge Dickinson in a cognate, though not precisely analogous, situation in the case of Wood v. United States, 55 F. (2d) 733 (E. D. Pa. 1931): "What he has overlooked, however, is that what may be income to one may be capital to another, and this oversight has led him to argue fallaciously."

reason not "income * * * which is to be distributed currently" within the meaning of the Act. Clearly such a conclusion does not flow from the premise. Even if we did not have the words "of the estate or trust" to remove all uncertainty as to the meaning of the statute, why is it material to the question involved that the payments made by the estate to the beneficiary are in effect made in performance of a "contract or convention" between the testator and his widow? To be sure the "contract or convention" exists and the payments are made in pursuance thereof. They constitute in fact the price paid by the estate for the surrender of the widow's statutory right; but, as said before, that very price is "the income of the estate or trust" . . . "which [under the will] is to be distributed currently by the fiduciary to the beneficiaries" and by the unequivocal words of the statute such "income of the estate or trust . . . shall be allowed as an additional deduction in computing the net income of the estate or trust".[24]

If the view adopted by the Board were sustained the illogical consequences would present insurmountable difficulties. For example, if there were logic in the Board's conclusion that because the payments by the estate to the widow constituted part performance of a "contract or convention" they are not proper deductions, what would be the situation when, in the course of time, the widow had received payments of income of the aggregate value of her statutory right? Payments of income made to her after that date would be none the less made in performance of the "contract or convention"; for the price or consideration offered by the testator for the surrender of the widow's statutory right is the right to receive the payments of income *during her entire lifetime* and not merely until such payments equal the capital value of the statutory right which she was asked to surrender. The widow would thenceforward be obliged to include the payments in her own individual return, for they would then be income to her and not a recoupment of capital as before; and the trustees would also be obliged to pay a tax on the said income, inasmuch as the reason now advanced for not permitting it as a deduction to the trustees would be just as effective then.[25]

It is unnecessary to multiply examples of anomalous consequences of the *Butterworth* decision or to enquire into the question of hardship. Since plain English and plain logic point the only possible conclusion, there is no need to take issue with that portion of the opinion of the Board which holds that the law takes no special interest in widows. If called upon to pass a

[24] It is obvious that the Illinois case of Requa v. Graham, 187 Ill. 67, 58 N. E. 357 (1900), cited by the Board can have no application to the question here involved, since it is concerned solely with whether trust funds and the proceeds thereof shall be protected against attaching creditors under an Illinois exemption statute.

[25] The Board avowedly dodges this question in the Butterworth opinion, *supra* note 15, expressly pointing out that the only question which the Board will consider is ". . . the treatment of the annual sums by the trustee before the time they equal the value of the right surrendered by the widow. We have no question as to the treatment of such sums by either the trustee or the widow after that time."

similar general comment as to whether the law in general owns a "beneficent purpose" towards children (the Board acknowledges that it does own such a purpose towards charitable institutions) the answer of the Board would probably be in the affirmative; yet children may be cut off without a penny and without redress (which is also true of charities), but the law so cherishes the position of widows that in most states of the Union they can, without reason given, disregard the husband's testamentary provisions and take absolutely at least one-third of his entire estate.

It is also to be remembered *obiter,* especially in connection with the above noted general policy of construing ambiguous tax laws in favor of the taxpayer and against the taxing authority, that the courts are not inclined to permit that to be done by indirection which is not properly feasible directly. Under the principle of the *Warner, Bolster, Allen* and other like cases, the fact that a widow cannot be made to pay any kind of an income tax upon what is in fact a recoupment of capital to her (until the aggregate amount of the testamentary payments to her equal the amount of her surrendered capital) is of great practical financial benefit to the widow in most cases. Unless she was comparatively young at the death of her husband there is at least a likelihood that she will not be obliged to pay income tax for the rest of her life. If the ruling of the Board of Tax Appeals were to be sustained, not only would the benefit of the principle of capital recoupment be entirely lost to her but it would in fact penalize her; for the exemption to which her trustees, if taxable, would be entitled would obviously be less than the exemption to which she would be entitled; nor would her individual gifts to charities, *et cetera,* made out of proceeds of the testamentary trust, be deductible by the trustees.

In spite of the insistence of the Board that widows are not favored by the law it is at least possible, quite apart from the other controlling considerations already noted, that the courts might well regard the Board's view as expressed in the *Butterworth* opinion, or even an act of Congress codifying the said view, as an attempt to do indirectly what cannot be done directly and would condemn the whole transaction by looking at its substance rather than at its form.[26] The Court might well say of the substance of the transaction

[26] The Supreme Court of the United States seems to have so acted in the case of Lederer v. Stockton, 260 U. S. 3, 43 Sup. Ct. 5 (1922). In that case a testamentary trust was to be paid to annuitants in fixed amounts and to be accumulated as the several annuitants died until the death of the last surviving annuitant, whereupon the corpus was to be paid to a hospital. When only one annuitant, receiving less than one-fifteenth of the total income, remained alive the trustee transferred the whole residuary fund, subject, of course, to the remaining annuity, as a loan to the hospital, taking back into the trust as security for the loan a mortgage on the hospital property. The following two sentences from the unanimous opinion delivered by Chief Justice Taft sufficiently reveals the nature of the statute involved, the decision reached, and the reason for the decision, as well as the fact that the Court chose to consider solely the substance and not the form of the transaction: "As the Hospital is admitted to be a corporation, whose income when received is exempted from taxation under section 11(a), we see no reason why the exemption should not be given effect under the circumstances. To allow the technical formality of the trust, which does not prevent the Hospital from really enjoying the income, would be to defeat the beneficent purpose of Congress." At 8, 43 Sup. Ct. at 5.

that it is nothing more nor less than an attempt to apply an income tax statute to what is really capital recoupment.

Conclusion

It is submitted that at all events under the provisions of the Act of 1924 and similar provisions in succeeding statutes the trustees are unquestionably entitled to deduct "income of the estate or trust . . . which is to be distributed currently by the fiduciary to the beneficiaries" and that to the extent that, and so long as, such payments in the hands of the beneficiaries represent a recoupment of capital surrendered as the price of obtaining the benefits offered by the provisions of the will, the same are not taxable as individual income of the beneficiary. The latter point is already conclusively ruled by the courts.

It is further submitted (and this may be of great practical importance to trustees and beneficiaries who have been paying income tax for a number of years through misconception of their rights) that the surviving spouse's right of recoupment of capital, because of its very nature, continues to exist until the surrendered capital is recouped. The fact, for example, that the widow of a testator who may have died ten years ago has been mistakenly paying income tax during the said ten years can in no way impeach her right henceforward, between now and the time of her death, to recoup so much of the surrendered capital as she can from the future avails which are to accrue to her from her husband's testamentary trust. Since the income tax payments which she has made to the government during the past ten years were erroneously made, she can, of course, make claim against the government for the refund of such payments; but it seems probable that her right to collect such refunds will be subject to the time limitations fixed by the statute for claiming refunds of tax paid in error.

The taxing authorities will doubtless urge that the sustention of the view of the law set forth in this article will mean the loss of vast sums of money to an already impoverished federal government. This is probable true. But no doubt the present Congress in its great wisdom will discover other fruitful means to replenish the coffers of the Republic.