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CADILLACS, GOLD WATCHES, AND THE TAX REFORM ACT OF 1986: THE CONTINUING EVOLUTION OF THE TAX TREATMENT OF GIFTS TO EMPLOYEES

by

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I. INTRODUCTION

The Tax Reform Act of 1986 added three new Internal Revenue Code provisions applicable to "gifts" from employers to employees. New I.R.C. Section 102(c) sets forth a general rule that property transferred by an employer to an employee shall not be excluded from the employee's gross income as a gift. A new exclusion for certain employee awards appears in Section 74(c). The exclusion is keyed to Section 274(j), a new provision limiting an employer's deductions for such awards. These three provisions should mark the end, or at least the beginning of the end, of many years of uncertainty for taxpayers and inconsistency on the part of the courts, the Congress, and the Commissioner. At the same time, the new provisions, like any new legislation, give rise to new uncertainties.

The purpose of this article is to explore the historical background underlying the 1986 changes to explain the changes, and to assess their meaning and significance.

II. THE DUBERSTEIN OPINION

Commissioner v. Duberstein, decided in 1960, is generally regarded as the watershed case on the question of when, if ever, a gratuitous transfer in a business context is a gift and thus excludable from gross income under Section 102. In Duberstein, the Supreme Court stated that the word "gift," as it is used in Section 102, means a transfer that "proceeds from a 'detached and disinterested generosity'... 'out of affection, respect, admiration, charity or...

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1 Pub. L. No. 99-514, hereinafter referred to as "the Act."

2 Act section 122.

3 See infra notes 385-96 and accompanying text.

4 See infra notes 373-80 and accompanying text.

5 Id.

6 See infra text accompanying notes 385-406.

7 See infra text accompanying notes 10-352.

8 See infra text accompanying notes 353-84.

9 See infra text accompanying notes 385-418.

like impulses.' (Citations Omitted)." Whether a particular transfer is a gift, the Court held, is a question of fact to be decided on a case by case basis.

In *Duberstein*, the taxpayer had received a Cadillac from a business associate as a token of the associate's appreciation for profitable business referrals Mr. Duberstein had provided. The associate was under no obligation to compensate Mr. Duberstein for the referrals, but apparently he thought the gift was prudent from a business standpoint. The Tax Court determined, as a factual matter, that the transfer was intended as compensation and, therefore, was not a gift for purposes of section 102. The Court of Appeals reversed. The Supreme Court concluded that the Court of Appeals should not have reversed the Tax Court's factual conclusion because that conclusion was not "clearly erroneous." Therefore, the Supreme Court reversed the Court of Appeals' decision and allowed the Tax Court's decision to stand.

*Stanton v. United States*, a companion case to *Duberstein*, involved payments by an employer to a departing employee. The taxpayer had resigned his job under circumstances that appeared to be acrimonious. The employer's board of directors voted to pay Mr. Stanton a "gratuity" of $20,000, on the condition that Mr. Stanton release any claim against the employer for pension or retirement benefits. In fact, Mr. Stanton was not entitled to any such benefits. Without elaboration, the trial court held that the payment was a gift and as such was excluded from Mr. Stanton's gross income by section 102. The Court of Appeals reversed, holding that Mr. Stanton had failed to demonstrate that the payment was anything other than compensation for services. The Supreme Court vacated the Court of Appeals' decision, stating that the conclusory nature of the trial court's opinion made it impossible to determine whether its findings of fact were clearly erroneous. The Court remanded the case to the District Court for more detailed findings.

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1. *Id.* at 285.
2. *Id.* at 290.
3. *Id.* at 280.
4. *Id.* at 281. The donor deducted the value of the Cadillac as a business expense.
8. *Id.* at 293.
9. The taxpayer apparently had objected to the firing of a colleague. 363 U.S. at 282-83.
10. *Id.*
11. *Id.*
12. *See* 363 U.S. at 292, n.14, citing the oral findings of the district court.
13. 268 F.2d 727 (2d Cir. 1959).
14. 363 U.S. at 292.
15. *Id.* On remand, the district court recited the same facts and held that the payment was a non-taxable gift. 186 F. Supp. 393 (E.D.N.Y. 1960). The district court concluded that the payment was motivated by "good will, esteem, and kindness . . . and . . . a deep sense of appreciation for (the taxpayer's ser-
Rather than setting forth specific criteria for determining whether a transfer is a gift, the Supreme Court in Duberstein stated that "(d)ecision of the issue . . . must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case." The Court did, however, articulate a definition of what is and is not a gift, drawing from language in earlier cases. The Court pointed out that a mere absence of a legal or moral obligation does not make a transfer a gift for purposes of Section 102. Thus, a transfer can be a gift in the common law sense but still not qualify for exclusion from the recipient's gross income. In order to be a gift for purposes of Section 102, the donor must make the gift out of "detached and disinterested generosity." Conversely, a transfer is not a gift if the donor is motivated by "the constraining force of any moral or legal duty or from 'the incentive of anticipated benefit of an economic nature.'" The Court specifically stated that "[w]here the payment is in return for services rendered, it is irrelevant that the donor derives no economic benefit from it." The Court declined to adopt a "test" proposed by the Commissioner — that "(g)ifts should be defined as transfers of property made for personal as distinguished from business reasons" — stating that to adopt such a test "would be painting on a large canvas with indeed a broad brush." In support of the proposed test, the Commissioner advanced various propositions, including the propositions that "payments by an employer to an employee, even though voluntary, ought, by and large, to be taxable," and "that the concept of a gift is inconsistent with a payment's being . . . a deductible business expense." In rejecting the proposed test, the Court observed, perhaps significantly, that "it doubtless is, statistically speaking, the exceptional payment by an employer to an employee that amounts to a gift," and that "it is doubtless relevant to the over-all inference [of whether a transfer is a gift] that the transferor treats a payment as a business deduction."
III. DUBERSTEIN IN THE EMPLOYER-EMPLOYEE CONTEXT

It is not surprising that controversies have arisen over whether transfers from employers to employees constitute gifts for purposes of Section 102. As the Supreme Court stated in Duberstein38 and earlier cases,39 a gift is a transfer out of "detached and disinterested generosity."40 Conversely, if the donor is motivated by something other than generosity, the transfer is not a gift.41 In the employer-employee context, motives other than generosity are almost always present. When an employer makes a purported gift to an employee, the most obvious inference is that the employee is being compensated for services rendered. Clearly, such compensation is not a gift.42 There are, however, other possible motives besides a desire to compensate the employee. Often, the transfer might be made for the purpose of establishing or enhancing good will on the part of an individual employee,43 employees as a group,44 or the general public.45 While the employer's desire to enhance good will can be distinguished from the more basic intention to compensate an employee, it cannot accurately be labeled "detached and disinterested generosity."46

Presumably, it was the almost universal presence of motives other than generosity that prompted the government to assert in Duberstein that payments by an employer to an employee "ought, by and large, to be taxable."47 While the Supreme Court declined to accept the proposition as a basis for deciding the status of a payment, the opinion does concede that a true gift from an employer to an employee is a rare occurrence.48

When a donor is motivated in part by generosity and in part by a wish to compensate the recipient for services or a desire to promote business good will, does the existence of any motivation besides generosity taint the gift? The Duberstein opinion appears to say not. The Court states that in order to determine whether a transfer is a gift, one must look to "the basic reason for [the donor's] conduct . . . the dominant reason that explains his action in making the transfer." (Emphasis added).49 The clear implication is that motives other than generosity do not preclude gift treatment, so long as generosity is the "dominant" motive.50

39 See supra notes 27-31.
40 Duberstein, 363 U.S. at 285.
41 Id. See supra text accompanying note 30.
42 Id. See supra text accompanying note 31.
45 Id.
46 Duberstein, 363 U.S. at 285. See also infra notes 72-76.
47 Id. See also text accompanying note 34.
48 Id. at 287. See also supra text accompanying note 36.
49 Id. at 286.
50 See Willis and Hawley, I.R.C. Section 274(b) and Duberstein Resurface: The Emperor Still Has No Clothes,
Employers normally deduct payments to employees as ordinary and necessary business expenses. "Gifts" made for the purpose of compensating employees clearly are deductible by the employer. Gifts made for the more generalized purpose of establishing or enhancing good will are also deductible, as they are directly related to the employer's business. Payments arising purely out of generosity, on the other hand, presumably would be nondeductible personal expenses. Based on these factors, the government suggested in Duberstein that, by definition, an item that is deductible by the donor as a business expense cannot be a gift in the hands of the recipient. This assertion seems particularly persuasive in view of the Court's approach to mixed motive gifts — i.e. that the dominant motive controls. When a business expense is incurred partly for personal reasons, the usual approach in determining deductibility is to look to the primary purpose for incurring the expense. In fact, this approach has been applied in determining whether an employer can deduct the cost of gifts to employees. Thus, the employer's tax treatment would appear to be a convenient and logical means for determining the employer's dominant motivation. Nevertheless, the Supreme Court, while recognizing that the donor's deduction of the cost of a gift is relevant in determining his motivation, declined to treat it as controlling.

The constant presence of motives other than pure generosity, along with the apparent logical inconsistency between deduction by the donor and exclusion by the donee, has given rise to numerous cases and rulings involving "gifts" to employees. A sampling of these cases and rulings appears below, grouped into five categories: holiday gifts, employer charity, payments to surviving spouses of deceased employees, retirement payments, and bonuses.

25 ARIZ. L. REV. 907 (1983). The authors criticize the "dominant motive" test of Duberstein as a misreading of Bogardus and suggest an alternative approach of apportioning a transfer to an employee between compensatory and non-compensatory elements.

1.R.C. § 162(a) allows a deduction for ordinary and necessary business expenses, including "a reasonable allowance for salaries or other compensation for services actually rendered."

1d.


41.R.C. § 262 prohibits the deduction of "personal . . . expenses."

5Duberstein, 363 U.S. at 287. See supra text accompanying note 34. See also Shaviro, A Case Study for Tax Reformers: The Taxation of Employee Awards and Other Business Gifts, 4 VA. TAX. REV. 241 (1985), in which the author suggests that it is unacceptable from a policy standpoint to allow the employer to deduct the value of a gift while allowing the employee to exclude the value of the gift from gross income.

6See supra text accompanying notes 49-50.

7See, e.g., Treas. Reg. § 1.162-2(b)(1), authorizing a deduction for the expenses of business related travel only if the trip is primarily for business as opposed to personal purposes.

8See, e.g., Bank of Palm Beach v. United States, 476 F.2d 1343 (Ct. Cl. 1973), infra notes 155-62 and accompanying text.

9Duberstein, 363 U.S. at 387. See also supra text accompanying note 37.
A. Holiday Gifts

To the average person, a birthday or holiday present is the quintessential gift. If social pressure is disregarded, most such presents are manifestations of generosity and as such fall squarely within the income tax concept of gifts. In the employer-employee context, however, generosity and social pressure are not necessarily the donor's only motivations. The employer might also use the occasion of a holiday or an employee's birthday to provide additional compensation, and virtually every birthday or holiday gift to an employee is made, at least in part, for the purpose of creating or enhancing good will. Under a strict application of the traditional test, many of these transfers would be taxable to the recipients. The Internal Revenue Service has, however, taken a more liberal approach. In Revenue Ruling 59-58, the Service stated that the value of a "turkey, ham, or other item of merchandise" given by an employer to each of his employees as a holiday gift is excludable from the employees' gross income. The same Ruling held that the employer can deduct the cost of the items as a business expense since such gifts are made "primarily for the business purpose of promoting good relations with . . . employees." Cash gifts, and presumably gifts of more than nominal value, would fall outside the scope of the Ruling and would be includable in the employee's gross income.

B. Employer Charity

According to the Duberstein opinion, a transfer is an excludable gift if the giver is motivated by "charity." Thus, if an employer makes a gift to an employee out of primarily charitable instincts, the gift is excludable under the Duberstein criteria. Typically, however, the employer's motives are not purely charitable. In addition to the psychic satisfaction of helping someone in need, the employer expects to derive enhanced good will from such transfers. Presumably, under Duberstein the excludability of the transfer as a gift would depend upon which motivation predominates — charitable generosity or public relations.

The Service addressed the tax treatment of employer charity in Revenue Ruling 53-131, which involved a corporation that was one of the largest

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60 See supra text accompanying notes 27-31.
61 See generally supra notes 41-46.
63 Id.
64 Treas. Reg. § 1.61-2(a)(1) specifically requires that cash bonuses must be included in the recipients' gross income. Revenue Ruling 59-58 cites "the small amount involved" as justification for excluding the value of the merchandise from the employees' gross income. 1959-1 C.B. at 18.
65 Duberstein, 363 U.S. at 285. See also supra text accompanying note 11.
66 See supra notes 49-50 and accompanying text.
68 The fact that the donor was a corporation is significant in view of the government's position in Duberstein that "a business corporation cannot properly make a gift of its assets." 363 U.S. at 287.
employers in an area that was struck by a tornado. The corporation established a relief fund to provide assistance to employees who had suffered injuries or whose homes had been damaged or destroyed. The Ruling first addressed the question of whether the employer may deduct its contributions to the fund as a business expense. The Ruling holds that the contributions are ordinary and necessary expenses, and therefore are deductible, because they promote goodwill among the employees as well as in the community at large, which is “essential to the successful conduct of the business.” The Ruling then addresses the tax treatment of the recipients and concludes that payments received from the fund are not includable in gross income. While the Ruling points out that the payments are “gratuitous and spontaneous,” the word “gift” does not appear in the Ruling and no reference is made to the statutory exclusion for gifts. Apparently, the Service concluded that such items simply do not constitute gross income. In view of the position taken by the Commission six years later in Duberstein, this is the only plausible explanation for the non-taxability of the payments to the employees. The payments would not be gifts under the standards proposed by the government in Duberstein — i.e. that payments by an employer to an employee, especially if they are deductible by the employer, are not gifts. Moreover, the government argued in Duberstein that a corporation, as a matter of state law, is incapable of making a gift. Even under the Supreme Court's Duberstein criteria, payments made primarily for public relations purposes do not reflect “detached and disinterested generosity.”

Unlike Revenue Ruling 53-131, Revenue Ruling 59-5877 specifically states that the holiday turkey or ham is an “excludable gift.” For reasons similar to those outlined above, this conclusion is totally at odds with the government's position in Duberstein. The Ruling can be explained only on practical grounds. Presumably, the Service decided that if only nominal amounts are involved, the revenue to be generated by taxing the value of the holiday turkey is outweighed by the negative sentiment that would be generated by requiring employers to

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70 Id.
71 Id.
72 Similar results have been reached in the context of government and institutional charity. See, e.g., Rev. Rul. 76-144, 1976-1 C.B. 17, ruling that federal payments to needy victims of major disasters do not constitute gross income to the recipients.
73 Duberstein, 363 U.S. at 278.
74 See supra notes 32-37 and accompanying text.
75 See supra note 68.
76 See supra text at note 29. See also Willis and Hawley, supra note 50, suggesting that under Bogardus, the presence of any motive other than generosity should preclude gift treatment.
78 Id. at 18.
79 See supra text accompanying notes 73-76.
80 1959-1 C.B. at 18.
treat such items as compensation and withhold the resulting tax liability from the employees’ pay.  

C. Payments to Spouses of Deceased Employees  

Gratuitous payments to the surviving spouse or other dependent of a deceased employee represent a type of employer charity, but they are by nature different from charity of the type described in Revenue Ruling 53-131. Unlike the disaster aid described in Revenue Ruling 53-131, payments made by reason of an employee’s death normally reflect gratitude, and arguably compensation, for the deceased employee’s services. By statute, recipients of such payments may exclude up to $5,000 from gross income, regardless of whether the payment is the result of spontaneous generosity or a contract between the employer and the employee. If the employer gives the employee’s survivor more than $5,000, the excess is includable in the recipient’s gross income unless it constitutes an excludable gift under the Duberstein criteria. As evidenced by the cases and rulings discussed below, the question of when payments to the survivors of deceased employees are gifts has been, and continues to be, difficult.

The Service’s earliest pronouncement on the question of gratuitous payments by an employer to a deceased employee’s survivors was issued in 1921. In declaring that a corporation’s payment of the equivalent of two months’ salary to the widow of a deceased officer was an excludable gift, the Service appeared to be applying the common law definition of “gift” later rejected in Duberstein. Without elaboration, the Decision simply states that as a gratuitous transfer not supported by consideration, the payment constitutes a gift. The Service applied similar reasoning in I.T. 3329 to conclude that monthly payments made to an officer’s widow for one year after the officer’s death were gifts. The Ruling states that “(w)hen an allowance is paid by an organization to which the recipient has rendered no service, the amount is deemed to be a gift or gratuity and is not subject to Federal income tax in the hands of the recipient.” Citing regulations then in effect, the Service also ruled that the employer could

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81 Cf. Shaviro, supra note 55, at 245-46, suggesting that the value of such items to the recipient is more psychic than economic.
82 If the employer is contractually obligated to make such payments, they are not gifts even under the traditional property law definition.
83 See supra text accompanying notes 67-76.
84 I.R.C. § 101(b). The exclusion is not available, however, if the employee had a “nonforfeitable right” to receive the payment while alive. I.R.C. § 101(b)(2)(B).
85 See text at notes 26-31 supra.
86 Q.D. 1017, 5 C.B. 101 (1921).
87 See supra notes 27-28 and accompanying text.
88 5 C.B. at 101.
89 1939-2 C.B. 153.
90 Id. at 154.
deduct the payments as a business expense. The Service changed its position on the gift status of payments to survivors of deceased employees in I.T. 4027. Revoking O.D. 1017 and modifying I.T. 3329, the Service stated that payments made by an employer to the widow of a deceased employee in consideration of services rendered constitute gross income, even in the absence of a contractual obligation or established plan. Citing a Fifth Circuit case, the Service stated that I.T. 3329 was incorrect in focusing on the fact that the recipient of the death benefit had not performed services. The correct inquiry, according to I.T. 4027, is whether services have been performed for the payor, either by the recipient or the deceased employee.

Prior to Duberstein, and to a large extent since Duberstein, courts have been reluctant to accept the Service’s position that payments to the survivors of deceased employees are not gifts. Generally, the courts have applied a checklist of factors enunciated by the Tax Court in 1955, often concluding that the payments are excludable gifts.

In Estate of Hellstrom v. Commissioner, a pre-Duberstein case, the Tax Court addressed the question of gratuitous payments to the widow of a deceased employee. The Court held that the payments were excludable gifts even though they were made “in recognition of” the deceased employee’s services. The “controlling facts,” according to the Court, were that the payments were made to (the widow), and not to (the employee’s) estate; that there was no obligation on the part of the corporation to pay any additional compensation to (the employee); (the corporation) derived no benefit from the payment; (the widow) performed no services for the corporation; and (the services of the deceased employee) had been fully compensated for.

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91 The applicable regulation provided that when the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, such payments may be deducted. Id.
95 Varnedoe v. Allen, 158 F.2d 467 (5th Cir. 1946).
96 See text at note 90, supra.
97 See infra text accompanying notes 122-34.
99 The corporate minutes indicated that the payments were “in recognition of” the deceased employee’s services. Id. at 918.
100 The Court quoted language from Bogardus v. Commissioner, 302 U.S. 34 (1937), stating that “a gift is none the less a gift because inspired by gratitude for past faithful services.” Hellstrom, 24 T.C. at 919.
101 Hellstrom, 24 T.C. at 920.
Based upon these factors, the Court concluded that the principal motive of the corporation in making the payment was to do an act of kindness for the employee’s widow, and that the payment therefore was a gift. The Court found no significance in the fact that the corporation had deducted the payment as a business expense.

While the Tax Court’s ultimate conclusion in *Hellstrom* — that the corporation’s primary motivation was to do an act of kindness — is stated in terms that are consistent with the standards later articulated in *Duberstein*, most of the factors cited by the Court indicate that the case may well have been decided on the basis of the common law definition of gift (i.e., a transfer of property without consideration). This would explain the Tax Court’s “abrupt swerve” after the Supreme Court emphasized in *Duberstein* that the absence of consideration does not make a transfer an excludable gift. The Tax Court made its abrupt swerve in *Estate of Pierpont v. Commissioner*, its first post-*Duberstein* case addressing the death benefit question. In *Pierpont*, the Court concluded that payments essentially indistinguishable from those in *Hellstrom* were not excludable as gifts but rather represented additional compensation for the deceased employee’s services. The Court based its conclusion on a finding that payments “in recognition of services rendered” by the deceased employee reflect not “detached and disinterested generosity” but a dominant motivation to pay additional compensation. The Court also cited the lack of any evidence that the payments were motivated by the needs of the employee’s survivors.

In two memorandum decisions issued shortly after *Pierpont*, the Tax Court cited *Pierpont* and applied similar reasoning in concluding that awards to widows of deceased employees were not excludable gifts. In *Estate of Kuntz*, the directors of the deceased employee’s corporate employer authorized payments to his widow “as additional compensation and in consideration of services heretofore

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104 Id.
105 Id. at 919.
106 See supra text accompanying notes 26-31.
107 The Second Circuit Court of Appeals, in *Carter v. Commissioner*, 453 F.2d 61 (1971), accused the Tax Court of making an “abrupt swerve” from its earlier position on the issue of payments to survivors of deceased employees.
109 35 T.C. 65 (1960).
110 The decision of *Pierpont* had been delayed pending the issuance of the Supreme Court’s opinion in *Duberstein*. Pierpont, 35 T.C. at 67.
111 The taxpayer’s late husband was president and majority shareholder of a wholesale drug company. The corporation paid the taxpayer approximately $10,000 following the death of her husband. The payments were designated “salary continuation,” and were roughly equivalent to six months’ salary. *Id.* at 66. Perhaps coincidentally, in view of *Duberstein*, the corporation also gave the taxpayer a Cadillac. *Id.*
112 *Id.* at 68.
113 *Id.*
114 29 T.C.M. (P-H) 60-1531 (1960).
rendered to this corporation by the (deceased employee).”115 The Court had little trouble concluding, as a factual matter, that the directors did not intend the payment as a gift.116 Likewise, in Estate of Olsen,117 a corporate resolution citing “the valuable services which (the deceased employee) has rendered to (the corporate employer) during the last several years” resulted in a finding of taxable compensation rather than non-taxable gift.118

In Pierpont, Kuntz, and Olsen, the Tax Court clearly implied that it was abandoning the criteria articulated in Hellstrom119 in light of the Supreme Court’s opinion in Duberstein. In Pierpont, the Court stated that, in view of Duberstein’s “clarification” of the subject, “we have not found it profitable to discuss the numerous earlier decisions in the lower courts dealing with payments by an employer to the widow of a deceased employee.”120 Kuntz and Olsen contain similar statements discounting the value of pre-Duberstein precedent.121

The appellate courts have not been willing to view pre-Duberstein precedent as obsolete. Pierpont, Kuntz, and Olsen were all reversed on appeal, and the appellate court opinions in all three cases rely to some extent on pre-Duberstein precedent. The Fourth Circuit Court of Appeals vacated the Tax Court’s Pierpont decision in a appeal styled Poyner v. Commissioner.122 Stating that Duberstein “did not destroy the authority of the earlier Tax Court cases and the guides enunciated in them,”123 the Court recited the Hellstrom124 criteria and observed that “(t)he stipulated facts directly respond to every one of the five factors, and in each instance the response is favorable to the widow.”125 The Court conceded, however, that in light of Duberstein, the fact finder could consider “whatever other factors (it) might think helpful,”126 and remanded the case for “proceedings not inconsistent with this opinion.”127

116 Id.
118 30 T.C.M. at 61-883.
119 See supra text at note 103, supra.
120 35 T.C. at 69.
121 In Olsen, the Court said
[We] think it unnecessary, in view of the clarification of this general subject by the opinion in the Duberstein case, to discuss the numerous decisions heretofore entered (either prior to said opinion or without consideration of the principles therein set forth) which have dealt with payments by employers to widows of deceased employees. 30 T.C.M. at 61-885.

In Kuntz, the Court distinguished a Sixth Circuit case cited by the taxpayer, but “note(d) for completeness” the fact that the case was decided before Duberstein. 29 T.C.M. at 60-1532.

122 301 F.2d 287 (4th Cir. 1962). Poyner was the co-executor of Mr. Pierpont’s estate.

123 301 F.2d at 292.

124 See text at note 103, supra.

125 301 F.2d at 291.

126 301 F.2d at 292.

127 Id. Apparently, the decision on remand was not reported.
In reversing the Tax Court in *Kuntz*, the Sixth Circuit Court of Appeals relied on *Reed v. United States*, a *per curiam* opinion it had issued prior to the Supreme Court's decision of *Duberstein*, and a Tenth Circuit case decided after *Duberstein*. Distinguishing *Duberstein* on the facts, the Court held that the "only reasonable inference" from the facts was that the payment was a gift, and reversed the Tax Court. In *Olsen*, the Eighth Circuit cited *Poyner* and *Kuntz* and reversed the Tax Court's decision, stating that "'[i]f the payment made to Mrs. Kuntz upon the death of her husband was a gift, so was the payment to Mrs. Olsen.'"

The Third Circuit Court of Appeals affirmed the Tax Court's finding of "no gift" in *Smith v. Commissioner*, declining to follow *Olsen, Poyner, and Kuntz* because "the question . . . remains basically one of fact, for determination on a case-by-case basis." Applying the *Duberstein* rationale, the Court concluded that the Tax Court's factual determination was not "clearly erroneous" and therefore should not be disturbed.

Possibly smarting from the *Poyner, Kuntz, and Olsen* reversals, the Tax Court resurrected the *Hellstrom* criteria in *Estate of Carter*, a 1970 memorandum decision. The opinion begins with a citation to *Duberstein* for the proposition that the question of whether a transfer is a gift is one of fact and that the primary consideration is the intention of the transferor. Then the Court outlined various factors that militate for or against a conclusion that a payment is a gift, citing the *Hellstrom* criteria as well as numerous other factors. The Court proceeded to apply those factors to the facts at hand: a payment of approximately one year's salary and commissions to the widow of a deceased brokerage firm employee. In concluding that the payment was not a gift, the

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128 *Kuntz* v. Commissioner, 300 F.2d 849 (6th Cir. 1962).
130 *Kasynski* v. Commissioner, 284 F.2d 143 (10th Cir. 1960).
131 300 F.2d at 852.
132 *Id.* The "only reasonable inference" language was taken from the *Kasynski* opinion, where the Court of Appeals held that the District Court's finding of "gift" was "a reasonable inference." 284 F.2d at 146.
133 *Olsen* v. Commissioner, 302 F.2d 671 (8th Cir. 1962).
134 302 F.2d at 673. The Court also cited several pre-*Duberstein* cases. 302 F.2d at 674.
136 305 F.2d at 782, quoting *Duberstein*.
137 305 F.2d at 780. The taxpayer's late husband was an employee and shareholder of a family owned business. After her husband's death, the corporation paid the taxpayer approximately $72,000 over a two year period. The Tax Court found that the motive behind the payments was to provide additional compensation for the decedent's services. 305 F.2d at 779.
138 *See* text at note 103, supra.
140 39 T.C.M. at 70-1541.
141 *Id.*
142 The decedent worked for the brokerage firm for 38 years, but had no ownership interest in the firm. 39 T.C.M. at 70-1538.
Court relied primarily on two factors. First, the Court pointed out that the employer had deducted the payment as a business expense.\footnote{143} The Court said that deduction by the payor, "while not conclusive negates donative intent."\footnote{144} The Court also emphasized the lack of any evidence that the payments were based on the surviving spouse's financial need.\footnote{145}

Accusing the Tax Court of making an "abrupt swerve" from its pre-Duberstein position,\footnote{146} the Second Circuit Court of Appeals reversed the Tax Court's decision in \textit{Carter}.\footnote{147} The Court concluded that the facts in \textit{Carter} were indistinguishable from those in \textit{Olsen} and more favorable to the taxpayer than those in \textit{Kuntz},\footnote{148} and implied that the Tax Court should return to the pre-Duberstein approach taken in \textit{Hellstrom}.\footnote{149} The Court buttressed its reasoning with the observation that the Tax Court's tendency to find "no gift" in post-Duberstein cases, compared with the district courts' almost uniform finding of "gift," imposed an unfair burden on taxpayers who could not afford to pay the disputed liability and sue for a refund.\footnote{150} In a dissenting opinion, one judge pointed out that the majority's \textit{de novo} examination of the facts went far beyond the appropriate standard of review.\footnote{151} The dissenting opinion stresses Duberstein's message that the question is one of fact to be decided by the trial court.\footnote{152} In response to the majority's comments on the divergence between the Tax Court and the District Courts, the dissenting opinion states that "Duberstein contemplated lack of 'symmetry' between 'the variety of forums in which federal income tax cases can be tried.'"\footnote{153}

As indicated above, the employer deducted its payment to Mr. Carter's widow.\footnote{154} The Commissioner challenged that deduction, and the issue was litigated in \textit{Bank of Palm Beach v. United States}.\footnote{155} In holding for the taxpayer, the Court of Claims cited the same factors the government had cited in \textit{Carter} to argue that the payment was not intended as a gift — \textit{i.e.}, that the payment represented additional compensation for Mr. Carter's services and that the

\footnotesize{\begin{itemize}
\item \footnote{143} 39 T.C.M. at 70-1542. The employer's deduction was later upheld by the Court of Claims in Bank of Palm Beach v. United States, \textit{infra} note 155.
\item \footnote{144} 39 T.C.M. at 70-1542.
\item \footnote{145} \textit{Id}.
\item \footnote{146} Estate of Carter v. Commissioner, 453 F.2d 61, 65.
\item \footnote{147} \textit{Id}.
\item \footnote{148} 453 F.2d at 70. Presumably, the Court found the \textit{Carter} facts more appealing because the deceased employee had been in poor health for some time and owned no interest in the employer corporation.
\item \footnote{149} \textit{Id} at 64-69.
\item \footnote{150} 453 F.2d at 67-69.
\item \footnote{151} 453 F.2d at 70 (Davis, J., dissenting).
\item \footnote{152} \textit{Id}.
\item \footnote{153} 453 F.2d at 72, citing 363 U.S. at 290.
\item \footnote{154} See supra text accompanying note 143.
\item \footnote{155} 476 F.2d 1343 (1973).
\end{itemize}}
amount of the payment was determined by reference to his salary rather than the needs of his widow.\textsuperscript{156} The Court went on to point out that the payment was also prompted by “the desire by (the employer) to secure a legitimate business benefit, an increase in employee morale.”\textsuperscript{157} Implicitly, the Court concluded that the payment was not intended as a gift, notwithstanding the Second Circuit’s holding in \textit{Carter}.\textsuperscript{158} The Court distinguished several earlier cases which had denied deductions for payments to survivors of deceased employee-shareholders, since Mr. Carter had not owned an interest in his employer’s business.\textsuperscript{159} Thus, the payment to Mr. Carter’s widow could not be called a disguised dividend.\textsuperscript{160} The Court concluded that the facts were more closely analogous to those in \textit{Fifth Avenue Coach Lines v. Commissioner},\textsuperscript{161} a case in which the Tax Court had held deductible an employer’s payments to the widow of a deceased non-owner employee.\textsuperscript{162}

D. Retirement Payments

Section 61(a)(11) provides that pensions are includable in gross income. Section 102 would, of course, exclude from gross income any payment to a retiring employee resulting from “detached and disinterested generosity”\textsuperscript{163} rather than a desire to compensate the employee for past services. The Tax Court addressed the question of gratuitous pensions in \textit{Walker v. Commissioner}.\textsuperscript{164} \textit{Walker}, a pre-\textit{Duberstein} case, involved a corporate employer’s gratuitous payment of six months’ salary to an employee forced to retire for health reasons.\textsuperscript{165} In holding that the payment represented taxable compensation and not an excludable gift, the Tax Court stated that if the recipient of a payment has performed services for the payor, “the presumption is that the amount received is for the service and is not a gift.”\textsuperscript{166} In concluding that the taxpayer had failed to rebut this presumption, the Court cited the payor’s deduction of the payment,\textsuperscript{167} a statement in the minutes of the committee meeting authorizing the

\begin{footnotes}
\item[156] Id. at 1348.
\item[157] Id. at 1349.
\item[158] The opinion states that a payment to the surviving spouse of a deceased employee represents deductible compensation “(i)if the amount paid to the widow is not, in reality, a disguised gift, . . . .” Id. at 1347. The opinion is self-contradictory in that it also states that “a payment might be excludable by the recipient and nevertheless deductible by the employer.” Id. at 1345.
\item[159] 476 F.2d at 1347-48, n.7.
\item[160] Id.
\item[161] 31 T.C. 1080 (1959), rev’d on other issues 281 F.2d 556 (2d Cir. 1960).
\item[162] The Tax Court concluded that the payments were additional compensation for the deceased employee’s services. \textit{Fifth Avenue Coach}, 31 T.C. at 1086. While the employee’s widow had not included the payments in gross income in the years in questions, 1944 through 1948, she had reported as gross income payments received in years subsequent to the issuance of I.T. 4027. Id. See supra notes C-55 through C-60 and accompanying text.
\item[163] \textit{Duberstein}, 363 U.S. at 285.
\item[164] 25 T.C. 832 (1956).
\item[165] Id. at 834. The employee had suffered a nervous breakdown.
\item[166] Id. at 836. The Court cited \textit{Noel v. Parrot}, 15 F.2d 669 (4th Cir. 1926).
\item[167] \textit{Walker}, 25 T.C. at 835.
\end{footnotes}
payment that the taxpayer "merited some gift from the Company in recognition of his loyalty," and the fact that the shareholders of the corporation had not approved the transfer. Implicit in the Court's reliance on the lack of shareholder authorization is acceptance of the principle that a corporation normally cannot make a gift, a position later asserted by the government in *Duberstein*.

In a series of pre-*Duberstein* cases involving payments by church congregations to retiring ministers, the Courts of Appeals reversed the Tax Court's findings of "no gift" with striking similarity to the post-*Duberstein* cases involving payments to spouses of deceased employees. The first case, *Schall v. Commissioner*, involved a congregation's payment of $2,000 per year to its minister, who had retired because of poor health. The resolution authorizing the payment characterized it as "salary or honorarium" and named the taxpayer "Pastor Emeritus," a position "with no pastoral authority or duty." The Court concluded that the payments, although gratuitous, represented compensation for past services and thus were not excludable as a gift. The Fifth Circuit Court of Appeals found that the Tax Court "clearly erred in holding that the payments . . . were taxable income." The Court stated that "all the facts and circumstances . . . clearly prove an intent to make a gift," and that "a gift is none the less a gift because inspired by gratitude for past faithful service of the recipient."

*Abernethy v. Commissioner* involved facts similar to those in *Schall*, and the taxpayer cited the Fifth Circuit's decision as authority for his argument that his pension payments should be excluded from gross income as gifts. The Tax Court stated that there was "a distinguishing difference between the facts of *(Schall)* and those in the instant case" but failed to explain what that difference was. Perhaps more to the point, the Tax Court said "we are not convinced that our holding in the *Schall* case was wrong notwithstanding the reversal

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168 *Id.* at 838.
169 *Id.* at 837 (citing *Noel* 15 F.2d 669).
170 *Duberstein*, 363 U.S. 287.
171 See supra text at notes 122-134.
172 11 T.C. III (1948).
173 *Id.* at 113.
174 *Id.* at 114-15. The Court pointed out that the taxpayer had not received a raise in 18 years and suggested that the congregation suddenly realized that he had been undercompensated when he was forced to retire early because of his health. *Id.*
175 *Schall v. Commissioner*, 174 F.2d 893, 894 (5th Cir. 1949).
176 *Id.*
177 *Id.* (citing *Bogardus* 302 U.S. 34).
178 20 T.C. 593 (1953).
179 *Id.* at 594.
180 *Id.* at 596.
181 Presumably, the Court was referring to the fact that the taxpayer in *Schall* retired unexpectedly after suffering a heart attack.
thereof by the Circuit Court." The Tax Court reached a similar conclusion in *Mutch v. Commissioner*, a memorandum decision issued eight days after *Abernethy* and involving virtually identical facts.

Citing the Fifth Circuit's holding in *Schall*, the Third Circuit Court of Appeals reversed the Tax Court's decision in *Mutch*. The Third Circuit's opinion relies heavily on the fact that the taxpayer was not required to render any additional services in order to receive his retirement payments. Three months after the Third Circuit issued its opinion in *Mutch*, the Court of Appeals for the District of Columbia Circuit, in a *per curiam* decision, reversed the Tax Court's decision in *Abernethy*.

In the wake of the reversals in *Schall*, *Mutch*, and *Abernethy*, the Service decided to give up the fight, announcing in Revenue Ruling 55-422 that it would not continue to litigate cases involving payments by church congregations to retired preachers if certain criteria are present. Those criteria include a close personal relationship between the preacher and the congregation, the lack of any established plan or practice of making such payments, the absence of any duty on the part of the recipient to render further services, and evidence that the amount paid was determined in light of the recipient's needs and the congregation's ability to pay. The lack of post-*Duberstein* cases involving such payments tends to indicate that the Service continues to follow Rev. Rul. 55-422.

The Service did litigate a case involving a preacher's retirement payments in 1960, and the Tax Court agreed that the payments involved in that case fell outside the scope of Rev. Rul. 55-422 and the *Schall*, *Mutch*, and *Abernethy* decisions. The case, *Perkins v. Commissioner*, involved payments to a retired Methodist minister. The payments were funded in part by contributions made by the minister's congregation to a central pension fund for Methodist ministers, but the amount of taxpayer's pension was determined under a formula established by the regional Conference and the disbursements were actually made by the Conference's Board of Pensions. In holding that the payments were not gifts, the Tax Court cited the existence of an established plan for making such payments, the lack of a personal relationship between the payor (the Board of

182 *Schall*, 20 T.C. at 596.
183 12 T.C.M. (CCH) 705 (1953).
185 209 F.2d at 392.
188 *Id.*
189 *Id.*
191 34 T.C. 117 (1960).
192 *Id. at* 118.
Pensions) and the recipient, and the fact that the amount of the payments was not determined with reference to the taxpayer's needs.\textsuperscript{192}

In one of the few post-	extit{Duberstein} cases dealing with payments to retiring employees, the Tax Court, in a memorandum opinion, held for the taxpayer. The case, 	extit{Brimm v. Commissioner},\textsuperscript{193} involved an individual who had taught at a church-supported graduate school for 11 years. The taxpayer was one of several employees who received a payment equal to one year's salary when the school closed as a result of increasing costs and declining enrollment.\textsuperscript{194} Recognizing that the payment was an expression of gratitude for services rendered, the Court nevertheless held that the payment was a gift under the \textit{Duberstein} criteria.\textsuperscript{195} The employer admittedly was not obligated to make the payment, and the Court pointed out that no further benefit such as good will could be derived, since the employer was closing its doors.\textsuperscript{196} The Court cited the Court of Appeals opinions in \textit{Schall}, \textit{Mutch}, and \textit{Abernethy} as authority for the proposition that "long and faithful service may create the atmosphere of goodwill and kindliness toward the recipient which tends to support a finding that a gift rather than additional compensation was intended."\textsuperscript{197}

The taxpayer in \textit{Estate of Sweeney v. Commissioner},\textsuperscript{198} a 1979 Tax Court memorandum decision, did not fare as well. The taxpayer, a medical doctor, was the founder of a charitable foundation, which operated a summer camp for diabetic children. The taxpayer was employed by the foundation from 1950 until 1975 and worked without pay until he began receiving a $500 per month "honorarium" in 1964.\textsuperscript{199} The foundation continued to pay the taxpayer $500 per month after his retirement in 1975, and the payments continued until his death in 1976.\textsuperscript{200} The taxpayer had not reported any of the payments as gross income, contending that they were excludable gifts.\textsuperscript{201} Citing \textit{Duberstein}, the Court held that the payments represented compensation for services and thus were not gifts, notwithstanding the lack of a contractual obligation or the fact that the directors of the foundation called the payments "gifts."\textsuperscript{202}
E. Bonuses

It would seem that a bonus paid to an employee as a reward for services performed is inherently compensatory and therefore not a gift, even if the employer is under no contractual obligation to make the payment. Nevertheless, courts have grappled with the tax character of such payments for over sixty years and have continued to do so even after the Duberstein decision.

The Board of Tax Appeals first addressed the question in John H. Parrott. In Parrott, a corporation’s board of directors voted to set aside a “gratuitous appropriation” of roughly $150,000 for distribution to certain officers and employees in such proportions as the members of the corporation’s executive committee “deem wise and proper.” The taxpayer, an employee and director of the corporation, received a $35,000 share of the appropriation, which was paid to him in cash. After the payments were authorized, but before they were made, most of the corporation’s stock was sold. The purchaser approved the payments, and the recipients of the payments resigned their positions upon receipt of the payments. The corporation deducted the payments as salaries.

The Board of Tax Appeals rejected the taxpayer’s contention that the payment was a gift, noting that the evidence supported a conclusion that the payment “was intended for the purpose of rewarding officers and employees for long and faithful service and of encouraging them and their successors to fidelity and zeal in the future.” The Board added that it would be “irregular” for a corporation’s directors to make a “gift” of corporate assets.

The taxpayer paid the deficiency under protest and sued for a refund in United States District Court, which awarded a judgment to the taxpayer.
Applying the traditional property law definition of "gift" — a transfer of property without consideration — the Court found that the payment was indeed a gift. The Court conceded that a gift of corporate assets by the corporation's directors would be unlawful without consent by the shareholders, but concluded that the shareholders had implicitly approved of the distribution since they were aware of it and did not object.

The Court of Appeals reversed the District Court's decision, stating that to call the distribution a gift "would do violence to the well understood meaning of that word. . . ." The Court concluded that the payment was not without consideration. Rather, the payment was made as compensation for the past services performed by the taxpayer and his agreement to resign his position. The Court found significance in the fact that the corporation had deducted the payment as well as the fact that a gift of corporate assets by the directors would be illegal.

The Second Circuit Court of Appeals cited Parrott in Fisher v. Commissioner affirming the Board's determination that a bonus paid to a resigning employee was not an excludable gift, even though the employer was under no contractual obligation to make the payment.

The Board of Tax Appeals distinguished Parrott and held for the taxpayer in David R. Daly. Daly involved payments by a corporation to its president. The president's annual salary was $20,000, and over a thirteen month period corporation's directors authorized three "gifts" to the president, totalling $72,000. The president had become seriously ill shortly before the first payment was authorized and died approximately six months after the third payment was authorized. He also continued to receive his salary until one month before his death. The Board concluded that the payments were not supported by consideration and thus were excludable gifts. The Board distinguished Parrott on the ground that the employer in Daly, unlike the employer in Parrott.

218 Id. at 370.
219 Id. at 371.
221 Id. at 672.
222 Id. at 671.
223 Id. The Court dismissed the District Court's ratification theory, stating that "we are dealing with the interpretation of resolutions, not the validity of the action taken under them." Id.
224 59 F.2d 192 (2d Cir. 1932).
225 Id. at 193. The Court accorded significance to the fact that the employer had deducted the payment as a business expense. Id.
226 3 B.T.A. 1042 (1926).
227 Id. at 1043.
228 Id.
229 Id.
230 Id. at 1044.
rott, had not deducted the payment as compensation for services.\textsuperscript{231}

The Board of Tax Appeals again distinguished Parrott in John H. Rosseter.\textsuperscript{232} In Rosseter, the taxpayer was president of a corporation, and the shareholders of the corporation approved a resolution to make a $50,000 “gift” to the taxpayer “as evidence of the appreciation of the stockholders for the very efficient and valuable services rendered to the company.”\textsuperscript{233} The Board found that the intention to make a gift was “clear and conclusive,” presumably because of the language in the shareholders’ resolution.\textsuperscript{234} The Board stressed the fact that the corporation had not deducted the payment and distinguished Parrott, presumably on that basis.\textsuperscript{235} One judge dissented in a two sentence opinion, concluding that “(t)he so-called “gift” received by Rosseter was, in the final analysis, compensation received for services.”\textsuperscript{236} The Court of Appeals affirmed the Board’s decision in favor of the taxpayer.\textsuperscript{237}

In C. D. Jones,\textsuperscript{238} a case decided four months before Rosseter, the Board of Tax Appeals upheld the Service’s determination that payments to corporate employees upon a sale of the corporation’s stock were not excludable gifts. The Jones case involved payments made by a trustee for the selling shareholders out of the proceeds from a sale of all of the corporation’s stock.\textsuperscript{239} The gift was divided among the corporation’s employees in proportions set out in a letter from the corporation’s president to the trustee.\textsuperscript{240} The Board was “unable to distinguish this proceeding in principle from the case of Noel v. Parrott.”\textsuperscript{241} The Board was not persuaded by the opinion of a dissenting judge, who argued that the facts were distinguishable from those in Parrott because the “gifts” were paid out of the proceeds to be received by the shareholders rather than out of corporate assets.\textsuperscript{242} The Court of Appeals, however, found this distinction significant and reversed the Board’s decision.\textsuperscript{243}

\textsuperscript{231}Id. at 1045.
\textsuperscript{232}12 B.T.A. 254 (1928).
\textsuperscript{233}Id.
\textsuperscript{234}Id. at 256.
\textsuperscript{235}Id. Parrott might also be distinguished on the ground that it involved an action by the corporation’s directors rather than its shareholders, but the Board’s opinion does not point out this distinction.
\textsuperscript{236}12 B.T.A. at 256.
\textsuperscript{237}Blair v. Rosseter, 33 F.2d 286 (9th Cir. 1929).
\textsuperscript{238}10 B.T.A. 202 (1928).
\textsuperscript{239}Id. at 206. The contract between the purchaser and the selling shareholders had originally called for the company to make the payments, but at the purchaser’s request the provision obligating the company to make the gifts was removed and the purchase price was increased by the amount of the proposed gifts. Id. at 205.
\textsuperscript{240}Id. at 206.
\textsuperscript{241}Id. at 208.
\textsuperscript{242}Id. at 210 (Green, dissenting).
\textsuperscript{243}Jones v. Commissioner, 31 F.2d 755 (3d Cir. 1929).
The Board of Tax Appeals appeared to change course in *William C. Barnes*, holding that a payment similar to the one in *Jones* was an excludable gift. The Board cited the Third Circuit's *Jones* opinion as authority and made no attempt to distinguish its own *Jones* opinion. Ironically, both the Court of Claims and the Court of Appeals for the Fifth Circuit held for the Commissioner in cases arising out of the same transaction as *Barnes*.

In *Lunsford v. Commissioner*, the directors of an acquired corporation voted to make a “gift” from corporate assets to an employee of the acquiring corporation. The employee had represented the acquiring corporation in the purchase transaction, and the directors of the acquired company stated that they wished to “remember (the employee) with a momento. . . .” The gift was contingent on approval of the owner of the acquiring corporation, which, of course, indirectly owned the acquired corporation following the purchase. The Board of Tax Appeals found that the payment was not a gift but instead represented compensation for the employee’s services in connection with the acquisition. The Court of Appeals reversed, relying primarily on the lack of an employment relationship between the payor and the payee.

The taxpayer in *Cunningham v. Commissioner* received a bonus equal to one year’s salary when he resigned his position as president of an acquired corporation to allow the new directors to name a new president. The Board of Tax Appeals, without an opinion, affirmed the Service’s determination that the payment was not a gift. In a one page opinion that cites no authority, the Court of Appeals reversed, finding that the payment was “voluntary” and therefore a gift.

244 17 B.T.A. 1002 (1929).
245 10 B.T.A. 202 (1928).
246 The taxpayers were employees of El Paso & Southwestern Railroad Co., a wholly owned subsidiary of a corporation called El Paso & Southwestern Co. (the “holding company”). The holding company sold the subsidiary to another corporation and the shareholders of the holding company approved payment of bonuses aggregating approximately $1,000,000 to the employees of the subsidiary. The bonuses were allocated among the employees by three of the subsidiary’s officers. 17 B.T.A. at 1002-7.
247 Id. at 1010-11.
248 Schumacher v. United States, 55 F.2d 1007 (1932).
249 Bass v. Hawley, 62 F.2d 721 (5th Cir. 1933).
250 22 B.T.A. 881 (1931).
251 Id. at 882.
252 Id.
253 Id. at 887.
254 *Lunsford v. Commissioner*, 62 F.2d 740 (6th Cir. 1933).
255 67 F.2d 205 (3d Cir. 1933).
256 Wilfred H. Cunningham, 26 B.T.A. 1491 (1932) (memorandum decision).
257 *Supra* note 255. As evidence that the payment was without consideration, the Court pointed out that the directors sought shareholder ratification. Id.
A transaction that was factually similar to Parrott, Jones, and Barnes gave rise to three Court of Appeals decisions and, ultimately, a Supreme Court case. The transaction involved employees of the Universal Oil Products Company. The shareholders of Universal sold their stock for a total consideration of $25,000,000 after taking $4,100,000 from the assets of Universal and forming a new corporation called Unopco. The stock of Unopco was held by the original Universal shareholders in proportion to the Universal stock they owned. At the suggestion of the Unopco board of directors, the shareholders voted to distribute $607,500 of the $4,100,000 “as a bonus to sixty-four (64) former and present employees, attorneys and experts of Universal Oil Products Company . . . in recognition of the valuable and loyal services of said employees, attorneys and experts . . .” The shareholders authorized the board of directors to determine how the bonus would be apportioned.

Several of the recipients maintained that their bonuses were excludable from gross income as gifts. The Board of Tax Appeals upheld the Commissioner’s determination that the bonuses were taxable compensation. In separate proceedings, three of the recipients took their cases to the Court of Appeals. The first of the three cases was decided by the First Circuit in February of 1937. In that case, styled Walker v. Commissioner, the Court affirmed the Board’s decision. Stating that whether a payment constitutes a gift depends upon the intention of the payor, as determined from the facts and circumstances surrounding the payment, the Court declined to question the Board’s finding of fact. The Court cited, but did not rely upon, an earlier statement by the Supreme Court that “payment for services, even though entirely voluntary, is nevertheless compensation within the statute.” A dissenting judge argued that since the recipient had not been an employee of Unopco, there was not “the slightest evidence of compensation.”

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258 Parrott, 1 B.T.A. 1.
259 Jones, 10 B.T.A. 202.
260 Barnes, 17 B.T.A. 1002.
261 Walker v. Commissioner, 88 F.2d 61, 62 (1st Cir. 1937).
262 Id.
263 Id.
264 Id.
265 Id.
266 All of the decisions were unreported memorandum decisions. E.g. Arthur G. Bogardus, 34 B.T.A. 1310 (1936).
267 88 F.2d 61 (1st Cir. 1937).
268 Id. at 62.
269 Id. at 63. The Court stated that while the evidence was “conflicting,” the Board’s determination was final. Id.
270 Id. at 62, citing Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929).
271 88 F.2d at 63 (Morton, Circuit Judge, dissenting).
The Second Circuit decided the second case, *Bogardus v. Helvering*, in March of 1937. Writing for the Court, Judge Hand stated that when the donor is under no legal obligation to make a payment, the status of the payment as a gift depends upon the donor's motivation. If that motivation is a desire to compensate the recipient for services, the payment is not an excludable gift. While recognizing that an employer might make a gift to an employee, Judge Hand observed that "such cases will be uncommon, especially if (the employer) declares that the payment is 'in recognition of' past services." Judge Hand concluded that the same analysis should apply to the transfer authorized by the Unopco shareholders, who had benefited from the employees' services, even though they had not been their employers in the strict legal sense. Ultimately, however, the Court based its conclusion on deference to the Board's initial finding of fact. One judge dissented, stating that "the facts indicate that the shareholders of Unopco, by reason of selling their Universal shares, for such fabulous sums, were moved to an act of 'spontaneous generosity,' rather than actuated by a sense of moral obligation to pay for services. . . ." 

The Fourth Circuit viewed the size of the shareholders' windfall as evidence of a lack of donative intent in *Hall v. Commissioner*, the third Court of Appeals case dealing with the Unopco payments. In an opinion issued in April of 1937, the Court observed that "the stockholders were cutting a larger melon than they had anticipated and felt that certain faithful employees who had contributed greatly to its growth should be given a larger share than had theretofore been allotted them." Noting that the case fell "squarely within the principle laid down by us in *Noel v. Parrott*," the Court affirmed the Board's finding that the payment was not a gift.

The Supreme Court granted certiorari in the *Bogardus* case and reversed the Second Circuit in a five-to-four decision. Writing for the majority, Justice Sutherland found that the payments were motivated by "spontaneous generosity" and therefore were excludable gifts. The opinion states that the Court

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272 F.2d 646 (2d Cir. 1937).
273 Id. at 648.
274 Id.
275 Id.
276 Id.
277 Id. at 649. Judge Hand stated that "the decision is not primarily for us at all; the Commissioner had first to make his, and then the Board its own; more exactly, the taxpayer had to show the Board that the Commissioner had been wrong, and he must show us not only that the Board was wrong, but that its conclusion was beyond any reasonable inference from the evidence." Id.
278 88 F.2d at 649 (Swan, Circuit Judge, dissenting).
279 89 F.2d 441 (4th Cir. 1937). The decision was reversed on rehearing subsequent to the Supreme Court's decision in *Bogardus*. 93 F.2d 1005 (4th Cir. 1938).
280 89 F.2d at 443.
281 Id.
282 Bogardus v. Commissioner, 302 U.S. 34.
283 Id. at 42.
is free to review the lower court's determination because the question of whether a transfer is a gift is "a conclusion of law or at least a determination of a mixed question of law and fact." The Court also observed that since the concepts of "gift" and "compensation" are mutually exclusive, "a bestowal of money cannot, under the statute, be both a gift and a payment of compensation." In finding that the payments in question were gifts, the Court relied heavily on the lack of an employment relationship between the shareholders and the employees. The Court discounted the fact that the shareholders had derived a benefit from the employees' services, stating that "(a) gift is none the less a gift because inspired by gratitude for the past faithful service of the recipient."

Writing for himself as well as Justices Stone, Cardozo, and Black, Justice Brandeis observed in dissent that "(t)o hold, as the prevailing opinion seems to do, that every payment which in any aspect is a gift is perforce not compensation and hence relieved of any tax, is to work havoc with the law." The dissenting opinion is short and remarkably similar in principle to Duberstein (a case that would not be decided until twenty-three years later). Justice Brandeis stated that the critical question of whether the payment had been motivated by pure generosity, as opposed to a desire to compensate the recipient, was a question of fact. Concluding that the facts at hand would support either interpretation, the dissenters would have let the Board's determination stand.

The Duberstein opinion cites Bogardus at several points but neither endorses nor overrules it. In a footnote, the Duberstein opinion intimates that Bogardus was incorrect to the extent it treated the "gift" question as a question of law. A rejection of that aspect of Bogardus is implicit in the Duberstein court's ultimate holding that the "gift" question is one of fact.

Twenty-three years after the Duberstein decision, the Tax Court addressed a situation similar to that in Bogardus. In Jamie L. Abdella, Judge Parker found that a payment to a corporate employee by shareholders who had sold their stock "at an enormous profit" and "chose to share some of those profits with certain employees and former employees of

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284 Id. at 38-9. This appears to be contrary to the position later taken by the Court in Duberstein, 363 U.S. 290.
286 Id. at 41-2.
287 Id. at 44.
288 Id. at 44.
289 Id. at 45.
290 Id. at 45-6.
292 363 U.S. at 289 (footnote 11). In a rather indirect fashion, the footnote describes as "sound" an earlier opinion's criticism of the Bogardus court's characterization of the question as one of law. Id.
293 See supra note 12.
the corporation" was a gift. Stating that "the fact that the recipient ... previously performed services for a corporation ... owned and controlled by the payors ... does not necessarily make the payments compensation for past services," the opinion cites Bogardus and points out in a footnote that "(t)he world of nontaxable gifts did not, as (the Commissioner) suggests, begin anew with (Duberstein)." The opinion quotes extensively from Duberstein, however, and concedes that the Supreme Court "stated the governing principles" regarding excludable gifts in Duberstein. Curiously, Judge Parker concluded that the payment was a gift even though the payors testified that the recipient had been underpaid and that they felt a moral obligation to share their profits with him.

IV. LEGISLATIVE CHANGES OCCURRING AFTER DUBERSTEIN AND BEFORE THE TAX REFORM ACT OF 1986

Two years after the Supreme Court decided Duberstein, Congress enacted section 274(b) of the Internal Revenue Code. Section 274(b) represents Congress's first attempt to deal with the question of whether a payment can be both an excludable gift and a deductible business expense — a possibility the Supreme Court had refused to foreclose in Duberstein, and one that ultimately became an officially reported reality with Carter and Bank of Palm Beach cases dealing with different sides of the same transaction.

295 Id. at 83-2502.
296 Id.
297 Id. at 83-2500.
298 Id. at 83-2502.
299 Id. at 83-2501.
300 Duberstein, 363 U.S. 278.
301 As originally enacted, section 274(b) provided as follows:

(b) Gifts. —

(1) Limitation. — No deduction shall be allowed under section 162 or section 212 for any expense for gifts made directly or indirectly to any individual to the extent that such expense, when added to prior expenses of the taxpayer for gifts made to such individual during the same taxable year, exceeds $25. For purposes of this section, the term "gift" means any item excludable from gross income of the recipient under section 102 which is not excludable from his gross income under any other provision of this chapter, but such term does not include —

(A) an item having a cost to the taxpayer not in excess of $4.00 on which the name of the taxpayer is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the taxpayer,

(B) a sign, display rack, or other promotional material to be used on the business premises of the recipient, or

(C) an item of tangible personal property having a cost to the taxpayer not in excess of $100 which is awarded to an employee by reason of length of service or for safety achievement.

(2) Special rules. —

(A) In the case of a gift by partnership, the limitation contained in paragraph (1) shall apply to the partnership as well as to each member thereof.

(B) For purposes of paragraph (1), a husband and wife shall be treated as one taxpayer.

302 See supra text accompanying notes 32-37.
303 Carter, 453 F.2d 65.
304 Palm Beach, 476 F.2d 1343.
305 Section 274(b) did not preclude the employer's deduction in Bank of Palm Beach because the payment
The argument that a payment should not be simultaneously excluded by the payee and deducted by the payor has been made on two levels. First, a payment made primarily for business purposes, and therefore deductible by the donor, by definition is not made out of "detached and disinterested generosity" as required by Duberstein for excludability by the recipient. Second, on a policy level, if the donor is allowed a deduction for a payment that the donee is not required to include in gross income, the result is an unacceptable "double benefit." While the enactment of section 274(b) addressed the policy concerns, it exacerbated the uncertainty over the meaning of the Duberstein standard.

The general rule of section 274(b) is that a taxpayer making "business gifts" may claim a deduction for such gifts only to the extent of $25 per donee per year, assuming the "gifts" otherwise meet the requirements for deductibility set forth in section 162. A higher limit, $100, was enacted for gifts "of tangible personal property . . . awarded to an employee by reason of length of service or safety achievement." The limitations of section 274(b) apply to "any item excludable from gross income of the recipient under section 102. . . ." By imposing a limit on the donor's ability to deduct gifts that are excludable from the recipient's gross income, Congress resolved, to an extent, the "double benefit" policy dilemma. At the same time, however, Congress implicitly recognized the possibility that a payment can be both deductible as a business expense and excludable as a gift. Absent such a possibility, the limitations of section 274(b) would never be triggered. In fact, commentators have asserted that section 274(b) is superfluous because it is logically impossible for a payment to meet both the Duberstein standard for excludability and the requirements

was made before 1962. 476 F.2d at 1345. Cf. Jamie L. Abdella, supra note 294, a case arising out of a 1976 payment. The Tax Court held that the payment was excludable from the employee's gross income as a gift even though the employer had deducted it as compensation, stating that "the fact that the payors improperly claimed deductions should not preclude exclusion of the payment from the recipient's income as a gift. . . ." T.C. Memo (P-H) at 83-2502.

306 See supra text accompanying notes 51-54.
307 See supra text accompanying note 11.
308 See supra Shaviro accompanying notes 55.
309 See supra text accompanying notes 51-54.
310 See Section 274(b)(1)(C), Internal Revenue Code of 1954. The Conference Committee Report states that (i) it is a common practice of many employers to give such items as pins or watches to employees upon their completion of a specified number of years of satisfactory employment or in recognition of some safety achievement. Your committee felt that gifts for these purposes which serve to strengthen the relationship between business and its employees should not be discouraged by the tax law. Conf. Rept. No. 2508, 87th Cong. 2d Sess., 108 Cong. Rec. 21, 742 (1962).
311 See supra text accompanying note 308.
312 According to the Ways and Means Committee Report, the enactment of section 274(b) was not intended to change existing law on whether particular transfers were excludable from the recipient's gross income as gifts. H.R. Rep. No. 1447, 87th Cong., 2d Sess., reprinted in 1962-3 C.B. 405, at 423-24. The Finance Committee Report contains similar language, but one author has observed that the exceptions for display racks, advertising item, and employee achievement awards added by the Committee betray a fundamental misunderstanding of the scope of section 102. Shaviro, supra note 55 at 266.
for deductibility as a business expense. Assuming that Congress would not enact a superfluous statute, the $25 (or $100) per donee deduction allowed by section 274(b) can be rationalized as a legislative condonation of taxpayer practice, even though that practice departs from correct theory. Only three years prior to the enactment of section 274(b), the Service had ruled that the value of "merchandise of . . . nominal value, distributed by an employer to an employee at Christmas, or a comparable holiday" could be deducted by the employer as a business expense and excluded from gross income by the employee as a gift. While section 274(b) is somewhat broader in scope than the "Christmas turkey" ruling, it certainly is not inconsistent in principle.

The Economic Recovery Tax Act of 1981 dramatically liberalized the limitations of section 274(b) applicable to gifts of tangible personal property to employees. The maximum allowable deduction was increased from $100 to $400, and the language of the statute was changed to allow a $400 deduction even if the total cost of the "gift" exceeds $400. More significantly, the statute was amended to allow a deduction of up to $400 for tangible personal property awarded to an employee by reason of "productivity." The 1981 amendments also added a higher $1,600 per donee deduction limit for property awarded under a "permanent, written plan or program of the (employer) which does not discriminate in favor of officers, shareholders, or highly compensated employees as to eligibility or benefits," provided that the average award under such plan does not exceed $400.

While the increase in the deduction limit from $100 to $400 can be attributed to inflation, the other changes caused considerable consternation. Since the limitations of 274(b) never come into play unless the transfer is a gift under section 102, the inescapable implication was that transfers of the type described in section 274(b)(3) could, at least in some circumstances, be excludable gifts. The possibility that an employee could exclude, under section 102, $1,600 worth of property received from her employer under a written plan for rewarding productivity stretches the Duberstein standard beyond the breaking point. It is not surprising that the 1981 amendments to section 274(b)

314 Willis and Hawley, supra note 50, at 924.
315 For a discussion of taxpayer practice in reporting such items, see Shaviro, supra note 55, at 243-246.
318 Id.
319 Id.
320 Id.
322 See supra text accompanying note 311.
323 See supra notes 313-315 and accompanying text.
engendered a flurry of debate over the applicability of section 102 to recipients of "qualified plan awards." Various "experts," as well as two senators who were the initial proponents of more liberal deduction limits for qualified plan awards, maintained that "congressional intent ... was that the awards be tax free to employees." This position is questionable at best in light of a statement in the General Explanation that "(t)he (1981) Act does not change prior law as to whether amounts received by an employee constitute taxable compensation or a gift."  

Since the original enactment of section 274(b) in 1962, the Service and the Treasury have steadfastly maintained that it has no effect on the question of whether a particular transfer is a gift for purposes of section 102. The Service reiterated this position in a News Release issued after the enactment of the 1981 changes, stating that the value of a qualified plan award must be included in the employee's income "(u)nless it can be shown that the award was given because of the employer's detached generosity and in no way represented compensation for services. . . ." The Release observes that "(a) number of newspaper stories" commenting on the 1981 legislation "have erroneously concluded that all such awards are tax free to employees." In 1984, as a result of "disagreements . . . between some taxpayers and the IRS over whether . . . employee awards for length of service, safety, or productivity qualify for exclusion from gross income under section 102 as gifts," the Senate Finance Committee proposed, and the full Senate approved, a new statutory exclusion from gross income for "employee achievement awards.

The proposed exclusion would have applied to "watch(es), clock(s), or other timepiece(s), . . . emblematic jewelry or ring(s) . . . custom designed and manufactured to identify or symbolize the awarding employer or the achievement being recognized," and, "to the extent provided in regulations," items

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325 Under the 1981 amendments, the higher $1600 limit applied to "qualified plan awards." Economic Recovery Tax Act of 1981, § 265(b), adding Code § 274(b)(3).
326 The opinions of these "experts" appeared in the New York Times and the Wall Street Journal. Willis and Hawley, supra note 50, at 929.
327 "Senators Garn and Chaffee publicly maintained that Congress intended the awards to be tax-free to employees." Id.
328 Id. at page 927, n.112.
330 See, e.g., Treas. Reg. Sec. 1.274-3(b)(2) (1963), which states, in part, that "(t)he fact that . . . items are expected from the applicability of this section has no effect in determining whether the value of such items is includible in the gross income of the recipient."
332 Id.
334 Id. at 772-74.
"of a type traditionally used" to make retirement or employee achievement awards. Proposed section 74(c) would have excluded the value of such items from the recipient's gross income, up to certain dollar limitations, provided the items were awarded in recognition of "length of service (including retirement), productivity, and safety achievement." The proposed statute would have specifically included the value of such items in gross income to the extent such value exceeded the dollar limitations. While the proposed rules of exclusion and inclusion would have applied only to "qualified employee achievement award(s)," the accompanying Committee Report states that "(e)xcept to the extent that the new exclusion specifically applies, any amount of an employee award (whether or not satisfying the definition of an employee achievement award) is includible in the employee's gross income under section 61, and is not excludible under . . . section 102 (gifts)."

The proposed dollar limitations were based on the deduction limits of section 274, which would have been revised under the Senate's proposal. Generally, the existing $400 and $1,600 limits would have been liberalized to allow a deduction for awards to a single employee aggregating $4,800 in a single year ($1,600 for length of service, $1,600 for productivity, and $1,600 for safety achievement). More significantly, the Senate's proposal would have moved the limits on the deductibility of employee achievement awards from section 274(b) to new subsection 274(k). By virtue of this change, the applicability of the limits would not have depended upon excludability by the recipient under section 102, thus removing any implication that such awards could be excludable gifts.

The Senate's proposal was dropped in conference. Nevertheless, the tax legislation passed by Congress in 1984 did address gifts to employees, albeit indirectly. Section 61 of the Code, which defines gross income, was amended to include a specific reference to "fringe benefits" as taxable compensation. The Ways and Means Committee Report, quoting a Supreme Court opinion, states that gross income includes "any economic or financial benefit conferred on the employee as compensation." As part of the same act, Congress add-

335 Id.
336 Id.
337 Id.
338 Id.
339 Id. at 773.
340 Id.
342 See supra notes 322-32 and accompanying text.
344 Tax Reform Act of 1984, Pub. L. No. 98-369, Sec. 531(c).
ed new code section 132, which specifically excludes certain fringe benefits from gross income. The Committee Reports point out that any fringe benefit not excluded under either section 132 or “another statutory fringe benefit provision” is includable in the employee’s gross income.346 One author has observed that the 1984 changes “leave little room for disputing that employee awards should be included in the recipient’s taxable income . . . unless provided out of detached and disinterested generosity.” 347 This reasoning appears persuasive, assuming the term “fringe benefit” is read to include employee awards.348 Moreover, the language in the Committee Reports seems to imply that any item that is a “fringe benefit” is not excludable as a gift under section 102.349

As enacted in 1984, section 132 excludes from gross income four main categories of benefits.350 The category potentially applicable to “gifts” to employees is the “de minimis fringe,” which is defined by section 132(e) as “any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer’s employees) so small as to make accounting for it unreasonable or administratively impracticable.” 351 According to the Committee Reports, “traditional holiday gifts (to employees) of property with a low fair market value” are excludable from the recipients’ gross income as de minimis fringes.352

V. THE TAX REFORM ACT OF 1986

On November 27, 1984, the Treasury Department submitted its report to the president, titled Tax Reform for Fairness, Simplicity, and Economic Growth.353 That report proposed a denial of gift treatment for “all employee awards of tangible personal property.” 354 The report explained that “(t)he on-going business relationship between an employer and an employee is generally inconsistent with the disinterest necessary to establish a gift for tax purposes,” adding an

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346 Id. at 1169.
347 Shaviro, supra note 55, at 274-5.
348 See id.
349 See supra text accompanying note 346.
350 I.R.C. § 132 provides an exclusion for no-additional-cost services, qualified employee discounts, working condition fringes, and de minimis fringes. I.R.C. § 132(b) defines no additional cost service as a service the employer sells to customers and allows employees to use for free, provided no additional cost is incurred by the employer. The most familiar example of a no-additional-cost service is free travel on a space-available basis for airline employees. A qualified employee discount, as defined in § 132(c), is a discount on goods or services purchased by employees from an employer who offers such goods or services to the general public. A working condition fringe, according to § 132(d), is a benefit provided by the employer, the cost of which the employee could deduct as a business expense if she paid for it herself. Under section 132(e), a de minimis fringe is a benefit of such small value that accounting for it would be unreasonable or impracticable.
351 I.R.C. § 132(e)(1).
353 United States Dep’t of Treas., Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President (Nov. 1984). The Report is popularly referred to as “Treasury I.”
354 Id. at Vol. 2, pages 45-6.
observation that "in the unusual circumstances where an employee award truly has no business motivation [and thus would be an excludable gift], it cannot consistently be deducted as an ordinary and necessary expense of the employer's business." 355 In describing the existing law, the report stated that, notwithstanding misperceptions to the contrary,356 "(t)he fact that an award does not exceed the dollar limitations on deductions [imposed by section 274(b)] has no bearing on whether the award constitutes taxable compensation to the employee." 357

A similar proposal, along with a virtually identical supporting explanation, appeared in the President's Tax Proposals to the Congress for Fairness, Growth and Simplicity, issued on May 29, 1985.358 The president's proposal, however, extended to "all employee awards" rather than just "awards of tangible personal property." 359

The Tax Reform Bill of 1985360 as passed by the House in December of 1985, followed the President's proposal by providing that section 102(a) "shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee." 361 Recognizing that the deduction limitations of section 274(b)(3) "have no application" if no transfer to an employee can be excluded as a gift,362 the House Bill proposed their repeal.363

While the House Bill appeared to lay to rest any "uncertainty . . . concerning the proper tax treatment of an employee award," 364 a footnote in the Ways and Means Committee report leaves open the possibility of gift treatment for transfers from an (individual) employer to an employee "made exclusively for personal reasons (such as birthday presents) that are wholly unrelated to an employment relationship." 365 The footnote adds, however, that such a transfer "cannot give rise to a deduction under section 162 or section 212." 366 The report does point out that an award can be deductible by the employer under section 162 and excludable by the employee as a de minimis fringe benefit under section 132(e), and suggests that de minimis fringe benefit treatment will apply, "under appropriate circumstances, to items presented to
employees upon retirement." 367 As an example of "appropriate circumstances," the report states that "in the case of an employee who has worked for the employer for 25 years, a retirement gift of a gold watch may qualify as a de minimis fringe benefit even though gold watches given throughout the period of employment could not so qualify for exclusion." 368

The Senate Bill contained similar provisions amending section 102 and repealing the limitations of section 274(b). 369 The Senate Bill differed from the House Bill, however, in that it added a new statutory exclusion, and corresponding deduction limitations, for employee achievement awards. 370 The Senate provisions were adopted by the Conference Committee and ultimately become sections 102(c), 74(c), and 274(j) of the Internal Revenue Code. 371

New Code section 102(c) provides that section 102(a), which excludes gifts from gross income, "shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee." 372 Section 74(c) provides a new exclusion for employee achievement awards. 373 The definition of employee achievement award, as well as dollar limitations on the exclusion, are keyed to new Code section 274(j), which places limits on the employer's deduction for such awards. 374 The General Explanation of the Tax Reform Act states that "(e)xcept to the extent that the new section 74(c) exclusion or section 132(e)(1) applies, the fair market value of an employee award (whether or not satisfying the definition of an employee achievement award) is includible in the employee's gross income under section 61." 375

Section 274(j)(3)(A) defines "employee achievement award" as "an item of tangible personal property which is — (i) transferred by an employer to an employee for length of service achievement or safety achievement, (ii) awarded as part of a meaningful presentation, and (iii) awarded under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation." 376 Significantly, an award recognizing only productivi-

368 Id.
369 H.R. 3838, as passed by the Senate, 99th Cong., 2d Sess., sec. 122.
370 Id.
372 I.R.C. of 1986, sec. 102(c).
373 I.R.C. of 1986, sec. 74(c).
374 I.R.C. of 1986, sec. 74(c)(1).
375 Staff of the Joint Comm. on Taxation General Explanation of the Tax Reform Act of 1986 at 37.
376 According to the General Explanation, (i)the types of conditions and circumstances that are to be deemed to create a significant likelihood of payment of disguised compensation include, for example, the making of employee awards at the time of annual salary adjustments or as a substitute for a prior program of awarding cash bonuses, or the providing of employee awards in a way that discriminates in favor of highly paid employees. General Explanation, supra note 375 at 35, n.15.
A tax cannot be an employee achievement award. An award is treated as having been given in recognition of length of service only if the recipient has been an employee for more than five years, and an employee can receive only one excludable length of service achievement award every five years. Safety achievement awards do not include items "awarded to a manager, administrator, clerical employee, or other professional employee," and only 10 percent of all other employees can receive safety achievement awards during any taxable year. For purposes of applying the limitations on length of service and safety achievement awards, awards excludable under section 132(e) as de minimis fringe benefits are disregarded.

Section 274(j)(2) limits an employer's deduction for achievement awards given to any single employee to $400 per year, but a higher limit ($1600) applies to awards given pursuant to a nondiscriminatory written plan if the average award under such plan does not exceed $400. For purposes of determining the average award under a plan, and presumably for purposes of determining whether the dollar limitations have been exceeded, awards "of nominal value" are disregarded.

Section 74(c) excludes from an employee's gross income the value of any employee achievement award to the extent that the cost of the award to the employer does not exceed the deduction limits of section 274(j). If the cost to the employer exceeds the limitations of section 274(j), the employee must include in gross income the excess of the cost of the award over the deduction limitation, or, if greater, the excess of the value of the award over the deduction limitation. Section 74(c)(3) provides that the same exclusion limits apply to employees of tax exempt organizations, even though the deduction limitations of section 274(j) would not apply to the employer.

VI. Analysis of the 1986 Changes

The addition of section 102(c) and the creation of a separate, non-gift exclusion for employee awards eliminates any argument that such awards are excludable as gifts. Moreover, as a general proposition, section 102(c) represents

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377 *Id.* at 35, n.14.
382 I.R.C. section 274(j)(3)(B)(ii) provides that the average cost of awards under a plan "shall be determined by including the entire cost of qualified plan awards, without taking into account awards of nominal value." The purpose of excluding awards of nominal value apparently is to prevent the employer from artificially lowering the average by giving away a large number of low cost items.
383 I.R.C. § 74(c)(1).
384 I.R.C. § 74(c)(2).
385 *See supra* notes 322-332 and accompanying text.
congressional approval of the argument made by the Commissioner in *Duberstein* — *i.e.*, that "payments by an employer to an employee, even though voluntary, ought, by and large, to be taxable."" The Ways and Means Committee report recognizes in a footnote the possibility of an employer making an excludable gift to an employee if the transfer is made "exclusively for personal reasons." Such an exception would seem to be implicit. For example, it could not be realistically argued that section 102(c) would render a mother's holiday gift to her son taxable simply because the son happens to be a part-time employee of his mother's business. A logical approach would seem to be that section 102(c) does not apply because the gift arises out of the parent-child relationship rather than the employer-employee relationship. A more vexing question is whether section 102(c) denies gift treatment to a birthday present by an employer to an employee if their relationship is purely professional. While the Ways and Means Committee footnote specifically refers to birthday presents as an example of "exclusively . . . personal" gifts, the more appropriate answer would seem to be that, absent some significant relationship other than that of employer-employee, such "gifts" should be treated as taxable compensation to the extent they are not excludable as de minimis fringe benefits under section 132(e). In any event, the Ways and Means Committee Report clarifies that an employer cannot claim a deduction for any transfer to an employee that is sufficiently "personal" to qualify for exclusion under section 102.

While section 102(c), together with the Committee Reports, goes a long way toward resolving some uncertainties, it also creates new uncertainties. In applying a limitation that applies to transfers by an "employer" to an "employee," the meaning of the words employer and employee will be critical. Section 102 does not define the words, and the only general definition applies, by its terms, only for purposes of the employment tax. For purposes of other income tax provisions using the words employer or employee, courts typically apply the traditional common law tests for determining the existence of an employment relationship. Presumably, similar principles will be applied in construing section 102(c).

A more troubling question is whether section 102(c) will preclude gift treatment in situations similar to that in the *Bogardus* case. A gift by shareholders

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386 *Duberstein*, 363 U.S. 287.
388 *Id*.
389 *See* *supra* text at note 352.
391 *See* I.R.C. section 3121(d).
392 *See*, *e.g.*, Rev. Rul. 55-547, 1954-2 CB 57, which states that the traditional common law test will be applied to determine employment status for purposes of the exclusion provided for employee death benefits.
393 *Supra* note 282. *See also* Rhodes, *Are Employer Bequests Income?*, 36 Tax Notes 1305 (1987). Professor Rhodes suggests that the applicability of § 102(c) to bequests by employers to employees might be uncertain because in such a situation there is no transfer "by an employer," as the employer is dead.
to an individual employed by a corporation appears, at first blush, to fall outside the scope of section 102(c) because there is no transfer by an employer to an employee. (Quaere whether the transfer is a transfer for an employer to an employee.) It is a relatively easy step, however, to re-cast the transaction as a contribution to the corporation's capital by the shareholders followed by a payment by the corporation to the employee, which clearly would be governed by section 102(c). It should be remembered, however, that the Supreme Court relied heavily on the form of the transaction in Bogardus and did not overrule Bogardus in Duberstein. Similar distinctions based on form might be applied to restrict the scope of section 102(c).

Other uncertainties are sure to arise under section 102(c). For example, will section 102(c) prevent gift treatment for a present from a manager to a staff member if both are employees of a large corporation? The applicability of section 102(c) to payments to survivors of deceased employees — i.e., whether such payments are "transfers . . . for the benefit of" the deceased employee — will also have to be addressed.

From a policy standpoint, the exclusion for employee achievement awards provided under section 74(c), under the limits of section 274(j), presents the same "double benefit" problem that was inherent in previous section 274(b)(1)(C). According to the Joint Committee's General Explanation, "Congress believed that the double income tax benefit of excludability and deductibility is acceptable for such types of employee achievement awards under rules intended to prevent abuse and limit the scope of the double benefit."

New sections 74(c) and 274(j) create the potential for a double detriment as well as double benefit. Employee Achievement Awards in excess of the limitations of section 274(j)(2) result in gross income to the employee as well as a denial of the employer's deduction.

and the relationship is terminated before the transfer takes place. Id. at 1306. Professor Rhodes does, however, concede that such an analysis elevates form over substance. Id. Professor Rhodes also suggests that the corporate veil might be pierced and § 102(c) invoked, in the case of a bequest by a shareholder to a corporate employee. Id.


See supra note 286 and accompanying text.

Supra note 291.

See supra note 308 and accompanying text.

General Explanation, supra note 375, at 33. The enactment of § 74(c) might be viewed as exacerbating the double benefit problem, since it will "increase taxpayer exploitation of the double benefit, both by eliminating the uncertainty and consequent risk and by stimulating publicity about the enactment of a new tax 'break.'" Shavio, supra note 55, at 279.

I.R.C. §§ 74(c)(2) and 274(j)(l). Presumably, the employer could easily avoid the deduction limitation by providing the award in such a manner that it falls outside the definition of "employee achievement award" set out in Code section 274(j)(3)(A).
no deduction for the employer, up to the dollar limitations, and allowing a deduction but no exclusion for any amount in excess of the limitations.\footnote{The employer might also be permitted to elect whether to deduct the cost of the award or allow the employee to exclude it from gross income. \textit{Cf.} Code §§\ 274(e)(2) and (3), which in effect allows employers who reimburse entertainment expenses incurred by their employees to choose between having the deduction limitations of §\ 274(a) apply to themselves, or, by treating the reimbursements as compensation, avoiding the limitations. If the reimbursements are treated as compensation, the employees, rather than the employer, are subject to the limitations of §\ 274(a).}

While cross references to section 132(e) were added to section 102 and section 74,\footnote{Tax Reform Act of 1986, \textit{supra} note 1, section 122, adding new Code §§\ 74(c)(4) and 102(c)(2).} the 1986 Act did not modify the exclusion for de minimis fringe benefits. The Committee Reports do, however, discuss the scope of the exclusion provided by section 132(e). The Ways and Means Committee Report, the Finance Committee Report, and the Joint Committee’s General Explanation all contain language “clarifying” that “the section 132(e) exclusion under present law for de minimis fringe benefits can apply to employee awards of low value, including traditional awards (such as a gold watch) upon retirement after lengthy service for an employer.”\footnote{H. Rep. 426, \textit{supra} note 362, at 105; S. Rep. 313, 99th Cong., 2d Sess. 49 (1986); General Explanation, \textit{supra} note 375, at 33.} The General Explanation states that “no serious potential for avoiding taxation on compensation arises from (such) transfers,” since “the award is not made in recognition of any particular achievement, relates to many years of employment, and does not reflect any expectation of or incentive for the recipient’s rendering of future services.”\footnote{General Explanation, \textit{supra} note 375, at 33.}

To suggest that a gold watch might be “property . . . the value of which is . . . so small as to make accounting for it unreasonable or administratively impracticable”\footnote{I.R.C. sec. 132(e)(1).} is absurd. Valuable jewelry is not even remotely similar to “occasional personal use of the company copying machine, occasional company cocktail parties or picnics for employees, . . . traditional holiday gifts of property with a low fair market value, . . . and coffee and doughnuts furnished to employees.”\footnote{H. Conf. Rep. No. 861, \textit{supra} note 345, at 1168.} Particularly in view of the fact that section 74(c) potentially excludes retirement awards costing the employer as much as $1600,\footnote{See \textit{supra} note 381 and accompanying text.} the application of section 132(e) to such awards seems inappropriate. It would appear that Congress simply cannot admit to itself, or the taxpayers, that the traditional gold retirement watch might be taxable. If the consensus of congressional opinion is that valuable retirement awards should not be taxed, Congress should have enacted a special, broader exclusion for retirement awards instead of attempting to force such awards into a statutory pigeon hole too small to accommodate them.
Historically, uncertainty and inconsistency have characterized the tax treatment of gifts to employees. Courts, Congress, and the Service have all contributed to the confusion over whether an employee may exclude from gross income the value of a gift from his employer, and whether the employer may deduct the cost of such a gift as a business expense.

Gifts have been excluded from gross income by statute throughout the history of the modern income tax, but Congress has never provided a definition of the term “gift.” Perhaps predictably, early court decisions and Internal Revenue Service pronouncements often adopted the traditional common law definition—i.e. a transfer of property without consideration. The Supreme Court narrowed this definition in Commissioner v. Duberstein, holding that an excludable gift must proceed from “detached and disinterested generosity.” The Court declined, however, to adopt objective criteria suggested by the Commissioner, including the propositions that “payments by an employer to an employee, even though voluntary, ought, by and large, to be taxable,” and that “the concept of a gift is inconsistent with a payment’s being deductible as a business expense.” Even with the guidance provided in Duberstein, courts continued to reach widely varying results in seemingly similar factual situations.

Shortly after Duberstein was decided, Congress enacted a dollar limitation on the deductibility of gifts as a business expense. This implied that a gift might be both deductible by the donor and excludable by the donee. Higher dollar limits for gifts to employees, which were subsequently liberalized even further, exacerbated the confusion over the proper scope of the statutory exclusion for gifts.

By adopting a blanket rule that transfers to employees are not excludable from the employees’ gross income as gifts, the Tax Reform Act of 1986 resolves much of the uncertainty that previously existed. The Committee Reports suggest that the rule would not deny a taxpayers’ exclusion of a “purely personal” gift from an individual who happens to be the taxpayer’s employer, cautioning that such a gift would not be deductible by the employer as a business expense.

Nor does “specific and illuminating” legislative history exist. Duberstein, 363 U.S. 284.

E.g. O.D. 1017, 5 C.B. 101.

Duberstein, 363 U.S. 278.

Id. at 285.

Id. at 287.

See supra text accompanying notes 100-153 and 206-299.

Supra note 301.

Supra note 313 and accompanying text.

Supra notes 322-332 and accompanying text.

L.R.C. § 102(c), supra note 372.

Supra notes 365-66 and accompanying text.
Ironically, Congress has adopted two of the criteria that the Supreme Court declined to embrace in *Duberstein.*418 In view of the intervening twenty-six years of confusion, the old saw "better late than never" seems particularly appropriate.

418 *Supra* notes 32-37 and accompanying text.