

Taxation--Transferred Property Held Includable in Gross Estate Where Grantor Retained Right to Income (McNichol's Estate v. Commissioner, 265 F.2d 667 (3d Cir. 1959))

St. John's Law Review

Follow this and additional works at: <https://scholarship.law.stjohns.edu/lawreview>

This Recent Development in New York Law is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in St. John's Law Review by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact selbyc@stjohns.edu.

Perhaps the Court wanted a "second look" at the case and implemented its desire by granting the reargument. Regardless, the rule still stands that reargument will not, and should not, be granted for the unique purpose of permitting the court to change its opinion.²⁷

Concededly, if the Court were only taking a "second look," the concept of reargument would seem to take on new meaning. The result of this new concept might be to prolong litigation rather than to seek its termination. The general rule, however, that reargument should not be sought with undue optimism undoubtedly prevails, even though the instant case could easily be read otherwise.²⁸



TAXATION — TRANSFERRED PROPERTY HELD INCLUDIBLE IN GROSS ESTATE WHERE GRANTOR RETAINED RIGHT TO INCOME.—Petitioners-executors appealed from a decision of the Tax Court which had approved inclusion in the gross estate of decedent the value of income-producing property conveyed by him to his children some ten years prior to his death. At the time of the conveyance it had been orally agreed that the grantor was to retain for life the income from the property. This agreement was carried out. In affirming the decision of the Tax Court, the Court of Appeals for the Third Circuit held that decedent actually enjoyed the property until death by receipt of the income irrespective of the enforceability of any right to it under state law. *McNichol's Estate v. Commissioner*, 265 F.2d 667 (3d Cir. 1959).

The case was decided under Section 811(c)(1)(B) of the 1939 Code,¹ presently found in Section 2036 of the 1954 Code, the Court

²⁷ 1 CARMODY-WAIT, CYCLOPEDIA OF NEW YORK PRACTICE 681 (1952).

²⁸ COHEN & KARGER, POWERS OF THE NEW YORK COURT OF APPEALS 696 (rev. ed. 1952).

¹ INT. REV. CODE OF 1939, ch. 3, § 811, 53 Stat. 120 (now INT. REV. CODE OF 1954, § 2036), the pertinent part of which reads:

"§ 811. Gross Estate

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States.

.....
(c) Transfers in contemplation of, or taking effect at, death.

(1) General rule.

To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise. . . .

(B) under which he has retained for his life or for any period not

placing decedent's transferral within that category of conveyances in which the transferrer retains "the possession or enjoyment of, or the right to the income, from the property" thereby subjecting it to inclusion in his gross estate. The unique aspect of the case is furnished by the Court's view of the fact that according to Pennsylvania law, the right to income was apparently unenforceable.² Although it was stated that the right was not necessarily unenforceable since decedent could have enforced it upon grantee's admission of its existence,³ such an admission was hardly likely in an action between disputing parties. As a practical matter, the possibility of enforcement was discarded,⁴ and it was concluded that the over-all transaction, viewed objectively, amounted in fact to retention of "the . . . enjoyment of . . . the property" within the meaning of the statute.⁵

Until now, the nature and degree of interest retained was for the most part the center of controversy in litigation involving these allegedly incomplete transferrals.⁶ Enforceability either existed in

ascertainable without reference to his death or for any period which does not in fact end with his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom. . . ."

² *McNichol's Estate v. Commissioner*, 265 F.2d 667, 670 (3d Cir. 1959).

³ *Id.* at 670 n.3.

⁴ *Id.* at 671. The Court rejected the contention forwarded by petitioner that the words "right to" added in 1932 were meant to limit the application of the statute to only enforceable claims to the income. It was pointed out that those words were in fact meant to extend the application of that clause to those situations where decedent, although never receiving the income himself, had a right to it.

⁵ *Ibid.* See *Wells-Fargo Bank & Union Trust Co. v. United States*, 80 F. Supp. 787 (N.D. Cal. 1948), in which the court held that a transfer of property, although absolute under California law, in effect resulted in a withholding of possession or enjoyment until grantor's death, since decedent retained absolute control of the property and received the income therefrom, and was therefore includible in decedent's estate. The conveyance was between husband and wife. *But see*, *Estate of Edgar M. Uhl*, 25 T.C. 22 (1955), where the court, in holding includible property conveyed into trust with retention of a right to \$100 per month, and additional amounts payable in the discretion of the trustee, relied heavily on the fact that decedent could have enjoyed the full income by merely borrowing heavily. The court reasoned that since creditors could enforce their claims against the entire income, it was includible. Rather than rely on the fact that decedent could possibly exercise control over a self-appointed trustee, the court apparently went to great lengths to find a legally enforceable means of enjoyment.

⁶ For example, possibility of reverter. Compare *Commissioner v. Nathan's Estate*, 159 F.2d 546 (7th Cir. 1947), *cert. denied*, 334 U.S. 843 (1948) (Right to income was reversionary—effective only after death of life tenant. *Held*, includible, by construing Section 811(c) in conformity to Treasury Regulation 105 which had been promulgated in 1937.) with *Nichols v. Bradley's Estate*, 27 F.2d 47 (7th Cir. 1928) (Contingent life estate *held* non-includible.).

fact or was presumed to exist. Here, however, "substance" rather than "form" was held controlling.⁷

This decision is in accord with efforts to eliminate tax avoidance through the use of cleverly devised incomplete property transfers. *May v. Heiner*,⁸ decided in 1930, interrupted an otherwise relatively uniform policy of inclusion.⁹ That case, however, prompted immediate legislative action to remedy the situation created by its holding,¹⁰ which barred the levy of an estate tax on property apparently on the sole basis of technical title passage during the lifetime of decedent.¹¹ These 1931 and 1932 amendments by the legislature aimed at correcting the *May* decision¹² are substantially retained in both the 1939¹³ and 1954¹⁴ Codes.

Commissioner v. Estate of Church,¹⁵ decided in 1949, expressly

⁷ *McNichol's Estate v. Commissioner*, 265 F.2d 667, 673 (3d Cir. 1959).

⁸ 281 U.S. 238 (1930).

⁹ See *Commissioner v. Estate of Church*, 335 U.S. 632 (1949). With reference to the includibility of trust property in settlors' estates where they had retained a life income, the Court in *Church* stated: "This principle of estate tax law was so well settled in 1928, that the United States Court of Appeals decided *May v. Heiner* in favor of the Government in a one-sentence *per curiam* opinion. 32 F.2d 1017. Nevertheless, March 2, 1931, this Court followed *May v. Heiner* in three cases in *per curiam* opinions, thus upsetting the century-old historic meaning and the long standing Treasury interpretation of the 'possession or enjoyment' clause." *Id.* at 639.

The three cases referred to by the Court, which were the immediate prompters of the legislation, were: *Burnet v. Northern Trust Co.*, 283 U.S. 782; *Morsman v. Burnet*, 283 U.S. 783; *McCormick v. Burnet*, 283 U.S. 784. all decided on March 2, 1931.

¹⁰ The amendments added in 1931 and 1932, pertinent to the instant situation, are contained in section 811 to which reference previously was made. The 1932 amendment [47 Stat. 279 (1932)] added "the right to" the income to the 1931 amendment [46 Stat. 1516 (1931)] which had included only retention of "the income" from transferred property in order to include it in decedent's estate. Both were amendments to the Revenue Act of 1926, ch. 27, § 302(c), 44 Stat. 70 (1926).

¹¹ *May v. Heiner*, 281 U.S. 238 (1930). Decedent had retained a right to a life income if her husband, trustee/beneficiary, predeceased her.

"The transfer . . . was not made in contemplation of death. . . . It was not testamentary in character and was beyond recall by the decedent. At the death of Mrs. May no interest in the property held under the trust deed passed from her to the living; title thereto had been definitely fixed by the trust deed. The interest therein which she possessed immediately prior to her death was obliterated by that event." *Id.* at 243.

¹² The Court in the instant case treats *Nichols v. Coolidge*, 274 U.S. 531 (1927), in which property was conveyed with an understanding that the grantor-decedent would enjoy the premises as long as she and her husband desired, similarly to the *May* case. Although it is true that emphasis was placed on title passage, there was also reliance on the fact that "the decedent had no valid agreement to that effect." Thus, the case, although under the earlier statute and before the 1931 and 1932 amendments, is less easily distinguished than the decision indicates.

¹³ INT. REV. CODE OF 1939, ch. 3, § 811(c) (1) (B), 53 Stat. 120.

¹⁴ INT. REV. CODE OF 1954, § 2036.

¹⁵ 335 U.S. 632 (1949).

overruled *May v. Heiner*¹⁶ and held includible in decedents' estates transfers made before 1931 with the right to income retained. Congress then followed with the Technical Changes Acts of 1949¹⁷ and 1953¹⁸ which precluded the application of that decision to pre-1931 and certain pre-1932 transfers. Today, post-1932 transfers are governed apparently by present Section 2036 of the Code as construed by *Church*.

The attitude of the Court in *McNichol's* toward the possibility that the right possessed by decedent was enforceable is much the same as that embraced by the Supreme Court in *Rutkin v. United States*.¹⁹ Although in that case Rutkin was under a legal obligation to return extorted funds, the Court felt that it would be naïve to base its decision on such a remote possibility. The extorted funds were therefore held includible as gross income to petitioner.²⁰ In the present case, the relation of the parties, the treatment of the property by decedent and the fact that he actually did receive the income, led to the inescapable conclusion that he effectively retained the enjoyment of the property. The validity of this conclusion that a contrary decision based on the possibility of the loss of such a right of doubtful enforceability would be unrealistic, turns on the extent to which the Court's attitude towards the enforceability of rights will be applied. Although in the instant case there seems to be little doubt that decedent enjoyed the property within the spirit, if not the letter of the statute, application to situations less apparent appear objectionable. It is difficult to determine the controlling factors in the instant case in order to establish a rule applicable to unenforceable rights which will effect inclusion of property in decedent's gross estate. The many factors that entered into the Court's decision make such a task relatively impossible.²¹

¹⁶ Note 11 *supra*.

¹⁷ 63 Stat. 895 (1949).

¹⁸ 67 Stat. 623 (1953), 26 U.S.C. § 2036 (1958).

¹⁹ 343 U.S. 130 (1952).

²⁰ The decision was five to four. The dissent felt that it was a thinly veiled attempt to enforce local criminal law rather than a legitimate exercise of the taxing power. *Rutkin v. United States*, 343 U.S. 130, 139 (1952) (dissenting opinion).

²¹ On the one hand the Court states: "And when filial devotion and respect in fact justifies the faith which a parent reposes in his children in transferring property to them upon their oral assurance that the income is to be his for life, it is entirely artificial to hold that the parent did not retain the enjoyment of the property until his death simply because his receipt of its income accrued under an oral agreement rather than one more formal in nature . . ." which appears to limit the holding to its facts, but then quotes with favor the following statement from the *Church* case: "[A]n estate tax cannot be avoided by a gift unless it is ' . . . a bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property . . .'" which would appear to indicate an extremely liberal approach to inclusion. *McNichol's v. Commissioner*, 265 F.2d 667, 673 (3d Cir. 1959).

Perhaps, legislation would provide the solution. It is felt, however, that in an area such as this, where it is the over-all effect of a transaction that determines its treatment, pronouncement through case law of general principles to be applied and promulgation of interpretive regulations are preferable to any statutory attempt to spell out the innumerable variations which would result in inclusions.



TORTS—LIBEL—STATEMENTS OF LESSER GOVERNMENT OFFICIAL HELD ABSOLUTELY PRIVILEGED.—Petitioner, as Acting Director of the Office of Rent Stabilization, issued a defamatory press release regarding suspension of two officers of the department. The release, which named the officers, intimated that they had acted irregularly in proposing a leave payment plan. The lower court, in remanding for new trial, found the press release qualifiedly privileged but refused to grant immunity because of petitioner's malice. Petitioner requested certiorari on the question of absolute privilege. *Held*, the statement was absolutely privileged. *Barr v. Matteo*, 360 U.S. 564 (1959).

Defamation, an attack upon an individual's good name and reputation, is historically divided into libel and slander. The former includes variously written forms of defamatory matter, the latter concerns oral statements.¹ "Libellous per se" connotes that the existence of damage to a plaintiff is a necessary result of the publication of the libel. This view also encompasses those publications, which although not defamatory on their face, require extrinsic facts to establish their defamatory meaning.²

In a defamation action, there are available to the defendant two absolute defenses, privilege and truth. The former defense is further subdivided into absolute and qualified, or conditional privilege. Etymologically and practically, absolute privilege, conferring immunity³ on the tortfeasor without regard to his purpose, or reasonableness of conduct, is a complete defense.⁴ Therefore, it is usually limited in its availability to judicial⁵ and legislative proceedings,⁶

¹ PROSSER, TORTS § 93 (2d ed. 1955).

² *Id.* § 92, at 582.

³ On use of the terms "privilege" and "immunity" see Veeder, *Absolute Immunity in Defamation: Judicial Proceedings*, 9 COLUM. L. REV. 463, 467-69 (1909).

⁴ PROSSER, *op. cit. supra* note 1, § 95 at 607.

⁵ See generally Veeder, *supra* note 3.

⁶ See generally Veeder, *Absolute Immunity in Defamation: Legislative and Executive Proceedings*, 10 COLUM. L. REV. 131 (1910).