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PROBLEMS IN ESTATE PLANNING

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A discussion of the taxes which accrue as an incident of the death of an owner of property may well be approached from the point of view of a few of the more obscure or less obvious practical problems which have arisen, and which may in any case arise, to trouble those in charge of the administration of the decedent's property. They are many and varied, and arise usually out of the complexities of (1) the varying forms of property; (2) the varying conditions of ownership, and enjoyment, of it; (3) the fact that power over property, and the power of taxation, are possessed by and exercised by our national government, our state governments, and foreign governments as well; and (4) the trend of decisions, or court-made law, which has an importance almost as great as that of the words we read in the statute.

In the State of New York we have had estate or transfer taxes for some sixty years. Our Federal Government has levied estate taxes since 1916. By whatever name known—estate taxes, transfer taxes, inheritance taxes, succession duties, death duties—they are a survival and development of something centuries old. They date back at least to the first century, and there is some evidence that they were already seven hundred years old then. We know that there was an inheritance tax levied by the Emperor Augustus in the days of Imperial Rome.[1] Where Augustus got the idea is not certain. One writer states that he pretended to find such a proposal among papers which he said were Caesar's, but which were forged.[2] Another[3] believes that the idea originated with the Egyptians and cites one case where a man was subjected to a severe penalty for evading the tax upon succeeding to the title to his father's house, and another case in which a father sold property to his sons at a nominal price, apparently for the purpose of avoiding the inheritance tax. These two cases might be regarded as evidence of tax

[1]The *vicesima hereditatium et legatorum*. The twentieth penny of inheritances. ADAM SMITH, WEALTH OF NATIONS, Book V, Chap. II; GIBBON, THE DECLINE AND FALL OF THE ROMAN EMPIRE (First Modern Library ed.) 142.

[2]BENDER, FEDERAL REVENUE LAW (1916).

[3]WEST, *The Inheritance Tax* in 4 COLUMBIA COLLEGE FACULTY OF POLITICAL SCIENCE STUDIES IN HISTORY, ECONOMICS AND PUBLIC LAW (1893) 2. See also *In re* Inman's Estate, 101 Ore. 182, 199 Pac. 615 (1921).

evasion and tax avoidance existing some thousands of years before our latter-day courts began to draw the invisible line wbich separates the two.

At any rate, whatever the generating source of the idea, the tax of Augustus was levied for the support of the Roman armies, at the rate of 5 per cent on all of the excess over the specified minimum, and with exemptions for certain legatees within specified degrees of kindred—all much like our modern transfer taxes.

Beginning with Rome, or with Egypt, as the case may be, inheritance taxes have on the way down to us been a part of the revenue raising scheme of many countries, among them Holland[4] and England,[5] both of which had such taxes several hundred years ago. Their popularity is no doubt due to the fact that they lend themselves so well to the main purpose of the sovereign—to pluck the maximum of golden feathers with a minimum of squawk from the goose.

Problems of Valuation

Estate taxes are levied upon value; and, in this case, as in others, value is a question of fact. As on all questions of fact, serious and honest differences of opinion can exist and divergent opinions must be reconciled and the fact determined. There is no single and conclusive measure, any competent evidence being admissible on the question. Once the value has been determined, important results necessarily follow. The first, naturally, is the amount of estate tax, and the lower the value the lighter the tax burden. If we look at it only from this one angle, obviously all of the taxpayer's interest is in the establishment of the lowest value which the facts can be made to support.

But, let us not close the matter up so quickly or so simply. Remember that in the hands of the legatee, or devisee, the value at the time of death becomes thereafter the cost of the property for income tax purposes, and it may be that the new owner will sell it. Whereas his interest earlier was in the establishment of a low value, now his interest is in having a high cost. It is very difficult to have both, and it may turn out that the choice between them was wrong.

Consider as illustrative the case of a resident of Pennsylvania who, let us say, died a few years ago leaving a relatively small estate, one asset of

[4]Inheritance taxes were imposed in the Netherlands in the seventh century. BLAKEMORE AND BANCROFT, THE INHERITANCE TAX LAW, p. 14.

[5]Death duties first appeared in England in the time of William and Mary when a tax on probates was imposed. W. & M., c. 21, § 3 (1694). The idea apparently was imported from Holland. 8 ENCYC. BRIT. (14th ed. 1932), title *Inheritance Taxes*. The estate duty as such was adopted in 1780. 20 Geo. III, c. 28 (1780). See also HANSON, DEATH DUTIES, p. 1.

which was a piece of real estate assessed for local tax purposes at $9,000.00 and reported at that figure for estate tax purposes. Assume that actual value might have been fixed at any figure between $9,000.00 and $15,000.00. The property was inherited by a resident of New York who this year sells it for $12,000.00. Now the owner has a gain of $3,000.00 subject to income tax. If the property had been valued originally at $12,000.00, the tax cost would have been only $60.00, but the income tax on the sale now is $750.00. Quite a penalty for failing to look far enough ahead!

Sometimes such results cannot be foreseen or avoided, but in the case assumed the devisee would have known that he was not going to occupy the property himself; he would sell it when the opportunity presented itself. That knowledge should have influenced the fixing of a higher estate valuation. Before contending too strongly for a low value it is good business to consider the nature of the property and what is going to happen to it later, whether it is likely to be held or more likely to be sold.

Gifts in Contemplation of Death

This same kind of problem sometimes arises as the result of a gift. Consider another assumed case: A father makes a gift of large value to his son, consisting of a block of stock controlling the father's business. The stock had an original cost of next to nothing, the value having been built up by the "plowing in" of profits over a period of some twenty-five years. The father then dies. The circumstances furnish strong support for the government's view that the gift was made in contemplation of death, and the value of the stock is included in the father's taxable estate. Nothing in that respect has been lost, because it would have been similarly included if the gift had not been made.

Later, however, a very substantial loss threatens. The son has a chance to dispose of the stock at a thoroughly satisfactory figure, and he finds that he has no cost. Having acquired the property by gift, the donee has as his basis only that cost which the property had in the hands of the donor.[6] That is the rule in the case of gift property, and no exception is made in favor of gifts in contemplation of death.[7] The present owner's cost, therefore, is approximately zero and all of his sale price will be capital gain which will involve a tax of many thousands of dollars. The father of course thought that he was doing his son a favor. What he actually accomplished was to visit upon him a heavy tax liability which he need never have suffered.

[6]INT. REV. CODE § 113 (a) (2) (1939).
[7]U. S. Treas. Reg. 111, § 29.113 (a) (2)-1 (1943).

This demonstrates the danger so often faced by owners of property who attempt on the basis of a very little knowledge to do their own estate planning without the benefit of advice. It demonstrates also the care which must be exercised when they do seek advice. It is only too easy to overlook the point that if a gift is to be made it should, so far as possible, be a gift of property which carries with it a high cost. All else being equal, give away high-cost property and retain low-cost property until the estate tax can build up the cost for the next owner.

Powers of Appointment

The estate tax can reach not only property of which the decedent had at some time been the owner, but also property which he never owned but over which he had power. Property which was originally owned by someone else and which was either bequeathed in trust, or placed by him in trust during his life, becomes, under some circumstances, subject to estate tax on the death of the person in whom a power of appointment reposed.

A significant change in the tax treatment of property subject to a power of appointment took place with the passage of the 1942 amendments to the Internal Revenue Code.[8] Before the passage of the Revenue Act of 1942 and ever since 1919 the property would be taxed only if the power was a general one (in other words, if the donee of the power could appoint any person he pleased to take the property), and only if the power was exercised and the property passed under it.[9] This is no longer true. Now the test is the existence of the power, whether or not it is exercised, unless it is one of the limited classes of powers which the statute exempts, or unless it was released.[10]

As the law was originally passed, the release had to be accomplished before January 1, 1943.[11] This deadline date was later extended to July 1, 1943,[12] still later extended to March 1, 1944,[13] then to January 1, 1945,[14] and has now been extended to July 1, 1945,[15] allowing some additional months for the doing of the necessary housekeeping to put things in order.

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[8]Revenue Act of 1942 § 403(a), amending Int. Rev. Code § 811(f) (1939).

[9]Helvering v. Grinnell (Stone Estate), 294 U. S. 153, 55 Sup. Ct. 354 (1934); James C. Webster et al., Executors (Sanford Estate), 38 B. T. A. 273 (1938).

[10]Revenue Act of 1942, § 403 (d) (3). Revenue Act of 1942, § 403 (a), amending Int. Rev. Code § 811 (f) (1939).

[11]Revenue Act of 1942, § 403 (d) (3).

[12]Pub. L. No. 809, 77th Cong., 2d Sess. (Dec. 17, 1942).

[13]Current Tax Payment Act of 1943, § 10. 57 Stat. 150 (1943) 26 U. S. C., Supp. II, §§ 811 note, 1000 note.

[14]Revenue Act of 1943, § 505.

[15]Revenue Act of 1942, § 403 (a), amending Int. Rev. Code § 811(f) (1939).

Suppose I have a power of appointment under the will of my father who left property in trust, for whatever purpose, and gave me the power to appoint the person who would take the corpus upon the termination of the trust. Suppose, further, that the provision of his will was that if I fail to exercise the power the trust property would go to my children. Since I would have named my children anyway I do not need to exercise the power, and prior to 1942 the property would not be taxed if I did not do so, but would be taxed if I did. Clearly, then, my children would be better off if I failed to exercise the power. Since the 1942 Act[15a] was passed the rule is different; the property would be taxed anyway. There are, however, some saving provisions in the statute. For example:

(1) The new rule does not apply in the case of a limited power which existed before the Act was passed, unless the power is exercised.[16] Therefore, all we need do as to such powers is to be sure that they are not exercised. Merely being silent on the point is not enough because there is a rule of law that, if in the residuary clause of my will I make the usual provision disposing of "all my property, real, personal and mixed, of whatsoever kind or nature and wheresoever situate," that provision will be construed to extend to and constitute an exercise of any powers of appointment which I may possess.[17] Accordingly, I must do something affirmative to show that I am not intending to exercise the power, and the simple way to do this is to include a provision in my will somewhat to this effect:

> "As to any funds held in trust under the will of my father, the late ...., over and in respect of the principal of which funds I was given a power of testamentary appointment, I do not exercise said power and I expressly disavow any intention to exercise the same."

(2) The new rule does not apply either if the power to appoint is so limited that it can be exercised only in favor of certain relatives.[18] This exemption is accomplished by definition, the term Power of Appointment

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[15a]Pub. L. No. 511, 78th Cong., 2d Sess. (Dec. 20, 1944).

[16]Revenue Act of 1942, § 403 (d) (1).

[17]N. Y. PERS. PROP. LAW § 18; N. Y. REAL PROP. LAW § 176. Under both sections the intention not to exercise the power must appear either expressly or by necessary implication. As to personal property, the intent must appear "therein" (in the will); the word "therein" does not appear in the section governing real property, but this difference does not appear to have been mentioned in the cases. Speir v. Benvenuti, 197 App. Div. 209, 189 N. Y. Supp. 885 (2d Dep't 1921). *In re* Flewwellin's Will, 122 Misc. 256, 202 N. Y. Supp. 496 (Surr. Ct. 1924); New York Life Insurance & Trust Co. v. Livingston, 133 N. Y. 125, 30 N. E. 724 (1892); Lockwood v. Mildeberger, 159 N. Y. 181, 53 N. E. 803 (1899); Chase National Bank v. Chicago Title & Trust Co., 155 Misc. 61, 279 N. Y. Supp. 327 (Sup. Ct. 1935), *affirmed* 271 N. Y. 602, 3 N. E. (2d) 205 (1936), *reargument denied* 271 N. Y. 659, 3 N. E. (2d) 472 (1936).

[18]Revenue Act of 1942, § 403(f) (2) (A) amending INT. REV. CODE § 811(f) (1939).

being so defined that it does not include a power to appoint if the power is limited to these classes:

1. The decedent's spouse
2. The spouse of the creator of the power
3. The descendants of the decedent
4. The descendants of the decedent's spouse
5. The descendants of the creator of the power
6. The descendants of the creator's spouse
7. Spouses of the descendants
8. Charitable organizations.

Now suppose that I have a general power and I want to release it partially so that its exercise will meet this test of limitation. Can it be done? The Revenue Act is silent, although the regulations would lead one to believe that the Treasury Department thinks it can be done;[19] but if I attempt to do it, it would seem that the validity of my act will be determined under local law, while its effectiveness for tax purposes will be determined under the Revenue Act. By amendment of the Real Property Law, passed since the enactment of the Revenue Act of 1942,[20] New York State has made provision for release and limitation of powers. Examination of the new section would lead to the conclusion that a partial release made under it would be effective for estate tax purposes. But that has not yet been decided.

All of this means, as a practical matter, that old wills should now be reviewed to see whether the grant of powers of appointment is wise and whether the powers might well be limited. It means, too, that the subject should be carefully studied by those who advise in the making of wills and the creation of trusts so that, in their drafting, situations will not be unnecessarily created leading to property being taxed twice. It means, finally, that those who now have powers of appointment should examine into the subject to see whether such powers should be released or limited.

Trusts Controlled by the Grantor

While specific statutory provisions do not make one tax dependent upon the other, or make the taxable situation in one case conclusive as to the other, it is generally true that a trust the income from which is taxable as a part of the grantor's income during his life will also be regarded as a part of his estate for tax purposes when he dies.[21]

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[19]U. S. Treas. Reg. 105, § 81.24 (as amended by T. D. 5239, March 10, 1943; T. D. 5283, July 12, 1943; T. D. 5351, March 27, 1944) (b)(3)(iii).

[20]N. Y. Real Prop. Law § 183.

[21]Int. Rev. Code § 811(c) (Estate tax); Int. Rev. Code § 167 (Income tax) (1939).

Control by the grantor over the trust property is an element that has caused a great deal of controversy, even in those cases where he did not himself have any interest in either principal or income, or any power to designate who should enjoy them. His dominion and control may amount substantially to ownership, as the Supreme Court decided in 1940 in the *Clifford* case,[22] in which the grantor had created a trust for the benefit of his wife for a term of five years, subject to earlier termination upon the death of either the grantor or the beneficiary. During the trust term all income was to go to the wife and upon termination the corpus was to go to the grantor, who was vested meanwhile with broad powers of control and discretion as to the amount of income to be distributed annually.

When the 1934 Revenue Bill was before the Committee on Ways and Means, the Treasury recommended that the income from both revocable trusts and short-term trusts should be made taxable to the grantor.[23] The recommendation was adopted as to revocable trusts, but rejected as to short-term trusts.[24] In the *Clifford* case the Supreme Court nevertheless held that the income of a short-term trust, under the circumstances of that case, was taxable to the grantor, the Court viewing the congressional rejection of the Treasury's recommendation as a choice not between taxing or not taxing grantors of such trusts, but between generalized and specific treatment of the subject. According generalized treatment to the facts before it, the Court decided that under the provisions of Section 22(a) of the Code the grantor was to be regarded as the real owner of the trust property, the circumstances of relationship calling for special scrutiny lest what is in reality but one economic unit be multiplied into two or more.

On the same day the Court decided another case[25] involving substantially the same facts, but the decision went the other way on a question of procedure. In the courts below, the Treasury had not only failed to rely on Section 22(a), but had expressly disclaimed reliance upon it, and the Court declined to permit an appeal on a different theory. This case, therefore, even though decided adversely, did not diminish the success of the Treasury in the *Clifford* case or limit the principle which was there established.

Following any such important victory, the Treasury is likely, for the protection of the revenue, to claim the entire field as its own and to surrender individual positions in it only as decided cases later begin to delimit the

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[22]Helvering v. Clifford, 309 U. S. 331, 60 Sup. Ct. 554 (1940).

[23]*Hearings on H. R. 7835*, 73d Cong., 2d Sess. (1933) 151. *Hearings on H. R. 1385*, 73d Cong., 2d Sess. (1933) 24.

[24]INT. REV. CODE § 166 (1939).

[25]Helvering v. Wood, 309 U. S. 344, 60 Sup. Ct. 551 (1940).

ground within which the principle of the government's victory can operate. An example of this judicial limiting of the field is a case recently decided by the Tax Court of the United States, which earlier had been decided against the taxpayer on another point, which was appealed and remanded for examination into the question of the grantor's control, and which is now decided by the Tax Court in the taxpayer's favor.[26] An example on the other side is a case decided recently by the Circuit Court of Appeals for the First Circuit,[27] in which the author unfortunately will appear in the books as counsel for the unsuccessful petitioner. Turning mainly on the question of the grantor's control, the case decided that the trust property is a part of her taxable estate.

Reciprocal Trusts

There is a principle of taxation which applies to reciprocal trusts, or cross trusts as they are sometimes called, where for example a husband and wife, each possessed of substantial property, acting in concert, create two trusts, each naming the other as beneficiary. Such an arrangement is differentiated from the ordinary case of a single trust where, no interest or control having been retained by the grantor and no consideration of contemplation of death being present, the trust property would not be included as a part of the grantor's taxable estate;[28] nor would it be included as a part of the beneficiary's taxable estate, since the latter had nothing but a grant of the income for life.[29] But where they created reciprocal trusts it is held for estate tax purposes that what they really did was exchange the properties one for the other, and that each one's trust was in substance created by the beneficiary, not by the one who appeared in the trust instrument as nominal grantor.[30] Viewing each trust, therefore, upon the death of the beneficiary, it appears as a trust created by the decedent with income retained by him, and it is accordingly a part of his estate.

The rule has no application in the absence of concerted action. The Tax

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[26]Stuart v. Commissioner, 2 T. C. 1103 (1943). Original decision, 42 B. T. A. 1481 (1940); *rev'd* 124 F. (2d) 772 (C. C. A. 7th, 1941), *rev'd and remanded sub nom.*, 317 U. S. 154, 63 Sup. Ct. 140 (1942). Helvering v. Clifford, 309 U. S. 331, 60 Sup. Ct. 554 (1940), limited as resting on its particular facts, and distinguished as to substantial factual differences from this case. See Note (1943) 29 Cornell L. Q. 128.

[27]Wasserman v. Commissioner, 139 F. (2d) 778 (C. C. A. 1st, 1944).

[28]Int. Rev. Code § 811(c). U. S. Treas. Reg. 105, §§ 81.16, 81.17 and 81.18 (1942).

[29]Int. Rev. Code § 811(a) (1939). U. S. Treas. Reg. 105, § 81.13 (1942). 1 Paul, Federal Estate and Gift Taxation (1942) § 4.03.

[30]Allan S. Lehman et al, Executors, 39 B. T. A. 17 (1939), *aff'd*, 109 F. (2d) 99 (C. C. A. 2d, 1940), *cert. denied*, 310 U. S. 637, 60 Sup. Ct. 1080 (1940). Estate of Frederick S. Fish, 45 B. T. A. 120 (1941). Estate of Mary H. Hughes, 44 B. T. A. 1196 (1941) followed.

Court of the United States recently decided a case[31] in which husband and wife did each create a trust for the benefit of the other, but the proof showed that their son was the moving spirit in the making of the arrangement, that he discussed it with each of the parents independently and without the knowledge of the other. It was held that the trusts were not reciprocal, were not made each in consideration of the other, and that the trust property could not be included in the taxable estate of the beneficiary when he died.

Trusts for the Benefit of the Grantor

Another class of trusts which has been held taxable to the grantor, both for income tax and for estate tax purposes, is the trust the income from which is to be used for the grantor's benefit.[32] If he creates a trust the income of which is used for the payment of something which is his legal obligation, such as the support and education of his children, the corpus of the trust is a part of his taxable estate when he dies, and the income is taxed to him in the meantime.[33]

So far as it touches the taxation of the income, this rule is an extension, on the theory of constructive receipt, of the statutory provision for taxing the grantor in the case of income which is distributable to him, its first positive application appearing in an alimony case in 1935.[34] There followed the *Black* case[35] before the Board of Tax Appeals in 1937, which placed outside the operation of the rule those cases in which income might lawfully have been used, but in fact was not used, for the support of dependents. This view of the Board, which was adopted by the Treasury in a General Counsel's Memorandum,[36] was disapproved by the Supreme Court in 1942,[37] the Court deciding that the possibility of the use of income for the support of dependents was sufficient to render it taxable to the grantor, even though the income was not so used. The Treasury declined to give general retroactive effect to the Supreme Court's decision because of the hardships and the administrative difficulties which were foreseen,[38] and the Revenue Act of 1943 nulli-

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[31]Lindsay v. Commissioner, 2 T. C. 174 (1943).

[32]Income tax: Old Colony Trust Co. v. Commissioner, 279 U. S. 716, 49 Sup. Ct. 499 (1928); Burnet v. Wells, 289 U. S. 670, 53 Sup. Ct. 761 (1932); Douglas v. Willcuts, 296 U. S. 1, 56 Sup. Ct. 59 (1935). Estate tax: Helvering v. Mercantile-Commerce Bank & Trust Co., 111 F. (2d) 224 (C. C. A. 8th, 1940), *reversing* Estate of Paul F. Donnelly, 38 B. T. A. 1234 (1938).

[33]See cases cited *supra* note 32.

[34]Douglas v. Willcuts, 296 U. S. 1, 56 Sup. Ct. 59 (1935).

[35]E. E. Black, 36 B. T. A. 346 (1937).

[36]G. C. M. 18972, 1937-2 Cum. Bull. 231.

[37]Helvering v. Stuart, 317 U. S. 154, 63 Sup. Ct. 140 (1942), *rehearing denied,* 317 U. S. 602, 63 Sup. Ct. 140 (1942).

[38]I. T. 3609, 1943-10-11437, 1943-1 Cum. Bull. 505.

fies its effect for the future, and conditionally also for the past, by returning to the rule announced in the Board's decision and the General Counsel's Memorandum referred to above.[39]

But it may be that the father, who could not himself effectively set up such a trust, is the husband of a lady of substantial means. She can create a trust for the purposes mentioned, because the support of the children is not her burden and the income is not used for her benefit. There are trusts of this nature in existence and they operate successfully for tax purposes.[40]

LIFE INSURANCE: TAXABILITY

The taxation of life insurance upon the death of the owner has had a very interesting history made up of statutory enactments, departmental application and judicial interpretation in litigated cases. Actually, the law on the subject, so far as the statutes themselves state the law, looks as if it ought to be quite simple. Setting aside state laws and considering only the federal law,[41] it provided that the taxable estate should include amounts receivable by the decedent's estate and certain other amounts receivable by others,

> "as insurance under policies taken out by the decedent upon his own life."

It would be difficult to imagine a shorter, more concise, clearer provision than those thirteen words. That identical provision stood in the law for twenty-four years beginning with 1918,[42] and it would seem that in that length of time we ought to have found the answer to its meaning. We did find out; in fact, we learned that at different times it had four different meanings. And, remember, meanwhile there had been no change in the statute. Now the statute has been changed so as to lay down a fifth rule.

The first test was the payment of premiums.[43] That was the only test under the original rule. If they were paid all by the decedent, all was taxable; if none were paid by him, none was taxable; if they were paid partly by the decedent, a corresponding portion was taxable. That was a simple, understandable rule and under it many estates were settled, millions of insurance was placed in force, trust arrangements were made and property rights became vested. It stood for ten years.

[39]Revenue Act of 1943, § 134.
[40]Commissioner v. Yeiser, 75 F. (2d) 956 (C. C. A. 6th, 1935) (Ohio law); H. Cecil Sharp, 42 B. T. A. 336 (1940) (Massachusetts and New York law); Lillian M. Newman, 1 T. C. 921 (New York law).
[41]INT. REV. CODE § 811(g) (1939).
[42]Revenue Act of 1918, § 402(f).
[43]U. S. Treas. Reg. 37 (Revised January, 1921), Art. 32.

The first element of confusion was introduced into the picture by the decision of the Supreme Court of the United States in 1929 which laid down the rule of "legal incidents of ownership."[44] In the case under review all premiums had been paid by the insured. That is important because it raises the question why it was necessary to introduce the "legal incidents" rule. The reason is that the case was fought out not on the facts but on a claim of unconstitutionality, the petitioner claiming that, even though the insured had paid the premiums, the insurance could not be taxed because (1) it was vested, and (2) it came from the contract, not from the decedent's estate. The Court was actually passing upon whether Congress *could* tax, there being no question that Congress *had* done so.

The Treasury seized upon the "legal incidents" rule and made that a test of taxability by incorporating the phrase into the regulations.[45] Here the second rule emerged: The insurance was taxable if the premiums had been paid by the decedent *and* if he retained legal incidents of ownership. The test of taxability now had two elements in it.

Five years later, in 1934, Mr. Jackson, then counsel for the Bureau and now on the Supreme Court bench, made another change.[46] Note that word "and" in the 1929 rule. The 1934 change was to make it disjunctive instead of conjunctive, the regulations being amended to make the insurance taxable, if,

(1) the insured had paid the premiums; *or*
(2) they had been paid by any other person except the beneficiary; *or*
(3) the decedent possessed any legal incident of ownership. And the term was so defined as to include a case where the rights of the beneficiary were conditioned upon his surviving the insured.

This 1934 change was not a capricious one, but was designed to overcome the effect of a decision by a district court in Kentucky, which had just ruled that a possibility of reverter was not an incident of ownership and was not sufficient to render the insurance taxable.[47] The principle thus announced was later upheld by the Supreme Court in a group of cases decided in 1935,

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[44]Chase National Bank v. United States, 287 U. S. 327, 49 Sup. Ct. 126 (1932).

[45]U. S. Treas. Reg. 70 (1929 ed.), Art. 27.

[46]U. S. Treas. Reg. 80, Art. 25, promulgated November 7, 1934. Although this article required the inclusion in the gross estate of insurance to which any of the three tests mentioned applied, Mr. Jackson's interpretation was that the insurance would be subject to tax only in the event that "the decedent possessed at the time of his death any of the legal incidents of ownership." See letter December 22, 1934, from Robert H. Jackson, Assistant General Counsel, to Messrs. Baker, Selby & Ravenel, Washington, D. C.

[47]Ballard v. Helburn, 9 F. Supp. 812 (W. D. Ky. 1933), *aff'd* 85 F. (2d) 613 (C. C. A. 6th, 1936).

in which it was definitely established that a mere possibility of reverter was not such an estate as could be taxed, and its extinguishment through death added nothing to what the beneficiary already had.[48]

At this point the courts all said that the law was now definitely settled, and it really did seem that little doubt remained; but the situation remained settled for only about three years. In 1937, Article 25 of the Commissioner's regulations was changed to throw overboard entirely the rule concerning the payment of premiums and tie up only to the presence or absence of legal incidents of ownership.[49]

All of this time, between 1918 and 1937, apparently we had been following the wrong rule and the change accomplished by the change of regulations was calculated to set things aright by the establishment of a fourth rule which applied a single test, fully as simple as the original one but having an entirely different basis. Even while thus rejecting it officially, however, the Bureau of Internal Revenue attempted in 1940, in the *Bailey* case,[50] to return to the original rule—the payment of premiums—but the decision of the case upon other grounds prevented that happening.

Now we have the fifth rule, established by the Revenue Act of 1942,[51] which made a number of changes only three of which need be mentioned here: (1) the words "policies taken out by the decedent upon his own life" were eliminated and there were substituted the words "policies upon the life of the decedent"; (2) the payment of premiums directly or indirectly by the decedent was reestablished as one test of taxability; (3) the possession by the decedent of any of the legal incidents of ownership was reestablished as the other test of taxability, but a reversionary interest was specifically excluded from the definition of the term. As to the payment of premiums by the decedent, those premiums paid by him prior to January 10, 1941, are eliminated if after that date he at no time possessed any incident of ownership.

There are two things to note about this latest rule: First, when are premiums paid indirectly by the decedent? Second, of what significance is the date January 10, 1941?

It is clear that if a premium comes due today and the insured gives to the beneficiary funds with which the latter pays the premium, payment has been made indirectly by the insured. But even if the beneficiary pays from his

[48]Life insurance: Bingham v. United States, 296 U. S. 211, 56 Sup. Ct. 180 (1935). Trusts: Helvering v. St. Louis Union Trust Co., 296 U. S. 39, 56 Sup. Ct. 74 (1935).

[49]T. D. 4729, 1937-1 CUM. BULL. 284, amending U. S. Treas. Reg. 80, Art. 25.

[50]Bailey v. United States, 27 F. Supp. 617 (Ct. Cl., May 29, 1939), 30 F. Supp. 184 (Ct. Cl., December 4, 1939), 31 F. Supp. 778 (Ct. Cl., March 4, 1940).

[51]Revenue Act of 1942, § 404(a), amending INT. REV. CODE § 811(g). Revenue Act of 1942, § 404(c).

own funds the premium on a policy of which he is the absolute owner, what will be the rule if the beneficiary's property and income include something which he once received from his father, the insured? Might not the Bureau of Internal Revenue argue that if the beneficiary used money which had ever come from the insured—in trust, outright, or in any other manner—the insured was making indirect payment? Such a case would have in it more than meets the eye; but it must always be remembered that an administrative policy is not invariably published in the newspaper, often coming to light only in the course of a controversy.

The date January 10, 1941, is the date of the issuance of Treasury Decision 5032,[52] the effect of which was that even if the insured had paid the premiums before January 10th, but not afterwards, his estate would still not be taxed if he had disposed of ownership before that date. It would be taxed, however, if he owned the policy on January 10th but gave it away subsequently. Without any enabling change of the statute, all that happened on that date was that an administrative officer announced that the rules had been changed by him, and it seemed that a serious question existed as to his authority to make the change. Now, however, the change has been incorporated into the statute and I take it that, under general rules of construction, the legislative adoption of the administrative rule may be considered as a ratification of the Commissioner's action. There still remains, though, the question of constitutionality which will no doubt eventually lead to litigation. When the provision was under consideration, prior to the enactment of the Revenue Act of 1942, the opposition of the American Bar Association was expressed in the hearings of the House Committee on Ways and Means,[53] through the chairman of the Federal Estate and Gift Tax Committee, a committee of the Association's Taxation Section. Mr. Kilpatrick, the witness, stated the Association's opinion that the contemplated action would be unconstitutional. That last is an unfashionable word nowadays, it is true, but perhaps it survives in this case.

TRANSFER OF LIFE INSURANCE

Where new life insurance is involved, it is relatively easy to plan its acquisition and its disposition in such manner as to take advantage of available factors of favorable tax treatment, but difficulties are multiplied when we are dealing with insurance already in force under arrangements which

[52]T. D. 5032, 1941-1 CUM. BULL. 427.
[53]*Hearings before Committee on Ways and Means, on Revenue Revision*, 77th Cong., 2d. Sess. (1942) 191.

call for change. New plans which affect old insurance frequently call for transfer of policies, and the form of and consideration for the transfer may prove to be important from the standpoint of both estate tax and income tax; gift tax, too, perhaps. This must be appreciated in advance, because if the question arises as a practical problem it will be only when income has already been realized or an estate tax or gift tax liability already incurred.

One of the favorite and widely used methods of transferring the benefits of life insurance is by change of the beneficiary. If the right to payment when payment becomes due were the only right conferred by the policy, the change of beneficiary form might be universally effective; but tbat is not true. Other benefits are conferred and it is important that, whatever the method used, they be given due consideration in advance. I have more than once had as a subject of controversy in a tax case the proceeds of life insurance which had been transferred, and have wished that I might have had a hand in the matter at the time the form was chosen.

If prior to January 10, 1941, a policy was transferred by an irrevocable change of beneficiary, and if the beneficiary ever since the transfer has paid the premiums with his own funds, no payment of premiums by the insured could, under the latest rule, be seized upon as grounds for the taxation of the proceeds in his estate in the event of his death. But an examination of the policy may show that it includes, as many policies do, an agreement that the insured—not the current owner, but the insured—could at any time prior to his death borrow on the security of the policy. This right would not be transferred specifically to the new owner by a change of beneficiary form. The right to borrow on the policy seems to be a very important legal incident of ownership and if the decedent possessed that right after January 10, 1941, it would seem that a sufficient ground exists for the inclusion of the proceeds in his taxable estate.

An absolute assignment which would embrace all rights would have been a preferable form for use in such a case, but it could not be expected that the issuing insurance company would counsel such action. It is not in the business of giving advice and it assumes no responsibility for the tax effects which may result from one arrangement or another. Its business is to insure my life and to see that upon my death the proceeds of the policy are disposed of in accordance with the contract terms to which it is a party. For its purpose a change of beneficiary form is sufficient, and if any other method of transfer is to be selected it is the duty of the planning agent to see to the proper form.

Consideration, too, is important. If the transfer be without consideration there may be a gift tax; if there is a consideration, the result may be an income tax liability; and the choice between the two is not always obvious. There are circumstances which would make advisable the deliberate transfer of insurance in such fashion as to make the proceeds subject to income tax if the insured should die. If he continues to live for a few years the advantages which flow from the transfer may far outweigh any possible income tax which may become due in the future.

MULTIPLE TAXATION

The subject of foreign taxes is of especial importance to residents of the border states, many of the people with whom they daily transact business having interests of varying nature in property which may either be physically located across the frontier, or have a tax situs there which puts it within the power of taxing authorities in Canada to sit in on its transfer when the owner dies. So far as a resident of New York and his property are concerned, there is little difference between a foreign state such as Utah, and a foreign nation such as Canada. The problems of estate taxation differ only in detail and in degree in the two cases.

In earlier days the subject did not have the importance that it has today: first, because the Canadian dominion government did not have a federal estate tax law, which it has today;[54] second, because the State of New York had arrangements of reciprocity with Ontario[55] and allowable credits for taxes paid to other states[56] which no longer exist; third, because of rules which protected the residents of one of our states from taxation of intangibles by other states;[57] and, finally, because the rates of tax levied by our own Federal Government were not so high as to make the problem a serious matter of ability to finance taxes, as is the case now.

(1) *Real Estate:* Neither the United States nor the State of New York lays any tax upon the estate of a resident here because of the ownership of real property abroad.[58] Accordingly, the ownership by a New York resident of real estate in Canada will not result in its being taxed on both sides of the border. Nor will the ownership of a business block in Pennsylvania result in conflicting or duplicated claims by the two states. Either may,

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[54]The Dominion Succession Duty Act, 1941, 4-5 George VI, c. 14.

[55]Reciprocity became effective March 16, 1929, pursuant to Ontario Succession Duty Act § 10(3). Repealed April 4, 1934.

[56]N. Y. Laws 1940, c. 138, effective March 10, 1940.

[57]Farmers Loan & Trust Co. v. Minnesota, 280 U. S. 204, 50 Sup. Ct. 98 (1929); Baldwin v. Missouri, 281 U. S. 586, 50 Sup. Ct. 436 (1929); First National Bank of Boston v. Maine, 284 U. S. 312, 52 Sup. Ct. 174 (1931).

[58]United States: INT. REV. CODE § 811. New York: N. Y. TAX LAW § 249(r).

however, call for consent to the transfer;[59] and this in turn may call for a report to foreign authorities not only as to the ownership of the real estate itself, but as to all other property owned by the decedent. Such a report may bring up for review the decedent's entire estate and raise the question whether any other property, not situate within the foreign jurisdiction, may be taxed there. Further, in some cases taxes are not levied on the value of the foreign property alone but are computed on the whole estate, including the property owned here, and then reduced to a proportion based upon the foreign values.

The remedy, of course, is to have title so vested as not to require such a report. If I have a large estate, and my wife a small one, better that the title be vested in her. True, if she predeceases me the question will come up sooner, but the tax burden will not be as large nor will the examination be as expensive as it would be if my estate were the one being examined. Perhaps one of the children would be a still better candidate for the holding of title. And if I want assurance of occupancy, I could take a lease without danger.

(2) *Stocks:* Greater general interest in Canadian taxes attaches to the holding of intangible property, particularly in the form of corporate stocks, because of the volume of property represented here by shares of Canadian corporations. In the absence of special arrangements by the corporations, the shares cannot be transferred of record without Canadian tax waivers[60] and the tax which is a condition of the waivers is a complete loss, no credit being allowed for it on this side.[61]

The remedy: If a nonresident estate owns Canadian securities registered in the name of the decedent, and if the securities can be fully transferred outside Canada and without the assistance of the dominion or provincial authorities, there is nothing for either of them to tax. Accordingly, it is important to inquire whether a Canadian corporation has a transfer agent here and important, too, to inquire whether the transfer agent will act without reference to Canada—both being necessary elements in any feeling of assurance. Although they seem to be well protected in acting independently by a line of decided cases, of which the more important are the *MacFarlane*[62]

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[59]The tax being a lien, the question arises as a practical matter of conveying a clear title.

[60]Dominion Succession Duty Act, § 49(1). Ontario Succession Duty Act of 1939, § 8(1).

[61]United States: INT. REV. CODE §§ 812(b), 813(b). New York: N. Y. Laws 1940, c. 138.

[62]*Re* MacFarlane, [1933] O. R. 44.

and *Williams*[63] decisions, some transfer agents in this country, out of what may seem to be an excess of caution, decline to take the responsibility of making record transfer without waivers from both the provincial and dominion governments. So long as the proper conditions of ownership and situs of the property exist, this does not entail taxation, but it does lead to the necessity of a report to and examination of the estate by the Canadian authorities. It should be realized also that the granting or the withholding of a waiver is a matter of administrative policy, and that administrative policies are subject to change.

Now, suppose that there is no transfer agent here, or that the transfer agent's policy is one that will lead to Canadian tax, or Canadian examination. In that case, record ownership should be such that no transfer from the decedent's name is necessary. Several different methods have been used to accomplish this result:

1. The record ownership by a holding corporation, as in the Oakes estate.[64] If the holding corporation itself cannot be reached, this is an effective method.

2. The holding of title in "street name." If stock is registered in the name of a stock exchange firm, no record transfer involving the decedent is necessary. Thus a substantial foreign tax may be rendered unnecessary at the cost of a few pennies involved in the street-name transfer.

3. The family partnership is another useful method, where the street name is not available or not desirable. For income tax purposes the partnership may be wholly ineffective; and recent decisions by our federal Bureau of Internal Revenue[65] and by the New York State Tax Commission,[66] backed up by decisions in litigated cases,[67] have rendered the arrangement much less popular than it was a few years ago. It is still useful, however, in the matter of estate taxes. In effect, it makes available a street-name registration where it would not otherwise be possible.

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[63]Williams v. The King, [1941] 1 D. L. R. 22.

[64]Canadian securities owned by Sir Harry Oakes had been transferred to a holding corporation, the stock of which was held by him.

[65]Although partnerships between husband and wife are permissible under New York law, and so recognized by the Commissioner of Internal Revenue (See G. C. M. 5761, VIII-I CUM. BULL. 109), special scrutiny is given to such cases because of the relationship of the parties, particularly in the absence of capital contributions and the absence of services by one or more of the partners. See cases cited *infra* note 68.

[66]See cases cited *infra* note 68.

[67]Robert S. Eaton, 37 B. T. A. 283 (1938), *aff'd* 100 F. (2d) 1013 (C. C. A. 2d, 1939), *cert. denied* 307 U. S. 636, 59 Sup. Ct. 1032 (1939). Harry C. Fisher, 29 B. T. A. 1041 (1934), *aff'd* 74 F. (2d) 1014 (C. C. A. 2d, 1935). Meehan v. Valentine, 145 U. S. 611, 12 Sup. Ct. 972 (1891). B. A. Schroder, B. T. A. Memo, June 23, 1942, *aff'd sub nom.* 134 F. (2d) 346 (C. C. A. 5th, 1943). Eaton v. State Board of Tax Commissioners, 261 App. Div. 468, 26 N. Y. Supp. (2d) 886 (3rd Dep't, 1941).

(3) *Bonds:* The Canadian authorities look somewhat differently upon bonds, notes and other evidences of debt issued by Canadian corporations. If the bond or note is a specialty—if it bears the corporation's seal, in other words—it is not taxable.[68] If no seal is present, it is regarded as a taxable item.[69] This, it should again be stated, is present administrative policy and is subject to modification.

(4) *Gifts:* One other point before we leave the subject of Canadian taxes. If a tax is due, the subject of gifts is raised, and in the past the Canadian authorities have gone back over a period as long as thirty years, to tax a gift made by the decedent during his life.

What has been said concerning Canada applies also to the several states of this country, all of which have constitutional power to levy taxes on the estates of nonresidents because of the ownership of intangible property having a tax situs which extends across state borders. This has been the subject of a great deal of litigation over a period of forty-odd years,[70] and there have been three distinct trends of judicial decisions on the problem.

The Judicial Trend

This matter of trends has an importance which can hardly be exaggerated, because the actions we take today will not in the nature of things be reviewed until at least a few years from now, and the trends now becoming evident may by that time have become settled in the form of definite rules by which taxation on the one hand, or tax exemption on the other, will be determined.

If we look up the authorities on a given point, we of course like to find a definite answer, and like to find one that is supported on all four of its corners by decisions of the Supreme Court of the United States, the only court in the land from which there is no appeal. But courts change, too, and within very recent history the Supreme Court has undergone changes. In a number of directions the view of the minority has become the view of the majority. In a number of directions the present court has been re-examining, frowning upon, and in some cases discarding, decisions which we had thought possessed the sanctity almost of antiquity. By all means, then, find, if you can, authority for your position in the decisions; but remember, after you have found it, that it became crystallized through the spinning and the run-

[68]Williams v. The King, [1941] 1 D. L. R. 22.

[69]Specialties are granted no special exemption as such under Canadian law, but whether or not a debt is a specialty will determine its situs for purposes of taxation.

[70]Since 1903, wben Blackstone v. Miller (*infra* note 72) was decided by the Supreme Court of the United States.

ning out of a trend, and realize that if there is now a trend forming in the other direction there may be a different rule awaiting us at the completion of the next cycle.

Forty-two years ago the Supreme Court laid down a principle of estate taxation which stood for twenty-seven years. It decided that there was no constitutional bar to the taxation of intangible property by more than one state.[71] That decision seemed to settle the question, and for a long time it did in fact remain settled, but I recall a case[72] in 1930 involving a similar problem in a claim against the State of Iowa for the recovery of a substantial amount of money paid to that state as an inheritance tax on the transfer of notes owned by a deceased resident of New York, which were secured by mortgages on real estate located in Iowa. The Iowa statute beyond question taxed such debts of its citizens, even though they were owned by nonresidents, and the state's authority to tax them was supported by the decision in *Blackstone* v. *Miller*. A great many cases, however, had gone into and out of the courts since 1903, all based upon the continued complaint of citizens against intangibles being taxed in more than one jurisdiction, and there seemed to be a trend in the law toward giving to a promissory note the character of tangible rather than intangible property, toward making the debt inseparable from the paper which declared and constituted it. This trend had reached the point where cases, even though still against the taxpayer, were being decided by divided courts.[73] A suit was brought against the State of Iowa in the federal courts. The tax was recovered because, while that case was on the way up, the Supreme Court handed down another opinion in which it stated:

> *Blackstone* v. *Miller* no longer can be regarded as a correct exposition of existing law; and to prevent misunderstanding it is definitely overruled.[74]

With *Blackstone* v. *Miller* removed as authority, the Court held that the State of Minnesota could not tax Minnesota bonds owned by a nonresident decedent. Similarly, Iowa could not tax Iowa mortgages. This rule reversed completely the one set in 1903, and was followed by a number of cases, including two

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[71] Blackstone v. Miller, 188 U. S. 189, 23 Sup. Ct. 277 (1903).

[72] Estate of Archibald C. Smith, v. State of Iowa, 209 Iowa 655, 228 N. W. 638 (1930), decided January 21, 1930, on authority of Farmers Loan & Trust Co. v. Minnesota, 280 U. S. 204, 50 Sup. Ct. 98 (1929).

[73] Buck v. Beach, 206 U. S. 392, 27 Sup. Ct. 712 (1906); Wheeler v. Sohmer, 233 U. S. 438, 34 Sup. Ct. 607 (1913); Frick v. Pennsylvania, 268 U. S. 473, 45 Sup. Ct. 603 (1924).

[74] Farmers Loan & Trust Co. v. Minnesota, 280 U. S. 204, 50 Sup. Ct. 98 (1929).

important ones in the Supreme Court.[75]

But the second trend has now again been reversed. After standing for twelve years, those decisions which overturned the *Blackstone* case were in their own turn abandoned as authority, and *Blackstone* v. *Miller* was reinstated in 1942 in the case of the Harkness estate, the Supreme Court deciding that the State of Utah could constitutionally tax $1,000,000 worth of stock of the Union Pacific Railroad, although the stock was owned by a resident of New York and had always been physically located in New York City.[76]

The opinion in the Utah case was written by Mr. Justice Douglas, and a strong dissenting opinion was written by Mr. Justice Jackson, with Mr. Justice Roberts concurring in the dissent. Justice Jackson pointed out that, although only stock was involved in the case before the Court, the principle announced would reach other forms of intangible personal property, including corporate bonds and bonds of states and municipalities.[77] In fact, he visualized the possibility that even the Supreme Court's decisions as to tangible property might be overhauled, there being little restraint in the present trend of decisions.

All of this has a most unsettling effect. Naturally, the courts below consider themselves bound to follow the Supreme Court; but when they have done so, they find later that they should not have done so, and that they were wrong when they did. The resulting confusion has reached the point where two justices of the Supreme Court recently, in a dissenting opinion,[78] expressed the opinion that the tendency to disregard precedents is causing the law to become not a chart to govern conduct, but a game of chance. These two justices were Roberts and Frankfurter. Mr. Justice Frankfurter is the same one who, only two years before, wrote the prevailing opinion in the *Hallock* case[79] and thereby nullified more than fifty decisions, some of

[75]Baldwin v. Missouri, 281 U. S. 586, 50 Sup. Ct. 436 (1930); First National Bank of Boston v. Maine, 284 U. S. 312; 52 Sup. Ct. 174 (1932).

[76]State Tax Commission of Utah v. Aldrich, 316 U. S. 174, 62 Sup. Ct. 1008 (1942).

[77]"Certain it is that while only corporate stock is expressly mentioned in the opinion or involved in the judgment today, the fiction of benefits and protection is capable of as ready adaptability to other intangible property. Our tomorrows will witness an extension of the taxing power of the chartering or issuing state to corporate bonds and bonds of states and municipalities . . . .", Utah v. Aldrich, 316 U. S. 174, 200, 62 Sup. Ct. 1008, 1021 (1942).

[78]From the dissenting opinion by Mr. Justice Roberts: "In the present case, the court below naturally felt bound to follow and apply the law as clearly announced by this court. If litigants and lower federal courts are not to do so, the law becomes not a chart to govern conduct but a game of chance; instead of settling rights and liabilities it unsettles them." Mahnick v. Southern Steamship Co., 321 U. S. 96, 112, 64 Sup. Ct. 455, — (1944).

[79]Helvering v. Hallock, 309 U. S. 106, 60 Sup. Ct. 444 (1939).

which had stood for a decade, in order to change a rule of statutory construction. Mr. Justice Roberts at that time disagreed with him,[80] and now we find the two aligned on the side of precedent. As was said a while ago, there is more to it than meets the eye.

PLANNING

Estate planning has no doubt become much more difficult in modern times, but its very difficulty has caused it to become correspondingly more important. At the same time, progressive reductions in exemptions have made it important to a great many more people. Those whose financial dimensions would put them beyond the need of concern if exemptions are $100,000 plus insurance[81] have a very live interest in the matter when exemptions get down to $60,000 including insurance.[82]

There is no such thing as a standard plan, any more than there is a standard suit of clothes, for each plan must be so designed as to fit the needs of a particular situation. All that can be accomplished is to make the planning as nearly scientific as possible; and if a tax-exempt arrangement is the aim, this means that there should be eliminated from the arrangement as many as possible of the elements which have led to controversy in the past. With a thougbt to history, and an eye to legislative and judicial trends and the visions of things to come which they cause to appear from time to time on the horizon, we should plan as well as we can for the best, be prepared for the worst, and expect that the right answer will lie somewhere between the two.

[80]See Mr. Justice Roberts dissenting, with Mr. Justice McReynolds joining, in Helvering v. Hallock, 309 U. S. 106, 60 Sup. Ct. 444 (1939).
[81]See Revenue Act of 1926 § 303 (a) (4).
[82]See Revenue Act of 1942 §§ 404(a), 414(a).