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### Inheritance Taxation--Transfers in Contemplation of Death-- Constitutional Law

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## TAX COMMENT

Editor—THEODORE S. WECKER.

INHERITANCE TAXATION—TRANSFERS IN CONTEMPLATION OF DEATH—CONSTITUTIONAL LAW.—“In matters of taxation, the problem of the government has always been to compel the gracious yielding of the unwilling taxpayer to its sovereign power.”<sup>1</sup> It is not startling, therefore, that inheritance and death transfer tax statutes have met with much circumvention and interposition in the form of the practice of disposing of property by gifts *inter vivos*. The Revenue Acts of 1916,<sup>2a</sup> 1918,<sup>2b</sup> 1921,<sup>2c</sup> and 1924<sup>2d</sup> included sections the dominant purpose of which was to reach substitutes for testamentary dispositions and thus to prevent the evasion of the estate tax.<sup>3</sup> The method adopted by these sections proved ineffective in its practical administration with a great loss to the government in consequence,<sup>4</sup> and section 302 (c),<sup>5</sup> accordingly, was adopted. The most recent expression of the Supreme Court, in *Heiner v. Donnan*,<sup>6</sup> however, declared the second sentence of this section unconstitutional.<sup>7</sup>

In this case, the facts were as follows: One Donnan died within two years after transferring by complete and irrevocable gift *inter vivos* certain securities to trustees for his four children, and after advancing a sum of money to his son. Both transactions were without consideration. The Commissioner of Internal Revenue included

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<sup>1</sup> Harrow, *Summary Procedure Against Transferees Under the Revenue Acts of 1926 and 1928* (1930) 5 ST. JOHN'S L. REV. 11, 11.

<sup>2a</sup> REV. ACT OF 1916 §202 (b), c. 463, 39 STAT. 756, 778.

<sup>2b</sup> REV. ACT OF 1918 §402 (c), c. 18, 40 STAT. 1057, 1097.

<sup>2c</sup> REV. ACT OF 1921 §402 (c), c. 136, 42 STAT. 227, 278.

<sup>2d</sup> REV. ACT OF 1924 §302 (c), c. 234, 43 STAT. 353, 304 (26 U. S. C. A. §1094, note).

<sup>3</sup> See *U. S. v. Wells*, 283 U. S. 102, 116, 117, 51 Sup. Ct. 446, 451 (1930), citing *Nichols v. Coolidge*, 274 U. S. 531, 47 Sup. Ct. 710 (1926) and *Milliken v. U. S.*, 283 U. S. 15, 51 Sup. Ct. 324 (1930).

<sup>4</sup> Justice Stone, in his dissenting opinion in *Heiner v. Donnan*, — U. S. —, 52 Sup. Ct. 358, 363, at 367, 368 (1932), compiled the following statistics: “102 cases, decision of which was determined by the answer to the question of fact, whether a gift had been made in contemplation of death have arisen; in 20 cases involving gifts of approximately \$4,500,000 the government was successful; in 78 involving gifts largely in excess of \$120,000,000, it was unsuccessful; in another the jury disagreed.” See also HOUSE REP. No. 1, 69th Cong. 1st Sess. at 15.

<sup>5</sup> REV. ACT OF 1926 §302 (c), c. 27, 44 STAT. 9, 70 (26 U. S. C. A. §1094 [c]). This section provides in part as follows: “Sec. 302. 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 \* \* \*.”

“(c) \* \* \* [2d sentence] Where within two years after his death \* \* \* and without such a consideration, the decedent has made a transfer, \* \* \* such transfer shall be deemed and held to have been made in contemplation of death \* \* \*.”

<sup>6</sup> *Heiner v. Donnan*, — U. S. —, 52 Sup. Ct. 358 (1932).

<sup>7</sup> *Supra* note 5.

in the gross estate of decedent the value of the property transferred, imposing a death transfer tax on authority of section 302 (c). Despite the declaration of the second sentence of this section that "such transfers shall be deemed and held to have been made in contemplation of death," the trial Court found as a fact that neither the transfer in trust nor the advancement was made in contemplation of death. Judgment was rendered against the commissioner on the ground the second sentence of Section 302 (c) was unconstitutional, and violative of the due process clause of the Fifth Amendment. The Supreme Court affirmed this decision, Justices Stone and Brandeis dissenting.

This ultimate fate of section 302 (c) was presaged by several antecedent cases. In the lower courts, five decisions declared, in similar situations, the unconstitutionality of this provision.<sup>8</sup> The Kentucky Court of Appeals declared invalid a provision of the Kentucky Statutes, which was parallel in form and purpose with the provision under discussion.<sup>9</sup> The Supreme Court foretold its decision in two of its own opinions, *Schlesinger v. Wisconsin*<sup>10</sup> and *United States v. Wells*.<sup>11</sup>

A Wisconsin statute<sup>12</sup> which provided that all gifts made within six years shall be conclusively presumed to have been made in contemplation of death was the subject of the *Schlesinger* case. The facts in this case were found to be that Schlesinger died testate, leaving a large estate; that within six years he had made four separate gifts aggregating more than five million dollars to his wife and three children; that none of these was really made in view, anticipation, or contemplation of death. The Supreme Court of Wisconsin defended the presumption and consequent taxation on the theory that, exercising judgment and discretion, the legislature found them necessary in order to prevent evasion of inheritance taxes.<sup>13</sup> In an opinion, written by Justice McReynolds, the Supreme Court answered this argument by stating that it was equivalent to declaring that "A may be required to submit to an exactment forbidden by the Constitution if this seems necessary in order to enable the state readily to collect lawful charges against B."<sup>14</sup> As to this, the Court there continued:

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<sup>8</sup> *Donnan v. Heiner*, 48 F. (2d) 1058 (D. C. W. D. Pa. 1931); *Hall v. White*, 48 F. (2d) 1060 (D. C. D. Mass. 1931); *Guinzburg v. Anderson*, 51 F. (2d) 582 (D. C. S. D. N. Y. 1931); *Delaware Trust Co. v. Handy*, 51 F. (2d) 867 (D. C. D. Del. 1931); *Guinzburg v. Anderson*, 54 F. (2d) 629 (C. C. A. 2d, 1931).

<sup>9</sup> *State Tax Comm. v. Robinson's Executor*, 234 Ky. 405, 28 S. W. (2d) 491 (1930). An inheritance tax statute (Ky. STATS. §4281 a-1, subsec. 2), providing that a gift, if made within three years of donor's death, shall be deemed taxable as made in contemplation of death, was declared unconstitutional, the Court stating that to justify an inheritance tax, it must be proved that the gift, whenever made, was actually in contemplation of death.

<sup>10</sup> *Schlesinger v. Wisconsin*, 270 U. S. 230, 46 Sup. Ct. 260 (1925).

<sup>11</sup> *U. S. v. Wells*, 283 U. S. 102, 51 Sup. Ct. 446 (1930).

<sup>12</sup> §1087-1, c. 64ff, WIS. STATS. (1919).

<sup>13</sup> 184 Wis. 1, 199 N. W. 951 (1924).

<sup>14</sup> *Supra* note 10, 270 U. S. at 240, 46 Sup. Ct. at 261.

"Rights guaranteed by the Federal Constitution are not to be so lightly treated; they are superior to this supposed necessity. The state is forbidden to deny due process of the laws for any purpose whatsoever."<sup>15</sup>

"A forbidden tax cannot be enforced in order to facilitate the collection of one properly laid."<sup>16</sup>

The power of Congress or of a state to provide for including in the gross estate of a decedent, for purposes of a death tax, the value of gifts made in contemplation of death, and their power to create a rebuttable presumption in this respect, was not denied in this case. The Court decided against that part of the statute that made the presumption conclusive "without regard to actualities"; that classifying gifts made during a specified period as made in contemplation of death was an arbitrary exertion of a power.

It remained, however, for the *Wells* case<sup>17</sup> to disperse the doubts concerning the true definition of the phrase "in contemplation of death." The Government there agreed that the early decisions<sup>18</sup> construed the words "in contemplation of death" as referring only to gifts *causa mortis*, but claimed that this definition had been abandoned in favor of more liberal constructions, pointing toward a tendency on the part of the legislatures and the Courts to broaden the meaning in order that the tax might be made effective. The Court said, however, that "while the interpretation of the phrase had not been uniform, there has been agreement upon certain fundamental considerations":<sup>19</sup>

1. "It is recognized that the reference is not to the general expectation of death which all entertain. It must be a particular concern giving rise to a *definite motive*."<sup>19a</sup> (*Italics ours.*)

2. "The motive must be of the sort which leads to testamentary disposition."<sup>19b</sup>

3. "It is sufficient if contemplation of death be the inducing cause of the transfer, whether or not death is believed to be near."<sup>19c</sup>

4. "The statute does not embrace gifts *inter vivos* which spring from different motives. Such transfers were made the subject of a distinct gift tax, since repealed."<sup>19d</sup>

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> *Supra* note 11.

<sup>18</sup> See cases collected in 7 A. L. R. 1028, 21 A. L. R. 1335.

<sup>19</sup> *Supra* note 11, 283 U. S. at 115, 51 Sup. Ct. at 451.

<sup>19a</sup> *Ibid.* 283 U. S. at 115, 51 Sup. Ct. at 451.

<sup>19b</sup> *Ibid.* 283 U. S. at 117, 51 Sup. Ct. at 451.

<sup>19c</sup> *Ibid.* 283 U. S. at 119, 51 Sup. Ct. at 452.

<sup>19d</sup> *Ibid.* 283 U. S. at 118, 51 Sup. Ct. at 452.

5. "The provision is not confined to gifts *causa mortis*."<sup>19e</sup>

6. Whether the motive is present should be determined from the surrounding circumstances, the "bodily and mental condition" of the donor at the time of the transfer, the period between the transfer and death, etc.<sup>19f</sup>

The *Wells* case dealt with a rebuttable presumption,<sup>20</sup> but *Heimer v. Donnan* involved a conclusive presumption. One of the issues which split the Supreme Court in *Heimer v. Donnan*<sup>21</sup> was whether the tax was intended as a death transfer tax or a tax in pure gifts *inter vivos*, for if it were the latter, the tax laid might not be unconstitutional. Speaking through Justice Sutherland, the majority said:

"The statute requires that this value shall be determined as of the time of the decedent's death, without regard to the value of the gift when received. The event upon which the tax is made to depend is not the transfer of the gift, but the transfer of the estate of the decedent. The tax falls upon the estate and not upon the gift, and is computed not upon the value of the gift, but by progressively graduated percentages, upon the value of the entire estate. It is \* \* \* apparent \* \* \* that Congress could not have had, even remotely, in mind the imposition of a gift tax."<sup>22</sup>

This the minority, in an opinion delivered by Justice Stone, stoutly denied:

"At the outset it is to be borne in mind that gifts *inter vivos* are not immune from federal taxation."<sup>23</sup>

"\* \* \* the obvious and permissible purpose of the present and related sections" is to tax gifts *inter vivos*.<sup>24</sup>

"\* \* \* It is not imperative that the motive of the donor be made the exclusive basis of the selection of these gifts for taxation."<sup>25</sup>

"The gifts taxed may, in some instances, \* \* \* bear no relation whatever to death, except that all are near death."<sup>26</sup>

It is submitted, however, that the evolution of the present statute, the transformation of a *prima facie* presumption into a conclusive pre-

<sup>19e</sup> *Ibid.* 283 U. S. at 115, 51 Sup. Ct. at 451.

<sup>19f</sup> *Ibid.* 283 U. S. at 117, 51 Sup. Ct. at 451.

<sup>20</sup> *Supra* note 2 (d).

<sup>21</sup> *Supra* note 6.

<sup>22</sup> *Ibid.* 52 Sup. Ct. at 362, 363.

<sup>23</sup> *Ibid.* 52 Sup. Ct. at 364.

<sup>24</sup> *Ibid.* 52 Sup. Ct. at 365.

<sup>25</sup> *Ibid.* 52 Sup. Ct. at 366.

<sup>26</sup> *Ibid.* 52 Sup. Ct. at 366.

sumption, tends to indicate that the taxing intention has retained its identity, and since pure gifts *inter vivos* were not included in the early history of the statute<sup>27</sup> it is more logical to argue that they are not now included in section 302 (c).

The majority opinion goes even further, asserting that even "if construed as imposing a gift tax, it is in that respect still so arbitrary as to cause it to fall within the ban of the due process clause \* \* \*,"<sup>28</sup> citing as the basis of its conclusion *Schlesinger v. Wisconsin*.<sup>29</sup> The latter case adopted the view of the Supreme Court of Wisconsin,<sup>30</sup> stating:

"The court below declared that a tax on gifts *inter vivos* only could not be so laid as to hit those made within six years of the donor's death and exempt all others—this would be 'wholly arbitrary.' We agree with this view \* \* \*."<sup>31</sup>

The minority, however, points out the question involved in *Heiner v. Donnan*<sup>32</sup> was not involved in the *Schlesinger* case, distinguishing between the two cases:

"There, all gifts made within six years of death were taxed. Here, only those within the statute. There, the tax was a successive tax, and so was a burden on right to receive, *Leach v. Nichols*, 286 U. S. —, 52 Sup. Ct. 338 (1932), and necessarily payable by the donee, but at rates and valuations prevailing at the time of the donor's death. Here the tax was upon the transfer effected by the donor's gift after the enactment of the statute, and is payable from the donor's estate at the same rates and values as though it had passed at his death."<sup>33</sup>

The minority opinion, further, points toward many decisions in which similar taxation of gifts made *inter vivos* was sustained.<sup>34</sup> Further,

<sup>27</sup> *Supra* note 2.

<sup>28</sup> *Supra* note 6, 52 Sup. Ct. at 362.

<sup>29</sup> *Supra* note 10.

<sup>30</sup> Estate of Schlesinger, 184 Wis. 1, 199 N. W. 951 (1924).

<sup>31</sup> *Supra* note 10, 270 U. S. at 239, 46 Sup. Ct. at 261.

<sup>32</sup> *Supra* note 6.

<sup>33</sup> *Ibid.* 52 Sup. Ct. 365.

<sup>34</sup> *Bromley v. McCaughn*, 280 U. S. 124, 50 Sup. Ct. 46 (1929) (a statute taxing all gifts *inter vivos* at the same rates and with the same exemptions as in the case of testamentary transfers was upheld); *Tyler v. U. S.*, 281 U. S. 497, 50 Sup. Ct. 356 (1929) (the Supreme Court upheld taxation, as a part of the donor's estate, of another selected class of gifts *inter vivos* estates by the entirety donated by one spouse for the benefit of both, although the gift was not testamentary, and neither title, possession, nor enjoyment passed at death); *Milliken v. U. S.*, 283 U. S. 15, 51 Sup. Ct. 324 (1930) (a selected class of gifts *inter vivos*, which were not testamentary, although made in contemplation of death, were so taxed as a part of the donor's estate). Similar taxation of gifts made *inter vivos*, but finally effective only at death, was sustained in *Reinecke*

in the *Schlesinger* case, "the classification of gifts was deemed to be arbitrary under the Fourteenth Amendment \* \* \*". Here we are concerned only with the Fifth Amendment."<sup>35</sup>

The true basis for the minority opinion, however, was "the difficulty of searching the motives and purposes of one who is dead, the proofs of which, so far as they survive, are in the control of his personal representative \* \* \*,"<sup>36</sup> and the tremendous loss in revenue because of this difficulty, for which Justice Stone elaborately and profusely gives statistics.<sup>37</sup>

It is respectfully submitted that the majority opinion is correct in its position that a death transfer tax was intended by section 302 (c) and it was therefore unconstitutional, but that the minority is on entirely sound ground in its declaration that a tax on pure gifts *inter vivos*, if enacted to remedy a serious situation, would be entirely valid. The true solution to the problem is more likely to be in a revision of section 302 (c), clearly expressing that a tax on pure gifts *inter vivos* is intended, rather than in a return to its forerunners, in view of the proven inutility of the latter.<sup>38</sup>

THEODORE S. WECKER.

STATE TAXATION OF FEDERAL INSTRUMENTALITIES—FEDERAL TAXATION OF STATE INSTRUMENTALITIES.—In *McCulloch v. Maryland*, the Supreme Court declared that the constitutionally granted powers of the federal government were not subject to regulation or control by the states through the exercise of their taxing powers.<sup>1</sup>

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v. Northern Trust Co., 278 U. S. 339, 49 Sup. Ct. 123 (1928); Chase National Bank v. U. S., 278 U. S. 327, 49 Sup. Ct. 126 (1928); see Taft v. Bowers, 278 U. S. 470, 49 Sup. Ct. 199 (1928).

It is submitted that a ruling of the Supreme Court in the future to the effect that a tax is invalid if intended to embrace gifts *inter vivos* would involve overruling the above cases.

<sup>35</sup> *Supra* note 6, 52 Sup. Ct. at 365.

<sup>36</sup> *Ibid.* 52 Sup. Ct. at 367.

<sup>37</sup> *Ibid.* 52 Sup. Ct. at 367, 368.

<sup>38</sup> *Supra* note 4. Section 302 (c) has been amended by the REV. ACT OF 1932, tit. VI, §803. In part, this section reads as follows:

"Sec. 803 (a) (Section 302 (c) \* \* \* is amended to read as follows:

"(c) \* \* \* any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, *unless shown to the contrary*, be deemed to have been made in contemplation of death \* \* \*." (Italics ours.)

<sup>1</sup> 17 U. S. 316 (1819). See also *Osborn v. Bank of U. S.*, 22 U. S. 738 (1824); *Weston v. Charleston*, 27 U. S. 449 (1829); *Dennis v. First National Bank of Great Falls*, 55 Mont. 448, 178 Pac. 580 (1919); *Chase National Bank of New York v. Spokane County*, 125 Wash. 1, 215 Pac. 374 (1923). See also Powell, *Indirect Encroachment on Federal Authority by the Taxing Power of the States* (1919) 31 COL. L. REV. 321.