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Taxability of Transfers Intended to be Effectuated at Donor's Death

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TAX COMMENT

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TAXABILITY OF TRANSFERS INTENDED TO BE EFFECTUATED AT DONOR'S DEATH.—The prerogatives and limitations of each division of the federal government were promulgated with a view towards insuring the efficient functioning of a system of "checks and balances." Regarded as traditional ensigns of popular government, the judicial, legislative and executive branches are each zealous in restricting one another to its respective scope but loath to assume another's functions. Often encountered is the reticence of the Supreme Court to supply deficiencies in Congressional enactments.[1] The judiciary will slyly call attention to the imperfect statute and calmly await a modification. This was recently forcibly illustrated in the application of the Federal Estate Tax Law,[2] involving transfers effectuated at the transferor's death.

The item of the tax statute that has been so particularly difficult to administer, reads as follows:

> "Any interest of which the decedent has any time made a transfer or with respect to which he has at any time created a trust, in contemplation of, or intended to take effect in possession or enjoyment at or after death, except in consideration of money or money's worth * * *."[3]

Stated in that form, the statute does not define what interests may be retained by the transferor. This led the Supreme Court, because of the indefiniteness and ambiguity, to favor the taxpayers' estate as against the collecting agency, by excluding from the taxable estate any transfer or gift that technically was not legally owned by the donor.[4] Though the action was contrary to the uniform decisions of the state tribunals construing the same language as was used in the federal act,[5] it persisted. It was also opposed to the rulings of the Treasury Department which, from the first, applied the same

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[1] Finkelstein, *Judicial Self-Limitation,* (1923) 37 Harv. L. Rev. 338; also Finkelstein, *Further Notes on Judicial Self-Limitation,* (1925) 39 Harv. L. Rev. 221.

[2] *Infra* note 3.

[3] Rev. Act of 1926, Sec. 302 (c).

[4] Nichols v. Coolidge, 274 U. S. 531, 47 Sup. Ct. 760 (1927); Reinecke v. Northern Trust Co., 278 U. S. 339, 49 Sup. Ct. 123 (1928).

[5] Op. cit. *supra* note 3.

implication to the section quoted, as given by state courts,[6] since the federal statute is drawn from state sources.[7]

To cap the climax of this uncertain state of affairs, the Supreme Court on April 14, 1930, construed the provisions with even greater leniency in the now famous case of May v. Heiner.[8] There, taxability under the Revenue Act of 1918 was denied where the donor created an irrevocable trust in 1917, the income payable to her husband during his lifetime and thereafter to herself with a remainder over. Mr. Justice McReynolds stated, "at the death of Mrs. May (donor) no interest in the trust deed passed from her to the living, title thereto had been definitely fixed by the trust deed.[9] In view of its previous attitude [10] it was evident that the Court enunciated a doctrine applicable to all cases in which irrevocable transfers in trust with reservations of life income to the settler were involved, and that the decision would not be limited to the peculiar facts of the case. With the opportunity presented in May v. Heiner, to vitalize section 302 (c) of the Revenue Act, the Supreme Court merely brought closer to the attention of Congress, that, as a matter of statutory construction of the language employed, no tax could be imposed.

The effect of the decision in the lower court was immediate. McCaughn v. Carnill [11] disregarded any distinction between the May case, where the donor gave away the income to another even though the corpus was not to pass until her death, and its own facts, wherein the settler at all times retained the income, by holding the estate not taxable. In Commissioner v. Northern Trust Co.[12] the settler reserved the income to herself for life. The Supreme Court affirmed the lower court, on the facts of the May case, by not considering the reservation a decisive factor, causing a loss of about $35,000 in taxes to the government.

Where the settler reserved the income of a trust for life, together with a right to sell the corpus, the Circuit Court included the transfer as part of the taxable estate.[13] The rule that "where the donor irrevocably disposes of the corpus of the income then the gross estate is not taxed," [14] was followed. Thus also, in Commissioner

[6] Keeney v. New York, 222 U. S. 525 (1910); People v. Kelley, 218 Ill. 509, 75 N. E. 1038 (1905); see Rothschaeffer, *Taxation of Transfers Intended to Take Effect in Possession or Enjoyment at Grantor's Death*, (1930) 14 Minn. L. Rev. 453 and 603; Matter of Green, 153 N. Y. 223, 47 N. E. 292 (1897).

[7] Handy, Inheritance and Other Death Taxes, (1929) p. 23.

[8] May v. Heiner, 281 U. S. 238, 50 Sup. Ct. 286 (1930), *rev's'g* 32 F. (2d) 1017 (C. C. A., 3rd, 1929).

[9] *Ibid.* at 241.

[10] *Supra* note 4.

[11] 43 F. (2d) 693, (C. C. A., 3rd, 1930) *certiorari denied,* 51 Sup. Ct. 350 (1931).

[12] 42 F. (2d) 732 (C. C. A., 7th, 1930).

[13] Commissioner v. Morsman, *infra* note 15.

[14] *Supra* note 12 at 734.

v. McCormick [15] the lower court includes as taxable a transfer wherein the settler retained (a) a life income; (b) a right of reverter in case of the death of her three children, the beneficiaries, and (c) the power to revoke the trust with the consent of any one beneficiary. May v. Heiner was carefully distinguished.

On March 2, 1931, the Supreme Court reviewed the last three cases mentioned. Commissioner v. Morsman [16] and Commissioner v. McCormick [17] were reversed by *per curiam* decisions, the court relying solely on the May v. Heiner rule in all the cases. Incidentally, these decisions caused the government to lose nearly $2,000,000 in taxation, leaving Congress aghast at the ease of tax evasion with the concomitant loss in revenue. Sharply and clearly was the fact brought home to the legislative division, that the Judiciary would not judicially legislate.

Before the ink of these decrees had dried, a bill was introduced by a Joint Resolution [18] to "stop up the gap." Its purpose was to amend the first sentence of section 302 (c) of the 1926 Revenue Act to read:

> "That 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 and personal, tangible or intangible whereever situated * * *.
>
> (c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or after his death, *including a transfer under which the transferor has retained for his life or any period not ending before his death* (1) *the possession or enjoyment of, or the income from, the property or* (2) *the right to designate the persons who shall possess or enjoy the property or the income therefrom;* except in case of a bona fide sale for an adequate and full consideration in money or money's worth."

It was immediately passed and made effective March 3, 1931, by the signature of President Hoover. It is interesting to note, that the New York Estate Tax Statute, which is a replica of the Federal Law, was amended to correspond to the latter, exactly one week later.[19]

It is easily manifest that the present legislàtion remedies a heretofore chaotic state of the law. The language now, is all-inclusive

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[15] 43 F. (2d) 343 (C. C. A., 7th, 1930).

[16] 44 F. (2d) 902 (C. C. A., 8th, 1930), *rev's'd* 51 Sup. Ct. 342 (1931).

[17] 51 Sup. Ct. 342, *rev's'g* 42 F. (2d) 347.

[18] House Joint Resolution No. 529 (1931).

[19] A bill to accomplish this was introduced on March 9th. It was passed and approved by Gov. Roosevelt on March 10. Thus paragraph 3 of Sec. 249r of the Tax Law (c 710 L. 1930 Act 10-C) harmonized with Sec. 302 (c) of the Federal Act.

and precludes the employment of the devices formerly utilized to avoid taxation. It is submitted that factually the retention by the donor of any "economic[20] benefits" moreover in the trust causes a tax to be imposed. At last, the original intention of the designers of the much-discussed section of the law is realized. Whether the present amendment can be made retroactive in its scope, as is the intention of its sponsor[21] is a question not at all free from doubt.

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DETERMINATION OF THE SITUS TO AVOID DOUBLE TAXATION OF INTANGIBLES.—The maxim "mobilia sequuntur personam" has proven inadequate for the solution of all our modern problems relating to the taxation of intangibles. It is therefore not to be expected that it can be easily applied to the taxation of intangibles. Indeed the Supreme Court has said of the maxim:

> "It was intended for convenience and not to be controlling where justice does not demand it."[1]

With the courts, therefore, readily disregarding the maxim as justice required, its principle soon lost significance with regard to tangible personal property. It was held, for example, that where personal property had acquired a permanent situs in a state, that state had the right to tax the property regardless of the place of residence of the owner. This proposition is of course predicated on the theory that a state is entitled to tax and to derive revenue from any property within its jurisdiction to which it affords protection. Nor was this proposition at all shaken by the realization that double taxation would thus ensue. In Blackstone v. Miller the proposition was put by Mr. Justice Holmes in these words:

> "The fact that two states, dealing each with its own law of succession, both of which have to be invoked by the person claiming rights, have taxed the right which they respectively confer, gives no ground for complaint on constitutional grounds."[2]

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[20] Rothschaeffer, op. cit. *supra* note 6; see also note 5, St. John's L. Rev. 147.

[21] Congressman Garner in advocating the amendment asserted that the retroactive feature would have accompanied this act, but for the fear that it would have defeated the entire bill.—Congressional Record of March 3, 1931.

[1] Board of Assessors v. Comptoit National D'Escompte, 191 U. S. 388, 24 Sup. Ct. 109 (1903).

[2] 188 U. S. 189, 207, 23 Sup. Ct. 277 (1903); see also Black, Constitutional Law (2nd ed., 1897) at p. 451: "There is nothing in the Constitution