EXPANDING THE MARITAL DEDUCTION: AN ANALYSIS OF INTERNATIONAL SYSTEMS OF TRANSFER TAXATION, THEIR TREATMENT OF THE TAXABLE UNIT, AND THE UNITED STATES' INADEQUATE MARITAL DEDUCTION

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I. INTRODUCTION

In developing and refining its system of taxation, a legislature must compare and contrast the values of various public policies. Traditional policy objectives include raising revenue, supplementing fiscal objectives, hindering undesirable activities, and advancing societal goals. To achieve these objectives, many countries around the world have developed systems of transfer taxation[1] in which transfers of wealth from one party to another are subject to tax. While some argue that transfer taxation as a whole is an invalid[2] or unnecessary[3] exercise of government power, this view neglects the important social function that transfer tax systems are designed to serve – eliminating "wealth holding" amongst the privileged few.[4]

While the overall system makes a valuable contribution to the achievement of this important social policy, there are certain relationships which have been

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1. Throughout this comment, the term "transfer tax" is used as a generic term for the varying technical names used in other countries for the tax levied upon the passing of wealth from one unit to another. In the United States, the term "transfer tax" includes estate, gift, and generation-skipping taxes. Around the world, there are various forms of transfer taxation, including inheritance tax, accession tax, and succession tax. Each will be discussed *infra*. Systems of transfer taxation achieve the policy objectives discussed in the text accompanying this footnote by "helping to check wealth concentration." James R. Repetti, *Democracy, Taxes, and Wealth*, 76 N.Y.U. L. REV. 825, 858 (2001).

2. *See generally* Alicia Lerud, Note, *Looking to the Past in Planning for the Future: Does the Modern Estate Tax Fit Within the Ideals of the Founding Fathers,* 6 NEV. L.J. 516 (Winter 2005-2006) (discussing the debate surrounding the constitutionality and propriety of the estate tax).

3. Net transfer tax collection totaled $28,802,193,000 from the 46,000 estate and generation-skipping tax returns and the 252,000 gift tax returns filed in 2008. INTERNAL REVENUE SERVICE DATA BOOK, 2008, at 3 tbl. 1, 4 tbl. 2 (2009). This accounts for only 1.2% of the yearly net collections. *Id.*

4. Repetti, *supra* note 1, at 826 (explaining that wealth transfer taxes prevent dynasties and wealth concentration, thereby contributing to long-term economic growth).

justifiably insulated from transfer tax liability due to either social desirability or meaning of those relationships or the economic interconnectedness of the parties involved in the exchange of wealth. As such, certain relationships are treated as a single "taxable unit," meaning that transfers between the parties within the unit are not subject to taxation.[5] This insulation is accomplished either through a complete exemption prior to computing the tax on the transfer or a complete deduction.[6]

Since the advent of the American transfer tax system, the only relationship rewarded exemption from the transfer tax as a single taxable unit has been that of the heterosexual married couple.[7] Other countries, however, have extended the defenition of the taxable unit to include those affiliations that approximate marriage, as well as other familial and interdependent relationships. For example, the United Kingdom treats same-sex partners who have entered civil unions in the same manner as heterosexual married couples for tax purposes, exempting both relationships from inheritance tax liability.[8] Even more liberal is the canton of Zurich, Switzerland, which insulates heterosexual married couples, homosexual partners, and decedents from succession taxes.[9] Compared to these expansive definitions of the taxable unit, and in light of emerging sociopolitical changes, the United States' definition is far less inclusive.

As will be discussed in greater detail in Part III, the basic policy behind the United States' current insulation of the heterosexual married couple from tax liability was the economic interdependence of spouses. Today, very few economically interdependent individuals resemble the outdated model of a working husband and a housewife[10] that the American definition of a taxable unit was based.[11] As of 2009, over six million unmarried heterosexual couples were living together,[12]about one quarter of whom have at least one joint child.[13] Additionally, multigenerational families (a grandparent, parent, and child living together in one home) constitute a significant percentage of all households.[14] In

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5. PAUL R. MCDANIEL ET AL., FEDERAL WEALTH TRANSFER TAXATION: CASES AND MATERIALS 574 (Robert C. Clark ed., 6th ed. 2009) [hereinafter MCDANIEL, WEALTH TRANSFER TAX].

6. *See infra* Section III.

7. For purposes of this comment, the terms "husband and wife" or "heterosexual married couple" apply only to those couples comprised of two United State citizens.

8. *See infra* Section III.B.

9. *See infra* Section III.C.

10. U.S. CENSUS BUREAU, HOUSE & HOUSEHOLD ECON. STATISTICS DIV., FERTILITY & FAMILY STATISTICS BRANCH, AMERICA'S FAMILY AND LIVING ARRANGEMENTS: 2009, tbl. F1 (2010), *available at* http://www.census.gov/population/www/socdemo/hh-fam/cps2009.html [hereinafter U.S. CENSUS BUREAU: AMERICA'S FAMILIES 2009].

11. For a comprehensive description of the changing familial landscape with regarding to taxation, see Marjorie E. Kornhauser, *Love, Money, and the I.R.S.: Family, Income-Sharing, and the Joint Income Tax Return*, 45 HASTINGS L.J. 63, 65-66 (1993).

12. U.S. CENSUS BUREAU: AMERICA'S FAMILIES 2009, *supra* note 10, at tbl. FG10.

13. *Id.*

14. In 2000, there were 3,929,122 multigenerational households, representing approximately 3.7% of total households. U.S. CENSUS BUREAU, MULTIGENERATIONAL HOUSEHOLDS FOR THE UNITED STATES, STATES, AND FOR PUERTO RICO: 2000 (2001),

light of the many ways that American families and economic interdependence now differ from the traditional model, the current transfer tax rules are "flawed in theoretical and practical terms because they fail to recognize the full diversity of American households and familial interconnectedness."[15]

The coming years will provide Congress an opportunity to reevaluate the American transfer tax system. In December 2010, Congress enacted the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010,[16] which altered both the rate and exemption amount of the estate tax. As of December 31, 2012, this legislative overhaul of the federal taxation system, most sweeping of its kind in recent history, is scheduled to "sunset," resulting in drastic changes to the United States' system of federal transfer taxation. As such, the next two years provide Congress with a particularly valuable opportunity to reconsider the federal transfer tax scheme as a whole and, most notably for purposes of this comment, to align its current definition of the taxable unit with those of its European counterparts.

The current administration and Congress could expand the United States' traditional definition of the taxable unit to include economically interdependent relationships such as: parent - dependent minor, adult child - dependent parent, caretaker - dependent mentally/physically challenged individual, and same-sex partners. Favorable transfer tax treatment for these types of relationships would advance policy goals similar to those now advanced by the current treatment of the heterosexual marital unit.

The imminent impact of the 2010 Tax Relief Act's sunset provision on the United States' system of transfer taxation makes the intricacies of the federal estate and gift tax ripe for reconsideration. However, administrative difficulties of expanding the taxable unit within the current economic climate could hinder the possibility of an expansion or redefinition in the context of transfer taxation. The tremendous federal deficit currently facing the United States may very well dissuade even the most socially progressive legislators from supporting any measure that decreases federal revenue, despite its favorable policy results. Nevertheless, the potential changes that will occur over the next two years present Congress with an opportunity to analyze whether some of the more liberal notions of a taxable unit found in foreign countries could be integrated into the United States' definition.

Regardless of what Congress ultimately decides about the transfer tax system, it is highly unlikely that more than a small percentage of Americans will remain

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http://www.census.gov/population/www/ cen2000/phc-t17.html. Of those multigenerational households, 65.2% were comprised of a householder with a child and grandchild, 32.8% were comprised of a householder with parent and child, and 2.0% were comprised of a householder with parent, child, and grandchild. *Id.*

15. Bridget J. Crawford, *The Profits and Penalties of Kinship: Conflicting Meanings of Family in Estate Tax Law*, 3 PITT. TAX REV. 1, 36 (2005).

16. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 [hereinafter 2010 Tax Relief Act].

subject to transfer tax liability.[17] Given the anti-wealth-holding goal behind the transfer tax system as a whole, one might wonder why any expansion of insulated transfers is sensible at all. After all, from a fiscal standpoint, the more transfers subject to tax, the better. From a redistributionist standpoint, the less wealth that remains in the hands of a privileged few, the better. The response to these viewpoints lies in the major policy purpose behind insulating any transfers in the first place – there are certain relationships that the federal government should consider "off-limits," similar to the way in which it views marriage.[18] As such, those parties whose economic interdependence serves overarching social policy goals should not be subject to transfer taxation. This proposition does not mean that a multimillionaire should be permitted to transfer his fortune to his economically independent heir free of tax. Rather, it will insulate transfers to those who are truly economically intertwined with the transferor from tax liability.

II. INTERNATIONAL SYSTEMS OF TRANSFER TAXATION: AN OVERVIEW

Before exploring the intricacies of the various taxable units as defined in the United States, the United Kingdom, and the Canton of Zurich, it is important to understand the basic elements of each country's system of transfer taxation. This section provides an overview of the evolution of the transfer tax systems in the United States, the United Kingdom, and Switzerland.

A. United States

1. Development of the Unified System of Transfer Taxation

Federal taxation on the transfer of wealth began in the late 18th century on an *ad hoc* basis and was intended to be a source of revenue during periods of national economic crisis.[19] By the 1900s, industrialization and the rise of corporations had

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17. *See* Krisanne M. Schlachter, Note, *Repeal of the Federal Estate and Gift Tax: Will It Happen and How Will It Affect Our Progressive Tax System?,* 19 VA. TAX REV. 781, 810 (2000) (explaining that transfer taxes apply to only two or three percent of taxpayers).

18. *See* Nancy J. Knauer, *Heteronomativity and Federal Tax Policy*, 101 W. VA. L. REV. 129, 143 (1998) ("The recognition of a particular taxable unit signals that the relationships it creates are to be respected for tax purposes.").

19. In 1797, in an effort to raise money for the navy while fighting in an undeclared war against France, Congress levied the first of these ad hoc death taxes. Darien B. Jacobson et al., *The Estate Tax: Ninety years and Counting,* STATISTICS OF INCOME BULLETIN, Summer 2007, at 118, 119, *available at* http://www.irs.gov/pub/irs-soi/nientyestate.pdf [hereinafter 2007 SOI BULLETIN]. The Stamp Act of 1797 (1 Stat. 527) imposed a rudimentary estate tax on the recordation of legal documents, such as wills and letters of probate, and on receipts given for payments of intestate bequests. *Id*. The end of the crisis with France in 1802 brought the repeal of this stamp duty. *Id.* The next federal transfer tax was not imposed for nearly sixty years, in the midst of the Civil War, when the Revenue Act of 1862 (12 Stat. 432) not only reinstated the stamp duty, but also levied an inheritance tax upon transfers of personal property over $1,000 at death. *Id.* By 1864, the need for wartime revenues prompted Congress to extend transfer taxation to include the transfer of real property, with a succession tax imposed upon transfers of real property made at death and the first gift tax, levied upon real estate transferred during life. *Id.*; *see* Internal Revenue Law of 1864, 13 Stat. 285. At the end of the Civil War and the

resulted in increased levels of wealth concentration; along with this came novel ideas about the goals of federal taxation. To counteract wealth concentration, progressives like Theodore Roosevelt proposed both a permanent reinstatement of the inheritance tax as well as a graduated income tax.[20] This social-oriented rationale led to ratification of the 16th Amendment in 1913, creating the income tax.[21] However, without the need for revenue, the rationale did not prove persuasive enough for Congress to reinstate the transfer tax until shortly after the outbreak of World War I when the estate tax was imposed.[22] It has remained an element of federal taxation ever since.

With the progressive policy against wealth concentration as an underlying rationale for both the income and estate taxes, the end of World War I did not prompt the termination of the transfer tax as it had in years past. Instead, the transfer tax system was expanded. Congress, quickly realizing that taxpayers were able to thwart the estate tax by transferring their wealth to intended heirs during life; responded by enacting a tax on *inter vivos* transfers in 1932,[23] a feature of the American transfer tax system that remains today.

Things remained relatively stable on the transfer tax front after 1935 (with the exception of the marital deduction created by the Revenue Act of 1948, which will be discussed in much greater detail in Part III) until the mid-1970s, when a predominantly Democratic Congress had the feeling "that the public desired tax reform" and undertook major revisions of the income and transfer tax systems.[24] Congress noted that "it cost substantially more to leave property at death than to give it away during life" due to the lower rate schedule that applied to *inter vivos* transfers. [25] To eliminate this discrepancy, estate and gift estate tax rates were unified, although the systems remained technically separated.[26] Along with the

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restabilization of the American economy came the repeal of the inheritance, succession, and gift taxes by 1870, reaffirming the limited purpose of early transfer taxes. 2007 SOI BULLETIN, *supra*, at 119. Relying upon its previous revenue raising success, Congress again levied a death and gift tax upon transfers of personal property upon the outbreak of the Spanish-American War in 1898. *Id.* at 120. Rather than including a stamp duty, the War Revenue Act 1898 (30 Stat. 448) created a death tax which combined elements of estate and inheritance taxes in that the tax rate was progressive relative to the size of the decedent's total estate and was graduated relative to the relationship between the decedent and his beneficiary. *Id.* Prior to its repeal in 1902 at the end of the Spanish-American War, the Supreme Court confirmed the constitutionality of the inheritance tax as an indirect tax on the transfer of wealth, not a direct tax on the property itself, in Knowlton v. Moore, 178 U.S. 41 (1900). For a more detailed overview of the history of the transfer tax, see 2007 SOI BULLETIN, *supra* note 19.

20. 2007 SOI BULLETIN, *supra* note 19, at 120 (citing BORIS I. BITTKER, ET AL., FEDERAL ESTATE AND GIFT TAXATION 3-9 (Thompson/West 9th ed. 2005)).

21. *Id.*; U.S. CONST. amend. XVI.

22. 2007 SOI BULLETIN, *supra* note 19, at 120; Revenue Act of 1916, 39 Stat. 756 (1916).

23. *Id*. at 20, at 122; Revenue Act of 1932, 47 Stat. 169 (1932).

24. *See* Stanley S. Surrey, *Reflections on the Tax Reform Act of 1976*, 25 CLEV. ST. L. REV. 303, 303 (1976) (describing the legislative process behind the Tax Reform Act).

25. 2007 SOI BULLETIN, *supra* note 19, at 122 (quoting BORIS I. BITTKER, & ELIAS CLARK, FEDERAL ESTATE AND GIFT TAXATION 20 (6th ed. 1990)) (internal quotation marks omitted).

26. *Id.*; Tax Reform Act of 1976, Pub L. No. 94-455, 90 Stat. 1520.

unification of the estate and gift tax rates came a single, unified estate and gift tax credit. This unified credit could be used to offset gift tax liability during the donor's lifetime, but if any unused credit at the time of the donor's death remained available to offset his or her estate tax liability.[27]

2. Decoupling and Recoupling the Unified System

In 2001, the Bush administration passed a monumental piece of tax legislation designed to produce drastic income and transfer tax reductions for individuals. The Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA)[28] made sweeping changes to the estate and gift tax systems by gradually increasing exemptions and decreasing marginal rates on transfers of wealth.[29]

In addition to the constantly changing rate schedules and exemption amounts, EGTRRA also repealed the estate tax on December 31, 2009, effectively decoupling the estate and gift tax system.[30] During this one-year repeal of the estate tax, the gift tax was still in effect, but the top marginal rate was dropped from 45% to 35%.[31]

As had been projected by many tax scholars, the 2010 legislation "repealed the repeal" by allowing the estates of decedents dying during 2010 to elect either to

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27. 2007 SOI BULLETIN, *supra* note 19, at 122 (citing HOWARD ZARITSKY & THOMAS RIPY, FEDERAL ESTATE, GIFT, AND GENERATION SKIPPING TAXES: A LEGISLATIVE HISTORY AND DESCRIPTION OF CURRENT LAW 18 (1984)). In addition, the Tax Reform Act introduced a generation-skipping transfer (GST) tax, which made the termination of an intervening generation's interest a taxable event, as if two transactions were completed at once. *Id.* at 123. In other words, two levels of transfer tax would be imposed upon a trust established by a grandparent with the income to his child for life and the remainder to his grandchild upon the death of child: one traditional tax upon the completed transfer of grandparent to child and another as if child then transferred that property to child himself upon his death. *Id.* Not only were two levels of transfer tax imposed, but they were imposed immediately upon the completion of the initial transfer at the highest marginal rate. *Id.* The purpose behind the GST tax was to "ensure[] that the transmission of hereditary wealth is taxed at each generation level." *Id.* (quoting BORIS I. BITTKER & ELIAS CLARK, FEDERAL ESTATE AND GIFT TAXATION 30 (6th ed. 1990)) (internal quotation omitted).

28. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (codified as amended in scattered sections 26 U.S.C.).

29. Under the pre-EGTRRA unified transfer tax system, $1 million was exempt from both federal estate and gift taxes, with a maximum marginal rate of 55 percent. EGTRRA increased the exemption amount from estate and GST taxes periodically from $675,000 and $1.06 million, respectively, in 2001 to $3.5 million in 2009. Economic Growth and Tax Relief Reconciliation Act § 521. The gift tax exemption rose to $1 million in 2002 and remains as such until EGTRRA's expiration. As the exemption amounts increased, the top gift, estate, and GST tax rates dropped from 55% in 2001 to 50% in 2002. The rates continued to drop by 1% each succeeding calendar year until it leveled off at 45% in 2007. *See generally* 115 Stat. at 511 (marginal rates) & 521 (exemption amounts).

30. *Id.* § 501(a). This repeal means that there was no federal estate tax imposed on the estates of those dying during 2010; however, complicated carryover basis rules apply in lieu of the typical "stepped-up" basis rules. The one-year repeal also applied to the GST tax. However, discussion of such goes beyond the scope of this comment.

31. *Id.* § 511(d).

(1) apply the reinstated estate tax for 2010 with a $5 million exemption and a 35% top marginal rate, as applies to estates of decedents dying in 2011 or 2012, or (2) have no estate tax liability, but apply the complicated carryover basis rules that had been in effect in 2010. Therefore in 2011, the gift tax is reunified with the estate tax, with an applicable exclusion amount of $5 million and a top estate and gift tax rate of 35%.[32] This outcome is in stark contrast to what would have resulted had Congress not acted by December 31, 2010, at which time the pre-EGTRRA exemptions and rates would have resumed.[33]

3. Calculating Estate & Gift Tax

Although technically separate, the estate and gift tax systems are inextricably linked in two important ways. First, each taxpayer is provided with a single, "unified credit" which can be used to offset transfer tax liability imposed on both *inter vivos* and at death transfers.[34] Second, transfer tax rates are cumulatively progressive, meaning that each taxpayer gets only "one run up the rate ladder" for those taxable transfers made either during life or at death.[35] Thus, as the cumulative value of *inter vivos* and estate transfers grows, the marginal rates increase. By imposing a two-step calculation when assessing gift and estate tax, the Internal Revenue Code (Code) ensures that the appropriate tax rates apply.[36]

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32. *Id*. § 302(b).

33. Economic Growth and Tax Relief Reconciliation Act § 901(a).

34. I.R.C. §§ 2010(a), 2505(a) (West 2011). The unified credit is a federal tax credit provided to every taxpayer that can be used to offset transfer tax liability. *Id.* At birth, each American's unified credit is "the amount of tentative tax that would be determined…if the amount with respect to which such tentative tax is to be computed were equal to the applicable exclusion amount," or $5,000,000. *Id*. § 2010(c). Taxpayers are required to use their available unified credit to offset gift tax liability and therefore, the amount of unified credit available to a taxpayer is reduced each time a taxable gift incurring tentative tax is made, and until the unified credit is exhausted. *Id.* § 2505(a). The unified credit can often entirely offset a donor's/decedent's tax liability; however, it can never be used as a means to a government pay-out. *Id.* The Tax Relief Act of 2010 introduced the new concept of "portability," through which a surviving spouse may use the unused portion of the estate tax applicable exclusion of his/her predeceased spouse, thereby raising his/her exemption up to $10 million. Portability would be available to the estates of decedents dying after December 31, 2010 and is set to sunset on January 1, 2013. *Id.*

35. *See* Alana J. Darnell, Comment, *Toward an Integrated Tax Treatment of Gifts and Inheritances*, 34 SETON HALL L. REV. 671, 682 n.86 (2004) (citing Edward J. McCaffery, *Grave Robbers: The Moral Case Against the Death Tax*, 85 TAX NOTES 1429, 1434 (1999)) ("Taxpayers [are] forced to make only one run up the 'rate ladder' because all taxable gifts and, finally, the estate were added together and taxed at progressively higher rates.").

36. To calculate the gift tax, the donor must first determine her total lifetime taxable gifts. I.R.C. § 2502(a). To do so she adds the value of taxable gifts made in the present calendar year to the value of all previous lifetime taxable gifts. *Id.* Next, the donor must determine the tentative tax on her present year gifts. *Id.* To do this, she subtracts the tax (calculated at the present rates) payable on all previous lifetime taxable gifts from the tax (again calculated at the present rates) payable on the total lifetime taxable gifts. *Id.* Before computing the final gift tax due in the present calendar, the donor subtracts that available balance of her unified credit from her tentative tax to determine the amount of tax due on taxable gifts for the present calendar year. *Id.* To

Gift tax liability is imposed on *inter vivos* taxable gifts.[37] "Taxable gifts" are defined as total gifts made during the calendar year minus any allowable exclusions or deductions, including, but not limited to, the inflation-adjusted annual exclusion,[38] the unlimited exclusion for qualifying tuition or medical payments,[39] charitable deductions,[40] and the marital deduction.[41]

The only statutory direction in determining what constitutes a "gift" is found in § 2511, which states that the gift tax "shall apply whether the gift is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible."[42] These ambiguous terms were meant to be "used in the broadest and most comprehensive sense,"[43] and therefore, Congress left their specific interpretation to the Internal Revenue Service (IRS) and the courts. Over the years, a "gift" has come to be defined as a completed[44] transfer of property for less than full and adequate consideration in money or money's worth.[45]

Similarly, the estate tax is levied upon the taxable estate. To determine the taxable estate, the estate's executor must subtract deductions, including funeral and

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calculate the estate tax, the executor of a decedent's estate must ascertain the total lifetime and death transfers subject to tax by adding the value of the taxable estate to the value of the adjusted taxable gifts made by the decedent during life. I.R.C. § 2001(b). Next, the executor applies the appropriate rates, first to the value of the total taxable transfers to determine the total tentative tax, and second to the value adjusted taxable gifts made during the decedent's life to determine the gift tax that should have previously been paid. *Id*. The tentative tax on the estate is determined by subtracting the gift tax paid from the total tentative tax. *Id.* By subtracting the unified credit and any other applicable credits from the total tentative tax, the executor determines final estate tax payable, due nine months from the date of decedent's death. *Id.*

37. I.R.C. § 2501(a).

38. *Id.* § 2503(b). The annual exclusion is the amount that can be transferred tax-free to each donee by a donor in a single year. To qualify for the annual exclusion, the gift must be of present interest, meaning that the donee has an unrestricted right to the immediate use, possession, or enjoyment of the property or the income from the property. *See* Treas. Reg. 25.2503-3(b); Fondren v. United States, 324 U.S. 18 (1945).

39. *Id.* § 2503(e). A qualified medical or tuition payment is any amount paid as tuition to an educational organization or to any person who provides medical care by the donor on behalf of any individual, so long as the payment is made directly to the institution or person providing the service and the donor or the donee is not reimbursed for the payment. *See* Treas. Reg. 25.2503-6.

40. I.R.C. § 2522.

41. *Id.* § 2523. The marital deduction will be discussed in much greater detail in Section III.A

42. I.R.C. § 2511.

43. H.R. REP. NO. 72-709, at 27 (1932); S. REP. NO. 72-665, at 39 (1932).

44. Treas. Reg. § 25.2511-2(b) (1999) (indicating that a transfer of property is completed when "the donor has so parted with dominion and control as to leave him no power to change its disposition, whether for his own benefit or for the benefit of another").

45. *Id.* § 25.2512-8 (1992) (indicating that consideration is considered "full and adequate" only if the donor receives fair market value or if he enters into a bona fide, arm's length transaction with the transferee). Note, however, that if *some* consideration is received, the donor has made a gift only to the extent that the fair market value of the property transferred exceeds the consideration.

administration expenses,[46] charitable bequests,[47] and marital bequests[48] from the value of the gross estate.[49] The decedent's gross estate includes "the value at the time of his death all property, real or personal, tangible or intangible, wherever situated"[50] to the extent of the decedent's interest therein.[51] The IRS and courts have interpreted these provisions to apply to probate property beneficially owned by the decedent at his date of death.[52] However, inclusion in the gross estate does not end there. Unlike its stance regarding the gift tax provisions, Congress has enacted specific provisions requiring the inclusion of other property in which the decedent had an interest at his death, such as annuities,[53] jointly-held property,[54] general powers of appointment,[55] and *inter vivos* transfers in which the decedent retains an interest.[56] Therefore, the gross estate often includes much more than just the value of assets actually owned by the decedent upon her death.

B. United Kingdom

1. From a Probate Duty to the Modern Inheritance Tax

Transmission of property at death has been subject to various forms of taxation in the United Kingdom[57] since feudal times.[58] Its modern framework

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46. I.R.C. § 2053(a).

47. *Id.* § 2055.

48. *Id.* § 2056.

49. I.R.C. § 2051.

50. I.R.C. § 2031.

51. I.R.C. § 2033.

52. *See, e.g.,* Helvering v. Safe Deposit & Trust Co., 316 U.S. 56 (1942).

53. I.R.C. § 2039 (including in the gross estate the value of annuity or other payments to decedent's survivor if decedent had a right to receive or had actually received such payments, while alive (other than life insurance)).

54. I.R.C. § 2040(a) (creating the rebuttable presumption that decedent's gross estate includes the value of all property non-spousal jointly owned at his death, unless decedent's executor can prove otherwise); *id.* § 2040(b) (including half of the value of a spousal joint tenancy in the gross estate of the first spouse to die, without regard to the levels of consideration).

55. I.R.C. § 2041 (including a property over which decedent had a general power of appointment, defined as a power exercisable in favor of decedent, his estate, his creditors, or the creditors of his estate).

56. I.R.C. §§ 2036 – 2038. These complicated provisions include in decedent's gross estate any inter vivos transfer that is essentially testamentary in nature. Transfers are considered testamentary in nature when the transferor has retained either an economic benefit, I.R.C. §§ 2036(a)(1), (b), or power over the possession or enjoyment of property, I.R.C. §§ 2036(a)(2), 2038, or when the transferor's death is a precondition to enjoyment of the property transferred, I.R.C. §§ 2036(a)(2), 2037, 2038.

57. *European Countries – United Kingdom*, EUROPE.EU, http://europe.eu/abc/european_countries/eu_members/unitedkingdom/index_en.htm (last visited Mar. 27, 2011). Explaining that the United Kingdom (UK) includes Great Britain (England, Scotland, & Wales) and Northern Ireland (six counties of Ireland and a number of islands).

58. WILLIAM SPRAGUE BARNES, WORLD TAX SERIES: TAXATION IN THE UNITED KINGDOM 73 (1957).

began to take shape in the late 19th century with the introduction of the probate duty.[59] Through the years, the government developed a complex system of death taxes, which was only somewhat simplified by the Finance Act of 1894.[60] From 1894 until 1949, property passing at death was subject to three different taxes.[61] The first, and most straightforward, was an estate tax, which was levied upon the transmission of the estate of the decedent. The others, a legacy tax for the acquisition of personal property and a succession tax for the acquisition of real property, were based on the principle that the tax levied on transfers should reflect the relationship of the donee rather than the portion of the estate property received by each beneficiary.[62] However, the Finance Act of 1949 repealed the legacy and succession taxes,[63] and the estate tax (known as the estate duty until 1975) has been the sole tax on transfers of property made at death since that time. [64]

Prior to 1974,[65] the United Kingdom had taxed only transfers of wealth made at death and had declined to extend any tax to those transfers made during life.[66] As a result, the estate duty was considered nothing more than a "voluntary tax" due to the ease with which *inter vivos* transfers could be made so as to avoid any transfer tax at all.[67] When confronted with the utter failure of the estate duty, the government set out to tax those gifts made "in contemplation of death."[68] However, after savvy estate planners determined ways to slowly deplete their clients' estates before their eventual deaths, the concept of "potentially exempt transfers" was introduced; all gifts made within seven years of the decedent's date of death were to be included when assessing death taxes. The inclusion of lifetime transfers prompted Parliament to abolish the estate duty and transform it into the capital transfer tax (CTT).[69]

Initially, the CTT was designed to be a tax on cumulative lifetime transfers made within seven years of the decedent's death.[70] However, by 1982, the period of cumulation was extended to all transfers made within a ten-year period.[71] The Finance Act of 1986 rebranded the term "capital transfer tax" as the "inheritance tax" (IHT), and subjected any transfer of wealth made on or after March 18, 1986,

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59. *Id.*

60. *Id.*; *see also* Finance Act, 1894, 57 & 58 Vict., c. 30 (Eng.) (revising estate taxes).

61. BARNES, *supra* note 58, at 73.

62. *Id*.

63. Finance Act 1949, 12-14 Geo. 6, c. 47 § 27 (Eng.).

64. BARNES, *supra* note 58, at 73 (noting that the "estate duty" term originated in the Finance Act of 1984).

65. The capital transfer tax was commenced on 27 March 1974, despite its introduction in the Finance Act of 1975. *See* M&E PROFESSIONAL STUDIES, TAXATION 517, 519 (Emile Woolf et al. eds., Macdonald & Evans 1985) (stating that the Finance Act of 1975 introduced the capital transfer tax, but the tax was commenced on March 27, 1974).

66. J.A. KAY & M.A. KING, THE BRITISH TAX SYSTEM 66 (4th ed. 1986).

67. *Id.* at 67.

68. *Id.* at 66.

69. Finance Act, 1975, c. 7 § 19.

70. Finance Act, 1975, c. 7 § 22.

71. KAY, *supra* note 66, at 67.

to its terms.[72]

2. Understanding the Modern Inheritance Tax (IHT)

Despite its misleading name, there is no rate variation according to the relationship of the donor/decedent and the donee in determining the IHT.[73] To determine the applicable inheritance tax, the executor of a decedent's estate must first assess the decedent's tax estate, which includes the value of all chargeable transfers.[74] If the value of the estate exceeds the nil rate band (also known as the inheritance tax threshold),[75] the estate is liable for a 40% tax on the excessive value.[76] In other words, inheritance tax is only payable on the value of an estate *above* the nil rate band.

The tax estate includes the following items: all of the decedent's assets, whether real or personal;[77] all outright gifts[78] made within seven years of decedent's death;[79] all transfers in trust at death and certain *inter vivos* transfers in

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72. Finance Act, 1986, c. 41 § 100 *[hereinafter F.A. 1986*] (requiring that for any liability to tax arising on and after 25 July 1986, any reference in the legislation to capital transfer tax has effect as a reference to inheritance tax).

73. *See* PAUL R. MCDANIEL ET AL., FEDERAL WEALTH TRANSFER TAXATION 4, n.1 (Robert C. Clark ed., Thomson Reuters/Foundation Press 2009) (1977) [hereinafter MCDANIEL, WEALTH TRANSFER TAX] ("In general, an estate tax is imposed on the transmission of wealth and the applicable rates are unaffected by the relationship between the transferor and transferees; an inheritance tax also is imposed on the transmission of wealth but the rates vary according to the relationship between the transferor and the transferee.").

74. Inheritance Tax Act, 1984, c. 51 §§ 1, 3(1), *amended by* F.A. 1986 § 100 [hereinafter IHTA] (stating that to establish the value of the chargeable transfer, executor must determine the amount by which the transferor's estate is lessened immediately after the transfer than it would have been but for the disposition).

75. *Id.* § 8, sch. 19, para. 3(1). The inheritance tax threshold, also known as the "nil rate band" is the amount that is exempt from IHT on inter vivos of at death gifts for each person. The inheritance threshold is reassessed each year by the Treasury Department. *Id.* at sch. 1. For transfers made on or after April 6, 2010, the tax threshold/nil rate band is £325,000.

76. *Id.* at sch. 1.

77. *How to Value the Estate of Someone who has Died - The Basics*, HM REVENUE AND CUSTOMS, http://www.hmrc.gov.uk/inheritancetax/how-to-value-estate/basics.htm (last visited Mar. 27, 2011). Assets are anything of value, such as, money in checking or savings accounts, houses, land, business assets owned by the deceased, investments such as stocks and shares valued at the date of death, personal belongings, motor vehicles, pensions that include a lump sum payment on death, assets in a trust from which the deceased benefits, payouts from life insurance policies, foreign assets held abroad including foreign bank accounts, property or shares, and jointly held property.

78. The term "outright gifts" refers to any *inter vivos* transfer not in trust. *See Gifts*, HM REVENUE AND CUSTOMS, http://www.hmrc.gov.uk/inheritancetax/iht-probate-forms/help-iht205-C5/gifts.htm#2 (last visited Mar. 27, 2011) ("A specified transfer is an outright gift (not into a trust) that the deceased made during their lifetime….").

79. *Gifts That are Exempt from Inheritance Tax,* HM REVENUE & CUSTOMS, http://www.hmrc.gov.uk/inheritancetax/pass-money-property/exempt-gifts.htm#4 (last visited Mar. 27, 2011). All outrights gifts made within seven years of the decedent's death are includable in the tax estate; however, who pays the inheritance tax depends on the value of the

trust;[80] assets in which the decedent retained an interest-in-possession;[81] and assets in which the decedent reserved a benefit[82] minus any exemptions, relief or transfers that are not transfers of value.[83] Exemptions include, but are not limited to: the annual exemption;[84] donations to registered UK charities;[85] donations to certain UK political parties;[86] gifts made more than 7 years prior to death;[87] small gifts of

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property at the date of transfer in regard to the inheritance tax threshold at the time of decedent's death. If the value of the property transferred is less than the date of death threshold, the inheritance tax is paid out of the estate. *Id.* If the value of the property transferred is more than the date of death threshold, the inheritance tax is paid either by the estate or the donee, depending on the availability of estate assets and the terms of the original transfer. *Id.*; *see also Applying 'Taper Reliefs' to Gifts*, HM REVENUE & CUSTOMS, http://www.hmrc.gov.uk/inheritancetax/how-to-value-estate/gifts.htm#4; *see also* IHTA § 7(4), sched. 19, para. 2(4) (Whether ultimately paid by the estate or the donee, if the decedent dies within three to seven years of making the transfer, the full inheritance tax rate is reduced on a sliding scale, with relief ranging between twenty percent for those who die between three and four years of the transfer and eighty percent for those dying between six and seven years of the transfer.).

80. *Inheritance Tax on Transfers into Trust*, HM REVENUE & CUSTOMS, http://www.hmrc.gov.uk/trusts/iht/transfers-in.htm (last visited Mar. 27, 2011). In the event that the value of an *inter vivos* transfer to trust plus any chargeable gifts made within the past 7 years exceeds the date of creation inheritance tax threshold, an immediate inheritance tax is due. *Id.* If paid by the trustee, that tax is twenty percent and if paid by the settlor, that tax is twenty-five percent. *Id.* If the settlor dies within seven years of establishing this trust, an additional twenty percent inheritance tax is due at the time of death. *Id.* In the event that the value of the trust plus any chargeable gifts made within the past seven years does not exceed the date of creation inheritance tax threshold, the value of the trust is included in the decedent's tax estate. *Id.*

81. *Trusts That Do and Don't Pay Inheritance Tax*, HM REVENUE & CUSTOMS, http://www.hmrc.gov.uk/trusts/iht/which-trusts-pay.htm# 2 (last visited on Feb. 20, 2010); *see also* IHTA, *supra* note 74, § 5. If the decedent had been the beneficiary to income from a trust or had the right to use trust property, he was known as having an "interest in possession." *Id.* The value of this interest will be included in his tax estate if (1) the interest was established after March 22, 2006 (2) if the decedent passed his interest after October 5, 2008 (an action that formerly removed the interest from the decedent's estate via a transitional serial interest), the trust was established after March 22, 2006 and gave (a) an immediate post death interest, (b) a disabled person's interest, or (c) a transitional serial interest. *Id.*

82. A gift with reservation of benefit is a gift to any type of trust in which the decedent continues to enjoy some benefit, such as living rent-free in a house which has previously been transferred in trust. *See Investigation Form IHT403: Gifts With Reservation*, HM REVENUE & CUSTOMS, http://www.hmrc.gov.uk/manuals/ihtmanual/IHTM14025.htm ("In general terms, a gift is one with reservation if the done does not assume bona fide possession and enjoyment of the gifted property, or the gifted property is not enjoyed to the entire exclusion . . . of the donor . . . .").

83. IHTA, *supra* note 74, § 2.

84. *Id.* § 19. Since 1981, the annual exemption has been £3,000 in addition to other available exemptions from inheritance tax. *Id.* Any unused portion of the £3,000 can be carried over for 1 year. For example, if no portion of the annual exemption was used in Year 1, it can be applied in Year 2, making Year 2's total annual exemption £6,000. However, Year 2's exemption must be used first before any of the exemption is used. *Id.*

85. *Id.* § 23. In order to qualify for purposes of this exemption, the donee must use the donor's contribution for charitable purposes. *Id.*

86. *Id.* § 24(2). A "UK political party" for purposes of this exemption is a group that must either (1) have at least 2 members elected to the House of Commons or (2) have one elected

under £250;[88] gifts made in contemplation of a wedding or civil partnership;[89] and most importantly for purposes of this note, the unlimited spousal/civil partner exemption.[90] Reliefs include, but are not limited to: legally enforceable debts;[91] other liabilities;[92] funeral expenses;[93] and those incurred for business, farm, woodland, and national heritage.[94] Those transfers deemed to be of no value for inheritance tax purposes include transfers not intended to confer gratuitous benefit[95] and those for the maintenance of a family.[96]

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member in the House of Commons from a party that received at least 150,000 votes. *Id.*

87. *Id.* § 3A(4); *see Trusts That Do and Don't Pay Inheritance Tax*, *supra* note 81 (explaining that in order to qualify for the seven year exclusion, the decedent must not have retained any interest or benefit in the transferred property, or else it would qualify as a gift with retained benefit and be includable in the decedent's tax estate.).

88. IHTA, *supra* note 74, § 20 (providing that small gifts are outright gifts under £250 to any number of donees).

89. IHTA 1984 § 22(1) & (2), *amended by* The Tax and Civil Partnership Regulations 2005 (S.I. 2005/3229), 1(1). Gifts given for weddings or civil partnerships are exempt to various extents depending on the donor's relationship to the donee if the gift is given outright or the property comprised is settled by gift. IHTA, *supra* note 74, § 22. A parent of one of the parties to a marriage or civil partnership is entitled to a £5,000 exemption; a more remote ancestor (grandparent, etc.) is entitled to a £2,500 exemption; and a £1,000 applies in any other case. *Id*.

90. IHTA 1984 § 18, *amended by* The Tax and Civil Partnership Regulations 2005 (S.I. 2005/3229), 1(1), 7(5); *see infra* Section III.B for a detailed discussion of the spousal/civil partnership exemption.

91. *How To Value the Debts and Liabilities of Someone Who Has Died*, HM REVENUE & CUSTOMS, http://www.hmrc.gov.uk/inheritancetax/how-to-value-estate/debts.htm#1 (last visited Feb. 20, 2010). Debts include legally enforceable payments owed by the decedent at the time of his death, such as outstanding mortgages, loans, credit card bills, and checks for goods and services that had been received but not paid for. *Id.* To illustrate, the amount of any outstanding mortgages should be deducted from the value of property or from the remainder of the estate in the event that the amount owed on the mortgage exceeds the property value. Note, however, that outstanding checks intended as gifts are to be neither deducted nor included in the gross estate, but rather are to be treated as though they had never been written. *Id.*

92. *Id.*; IHTA, *supra* note 74, §175. "Liabilities" include those expenses which the decedent was responsible for paying at the time of his death, such as goods and services received but not yet paid for and household bills and expenses. *Id.*

93. IHTA, *supra* note 74, § 172; *How to Value the Debts and Liabilities of Someone Who Has Died*, HM REVENUE & CUSTOMS, http://www.hmrc.gov.uk/inheritancetax/how-to-value-estate/debts.htm#3 (last visited Mar. 27, 2011) (explaining that the term "funeral expenses" includes payments not only for the service and interment, but also for "reasonable mourning expenses").

94. IHTA, *supra* note 74, §§ 25, 104, 116, 125; *Business, Woodland, Heritage and Farm Reliefs*, HM REVENUE & CUSTOMS, http://www.hmrc.gov.uk/inheritancetax/pass-money-property/iht-reliefs.htm (last visited Mar. 27, 2011).

95. IHTA, *supra* note 74, § 10.

96. IHTA, *supra* note 74, § 11.

C. Switzerland

1. The Development of the Swiss Canton Tax System

The first appearance of a transfer tax[97] in the region that would eventually become the Confederation of Switzerland came in the mid-17th century, when the territory of Geneva imposed a legacy tax on beneficiaries other than the deceased's heirs.[98] This general scheme of transfer taxation was nationalized after the Swiss Confederation (then known as the Helvetic Republic) was overrun by the French during the Napoleonic Era.[99] In 1815, the Congress of Vienna reestablished Swiss independence and the country voluntarily divided into relatively autonomous cantons.[100] After a few decades of civil unrest, the Swiss Constitution was promulgated in 1848 and established a federal system, based largely on the American model, with Article 3 establishing that "cantons are sovereign insofar as their sovereignty is not limited by the Federal Constitution; they may exercise all rights which are not transferred to the Confederation."[101] With regard to taxes, the Swiss Confederation was given exclusive jurisdiction over only a few.[102] Implementation of additional taxes was left entirely to the broad discretion of each canton. Some cantons retained a similar transfer tax system that had been in place during the Napoleonic Era, while others opted to abandon it.[103]

2. Cantonal Inheritance and Gift Taxes

Currently, Switzerland is a confederation made up of twenty-six cantons.[104]

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97. *See supra* note 1 and accompanying text. As was stated at the outset of this comment, I am using the term "transfer tax" as a generic term for the varying technical names used around the world for the tax levied upon the passing of wealth from one unit to another. In Switzerland, there is such a thing as a "transfer tax" (which is levied on the change in ownership of immovable property and the related rights thereto); however, I am using the term in its generic, rather than specific Swiss context.

98. MAX WEST, THE INHERITANCE TAX 39-40 (2d. ed. 1908) (1893).

99. *Id.* (stating that during this time, taxes were levied on collateral gifts and inheritances at progressive rates based on the relationship between the transferor and the transferee.).

100. *Id*.

101. Bundesverfassung, Constitution Federale, Sept. 12, 1848 [BV 1848, Cst 1848] art. 3 (Switz.).

102. BUNDESVERFASSUNG [BV] [CONSTITUTION] Apr. 18, 1999, SR 101, art. 130 (value added tax); *id.* art. 131 (special expenditure tax); *id.* art. 132 (stamp duties & Swiss withholding tax); *id.* art. 133 (customs duties); SWISS FEDERAL TAX ADMINISTRATION, THE ADVANTAGES OF THE SWISS TAX SYSTEM 9 (2011), *available at* http://www.estv.admin.ch/dokumentation/00079/00080/00745/index.html? lang=en (stating that in 1848 taxation was divided between the federal government and the cantons).

103. WEST, *supra* note 98, at 40.

104. *Canton (European Government),* BRITANNICA ACADEMIC EDITION, http://www.britannica.com/EBchecked/topic/93210/canton#ref=ref156736 (last visited Mar. 27, 2011). In Switzerland, "canton" is the name given to each of the twenty-three states comprising the Swiss Confederation. Three more cantons – Unterwalden, Basel, and Appenzell – are subdivided into half cantons (demicantons), which function as full cantons; therefore, the Swiss Confederation is often said to be comprised of twenty-six cantons.

At present, all but one levies an inheritance tax and all but two a gift tax.[105] Although most cantons impose transfer taxes, there is little harmony within the current cantonal systems; [106] it is therefore necessary to have uniform rules regarding which canton's system will apply in various circumstances. Transfer taxes are levied upon movable property based on the last residence of the decedent or the domicile of the donee and on immovable property based on the location of the real estate.[107]

Despite the lack of complete harmonization, some general observations can be made. Although some cantons have broader rules, each requires that "gifts" and "inheritance" (as defined by the Swiss Civil Code) be included in the taxable transfer base.[108] A "gift" is defined as any transfer where one person enriches another without receiving corresponding consideration; "inheritance" is simply considered all property transferred to another upon death under the Swiss Civil Code.[109] The next similarity among the cantons is the imposition of transfer tax liability upon the beneficiary or heir based on the market value of the gift or inheritance transferred.[110] Furthermore, all tax rates are uniformly progressive and graduated according to both the relationship between the transferor and the transferee and the value of the property received by that transferee.[111] Finally, each

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105. SWISS FEDERAL TAX ADMINISTRATION THE ADVANTAGES OF THE SWISS TAX SYSTEM 25 (2011), *available at* http://www.wifoe.tg.ch/documents/TheAdvantagesottheSwissTaxSystem.pdf. ("Almost all cantons levy inheritance and gift taxes; however, gifts are tax exempt in the canton of Lucerne. The canton of Schwyz levies neither an inheritance nor a gift tax."); *see also* HEIDI STUTZ ET AL., INHERITANCE IN SWITZERLAND: AN EMPIRICAL ANALYSIS WITH SPECIAL CONSIDERATION OF AMBIVALENT GENERATIONAL RELATIONS 3 (2006), *available at* http://www.buerobass.ch/pdf/2007/Erben_in_der_Schweiz_Zusammenfassung_englisch.pdf ("With the exception of the Canton of Schwyz, every canton levies an inheritance tax . . . .").

106. SWISS FEDERAL TAX ADMINISTRION, *supra* note 105, at 5. In 2001, a law on cantonal tax harmonization was passed by the Swiss national Parliament and has served to simplify the principles of taxation at the cantonal and local levels. However, this law applies only to direct taxes. *Id.* Since inheritance and gift taxes are considered to be indirect taxes, the law on tax harmonization is inapplicable and as such, great variety in the systems remains. Otmar Huber, *Inheritance and Gift Taxes*, *in* SWITZERLAND BUSINESS & INVESTMENT HANDBOOK 293, 295. For instance, the lowest marginal rate on transfers is 0% in Schwyz and the highest is 54.7% in Geneva. *Id.* at 5.

107. *Sandro Vecchio, Advantages Offered by the Swiss Tax System to Foreign Individuals*, 3 BULLET"ILN" (Dec. 29, 2004), http://www.imakenews.com/iln/e_article000337571.cfm?x=b11,0,w.

108. *See* Huber, *supra* note 106, at 298, 300 (noting that some cantons apply broader definitions than the Civil Code).

109. *Id.* at 297, 300; SCHWEIZERISCHES ZIVILGESETZBUCH [ZGB] [CIVIL CODE] Dec. 10, 1907, Part 3, 1st Division, 14th Title. One notable exception to "inheritance" is matrimonial property of a married/registered decedent. *See* Huber, *supra* note 106, at 296 ("Jointly acquired" property is distinguished from the separate estates of each spouse, and upon the death of a spouse the jointly acquired property is equally divided). The law of inheritance does not apply to this distribution of jointly acquired property. *Id.*

110. *Id*. at 300.

111. *Id*. at 301.

canton has a series of exemptions to be applied prior to computing taxable income and allowances to be deducted thereafter.[112] With regard to the rates, exemptions, and allowances the canton of Zurich falls in the middle,[113] as such it will be examined in greater detail.The canton of Zurich offers an attractive inheritance and gift tax system relative to the United States. Although all transfers are initially subject to taxation, generous exemptions for spouses and direct descendants, plus allowances for various other relationships, apply.[114] Once taxable income is computed, the applicable tax rates range from 2% (on transfers up to CHF 30,000[115]) to 7% (on transfers up to CHF 1,500,000).[116] If taxable inheritance exceeds CHF 1,500,000, a flat rate of 6% applies to the whole amount and a multiplier, ranging from 1 to 6 according to the relationship of the transferor to the transferee, is then applied to the calculated tax.[117]

III. DEFINING THE "TAXABLE UNIT"

After understanding the structure of the transfer tax systems in the United States, the United Kingdom, and the Canton of Zurich, Switzerland, the importance of taxable units insulated from tax liability becomes increasingly clear. This section identifies the relationships that constitute taxable units in each of these three systems and explores the rationales espoused by each for creating these insulated units. This section also explains the operational intricacies of the insulating transfers within each respective unit.

A. United States: The Heterosexual Married Couple

1. The Evolution of the Marital Deduction

Since 1982, most transfers of wealth between husbands and wives have been entirely insulated from tax liability by means of a complete marital deduction.[118]

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112. *See id.* ("With regard to close relatives, a wide variety of allowances are granted to the different categories of recipients.").

113. *See id.* at 297. For example, the cantons of Vaud, Appenzell Innerrhoden, Grisons, Jura, and Neuchâtel do not have tax exemptions for descendants, while the cantons of Uri, Obwalden, Zug, Fribourg, Ticino, Valais and Geneva provide tax exemptions not only for spouses and descendants but also for parents and grandparents. *Id.*

114. *See infra* Part III.C for a discussion of these exceptions in greater detail.

115. Switzerland's currency is the Swiss Fanc (abbreviated CHF). *Switzerland,* ENCYCLOPEDIA BRITANNICA, http://www.britannica.com/EBchecked/topic/ 577225/Switzerland (last visited Feb. 20, 2011). To put these CHF amounts in perspective, as of January 29, 2010, every 1 CHF was worth 1.0587 U.S. Dollars, making the two currencies almost equivalent. *Major World Currencies,* BLOOMBERG, http://www.bloomberg.com/markets/ currencies/ (last visited Feb. 20, 2011).

116. Erbschafts- und Schenkungssteuergesetz (ESchG) [INHERITANCE AND GIFT TAX ACT] Sept. 28, 1986, § 22(1). The tax rates are as follows: Up to CHF 30,000: 2%; 30,000 – 90,000: 3%; 90,000 - 180,000: 4%; 180,000 – 360,000: 5%; 360,000 – 840,000: 6%; 840,000 – 1,500,000: 7%. *Id.*

117. *Id.* § 22(2). Multipliers are as follows: Parent: 1; Grandparents & Stepchildren: 2; Siblings: 3; Stepparents: 4; Uncles, aunts, descendants of siblings: 5; Others: 6. *Id.* § 23.

118. I.R.C. §§ 2056(a), 2523(a) (2006); *see* Economic Recovery Tax Act of 1981, Pub. L.

When calculating his or her annual taxable gifts, a transferring spouse may deduct all qualified property interests that were transferred to the receiving spouse within the calendar year.[119] Likewise, the executor of a decedent spouse's estate may deduct all qualified property transferred to a surviving spouse in determining the decedent's taxable estate.[120] Congressional justification for the marital deduction lies in the theory of "economic unity" and that a transfer within a financially codependent couple should not be subject to federal taxation.[121] Once the property is transferred *outside* of the marital couple,[122] the imposition of federal transfer tax becomes appropriate and its general rules apply.[123] However, the original intestate, testamentary, or *inter vivos* transfer of wealth between husband and wife is not considered a transmittal of wealth outside of the taxable unit, and therefore, no transfer tax is incurred.

The tax benefits of marriage is a well-established concept and extends beyond the realm of transfer taxes, most apparently in the more common and familiar income tax territory. Prior to 1948, there were considerable income and transfer tax advantages for married couples residing in community property states.[124] In *Poe v. Seaborn*, the Supreme Court held that state property law ownership interests dictated federal income tax liability.[125] In community property states each spouse is deemed to own one-half of the couple's property, regardless of which spouse actually acquired the property or earned the income. Therefore, each spouse in a community property state was correspondingly taxed on one-half of that couple's taxable property.[126] The *Poe* court essentially validated income-splitting in community property states, allowing a spouse who earned all (or more of) the couple's income to make a tax-free gift to the other spouse in the amount of one-half of his earned income.[127] As a result, the couple as a whole incurred a lower

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No. 97-34, § 403, 95 Stat. 172, 301 (1981) (providing for an unlimited marital deduction on estate and gift taxes).

119. *See infra* Section III.A.2 for a discussion of the requirements necessary to obtain a complete marital deduction; *see also* Treas. Reg § 25.2523(a)-1 (as amended in 1995) (explaining the computation of a deductible interest).

120. I.R.C. §§ 2051, 2056(a) (2006); Treas. Reg. §§ 20.2056(a)-1 – 20.2056(d)- 3 (2004); *see infra* Part III.A.2 for a discussion on the requirements necessary to obtain a complete marital deduction.

121. S. REP. NO. 97-114, at 127 (1981) (explaining that the husband and wife are rightfully treated as a single economic unit for income tax purposes and should be likewise treated as such for transfer tax purposes); s*ee generally* Marjorie E. Kornhauser, *Deconstructing the Taxable Unit: Intrahousehold Allocations and the Dilemma of the Joint Return*, 16 N.Y.L. SCH. J. HUM. RTS. 140 (1999) (explaining "why our system has chosen the marital couple as the taxable unit").

122. The subsequent transfers outside of the marital unit will occur upon the donee spouse's later transfer to a third party or upon the death of the donee spouse.

123. *See* I.R.C. § 102 (2006) (providing the general rules for tax treatment of gifts and inheritances).

124. Bridget J. Crawford, *One Flesh, Two Taxpayers: A New Approach to Marriage and Wealth Transfer Taxation*, 6 FLA. TAX REV. 757, 763-64 (2004).

125. Poe v. Seaborn, 282 U.S. 101, 113 (1930).

126. *Id.* at 114.

127. Crawford, *supra* note 124, at 764.

income tax burden because each spouse was taxed on one-half of the couple's total income at a lower marginal rate, which resulted in less tax liability than if one spouse had been taxed on all of his earned income at a higher marginal rate.[128]

Although there was no federal gift tax in place at the time of *Poe*,[129] the court's decision nevertheless had a favorable impact on transfers made between couples in community property states; it was still good law in 1932 when both the gift and estate tax were permanently instituted.[130] Any gift of property made between spouses or to a third party was treated as being made equally from both husband and wife. Likewise, only one-half of the couple's property was included in each spouse's gross estate upon death. The community property scheme thereby lessened the underlying value of the property transferred by each spouse, which correspondingly resulted in a lower transfer tax liability to the couple as a whole.[131]

The dichotomy in federal tax treatment between married couples living in separate and community property states clashed with one of the most important policies in federal taxation: horizontal equity.[132] In an effort to restore horizontal equity to the federal tax system and to thwart the "administrative nightmares" which were already resulting from states switching from separate to community property regimes,[133] Congress enacted the Revenue Act of 1948.[134] The 1948 Act created the joint income tax return[135] and the marital deduction[136] to ensure parity of federal income and transfer tax treatment between marital couples, regardless of their state's property ownership laws.

The original marital deduction allowed a decedent or transferring spouse to pass non-community property to a surviving or transferee spouse and subsequently deduct either fifty-percent of the adjusted gross estate[137] or fifty-percent of the

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128. *See id*. at 764 n.28 (providing a simple demonstration of this proposition).

129. *See supra* Part II.A (explaining that the gift tax created in the Revenue Act of 1924, was repealed in 1926, and was not reinstated until the Revenue Act of 1932).

130. *See, e.g.,* Commissioner of Internal Revenue v. Harmon, 323 U.S. 44 (1944) (applying the decision in *Poe* in finding that, under Oklahoma law, one half of the income is the wife's income for tax purposes).

131. *Poe,* 282 U.S. at 111; *see also* MCDANIEL, WEALTH TRANSFER TAX, *supra* note 73, at 573.

132. DANIEL Q. POSIN & DONALD B. TOBIN, PRINCIPLES OF FEDERAL INCOME TAXATION 26 (6th ed. 2003).

133. Crawford, *supra* note 124, at 766 (citing S. REP. NO. 80-1013 at 302-03 ("[T]here is a lively fear that the tax advantages of community property will produce a migration of the relatively well-to-do taxpayers [from common law states]… If the necessary action is not taken, there will be a flood of State legislation."); S. REP. NO. 80-1013, at 1 (1948) ("Equalization is provided for the tax burdens of married couples in common-law and community-property States. The bill corrects existing inequalities under the estate and gift taxes, as well as the individual income tax.").

134. Revenue Act of 1948, Pub. L. No. 80-471, 62 Stat. 110 (1948).

135. *Id.* § 303, 62 Stat. at 115-16.

136. *Id.* § 361, 62 Stat. at 117-21; *id.* § 372, 62 Stat. at 125-27.

137. I.R.C. § 2056 (2006); Treas. Reg. § 20.2056(a)-1(c)(1) (1994).

value of that transferred property[138] for transfer tax purposes. These new schemes put couples in separate property states in the same position as those couples in community property states.[139] Regardless of the state property laws, transfers qualified for this marital deduction so long as the transfer from a decedent or donor spouse gave the surviving or recipient spouse sufficient rights over the transferred property, ensuring the property's inclusion in the gross estate of the surviving spouse at death or a gift tax upon the recipient spouse's disposal of the property.[140]

By the mid-1970s, the general Congressional sentiment was that the marital deduction as originally promulgated was insufficient.[141] The majority wanted to expand the deduction to ensure that "a decedent with a small- or medium-sized estate . . . [could] leave sufficient property directly to the surviving spouse for support during the lifetime of the spouse without the imposition of an estate tax."[142] Despite some legislative support for an unlimited transfer tax marital deduction, the Tax Reform Act of 1976 only increased the existing estate tax marital deduction to the greater of 50% of the decedent spouse's adjusted gross estate or $250,000.[143] However, the estate tax marital deduction could be reduced in the event that the couple had claimed a gift tax marital deduction for any transfers made after 1976.[144] The 1976 Act created a full marital deduction for the first $100,000 transferred after 1976, eliminated any marital deductions on the next $100,000 transferred, and maintained a 50% marital deduction on any transfer over $200,000.[145] This alteration indicated a Congressional departure from the horizontal equity theory behind the original marital deduction for interspousal transfers.[146]

Citing the need for simplification as its primary rationale, Congress eliminated the confusing and formulaic approach to determining a marital deduction in 1981.[147] The Economic Recovery Tax[148] created an unlimited marital deduction for all qualified transfers of wealth between spouses, whether made during life or upon death.[149] It was here that Congress finally codified the concept

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138. Treas. Reg. § 25.2523 (a)-1(c)(2) (1994).

139. *See* Crawford, *supra* note 124, at 766-67 ("For most practical purposes . . . the new rules achieved the desired geographic parity between common law and community property resident spouses.").

140. MCDANIEL, WEALTH TRANSFER, *supra* note 73, at 573-74.

141. *See generally* S. REP. NO. 94-938(II) (1976) (proposing an increase in the marital deduction).

142. *Id.* § III(A)(2).

143. Tax Reform Act of 1976, Pub L. No. 94-455, 90 Stat. 1520, 1854 (1976).

144. *Id.* (amending § 2056(c)(1)); Treas. Reg. § 20.2056(a)-1(c)(2) (1976).

145. Tax Reform Act § 2002(b), 90 Stat. at 1854-55 (amending I.R.C. § 2523(a)); Treas. Reg. § 20.2056(a)-1(c)(3) (1976).

146. MCDANIEL, WEALTH TRANSFER, *supra* note 73, at 574.

147. S. REP. NO. 97-117, at 127 (1982); H.R. REP. NO. 97-201, at 158 (1981).

148. Economic Recovery Tax Act, Pub. L. No. 97-34, 95 Stat. 172 (1981).

149. *Id.* § 403, 95 Stat. at 300; *see infra* Part III.A.2 (describing the statutory requirements for the unlimited marital deduction).

of the husband and wife as one true economic unit for federal transfer tax purposes, much like they had done for federal income tax purposes with the advent of the joint return in 1948.[150]

2. Technicalities of the Current Marital Deduction

The current marital deduction is a complex provision containing many technicalities and limitations.[151] While the marital deduction, when properly utilized, can create entirely tax-free transfers of wealth between a husband and wife, certain statutory requirements must be met in order to take advantage of this deduction.[152] The burden of establishing these statutory requirements rests upon the person requesting the marital deduction – the donor spouse for *inter vivos* transfers or the executor of the decedent spouse's estate for transfers made at death.[153] The donor spouse or the executor must prove that (1) the transferred "interest" was qualified,[154] (2) this qualified interest "passed" from donor to recipient,[155] and (3) the parties to the transactions were in fact "spouses."[156] For the purposes of transfer upon death, the executor must prove that the recipient spouse did in fact "survive" the donor spouse.[157] While these requirements may seem straightforward, there have been many questions regarding statutory interpretation and the scope of property that can pass tax-free under the marital deduction. For clarity's sake, the requirements of the estate tax will be more closely examined.[158]

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150. MCDANIEL, WEALTH TRANSFER, *supra* note 73, at 574.

151. *See id.* at 573 ("The sheer volume of litigation and number of issues litigated attest to the complexity of the marital deduction provisions.").

152. *See* Crawford, *supra* note 124, at 775-76 (providing a general discussion of these five requirements).

153. Treas. Reg. § 20.2056(a)-1(b)(2) (1994) (requiring that "[t]he executor . . . must submit proof necessary to establish any fact required under (b)(1)," including survivorship, transfer of the property interest from the decedent to the spouse, deductibility of the property interest, and the property interests). *Id.* § 20.2056(a)-1(b)(1).

154. I.R.C. § 2056(a) (2006) ("For purposes of the tax imposed by Section 2001, the value of the taxable estate shall, except as limited by subsection (b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate."); I.R.C. § 2523(a) (2006) ("Where a donor transfers during the calendar year by gift an interest in property to a someone who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year as amount with respect to such interest equal to its value."); *see also* Treas. Reg. §§ 20-2056(a)-1, 25-2523(a)-1 (1995) (providing the qualifications for a marital deduction on inheritances and gift transfers to a spouse).

155. I.R.C. §§ 2056(a), 2523(a) (2006); *see also* Treas. Reg. §§ 20.2056(c)-1-(c)-2, 25.2523(a)-1 (1995) (providing the qualifications for a marital deduction on inheritances and gift transfers to a spouse).

156. I.R.C. §§ 2056(a), 2523(a) (2006).

157. Treas. Reg. § 20.2056(c)-2(e) (1994).

158. *See* MCDANIEL, WEALTH TRANSFER, *supra* note 73, at 637-38. The wording of I.R.C. § 2523 closely parallels that of I.R.C. 2056 in explaining the types of property interests includable for purposes of the marital deduction and these provisions have been interpreted by courts in much the same way as those parallel estate tax provisions have been interpreted. *Id.* The major differences between the estate and gift tax marital deductions are that (1) the donor spouse is the

For an "interest in property" to qualify for the marital deduction, the interest must have been otherwise includable in the donor spouse's gross estate upon his death.[159] When the marital deduction was first developed in 1948, it was contemplated that a qualifying "interest in property" is "broad enough to cover all the interests included in determining the value of the decedent's gross estate."[160] Of course, this broad definition is subject to certain exceptions, the most notable being the terminable interest rule, which disqualifies those interests which will fail after a certain period, the happening of some contingency, or the failure of an event to occur.[161]

Qualified property interests are considered to pass "from the decedent to his surviving spouse"[162] if transferred by any of the means by which property may be transferred at death.[163] Alternatively, interests are considered to "pass" when transferred "by the decedent at any time,"[164] so long as the decedent spouse intended the surviving spouse to acquire these property interests and the surviving spouse so accepts.[165]

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person requesting a marital deduction for gift tax purposes rather than the executor of his estate as is the case for the estate tax and (2) the terminable interest rule has been broadened and more property interests may be disallowed. *Id.* For a more detailed analysis of the similarities and differences between the estate and gift tax marital deduction provisions, see *id*.

159. I.R.C. § 2056(a) (2006); Treas. Reg. §§ 20.2056(a)-2(b)(1) (1994); *see also* STEPHANIE J. WILLBANKS, FEDERAL TAXATION OF WEALTH TRANSFERS, 459 (2004) (providing an example of this statutory requirement).

160. S. REP. NO.80-1013, pt. 2, at 3 (1948).

161. I.R.C. § 2056(b)(1) ("Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section . . . ."); *see also* Treas. Reg. §§ 2056(a)-2(b), 2056(b)-1 (describing similar marital estate issues).

162. I.R.C. § 2056(a).

163. *Id.* § 2056(c) (" . . . an interest in property shall be considered as passing from the decedent to any person if and only if (1) such interest is bequeathed or devised to such person by the decedent; (2) such interest is inherited by such person from the decedent; (3) such interest is the dower or curtesy interest of such person as surviving spouse of the decedent; (4) such interest has been transferred to such person by the decedent at any time; (5) such interest was, at the time of the decedent's death, held by such person and the decedent . . . in joint ownership with the right of survivorship; (6) the decedent had power . . . to appoint such interest and appointed it to such person . . .; (7) such interest consists of the proceeds of insurance on the life of the decedent receivable by such person"); *see also* Treas. Reg. § 20.2056-(c)-1 – 20.2056(c)-3 (defining different scenarios where property is passed between parties).

164. I.R.C. §2056(c)(4).

165. *See* MCDANIEL, WEALTH TRANSFER, *supra* note 73, at 576 ("[E]xcept where the surviving spouse has elected to take against the decedent's will, or a person other than the surviving spouse has disclaimed an interest, the statue contemplates that only those interests qualify which the decedent intends the surviving spouse to take, whether under the will or other instrument or under the laws of intestacy, and which the surviving spouse in fact accepts."). One caveat to this general rule worth noting is that of disclaimers of property transferred by the decedent spouse to someone outside of the marital unit. In the event that transferred property is disclaimed by a third party and that disclaimed property then falls to the surviving spouse via intestacy or testament, the property is treated as having "passed" directly from the decedent to the surviving spouse for purposes of the marital deduction. Therefore absent a qualified disclaimer,

To prove that the recipient of a purported marital transfer was in fact the "spouse" of the donor, the marriage must have been valid under state law at the time of donor's death.[166] Inquiries into to the validity of prior divorces,[167] the effectiveness of current divorce proceedings,[168] or the existence of common law marriages[169] can require considerable analysis of state law.[170] However, even if the marriage is recognized under state law, the parties may not be considered "spouses" for purposes of federal transfer taxation. For purposes of federal law, "the word 'marriage' means only a legal union between one man and one woman as husband and wife and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife."[171] Therefore, while a handful of states recognize same-sex marriages under state law, these unions will be denied the benefit of the federal marital deduction.[172]

For estate tax purposes, the executor of the decedent spouse's estate must also prove that the spouse to whom a qualified property interest was transferred did in fact "survive" the decedent spouse.[173] In most cases, this is an easy task. However, in the event of simultaneous spousal deaths, the executor faces the

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any property interests received by the surviving spouse from another person does not qualify as having "passed" by the decedent spouse to the surviving spouse regardless of the fact that the source of the property interest may have been the decedent spouse's estate and the tax liability incurred by the estate is not deductible. *See* Treas. Reg. § 20.2056(c)-2(a)(4) (addressing the issue of "passing" between different parties); H. R. REP. NO. 65-68 (1976) (noting that express acknowledgement that the qualified disclaimers are to be taken into consideration for purposes of the marital deduction); For a full discussion on the use of disclaimers as a post-mortem estate planning tool to minimize aggregate spousal tax liability, see MCDANIEL, WEALTH TRANSFER, *supra* note 73, at 643.

166. S. REP. NO. 80-1013,pt. 2, at 6.

167. For example, the United States Court of Appeals for the Seventh Circuit has held:

When there are conflicting judicial decrees regarding the validity of a divorce, the decision should be followed for federal estate taxation purposes that would be followed by the state which has primary jurisdiction over the administration of a decedent's estate, i. e., the jurisdiction in which the decedent was domiciled at the time of his death.

Estate of Steffke v. Comm'r, 538 F.2d 730, 735 (7th Cir. 1976). Therefore, a husband's prior divorce in Mexico obtained on grounds not recognized in Wisconsin was invalid under Wisconsin law and the donee was not considered the donor's "spouse." *Id.* at 732.

168. *See, e.g.,* Rev. Rul. 57-368, 1957-2 C.B. 896 (addressing how taxes should function in divorce situations); Ecles v. Comm'r, 19 T.C. 1049 (1959), *aff'd*, 208 F.2d 796 (4th Cir. 1953) (per curium) (stating that for purposes of I.R.C. § 2056, spouses who are not legally separated or subject to an interlocutory divorce does not terminate their rights in each other's estates and are considered "spouses").

169. *See, e.g.*, Rev. Rul. 76-155, 1976-1 C.B. 286 (stating that where there is insufficient evidence of the couple's relationship to constitute a marriage under state law, the donee is not considered a "spouse" for federal transfer tax purposes).

170. *See* Comm'r v. Estate of Bosch, 387 U.S. 456, 464 (1967) (recognizing that the validity is often a question of state law and state court interpretations thereof must be given "proper regard" by federal courts).

171. Defense of Marriage Act (DOMA), Pub. L. No. 104-199, 110 Stat. 2419 (1996) (codified at 1 U.S.C. § 7 and 28 U.S.C. § 1738C).

172. *See infra* Part IV.

173. I.R.C. § 2056(a); Treas. Reg. 20.2056(c)-2(e).

difficult task of proving the order of death in order to best take advantage of the marital deduction.[174] If it cannot be proven which spouse actually died first, each spouse is deemed to have survived the other for purposes of estate administration under the Uniform Simultaneous Death Act.[175]

B. United Kingdom: The Married Couple & Same-Sex Civil Partners

1. Evolution of the Spouse/Partner Exemption

The spouse exemption was originally introduced in the mid-1970s to reflect society's concern for the welfare of survivors following the death of their spouses in order to ensure that their marital home need not be sold to pay inheritance tax.[176] By 1984, Parliament codified the spousal exemption in the Inheritance Tax Act of 1984, which stated that the "transfer of value is an exempt transfer to the extent that the value transferred is attributable to property which becomes compromised in the estate of the transfer's spouse."[177]

In 2005, the spousal exemption was expanded upon the passage of the UK's Civil Partnership Act of 2004.[178] This Act gave same-sex couples identical rights and responsibilities as traditional heterosexual married couples.[179] Although the Civil Partnership Act itself did not amend UK tax laws, regulations regarding its effect for tax purposes were promulgated and became effective at the same time.[180] As a result, each statutory mention of the terms "spouse[s]" or "marriage" was supplemented with the terms "or civil partner[s]" and "or civil partnership;"[181] with this change, the government's commitment to treat same-sex civil partnerships in the same manner as marriages for tax purposes was sealed.[182] In this way, the

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174. This administrative difficulty can be reduced by importing "presumptive order of death" clauses in spousal wills in order to best take advantage of the marital deduction. *See* MCDANIEL, WEALTH TRANSFER, *supra* note 73, at 574.

175. Unif. Probate Code, § 1-201(Uniform Simultaneous Death Act § 4) (1993). For a full discussion on how this may interfere with estate planning strategies, see MCDANIEL, WEALTH TRANSFER, *supra* note 73, at 640.

176. *See generally* David J. Mason & Linda Garrett Levy, *New Tax Relief for the Innocent Spouse: A 1.4 Billion Dollar Proposition*, THE NATIONAL PUBLIC ACCOUNTANT (Feb. 2000), http://findarticles.com/p/articles/mi_m4325/is_1_45/ai_n25028006/.

177. IHTA 1984, c. 51 § 18.

178. Civil Partnership Act of 2004, c. 33 [hereinafter CPA 2004].

179. *See e.g.* CPA 2004, c. 3 (regarding the rights of civil partners on property and financial arrangements).

180. The Tax and Civil Partnership Regulations 2005, *available at* http://www.legislative.gov.uk/uksi/2005/3229/contents/made; *see also* Henry Owdower, *Comparative Law Observations on Taxation of Same Sex Couples,* 111 TAX NOTES INT'L 229, 230 (2006) (referring to civil partnerships as "quasi-marriages" and analogizing them in all respects to a traditional marriage).

181. For example, before the CPA of 2004, the benefits now extended to civil partners were available only to spouses. *See* IHTA 1984 § 18 (governing transfers between spouses).

182. Owdower, *supra* note 180, at 239 (citing Explanatory Memorandum to the Tax and Civil Partnership (No. 2) Regulations 2005, 2005 No. 3230).

name and substance of the spouse exemption in the IHTA 1984 was expanded to include civil partners as well.[183] According to the Explanatory Memorandum to the Tax and Civil Partnership Regulations, civil partnerships were to be treated as a parallel status to marriage because the tax system, "wherever possible, [should] adapt to reflect changes in society" in order to ensure fairness.[184] It is important to note, however that civil partnerships may only be entered into by same-sex couples where neither partner is under sixteen, they are not close blood relatives, nor currently a party to a civil partnership or marriage.[185] Despite claims that the statute's limitations are discriminatory, courts interpreting the UK's Civil Partnership Act have upheld its validity.[186] In the most notable of these cases, two elderly sisters who had lived together in a mutually supportive and committed relationship in a jointly-inherited family home for over thirty years feared that the inheritance tax incurred upon the first sister's death would force the surviving sister to sell the home, echoing the original basis for spousal exemption.[187] The sisters filed a claim that the consanguinity provision of the Civil Partnership Act violated Article 1 of the First Protocol to the European Convention on Human Rights, [188] as well as Article 14 of that instrument.[189] However, the Grand Chamber of the European Court of Human Rights, found against the sisters and held that despite their cohabitation, their relationship was fundamentally different from that of the relationship between spouses or civil partners.[190] The Court went on to hold that the promotion of marriage and long-term same-sex relationships is a legitimate social aim and, therefore, the government cannot be criticized for granting fiscal advantages to couples in such relationships.[191]

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183. *See* IHTA 1984 § 18 (illustrating the previous state of the law, applying only to transfers between spouses).

184. Full Regulatory Impact Assessment [of the Tax and Civil Partnership Regulations, 2005 No. 3230] ¶ 5.

185. CPA 2004 § 3(1) (explaining the disqualifications to recognized civil partnership). For a table of the "prohibited degrees of relationship," see CPA 2004 3(2) & sched. 1, pt. 1.

186. *See e.g.* Burden and Burden v. U.K., App. No. 13378/05 Eur. Ct. H.R. para. 65-66 (2008).

187. *Id.* ¶ 3.

188. Article 1 protects the right to the peaceful enjoyment of one's possessions:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

European Convention on Human Rights, 1st Protocol, art. 1, March 20, 1952.

189. European Convention on Human Rights, art. 14, Nov. 4, 1950 ("The enjoyment of the rights and freedoms set forth in [the] Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status.").

190. Burden, App. No. 13378/05 Eur. Ct. H.R. ¶¶ 65-66.

191. *Id.* ¶ 20.

2. Technicalities of the Spouse /Partner Exemption

Transfers of property between married couples and civil partners are entirely exempt from inheritance tax, regardless of the value, form, or timing of the transfer.[192] Unlike the US marital deduction, property interests in the UK do not need be "qualified" to pass tax-free from one spouse or civil partner to another.

While this favorable treatment is certainly advantageous to the surviving spouse or partner who benefits from a tax-free transfer of wealth, the insulation of transfers between the martial/partnership unit could result in higher inheritance tax liability when the property so transferred is eventually taxed upon the death of the second spouse/partner. To mitigate this problem, Parliament affirmed the nil rate transfer in the Finance Act of 2008.[193] The nil rate transfer permits the executor of the second decedent spouse to apply any unused portion of the first decedent spouse's nil rate band to the second decedent spouse's estate,[194] so long as certain technical requirements are met.[195]

C. Zurich, Switzerland: Spouse, Partner & Descendent

1. Evolution of & Policy behind Broad Exemptions

The broad exemptions to transfer taxation in Zurich began with the spouse exemption, which was incorporated into the most recent Inheritance and Gift Tax

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192. The only notable exception to this rule is when the transferee spouse/partner is not domiciled in the UK, in which case only the first £55,000 of the aggregate transfer between spouses is exempt. The intended rationale behind this limitation is to ensure that most of the property passed between husband and wife or civil partners is eventually incorporated into the unit's tax base and is not outside of the scope of UK taxation power as being passed to another in a foreign domiciliary. *See generally* IHTA 1984, § 18(2).

193. IHTA 1984 § 8A *amended by* Finance Act of 2008, c. 9 § 10 & sched. 4.

194. *See id.* at sched. (4)(2)(8A) (explaining how to determine nil rate). To determine how much of the nil rate band may be transferred, the executor must look at the percentage of the nil rate band that was unused by the first decedent spouse/partner and apply that percentage to the current nil rate band in effect at the time of the second decedent spouse's/partner's death. *Id.* If the first decedent spouse/partner transferred all of his estate to his surviving spouse/partner, the entire transfer was exempt from inheritance tax, rendering 100% of his nil rate band unused. *Id.* In this case, the nil rate band of the second decedent spouse doubles, regardless of any increase in the nil rate band from the time of the first to second death, and any transfer within this greatly expanded threshold is free from inheritance tax liability. *Id.* If the first decedent spouse/partner used a percentage of his nil rate band, the executor of the second decedent spouse/partner may apply the percentage of the fist decedent spouse's/partner's nil rate band to the current nil rate band and add that total to second decedent spouse's/partner's nil rate band. *Id.* If the first decedent spouse/partner used all of his available nil rate band, there can obviously be no transfer. *Id*

195. *Id.* at sched. 4(2)(8B) (explaining that to qualify, the second decedent spouse must have died after October 9, 2007 and that the executor of the second decedent spouse's/partner's estate must make the claim for transfer to the HMRC within 24 months of the second decedent's death and provide the appropriate paperwork to prove (a) that the transfer is appropriate and (b) the percentage of the transfer).

Act in 1986.[196] Over the past decade, Zurich has expanded exemptions in two notable ways. First, in 1999, Zurich amended its inheritance and gift law to insulate transfers to direct descendants of the transferor from transfer tax liability.[197] Second, in 2002, Zurich became the first jurisdiction in the world to ratify same-sex partnerships by referendum. In doing so, voters in Zurich extended numerous marriage rights, including equal treatment under cantonal tax laws, to same-sex couples.[198] This referendum allowed qualified same-sex partners to utilize the full marital exemption to transfer tax that had previously been available only to heterosexual married partners, rather than relying on the limited allowance for domestic partners.[199] To qualify for a "registered partnership," the couple must be of the same sex, both partners must have lived in the canton for six months, and each must formally commit to running a household together, supporting, and aiding each another.[200]

On their face, the spousal/registered partner and descendent exemptions and the generous allowances for transfers to other dependent parties offered by Zurich can certainly be justified using the American rationale of economic interdependence. However, a study of general Swiss tax policy indicates that the true motive underlying this favorable transfer tax scheme may actually be a less noble. The Confederation of Switzerland has long been considered a tax haven for the wealthy, offering national bank secrecy laws and low rates.[201] At the cantonal level, trends indicate that the cantons are engaging in an internal tax-cutting competition in order to offer more desirable tax treatment in the already lenient Swiss system.[202] In fact, former Swiss President Hans-Rudolf Merz recently stated that "[t]ax competition is . . . nothing new for Switzerland. Indeed, it is in our blood."[203] Nevertheless, whether the true reason for Zurich's vast transfer tax

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196. Erbschafts- und Schenkungssteuergesetz [ESchG] [Inheritance and Gift Tax Law] Sept. 28, 1986 NR 41 § 1(D), § 11 (1986) (Switz.) [hereinafter Inheritance and Gift Tax Law].

197. *Id.*

198. Gesetz über die Registrierung gleichgeschlechtlicher Paare [Law on the Registration of Same-Sex Couples] Jan. 21, 2002 (Switz.).

199. *Id.*

200. *Id.* The legalization of these homosexual civil unions was extended to the entire country in 2004 when the Swiss Parliament passed the Federal Partnerschaft gleichgeschlechtlicher Paare [PartG] [Registered Partnership Law] June 18, 2004, by a three-fourths majority. Despite legislative opponents' attempt to overturn the law through a public referendum, Swiss voters formalized registered partnerships on June 5, 2005, and the law became effective as of January 1, 2007. Although registered partnerships remain separate from marriage in name, qualified homosexual couples are entitled to identical rights and obligations under Swiss federal and cantonal tax law. *See generally* Bundesgesetz vom 18. Juni 2004 über die eingetragene Partnerschaft gleichgeschlechtlicher Paare [PartG] [Federal Statute on the Registered Partnership of Same-sex Couples], June 18, 2004 (discussing same-sex partnerships in Switzerland).

201. *See* Imogen Foulkes, *Swiss Low-Tax Policy Irks E.U.,* BBC NEWS, Jan. 30, 2007 (explaining that many celebrities, including French rock star Johnny Hallyday and U.S. singer Tina Turner live in Switzerland for tax reasons).

202. *See id.* (describing how Swiss cantons are allowed to set their own taxes, with many not engaging in an internal corporate tax-cutting competition).

203. Hans-Rudolf Merz, President, Address to the 17th International European Forum

exemptions is the canton's appreciation for economic interdependence or a desire to lure wealthy residents with favorable tax treatment, the fact remains that it has one of the most liberal notions of the taxable unit in the world of transfer taxation.

2. Technicalities of Broad Exemptions & Allowances

The spouse and descendent exemptions[204] to gift and inheritance taxes in the canton of Zurich are actually quite simple. Prior to computing the taxable gift or estate, all property passed to a spouse/registered partner or a direct descendent may be excluded,[205] rendering each of these relationships an insulated taxable unit. Although not totally insulated, transfers between other relationships are still recognized via allowances to be deducted after computing the taxable gift or inheritance.[206] Deductions are permitted for the following relationships: CHF 200,000 for parents; CHF 15,000 for fiancés, siblings, grandparents, stepchildren, godchildren, foster children and home assistants employed for at least 10 years; CHF 50,000 for the partner of the deceased or the donor if the couple had lived together for at least 5 years in the same household and none of the previously mentioned deductions apply; and CHF 30,000 for dependent persons who have a permanent or partial occupational disability.[207] Therefore, while these relationships are not technically within the transfer "unit," they are still given some insulation from transfer tax liability.

IV. EXPANDING THE U.S. DEFINITION OF THE "TAXABLE UNIT"

A. Potential "Taxable Units"

As mentioned in the Introduction, the traditional notion of the American family and household is changing. As such, economic interdependence now extends beyond the traditional husband and wife context. It now includes relationships such as elderly parents who depend upon their adult children for support or the interdependence of same-sex partners.[208] However, these relationships alone do not automatically warrant insulation from transfer taxation.

Tax benefits are a matter of legislative grace; Congress may chose to grant or deny them as it sees fit.[209] However, if the true purpose of the marital deduction is to recognize economic unity, then otherwise interdependent "units" should not be

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Lucerne: Switzerland in International Tax Competition (Nov. 2, 2009), *available at* http://www.news.admin.ch/message/index.html?lang=en&msg-id=29859 (last visited Mar. 23, 2011).

204. Inheritance and Gift Tax Law § 1(D), § 11.

205. *Id.*

206. *Id.*

207. *Id*. § 2(C), § 217(a)-(e).

208. These are meant as examples, as there are countless familial relationship within this economic interdependence exists.

209. *See generally* Knauer, *supra* note 18 (describing the disparity between the U.S. Congress' treatment of same-sex couples and heterosexual married couples in tax policy).

penalized with a tax when transferring wealth simply because they are not married. Given the rationale behind the marital deduction, there is no logically discernible reason why unmarried heterosexual or homosexual partners who live together, raise children together, and have their entire social and financial lives intertwined are unable to transfer wealth tax-free in the same manner as a married couple.[210] If economic unity is truly the justification for the deduction, then there is also no apparent reason why a permanently disabled child or an entirely dependent elder should have a huge portion of his mother's or his daughter's estate subject to tax after her sudden death. Nevertheless, the American transfer tax system has and continues to treat these types of interdependent units differently, in direct contradiction to the stated policy rationale. One possible explanation is that defining the appropriate taxable unit is essentially a political issue, rather than one based on economics.[211]

B. Critical Assessment of the Rationale Behind the Current U.S. Marital Deduction

Since the marital deduction's first appearance in 1948, the Congressional definition and judicial interpretation of a financially interdependent unit has begun and ended with those in a heterosexual married relationship.[212] Despite the expansion of traditional notions of economic unity that have occurred as a result of the immense sociopolitical changes since the mid-20th century, the limited relationship recognized under the marital deduction has remained static.[213]

There has been no realistic Congressional attempt to expand the definition of the taxable unit, either by extending the relationships covered under the marital deduction itself, or by creating a new insulation device to protect transfers made between parties in other relationships. Without any specific legislative history concerning its reasons for declining to extend the taxable unit to more closely resemble the more liberal definitions used by countries abroad, Congressional intentions can only be assumed.

There are a few apparent reasons – some justified and others not – that may explain Congressional failure to expand the transfer taxable unit, including (1) the

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210. Each of these examples presumes that the annual deduction and unified credit have been exhausted.

211. Although technically discussing the taxable unit for purposes of the federal income tax, this logic can be extended to encompass the federal transfer tax as well. *See* Boris I. Bittker, *Federal Income Taxation and the Family,* 27 STAN. L. REV. 1389, 1421 (1975) (stating that the definition of the appropriate taxable unit is "so entangled with social and psychological issues of a non-tax character" that it is essentially a political issue, rather than one of economics).

212. *See, e.g.*, United States v. Stapf, 375 U.S. 118, 123-125 (1963) (holding that the martial deduction cannot be taken for gifts effectively made to children or privately selected individuals and the amount of the deduction is the net value received by the surviving spouse rather than the entire value of the transfer to the surviving spouse, where faced with the question of whether a decedent's estate is allowed a marital deduction under the precursor to § 2056 when a bequest to the surviving spouse is conditioned on her conveying property of equivalent or greater value to the couple's children).

213. *See supra* text accompanying note 173-174.

administrative challenges of expansion and the general fear of collusion; (2) the loss, in federal revenue, as a result of increased tax insulation; (3) conformity with the special treatment of married couples elsewhere in the Internal Revenue Code; and, with regard to same-sex partners, (4) the limitations imposed by the Defense of Marriage Act (DOMA).[214]

1. Administrative Challenges & Fear of Collusion

The IRS handles millions of returns of various types each year.[215] As such, the Service is justifiably concerned with easing the burdens associated with the Code's administration. At first blush, the thought of expanding the transfer taxable unit to include those relationships not easily reduced to or defined by state contract might cause an increase in administrative burdens. From an empirical perspective, it is much easier for the Service to ensure the validity of a heterosexual marriage than it is to ensure that an elderly parent is truly economically dependent upon her adult daughter or that homosexual partners are economic partners as well. However, the administrative challenges posed by the lack of formal state documentation are not alone enough to justify simply ignoring the issue when other relationships are just as, if not more, economically interdependent than the heterosexual martial unit. By requiring the taxpayer to provide detailed information regarding the underlying relationship and then using a checklist to ensure that certain objective criteria have been met, the Service could not only make certain that a transferor and a transferee are actually financially interdependent, but it could do so in a relatively efficient manner.

To prove the financial interdependence of the two parties to the transfer, the Service could require that the transferor of an *inter vivos* gift or the executor of a decedent's estate submit supplemental information along with his/the estate's transfer tax return in order to validate the legitimacy of the underlying relationship. A few examples of the types of information that may be required are recent income tax returns from each party, affidavits regarding the length of the relationship, the level of economic support and the parties' living arrangements, and any medical information significant to financial dependence of the transferee on the transferor. Placing a relatively high burden on the taxpayer to prove the legitimacy of the underlying relationship would quell the Service's inevitable fear of taxpayer collusion. Additionally, exaggerating or fabricating the underlying relationship between parties to the transfer should carry with it the same penalties as would the falsification of information in other instances. Once this information is submitted by the taxpayer, Service personnel could review the information using objective criteria to ensure that it was properly compiled and submitted. If not, the return and supplemental information could be more closely examined and audited if necessary.

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214. Pub.L. 104-199, 110 Stat. 2419 (codified as 1 U.S.C. § 7 and 28 U.S.C. § 1738C).

215. INTERNAL REVENUE SERV., PUBL'N 55B, INTERNAL REVENUE SERVICE DATA BOOK, 2008 4 (2008).

2. Lost Revenue

In tough economic times, it is difficult to justify curtailing any program that generates federal revenue. Expanding the taxable unit by insulating more relationships from transfer tax liability would do just that. While this does not explain a Congressional failure to consider the expansion of the taxable unit during times of American prosperity, it does provides a legitimate concern, given current economic realities. However, it is important to remember that the revenue generated by the federal transfer tax accounts for only 1.2% of total federal tax revenue, meaning that it accounts for a minuscule portion of overall federal revenue. As such, the argument against expanding the transfer taxable unit based on a theory of lost revenue loses much of its potency. At the same time, the social policy arguments that favor expansion gain increasing traction due to growing support for the recognition of the rights of same-sex partners. Nevertheless, because expanding the taxable unit will account for *some* decrease in revenue, it is certain to face opposition.[216]

3. Heterosexual Marriage throughout the Code[217]

Marital status is a pervasive element in the Code. This contention is most aptly demonstrated by the fact that marital status affects tax liability in over sixty provisions of the income tax section alone.[218] Although not all of these provisions always provide benefits by virtue of marriage,[219] two of the most important concepts in the entire Code – income splitting[220] and employee fringe benefits[221] – can offer benefits to heterosexual married couples that are otherwise denied to other economically interdependent taxpayers.

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216. To what extent revenue would be deceased is difficult to ascertain because records regarding the specific relationships between transferors and transferees are not kept. Without knowing this exact figure, it is safe to say that the transfer tax system would continue to generate revenue because many transfers subject to taxation would continue to exist, either because the underlying relationship simply would not qualify as one of the insulated units or because the taxpayer was unable meet his burden in proving the legitimacy of the underlying relationship.

217. Aside from the income tax provisions mentioned in this section, keep in mind that the marital benefits provided under the federal estate and gift tax provisions are perhaps the most notable. Since these provisions have already and will continue to be discussed in great detail, they are not included here.

218. CONG. BUDGET OFFICE, FOR BETTER OR FOR WORSE: MARRIAGE AND THE FEDERAL INCOME TAX xiii (1997) [hereinafter CBO REPORT] ("Differences in income tax liabilities caused by marital status are embodied in a number of tax code provisions.").

219. *See id.* at 29 (defining the "marriage penalty" as the "the difference between the tax liability of a couple filing jointly and their liability if they could file as individuals").

220. Income splitting is a right given to married couples who file joint returns to have their combined incomes subject to tax at a rate equal to that which would have been imposed if each had filed a separate return for one-half of the amount of their combined income. *See generally* BORIS I. BITTIKER ET AL., FEDERAL ESTATE AND GIFT TAXATION 347-48 (Little, Brown & Co. 6th ed. 1990) (1951).

221. *See* discussion *infra* Part IV.B.3.b.

a. Income Splitting

In the Code, marital status determines income tax filing status.[222] A married couple may choose to either file jointly or separately (but cannot file as individuals) with the most favorable rates afforded to married couples filing jointly.[223] Whether a married couple should file separately or jointly is based on complex interactions between rate schedules, available deductions, credits, and personal exemptions. Nevertheless, the fact remains that, with regard to filing, married couples have choices that other taxpayers do not.

In making this determination, married couples have the option of using a valuable tax reduction strategy known as income splitting, a tactic to be used when their joint return rate will produce lower income tax liability than would their individual rates if filing separately.[224] Without the ability to split income, the higher earning spouse will have his income taxed at a high marginal rate and the lower earning spouse will have her income (if any) taxed at a lower marginal rate, which could result in higher income tax liability for the couple as a whole.[225] By "splitting" or shifting some of the higher earner's income to the lower earning spouse, the higher earning spouse drops into a lower tax bracket, and the lower earning spouse rises into a higher tax bracket than she otherwise would have been in, thereby resulting in lower income tax liability for the couple.[226] A "marriage bonus" is said to result in the amount of tax saved by income splitting.[227]

Although income splitting results in marriage bonuses for only about one-half of married American taxpayers,[228] what is important to recognize is that income splitting is available for a heterosexual married couple, but is not available for other economically interdependent units.

b. Favorable Taxation of Spousal Fringe Benefits

Employer-provided fringe benefits have become an increasingly important part of the employee compensation regimes in the United States. The most notable fringe benefit is health insurance,[229] but many others, including, "no additional cost

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222. *See generally* I.R.C. § 1 (2008) (setting out different tax rates for married filing jointly, married filing separately, and filing single).

223. *Id*.

224. This is usually the case in one-earner marriages or in situations where one spouse earns significantly more than the other.

225. CONG. BUDGET OFFICE, FOR BETTER OR FOR WORSE: MARRIAGE AND THE FEDERAL INCOME TAX xiii (1997) [hereinafter CBO REPORT] (describing that a "married couple could face a federal tax bill that was more than $20,000 higher than they would pay if they were not married and could file individual returns").

226. *See id.* at 5-6 (describing an example of a marriage bonus).

227. *Id.* at 2.

228. *Id.* at 31 (concluding that 51% of all couples experience a marriage bonus). The other half of couples experience a marriage penalty or no change. *Id.*

229. I.R.C. §§ 105, 106 (IRC § 105 covers amounts employees receive from their employers as reimbursement for medical expenses and the value of services employees receive under employer-provided health care plans. IRC 106 complements IRC 105 by covering the

services,"[230] "qualified employee discounts,"[231] and meals and lodging,[232] are available. Receipt of fringe benefits is tax-free to the employee, and the cost of providing them is usually deductible as reasonable compensation by the employer.[233] This favorable tax treatment is available whether the fringe benefits are provided directly to the employee or to the employee's spouse or his dependents.[234] Although many progressive employers have extended the availability of fringe benefits to their employees' same-sex or unmarried partners, the corresponding tax benefits do not result. Instead, the employee must include the fair market value of the fringe benefit provided to his partner in his gross income.

c. Marital provisions based on faulty logic

It has been pointed out that the Code's marital provisions are based on assumptions of the "terms, merit, and nature of the taxpayer's relationship with his or her spouse."[235] These provisions do so by using "marital status to identify (i) a relationship where income or resource pooling occurs (or should occur), (ii) a relationship that is worthy of societal support in the form of tax deferral or other relief, and (iii) a relationship where the individuals never deal with one another at

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value of health and accident insurance premiums paid by the employer to cover employees).

230. Section 132(b) of the Internal Revenue Code defines "no additional cost services," as:

[A]ny service provided by an employer to an employee for use by such employee if (1) such service is offered fro sale to customers in the OCB of the employer in which the employee is performing services, and (2) the employer incurs no substantial additional cost (including foregone revenue) in providing such service to the employee (determined without regard to any amount paid by the employee for such service).

I.R.C. § 132(b).

231. Section 132(c)(1) of the Internal Revenue Code defines "qualified employee discounts," as:

[A]ny employee discount with respect to qualified property or services to the extent such discount does not exceed (A) [i]n the case of property, the gross profit % of the price at which the property is being offered by the employer to customers [and] (B) [i]n the case of services, 20% of the price at which the services are being offered by the employer to customers.

I.R.C. § 132(c)(1).

232. I.R.C. § 119.

233. *See* I.R.C. §§ 105-106, 119, 132 (providing that amounts paid by employer shall be excluded from an employee's gross income); I.R.C. § 162 (providing that amounts paid to employees as compensation for personal services rendered shall be allowed as a deduction).

234. I.R.C. § 132(h)(2) (stating that employees' spouses and dependent children are treated as employees for purposes of I.R.C. § 132 fringe benefits); I.R.C. § 105 (excluding actual payments for medical care made by the employer or the employer-provided health plan, but only to the extent the payments are for the medical care of the employee, employee's spouse, or employee's dependents); Treas. Reg. 1.106-1 (exempting the amount expended for the employee's, his spouse's, or his dependents' coverage under an "accident or health plan"). Technically, a same sex partner can be considered an employee's dependent; however, due to the stringent requirements provided by I.R.C. § 152(a)(9), this is very rare. For a description of the dependency requirements as related to same-sex couples, *see* Patricia A. Cain, *Heterosexual Privilege and the Internal Revenue Code,* 34 U.S.F. L. REV. 465, 472-73 n.30 (2000).

235. Knauer, *supra* note 18, at 161.

arm's length."[236] However, empirical evidence demonstrates that this assumption is overbroad and underinclusive.[237] It is overbroad in the sense that not all married couples pool resources and share equally in both income and expenses; it is underinclusive in the sense that many unmarried units do.

4. Defense of Marriage Act

The Defense of Marriage Act was enacted on September 21, 1996 by President Bill Clinton and applies to any statute or regulation promulgated by Congress or the United States government, including the Code.[238] Specifically, DOMA defines the word "marriage" as "a legal union between one man and one woman as husband and wife" and the word "spouse" as "person of the opposite sex who is a husband or wife."[239] Accordingly, any form of state-sanctioned marriage or the various statutory "spousal equivalent" relationships between same-sex couples recognized by states have no effect on matters of federal law.[240] As such, any state-sponsored benefit or protection from state sanctioned marriages or equivalent unions between same-sex partners pertain only to matters of *state* law and are generally applicable only to residents of the state where in which the marriage or union was entered.[241] As modified by DOMA, the Code adheres to these principles by permitting only heterosexual married couples to make tax-free transfers of wealth by means of the unlimited marital deduction, thereby preserving the traditional notion of the taxable unit. However, after examining the legislative intent behind DOMA and its encroachment on states' rights regarding marriage, it becomes clear that DOMA should be reevaluated, at least within the context of federal transfer taxation.

a. Questionable Legislative Intent and Outdated Policy

It is unclear whether DOMA's passage was the result of 1996's election-year politics [242] or rather a reaction to increasing lobbyist activity urging the national

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236. *Id.*

237. Marjorie E. Kornhauser, *Love, Money, and the I.R.S.: Family, Income-Sharing, and the Joint Income Tax Return,* 45 HASTINGS L.J. 63, 73 (stating that income pooling is occurring in a growing number of non-marital units).

238. Christopher J. Hayes, 47 HASTINGS L.J. 1593, 1598 (1996) (stating that DOMA "expressly bars recognition of same-sex marriages for any federal program or law"). In addition to the federal prong, DOMA also allows individual states to refuse to recognize same-sex marriages performed in and sanctioned other states; however discussion of this prong is beyond the scope of this Comment. *See, e.g.,* Knauer, *supra* note 18, at 130 n.3.

239. 1 U.S.C. § 7 (2006).

240. Mueller v. Comm'r, 39 Fed. App'x. 437, 438 (7th Cir. 2002) (stating that DOMA "presumptively denies federal recognition of same-sex marriages should any state choose to recognize such unions").

241. *See* Knauer, *supra* note 18, at 218 (explaining that if a same-sex couple is married in Hawaii, where same-sex is allowed, and later moves to Georgia, they would be considered unmarried for state and federal purposes).

242. *See* Carolyn Lochhead, *Senate Battle on Restricting Gay Marriages/Kennedy Says Bill Appeals to Nation's 'Darkest Side'*, S.F. CHRONICLE, July 12, 1996,

legalization of same-sex unions.[243] However, what is certain is that DOMA was passed during "'a remarkable rush to ban same-sex marriages"[244] in the wake of a 1993 Hawaii Supreme Court decision suggesting that there was a right to homosexual marriage under the Hawaii Constitution.[245] Notably, Congressional debates on the issue focused on heterosexual marriage as the fundamental unit of society from a moral standpoint, but involved no discussion on heterosexual marriage as the only viable economic unit.[246] The House Judiciary Committee recommended the passage of DOMA because it advanced the government's interest in (1) defending and nurturing the institution of traditional heterosexual marriage, (2) defending the traditional notions of morality, (3) protecting state sovereignty and democratic governance, and (4) preserving scarce government resources.[247]While the application and purpose of DOMA extend far beyond the realm of federal taxation, it is interesting to juxtapose its policy rationales with the legislative purposes consistently offered in support of the marital deduction. On one hand, the goal of DOMA is to preserve the institution of marriage based on little more than an outdated notion of morality. It has been argued that the true purposes behind DOMA are simply restatements of a Congressional intent to discriminate against homosexuals.[248] On the other hand, the legitimate Congressional goal consistently offered to defend and renew the marital deduction – to insulate economic and financially interdependent parties from the burdens of taxation upon completed transfers – although underinclusive, is based on economic reality.The archaic notions of "morality" used to support DOMA have eliminated the opportunity for two otherwise economic and financially interdependent parties from benefitting from the marital deduction despite the fact that these parties clearly fall within the purported rationale of the deduction. In passing DOMA, Congress has essentially concluded that the individuals in committed homosexual relationships are not financially interdependent upon one another, and in fact, they only act with "detached and disinterested generosity."[249] This position ignores the fact that, regardless of their sex, these individuals often stand in the exact same economic relationship to each other as individuals in a traditional heterosexual marriage do. Legislation infused with and based on morality cannot and should

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http://articles.sfgate.com/1996-07-12/news/17778058_1_marriage-bill-gay-marriage-defense-of-marriage-ac (quoting Sen. Kennedy's opinion that DOMA is "a mean-spirited form of legislative gay-bashing designed to inflame the public four months before the November election"); David Willman, *Clinton Signs Marriage Act, Lauds GOP on Health Bill*, L.A. TIMES, Sept. 22, 1996, http://articles.latimes.com/1996-09-22/news/mn-46623_1_marriage-act (reporting the signing occurred at 12:50 a.m. on the morning of September 21, 1996).

243. *Id*. (quoting Sen. Nickles' opinion DOMA came before Congress in 1996 because of "activists who want to have same-sex marriages throughout the country").

244. Henry J. Reske, *A Matter of Full Faith*, 82 A.B.A. J. 32, 32 (1996).

245. Baehr v. Lewin, 852 P.2d 44, 67 (Haw. 1993) (holding that discrimination based on gender may violate the Hawaiian equal protection clause).

246. Knauer, *supra* note 18, at 190-192.

247. H.R. REP. NO. 104-664, at 1-18 (1996), *reprinted in* 1996 U.S.C.C.A.N. 2905-23.

248. Gill v. Office of Personnel Mgmt., 699 F.Supp. 2d 374, 396 (D. Mass. 2010).

249. Comm'r v. Duberstein, 363 U.S. 278, 285 (1960) (explaining the legal standard for giving a gift).

not trump legislation based on economic and social reality. With an increasing number of gay and lesbian partners cohabitating and engaging in stable, loving, marriage-like relationships in the United States, a huge aspect of which is finance comingling, the time has come for DOMA's reevaluation. With respect to the marital deduction, Congress should acknowledge the economic realities of homosexual relationships in the 21st century, rather than harping on an outdated notion of tradition and morality.

b. DOMA's Potential Unconstitutionality[250]

Besides complaints of the overtly illegitimate policy basis, various arguments can be made that DOMA is unconstitutional because it violates both the Full Faith and Credit Clause[251] and the Equal Protection Clause,[252] it unlawfully encroaches on states' Tenth Amendment powers.[253] The U.S. Supreme Court has acknowledged that the regulation and definition of marriage falls squarely within each state's police power.[254] Therefore, for federal tax purposes, the marital status of taxpayers has traditionally been determined under the laws of the state of their residence.[255] As a result of this unwavering legal principle, Congress has given the

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250. For an excellent review of DOMA's constitutionality, see Derek B. Dorn, *Navigating the Same-Sex Marriage Landscape: A Primer for the New York Private Client Attorney*, NYSBA TRUSTS AND ESTATES LAW SECTION NEWSLETTER (N.Y. State Bar Association, Albany, N.Y.), Fall 2005, at 16-27 (analyzing laws of the federal government and various states governing same-sex marriage). For a scholarly discussion of constitutional aspects of DOMA, see, e.g., Deborah A. Batts, *Repeal DOMA*, 30 HUMAN RIGHTS MAGAZINE, Summer 2003, at 2; Brett P. Ryan, *Love and Let Love: Same-Sex Marriage, Past, Present and Future, and the Constitutionality of DOMA*, 22 U. HAW. L. REV. 185 (2000); Mark Strasser, *DOMA and the Two Faces of Federalism*, 32 CREIGHTON L. REV. 457 (1998); Mark Strasser, *The Privileges of National Citizenship: On Saenz, Same-Sex Couples and the Right to Travel,* 52 RUTGERS L. REV. 553 (2000); Anita Y. Woudenberg, Note, *Giving DOMA Some Credit: The Validity of Applying Defense of Marriage Acts to Civil Unions Under the Full Faith and Credit Clause*, 38 VAL. U. L. REV. 1509 (2004).

251. U.S. CONST. art. IV, § 1 ("Full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state. And the Congress may by general laws prescribe the manner in which such acts, records, and proceedings shall be proved, and the effect thereof."). This argument generally espouses that DOMA Section 2, which allows states to decline to recognize same-sex marriages sanctioned by other states, exceeds the limited power conferred on Congress by the Full Faith and Credit Clause.

252. U.S. CONST. amend. XIV, § 1 ("No State shall …deprive any person…within its jurisdiction the equal protection of the laws."). This argument has become particularly potent in light of the United States Supreme Court decision in Romer v. Evans, 116 S. Ct. 620, 631-636 (1996), which held that a Colorado constitutional amendment which nullified all executive, legislative, and judicial actions designed to protect the rights of gays and lesbians violated the Equal Protection Clause because it imposed a "special disability" on homosexuals as a class.

253. U.S. CONST. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or the people.").

254. Loving v. Virginia, 388 U.S. 1, 7 (1967).

255. *See* Rev. Rul. 76-255, 1976-2 C.B. 40 (holding that previously married tax payers must file amended returns as single individuals where a state court declared their marriage annulled for the taxable year in question); Drunker v. Comm'r, 77 T.C. 867, 872 (1981) (recognizing that

states almost exclusive access to the federal tax benefits offered by marriage.[256] However, Congressional deference in this regard ended upon the passage of DOMA in 1996. It is true that, before DOMA, there were certain federal regulations relating to the timing of changes in marital status[257] and the recognition of community property interests,[258] yet Congress had never categorically refused to recognize a state-sanctioned marriage for federal tax purposes. As such, the passage of DOMA sacrifices the deference Congress has always given to the states with regard to marriage in order to preserve the traditional notion of the taxable unit on a national level. This amounts to a significant violation of the Tenth Amendment that, until its repeal or judicial reversal, eliminates the possibility of any expansion of the current marital deduction.

Unfortunately, neither legislative repeal nor judicial reversal based on any of the aforementioned grounds seems likely in the near future. In the face of judicial challenges to DOMA, the Obama administration has supported DOMA's legality despite campaign promises to the contrary. Most recently, the Department of Justice (DOJ) filed a motion to dismiss an equal protection challenge brought by same-sex couples or the surviving spouses of same-sex partners who were married in Massachusetts and who have been denied the right to exercise various federal rights or receive federal benefits by virtue of DOMA.[259] The DOJ argued that DOMA passes the requisite rationale basis review[260] because a uniform standard of eligibility for federal rights and benefits throughout the nation was rationally related to a legitimate government interest.[261] Ironically, despite this and other recent attempts by the Executive Branch to uphold the legality of DOMA,[262] President Obama and the DOJ have maintained their stance that DOMA should be

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State law has traditionally determined marital status for Federal tax purposes), *aff'd*, 697 F.2d 46 (2d Cir. 1982), *cert. denied*, 461 U.S. 957 (1983).

256. *See* Christopher J. Hayes, Note, *Married Filing Jointly: Federal Recognition of Same-Sex Marriages under the Internal Revenue Code*, 47 HASTINGS L.J. 1593, 1602-1615 (1996) (providing a detailed analysis of Congressional deference to state's recognition of marital status and domestic relations).

257. *See, e.g.* Individual Income Tax Act of 1944, 58 Stat. 231, 238 (providing that marital status would be determined as of the last day of the taxable year).

258. Revenue Act of 1948, 62 Stat. 110, 114, 116-128 (authorizing married couples in all states to split their incomes and initiating gift-splitting and the 100% marital deduction for purposes of the federal transfer tax).

259. Defendants' Motion to Dismiss, Gill v. Office of Personnel Mgmt., 699 F. Supp. 2d 374 (D. Mass. 2010) (No. 1:09-cv-10309 JLT).

260. Despite some evidence to the contrary, the widespread belief is that the U.S. Supreme Court concluded that rational basis review was appropriate when evaluating anti-gay legislation. Romer v. Evans, 517 U.S. 620 (1996).

261. Memorandum of Law in Support of Defendants' Motion to Dismiss, *supra* note 259, at 17-18 (arguing that DOMA meets the rational basis review standard to maintain the status quo definition of "marriage" and "spouse" otherwise subsequent laws in States that allowed same-sex marriage would destroy the uniformity of Federal rights).

262. Defendant United States of America's Notice of Motion and Motion to Dismiss; Memorandum of Points and Authorities in Support Thereof, Smelt v. United States, No. SACV09-00286 DOC (MLGx) (C.D. Cal. June 11, 2009).

repealed.[263] Aware of this sympathetic stance, many petitioners are initiating constitutional challenges to DOMA. The most powerful of these was lodged by the Commonwealth of Massachusetts in July of 2009, alleging that: (1) the federal definition of marriage as a union between one man and one woman is unconstitutional and (2) that DOMA has interfered with the state's "sovereign authority" to define and regulate marriage.[264] Whether this or subsequent judicial challenges will be successful obviously remains to be seen. Recently, however, President Obama directed the DOJ to cease defending § 3 of DOMA because he believes it is unconstitutional.[265] Therefore, until a judicial repeal, the implications of DOMA on current federal law, namely on the Code and the marital deduction contained therein, are unfortunately sealed.

V. CONCLUSION

The US' definition of the "taxable unit" should be expanded for purposes of transfer taxation. After reviewing the country's changing economic and social realities, the policies behind the current marital deduction, and the unpersuasive Congressional reasons for limiting the concept of an insulated taxable unit to the heterosexual married couples, it is clear that the U.S. marital deduction is unjustifiably limited. This Comment began by explaining how the pending sunset of the EGTRRA/2010 Tax Relief Act makes the coming years a perfect opportunity for Congress to reevaluate the American transfer tax system and, most importantly, the concept of the marital deduction. As demonstrated, the systems of transfer taxation used in the United Kingdom and Zurich, Switzerland are sufficiently similar to the American model to justify Congressional reliance on the concepts used by its European counterparts. The United Kingdom offers a step in the right direction by allowing same-sex partners to qualify for its spouse/partner exception.

However, the UK system does not go far enough to insulate other relationships that may not approximate to marriage, such as economically dependent minors or elders, from transfer tax liability. On the other hand, the Canton of Zurich extends its definition of the insulated taxable unit too far by exempting *all* descendants from transfer tax liability. In doing so, this system fosters the possibility of wealth-concentration in family dynasties, which is an undesirable outcome that the current U.S. system inhibits. Regardless of whether the United States creates an insulated taxable unit that mirrors either of these

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263. Carrie Johnson, *Obama Says Marriage Law Should be Repealed,* WASH. POST, Aug. 18, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/08/17/AR2009081702722.html.

264. Marc Ambinder, *Obama Won't Go to Court Over Defense of Marriage Act*, NATIONAL JOURNAL, (Feb. 23, 2011), http://nationaljournal.com/obama-won-t-go-to-court-over-defense-of-marriage-act-20110223.

265. *Cf.* Brian Montopoli, *Obama Administration Will No Longer Defend DOMA,* CBS NEWS (Feb. 23, 2011, 12:44 PM), http://www.cbsnews.com/8301-503544_162-20035398-503544.html (stating that President Obama will not push for the repeal of DOMA, but will leave it to the courts or Congress).

European models exactly, there is something to be learned from each of them. Both systems utilize a definition of the taxable unit that is more realistic in light of the multitude of interdependent relationships that now exist in society. They are also more consistent with the stated policy objectives that justify the existence of transfer tax exemption. If Congress is to remain true to its own stated policy objectives, it must take this prime opportunity to extend the concept of the transfer taxable unit to more closely resemble economic and social realities.