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Minnesota Inheritance Tax: Some Problems and Solutions

The author analyzes the Minnesota inheritance tax provisions applicable to four types of "transfers": insurance transfers, powers of appointment, transfers taking effect at death and annuities and employee death benefits. After construing the relevant case law and comparing the applicable federal estate tax provisions, he develops suggestions for legislative reappraisal and revision of the Minnesota provisions.

David R. Brink*

THIS article will consist of two main phases. In the first it will analyze Minnesota inheritance tax law pertaining to four commonly encountered types of death transfer of property. These four types, hereinafter discussed separately, are Insurance, Powers of Appointment, Transfers Taking Effect at Death, and Annuities and Employee Death Benefits.

In each of these four tax situations, the governing section of the inheritance tax statutes emphasizes that the tax is primarily one imposed on a "transfer."¹ From this premise the Minnesota Supreme Court has drawn a distinction between an *estate* tax levied upon the transmission of property by a decedent and an *inheritance* tax levied upon the succession to property by a transferee.²

Mere recognition of the basic concept that the inheritance tax is a succession tax on *transfers* rather than an estate tax does not of itself provide an answer to the question of taxability posed by a given inheritance tax situation.³ In fact, a transfer consists of a number of parts. There must be an act of transfer from a transferor relating to a property interest and also an act of receipt of or succes-

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1. "A tax . . . is hereby imposed upon any transfer of property, . . . or any interest therein, . . . to any person. . . ." MINN. STAT. § 291.01(1) (1957). The transfers described are transfers of property subject to probate administration, transfers in contemplation of death or intended to take effect at or after death. In subsequent subdivisions of § 291.01, power of appointment property, joint tenancy property and life insurance are separately characterized as being the subjects of taxable transfers. Annuities are usually deemed taxable, if at all, as transfers taking effect at death.

2. *Chase v. Commissioner of Taxation*, 226 Minn. 521, 33 N.W.2d 706 (1948); *In re Estate of Rising*, 186 Minn. 56, 242 N.W. 459 (1932).

3. Witness the conflicts among the courts of different inheritance tax states over the specific topics hereinafter discussed.

sion to the transferred property by the transferee. Where one of these parts is recognized as the sole criterion of taxability, the result will be strikingly different from the result where another part is so recognized.

In general, courts applying inheritance tax statutes have tended either to emphasize the decedent's possession of interests in the property transferred on the one hand, or the transferee's receipt of the property on the other. In the former type of case, which is referred to herein as an "ownership theory" case, property passing to a transferee at the decedent's death will escape tax if the decedent had no interest in it at his death.⁴ In the latter type of case, which is herein called a "succession theory" case, property may be subject to tax if received by a transferee at the decedent's death, even though the decedent then had no interest in or control over the property.⁵ A spectrum of positions intermediate to the two extremes is possible depending upon the weight given to the particular factors composing each of the main types of transfer.

In Minnesota, it has been suggested judicially that the inheritance tax law imposes both a *transfer* tax (using that term as meaning a tax on transmission of ownership of property from the decedent) and a *succession* tax.⁶ However, an analysis of the law pertaining to each of the types of transfer herein discussed tends to reveal that Minnesota law has developed in the past along lines which can best be characterized as embodying extreme succession theory. Under each of the topics discussed below, the thesis is offered that a less severe application of succession theory would be more in accord with other state authorities, more fair and workable, and more in harmony with federal law. There are signs, in the shape of an important recent decision of the Minnesota Supreme Court,⁷ that a turn to less severe applications of the succession theory is already in the making in Minnesota.

Unfortunately, however, the process of lawmaking by decision comes slowly and painfully in this field. Inheritance taxes on prop-

4. As examples of ownership theory, see *People v. Northern Trust Co.*, 330 Ill. 238, 161 N.E. 525 (1928); *Wachovia Bank & Trust Co. v. Maxwell*, 221 N.C. 528, 20 S.E.2d 840 (1942); *In re Heine's Estate*, 100 N.E.2d 545 (Ohio P. Ct. 1950); *cf. In re Estate of Marshall*, 179 Minn. 233, 228 N.W. 920 (1930).

5. As examples of succession theory, see *Estate of Madison*, 26 Cal. 2d 453, 159 P.2d 630 (1945); *Chase v. Commissioner of Taxation*, 226 Minn. 521, 33 N.W.2d 706 (1948); *In re Hollander*, 123 N.J. Eq. 52, 195 Atl. 805 (Prer. 1938); *cf. DeCoster v. Commissioner of Taxation*, 216 Minn. 1, 11 N.W.2d 489 (1943); *In re Estate of Robinson*, 192 Minn. 39, 255 N.W. 486 (1934).

6. *In re Estate of Rising*, 186 Minn. 56, 242 N.W. 459 (1932); *State v. Brooks*, 181 Minn. 262, 232 N.W. 331 (1930).

7. *Blue Diamond Poultry Farms, Inc. v. Commissioner of Taxation*, 91 N.W.2d 595 (Minn. 1958).

erty not subject to probate administration are determined administratively by the Commissioner in the first instance.⁸ The assessment is usually not made until after final settlement of federal estate tax liability—a process which in itself may take as much as three years following the decedent's death.⁹ By this time the lawyer usually finds that the estate representative, transferee, and family members are clamoring for settlement of the estate. The State Department of Taxation normally concedes little or nothing with respect to arguable issues. A tax order, after frequently extended negotiations, is drawn by the Department and served. In the typical situation, it may impose a tax which is substantial in itself, but appears minor to the client when compared with the federal estate tax burden, the assured cost of further litigation, the necessity of further delays, and the lack of certainty of final outcome. The inheritance tax order is therefore not appealed from and thus die unborn all but a handful of the legal actions which might otherwise lead to more rapid development of our inheritance tax law.

Accordingly, if rapid movement and certainty in the inheritance tax field are to be gained, we must seek them through *legislation*. The 1959 session of the Minnesota Legislature offers an immediate opportunity to extend in the inheritance tax field the substantial revisions of state tax law following the pattern of federal models¹⁰ which were made at the 1957 sessions.

Therefore, the second phase of this article, following the discussion of each inheritance tax problem, will make brief suggestions for curative legislation. Federal models are used to the fullest extent possible, without abandoning the basic approach of the present law.¹¹ The adoption of these suggestions will eliminate many injus-

8. MINN. STAT. § 291.09 (1957). The writer understands that legislation is to be introduced at the 1959 session of the legislature which would provide that the tax on both probate and nonprobate transfers would be determined by the probate court under judicial procedures. Such procedures are already in use in neighboring states.

9. The federal estate tax return is likely to be filed or at least amended (under the procedure now permitted by Treas. Reg. § 20.2032-1(b)2 (1958)) after the lapse of the year following the decedent's death in order to insure proper use of the alternate valuation privilege. INT. REV. CODE OF 1954, § 2032. Present audit practice of federal estate tax returns, in the writer's experience, is such that as much as eighteen months may elapse between the filing of the return and a conference with the examining agent. The presence of unagreed issues, even assuming no higher administrative review or litigation is ultimately needed, will easily account for the balance of the three year period.

10. Minn. Laws 1957, chs. 301, 846, 932 (pertaining to income tax on decedents, estates, trusts and beneficiaries) and other sections substantially enacted the provisions of the 1954 Internal Revenue Code, where applicable, in the income tax sphere.

11. Federal models for such radical proposals as substitution of an estate tax (only) for an inheritance tax, elimination of the probate court-appointed appraiser system of valuing assets, and institution of a marital deduction have been ignored.

tices, pitfalls and inconsistencies between state and federal rules which now bedevil estate planners and practitioners and outrage clients.¹²

I. INHERITANCE TAX ON INSURANCE

The succession theory has been given free rein to date in taxing the proceeds of insurance on the life of Minnesota decedents. Subject to the usual personal exemptions¹³ and to certain insurance exemptions,¹⁴ our inheritance tax statute¹⁵ purports to tax the full proceeds of

all life or accident . . . policies taken out by decedent and payable on account of his death, receivable by named beneficiaries . . . as follows: (a) The proceeds of all such policies hereafter issued¹⁶ payable to named beneficiaries. (b) The proceeds of all such policies now in force¹⁷ payable to named beneficiaries in which the insured has the right to change the beneficiary or under which he has cash surrender right.

As to policies issued after 1949, at any rate, this statute appears broad enough to subject to inheritance tax not only the proceeds of insurance on the decedent's life where he possesses the incidents of ownership and pays the premiums, but also "key man insurance" on which a corporation pays the premiums and in which it owns all rights or insurance owned and paid for by the widow, if it can be assumed in each case that the insurance was "taken out by decedent."¹⁸ The latter type of insurance would not be subject to federal estate tax in the decedent's estate.¹⁹

12. One instance constituting a precedent of successful Minnesota legislation along federal lines is the transfer in contemplation of death. The statute here, MINN. STAT. § 291.01(3) (1957), was harmonized with the latest federal rule in 1955. This statute appears to work well and hence needs no comment in this Article. Two changes in tax laws other than inheritance tax laws which should be made to conform to federal statutes and eliminate traps for the unwary are: (1) authorize the annual exclusion for gifts in approved form to minors per INT. REV. CODE OF 1954, § 2503(c), and (2) make the last date for filing a decedent's final individual income tax return the fifteenth day of the fourth month after the close of his normal taxable year (April 15 in case of decedents filing on the calendar year basis) as under federal law instead of the fifteenth day of the fourth month following the month in which the decedent died as now required by Minn. Income Tax Reg. § 2042(1)a(4) (1957).

13. MINN. STAT. §§ 291.05(5)-(10) (1957).

14. MINN. STAT. § 291.05(4) (1957).

15. MINN. STAT. § 291.01(5) (1957).

16. That is, as to decedents dying under the statute currently in force, issued after April 25, 1949, the date of enactment of Minn. Laws 1949, ch. 735. *Blue Diamond Poultry Farms, Inc. v. Commissioner*, 91 N.W.2d 595 (Minn. 1958).

17. That is, in force on April 26, 1949. *Blue Diamond Poultry Farms, Inc. v. Commissioner*, *supra* note 16. See MINN. STAT. § 645.02 (1957) as to effective date of the 1949 statute.

18. The meaning properly to be ascribed to this phrase is hereinafter discussed at some length. See text discussion at notes 32-41 *infra*.

19. INT. REV. CODE OF 1954, § 2042.

In the absence of a statute specifically taxing insurance payable to named beneficiaries, courts of other states have usually held that the insurance proceeds are received by the beneficiary by virtue of the contract of insurance and not by virtue of the decedent's death; death is simply the event giving rise to maturity of the contract rights.²⁰ In fact, even in states where a statute *expressly* imposes a death duty on the proceeds of insurance payable to named beneficiaries, it has usually been held that the tax does not apply where the decedent possessed no rights in the policies.²¹ Thus the prevailing view has been to adopt the ownership theory when taxing life insurance proceeds, limiting taxability to situations in which the decedent possessed interests in the policy at his death. Whether the Minnesota courts will now hold this section subject to similar limitations remains open to some interesting but, unfortunately, not entirely conclusive speculation.

The Minnesota Supreme Court in 1943 reviewed the immediate predecessor of the present statute taxing insurance in *DeCoster v. Commissioner of Taxation*.²² In *DeCoster*, insurance had been issued upon the life of the decedent in 1936, naming him as beneficiary and granting him all rights of ownership. In 1938, the decedent assigned all rights in the policy to his wife, filing a Minnesota gift tax return for that year in which he reported the transfer of the cash surrender value at the time of transfer. The one premium falling due after the assignment was paid by the decedent, who died in 1939. The Supreme Court *held* the proceeds of the insurance subject to inheritance tax at the decedent's death. The statute taxing insurance,²³ which was effective July 15, 1937, like the present statute provided for taxation of all "policies now [1937] in force payable to named beneficiaries in which the insured has the right to change the beneficiary or under which he has cash surrender right." After finding the statute constitutional as against the contention that its subject was not expressed in its title, the court held that the proceeds were taxable because *on the effective date of the statute* the decedent possessed the rights to change the beneficiary and to surrender

20. *Tyler v. Treasurer*, 226 Mass. 306, 115 N.E. 300 (1917); see *In re Knoedler*, 140 N.Y. 377, 35 N.E. 601 (1893); *In re Voorhee's Estate*, 200 App. Div. 259, 193 N.Y. Supp. 168 (1922); *In re Haldrich's Estate*, 134 Misc. 751, 236 N.Y. Supp. 395 (1929); *Barkley v. South Carolina Tax Comm'n*, 191 S.C. 147, 3 S.E.2d 809 (1939); *In re Killien's Estate*, 178 Wash. 335, 35 P.2d 11 (1934); cf. *In re Estate of Marshall*, 179 Minn. 233, 228 N.W. 920 (1930).

21. *Martin v. Storrs*, 277 Ky. 199, 126 S.W.2d 445 (1939); *Wachovia Bank v. Maxwell*, 221 N.C. 528, 20 S.E.2d 840 (1942); *Werthan v. McCabe*, 164 Tenn. 611, 51 S.W.2d 840 (1932). The *Werthan* case suggests that payment of premiums or possession of the policies by the insured might be factors having some significance.

22. 216 Minn. 1, 11 N.W.2d 489 (1943).

23. Minn. Laws Ex. Sess. 1937, ch. 50 (now as amended MINN. STAT. § 291.01(5) (1957)).

the policy for cash. In so holding, the court dismissed, as of little help, cases where corporations were irrevocable beneficiaries of the insurance, and distinguished *Wachovia Bank v. Maxwell*,²⁴ where the incidents of ownership were in the decedent's wife from the inception of the policy.²⁵

Reduced to its essentials, the *DeCoster* case held that insurance payable to named beneficiaries is taxable at the death of an insured who once owned the policy, even though he has parted with *all* incidents of ownership in it prior to his death. This is one of several examples in Minnesota inheritance tax laws and decisions of the application of extreme succession theory. All emphasis is placed upon *receipt* of property (insurance proceeds) by the alleged transferee at the transferor's death. No emphasis is placed upon the possession of property rights (incidents of ownership in the policy) by the insured at death. Without doubt, a shifting of economic benefits, the key to inheritance taxation,²⁶ has occurred, but when? Under the more common ownership theory noted above, the "transfer" consists of the assignment of the rights with death thereafter marking only maturity of the contract assigned. Under the succession theory apparently the insured's death marks the shift of economic benefits, notwithstanding the intervening assignment. The shift of benefits appears to occur from the owner of the policy at the insured's death rather than from the insured who no longer possesses anything capable of being transferred. Even if succession theory is adopted as fundamentally correct, there would seem some logical objection in that, regarded as of the date of death, the transfer could hardly be one from the insured, since he had parted with his interest at some previous time.

Whatever its purely legal merits may be, this application of succession theory can be questioned as a matter of fairness. A decedent may leave a will making the customary direction to pay all estate and inheritance taxes from his estate. Under *DeCoster*, his estate, at least in the first instance, would pay tax on insurance on his life in which he had no interest at death—a tax perhaps computed at the high rates and low exemption allowed a stranger. To be sure, if another type of tax payment clause is used, the burden of the tax can clearly be shifted to the actual recipient of the proceeds. On the other hand, is it fair that this insurance should be taxed even to the recipient? The recipient under the *DeCoster* rule may well have

24. 221 N.C. 528, 20 S.E.2d 840 (1942).

25. The court notes that, notwithstanding the ownership of the policy by the beneficiary in the *Wachovia Bank* case, the premiums were paid by the insured.

26. See *In re McGrath's Estate*, 191 Wash. 496, 71 P.2d 395 (1937), *cert. denied*, Washington v. McGrath, 303 U.S. 651 (1938); *cf. In re Bradley's Estate*, 241 Minn. 394, 63 N.W. 2d 374 (1954); *State v. Brooks*, 181 Minn. 262, 270, 232 N.W. 331, 334 (1930).

paid value for the policy by paying the premiums as reckoned by actuarially computed premium tables assessing the risk. If so, why should his investment be treated differently from any other investment in a contract or other property? If he receives a death benefit, it is by payment of the normal premium price. Nor is there any benefit to the decedent, his estate, or any beneficiary designated by him. Everything here smacks of purchase and not of inheritance.

However, there are signs that the severe succession theory evidenced by the *DeCoster* case will be modified in the future. After *DeCoster*, the Minnesota Supreme Court had no further opportunity to consider the taxability of insurance in which the decedent had no incidents of ownership until *Blue Diamond Poultry Farms, Inc. v. Commissioner of Taxation*.²⁷ In *Blue Diamond*, at the death of the decedent, a corporation received the proceeds of three policies on his life. All three policies, by initial procurement or by subsequent assignment, were owned by the corporation and it paid all of the premiums. However, one policy was procured with the corporation as original owner, one was procured with the decedent as original owner and the corporation as beneficiary, and one was procured with the decedent as original owner and the decedent's wife as original beneficiary. The corporation's ownership of all three policies was complete in 1947. The decedent died in 1951. Upon certiorari from the Board of Tax Appeals, the Supreme Court reversed the Board's imposition of an inheritance tax on these proceeds. Three interesting situations were presented by the three policies here. However, the court had no occasion to deal with the question of taxability of insurance not owned by the insured at his death because it *held* in effect that a 1949 amendment of the law²⁸ constituted a new law dealing with the taxation of insurance and therefore that the references in the statute, as so amended, to "hereinafter issued" and "now in force" referred to the effective date of the amendment (April 26, 1949) rather than to the effective date of the original law (July 15, 1937).²⁹

Perhaps the most interesting feature of the *Blue Diamond* case is the siren suggestion at least twice made in the opinion that the soundness of the *DeCoster* decision might be reconsidered when the issues again were raised in a proper case.³⁰ Assuming that such a

27. 91 N.W.2d 595 (Minn. 1958).

28. *Ibid.*

29. Prior to *Blue Diamond*, the Commissioner insisted and many taxpayers assumed that the internal references in the present statute continued to relate to July 15, 1937. Therefore, it may be supposed that some claims to refund of inheritance tax will exist in cases where tax has been paid on insurance assigned by the insured or procured by others prior to April 26, 1949, where the decedent's death followed that date and where the right to seek the refund has not been lost by lapse of time.

30. 91 N.W.2d at 597, 598.

case arises, what conclusions might the court reach when reconsidering the issues presented in the *DeCoster* case?

One possibility would be that the court would hold unconstitutional the application of the statute to policies existing at its effective date *prior* to the decedent's death. However, in other states this argument has been rejected. The courts take the view, for constitutional purposes at least, that nothing vests in the beneficiary until the insured's death. Therefore no rights are impaired by the passage of a statute taxing insurance prior to such death.³¹

Another set of possibilities, if *DeCoster* is to be over-turned, arises from the failure of that decision to discuss the meaning of the requirement in the statute that the insurance be "taken out by decedent." Of course, if "taken out by decedent" simply means that the decedent's signature appears on the application for the insurance, then the insurance in *DeCoster* was clearly "taken out" by the decedent.³² However, in distinguishing the *Wachovia Bank* case, the court in *DeCoster* apparently recognized that the mere form of the application and the fact that it was signed by the decedent should not result in taxability.³³ It seems quite clear that making the form of the application or its signature the criterion of taxability would be technical in the extreme. The tax could easily be avoided by insured persons or insurance companies under such a test simply by omitting the requirement of the insured's signature on the application form. No authority for such a rule has been found in state decisions. "Taken out by decedent" evidently means something other than the form of signature of the application. Therefore, the *DeCoster* case will not need to be overruled in this respect.

The words "taken out by decedent" were undoubtedly adopted by our legislature from federal law³⁴ and other state laws. The words as used in the federal statute had a long history of varying administrative and judicial interpretations generally to the effect that the decedent must have possessed one or more "incidents of ownership"

31. *Dumesnil v. Reeves*, 283 Ky. 563, 142 S.W.2d 132 (1940); *State v. Cain*, 162 Tenn. 213, 36 S.W.2d 82 (1931); *In re Allis' Will*, 174 Wis. 527, 184 N.W. 381 (1921). No case has been found analyzing carefully the question whether this argument should apply equally to insurance which has been assigned to the beneficiary; cf. *State v. Brooks*, 181 Minn. 262, 232 N.W. 331 (1930).

32. The writer's personal experience is that in administrative practice the Department of Taxation does contend that signature of the application by the insured is tantamount to the policy's being taken out by the insured.

33. 216 Minn. at 6, 11 N.W.2d at 491.

34. Revenue Act of 1921, ch. 136, § 402, 42 Stat. 278, which was held constitutional in *Chase Nat'l Bank v. United States*, 278 U.S. 327 (1929), read in part as follows: "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 . . . tangible or intangible . . . (f) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over \$40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

or that he must have paid premiums or that both must have occurred together.³⁵ In its discussion of the *Wachovia Bank* case the court in *DeCoster* also apparently dismissed the payment of premiums by the insured as being one of the indicia of tax. The payment of premiums has not been found as an established criterion of taxation in the other states and is evidently not the meaning of "taken out by decedent" in Minnesota.

The Board of Tax Appeals in 1948 in *Pearson v. Commissioner of Taxation*,³⁶ made a very creditable effort to define "taken out by decedent" affirmatively in such a way as to be meaningful and to be consistent with the *DeCoster* case. The facts of the *Pearson* case were essentially the same as the *DeCoster* case—a decedent had assigned insurance to his wife after 1937 and prior to his death. In *Pearson*, however, the widow went on to pay the premiums. The Board held the proceeds of the insurance subject to tax but only insofar as the proceeds exceeded the premiums paid by the widow.³⁷ The Board drew upon principles which remained largely implicit in the *DeCoster* decision in attempting to define "taken out by decedent." Somewhat freely paraphrased, the Board said that neither the mere signature of the application nor the payment of premiums by the insured constituted taking out insurance; that insurance once owned by the decedent and assigned (as in *DeCoster* and *Pearson*) was taken out by decedent notwithstanding its subsequent assignment and hence would be subject to tax, whereas insurance owned at all times by the beneficiary could not have been taken out by the decedent and hence would not be subject to tax.³⁸ Thus, absence of the incidents of ownership will prevent taxation, but only in the situation where the insured has never possessed them. This may be called a "limited incidents of ownership test." The Board recognized the somewhat anomalous character of a rule which would impose a tax in one ownership situation (policy once owned by insured and assigned to beneficiary) and forego it in a situation having identical economic and legal incidents as of the time of the decedent's death (policy owned by beneficiary at all times). It stated, however, that if a remedy were needed for this rule, in the light of the *DeCoster* decision, that remedy must be for the legislature.

If the *Pearson* case correctly stated the law, then an insurance

35. Some of this history is well summarized in *Walker v. United States*, 83 F.2d 103 (8th Cir. 1936), and later in *Colonial Trust Co. v. Kraemer*, 63 F. Supp. 866 (D.C. Conn. 1945). The present provision, of course, requires for taxability that the decedent must possess incidents of ownership at his death, eliminating the payment of premiums test. INT. REV. CODE OF 1954, § 2042.

36. 1 P-H INH. & TRANS. TAX SERV. Minn. § 1008 (1949).

37. Allowance of the credit for premiums paid apparently represented some recognition that the assignment of the policy may represent in whole or in part the purchase of an investment rather than an inheritance.

38. 1 P-H, *op. cit. supra* note 24, at 1037.

policy like the one in *Blue Diamond*, which was owned by the corporate beneficiary from its very issuance but was issued after 1949, would escape tax and the other types of policies in *Blue Diamond*, if issued after 1949, would not. This result, if it were what the Supreme Court had in mind in the *Blue Diamond* opinion, could also be obtained without overruling the *DeCoster* decision.

It appears that what the Supreme Court in the *Blue Diamond* case is offering to reconsider is the time for determination of whether the insured has the right to change the beneficiary or to surrender for cash. The tax is imposed on "proceeds of all such policies now [When?—Time Number One] in force payable to named beneficiaries in which the insured has [When?—Time Number Two] the right to change the beneficiary or under which he has [When?—Time Number Two] cash surrender right."³⁹ The *DeCoster* case held that the "now" of the statute—identified as Time Number One above—meant July 15, 1937 (or, to put it in terms of the present statute, April 26, 1949). It also held in effect, without any discussion of the question, that the "has" of the statute—identified in each case as Time Number Two above—also referred to July 15, 1937.

On this narrow question it appears that *DeCoster* correctly defined Time Number One, but that the most reasonable identification of Time Number Two is *at the death of the decedent*. Under such an interpretation policies in existence at the effective date of the statute may be assigned by the insured prior to his death and the tax levied at his death thereby avoided.⁴⁰ This result was suggested by the court in *Blue Diamond* where, in analyzing the *DeCoster* case, it stated that:

The question thus presented was whether subsection (b) [section 291.01(5)(1)(b)] became applicable on the date of the enactment or whether it was to apply up to the date of the insured's death. We accepted the former view and upheld the assessment.⁴¹

The construction suggested, namely, that the possession of cash surrender right or right to change beneficiaries must be determined at the decedent's death appears reasonable. The statute imposes an inheritance tax *at death* on insurance proceeds "payable *on account of death*" on policies which (then) are payable to named beneficiaries. Item (b) of the statute⁴² was apparently intended to afford relief against the application of the more extreme provisions of item (a) to all policies in existence at the effective date of the statute. If the time for determination of the taxable status of the

39. MINN. STAT. §§ 291.01(5)(1)(b) (1957). (Emphasis added.)

40. Probably always subject to the requirement that the transfer not be one in contemplation of death.

41. 91 N.W.2d at 597.

42. MINN. STAT. § 291.01(5)(1)(b) (1957).

policies were the effective date of the statute, as held in *DeCoster*, little relief would be afforded by this intended relief measure, because only policies in which the insured at the effective date of the statute *happened* not to possess the specified rights would be protected from tax. No subsequent change by the insured in any policy in which he possessed such rights, short of cancellation of the policy (or perhaps making it payable to charity) could then ever divest the policy of its taxable incidents. However, if the insured's rights are to be viewed as of the time of his death, item (b) becomes a real relief measure. The insured is then given his remaining lifetime (subject possibly to the requirement that the transfer not be in contemplation of death) to divest himself of the otherwise taxable rights to change the beneficiary or surrender for cash.

If it should be held under facts like those in *DeCoster*, that policies in existence on April 26, 1949 may thereafter be assigned and the tax thereby avoided, what of policies not issued until *after* April 26, 1949? The *Blue Diamond* case does not offer any definite answer to that question. However, the opinion contains the following statement:

Had he [the insured] not relinquished these rights before that time [April 26, 1949] but had done so thereafter, then we would have before us exactly the same situation which the *DeCoster* case presented and we would be required to uphold the tax — assuming, of course, that we would adhere to that decision.⁴³

This statement, taken literally, fails to accord any special treatment to different policies depending on the circumstances of procurement and ownership. In particular, no special treatment is given the policy which was procured and owned by the *Blue Diamond* Company from its inception. It is difficult to believe that such a policy in any sense could be deemed "taken out by decedent." Moreover, even the *DeCoster* case itself seemingly doubted taxability in this situation.⁴⁴ However, it seems that no significance should be attached to this parity of treatment of the three policies by the court in the *Blue Diamond* case; presumably all three were assumed for purposes of the statement to have been owned by the decedent before 1949 and transferred thereafter.

We are therefore left without precise cues indicating the direction of future case law relating to post-1949 policies. However, the writer is willing to speculate that future decisions will follow along lines already suggested by the court in the *DeCoster* case and ampli-

43. 91 N.W.2d at 598.

44. "Insofar as these cases concern insurance policies procured and paid for by business firms or corporations wherein they are payees or irrevocable beneficiaries we receive little help in this proceeding. The person whose life is insured in such policies has no direct interest in the policy." 216 Minn. at 5, 11 N.W.2d at 491.

fied by the Board of Tax Appeals in the *Pearson* case. All policies on a decedent's life payable to named beneficiaries to be taxable must be "taken out by decedent," whether issued prior or subsequent to 1949. The phrase does not mean that taxability depends on the form of the application or whether the insured signed the form⁴⁵ nor does it mean that taxability depends on whether or not the decedent paid premiums—both *DeCoster* and *Pearson* give fairly precise negative answers to that question. Where insurance is procured and wholly owned at all times by the beneficiary and the insured does nothing but submit to the physical examination, answer questions, and provide the measuring life, the courts have generally refused to impose the tax.⁴⁶ The court in *DeCoster* in distinguishing *Wachovia Bank* seemingly agrees with this result. Hence some type of "incidents of ownership test" appears best to state the law in this situation.

If "taken out by decedent" were held to mean precisely the limited incidents of ownership test which the Board in *Pearson* had to evolve to fit *DeCoster*, the result as to post-1949 policies would be that, while policies never owned by the insured would escape tax, policies owned by the insured at any time (even though later assigned) would be subject to tax. Such policies would then constitute a strange class of property which, once acquired, could never be disposed of by the owner (except, as noted, by abandonment or transfer to charity) for purposes of Minnesota inheritance tax. This result would also ignore the judicial interpretations of "taken out by decedent" developed in the parent federal tax law. In applying the incidents of ownership test, the federal authorities have looked not to the incidents possessed by the insured at the inception of the policy, but to the incidents possessed by him *at death*.⁴⁷ Now that the *Blue Diamond* case has reopened the question of time for determination of the presence or absence of indicia of taxability, a true incidents of ownership test rather than the limited one which was evolved in *Pearson* can be stated judicially. As in the case of pre-1949 transfers, the required incidents in post-1949 policies should be examined as of the date of death. This result is reached on a broader ground than that suggested above as the basis for overruling *DeCoster* in pre-1949 cases. This ground, applicable not only to pre-1949 policies under item (1)(b) of section 291.01(5), but also to post-1949 policies under item (1)(a), is that policies are not "taken out by decedent" if at his death he possessed no incidents of owner-

45. See text discussion at notes 32-41 *supra*.

46. See notes 20 & 21 *supra*.

47. *Industrial Trust Co. v. United States*, 296 U.S. 220 (1935); *Bingham v. United States*, 296 U.S. 211 (1935); *Walker v. United States*, 83 F.2d 103 (8th Cir. 1936).

ship. This will amount to an affirmation of something akin to the ownership theory which has been the prevalent view in other states.

If such a true incidents of ownership test is held to govern, the Minnesota law applicable to insurance on persons dying currently can be summarized as follows:

- (1) In the case of policies issued on or before April 26, 1949
 - (a) if the decedent died possessed of the right to obtain the cash surrender value or to change the beneficiary, the proceeds will be taxable; or
 - (b) if the decedent did not possess either of these specified rights at his death, then (even though he might retain other incidents of ownership) the proceeds will escape tax.
- (2) In the case of policies issued after April 25, 1949
 - (a) if the decedent died possessed of any one or more of the numerous possible incidents of ownership (e.g., not only the right to surrender or change beneficiaries, but such other rights as the rights to convert the form of the policy, make loans against the policy, receive the reversion, elect form of settlement, or change terms of any governing insurance trust⁴⁸), the proceeds will be taxable; or
 - (b) if (either because of original procurement of the policy by the beneficiary or assignment of an existing policy to him) the decedent did not possess any incident of ownership in the policy at his death, the proceeds will escape tax.⁴⁹

If the foregoing analysis is correct, the only distinction between policies issued prior to 1949 and those issued subsequent thereto is that the taxability of prior policies depends on the presence or absence of two specified incidents of ownership whereas tax is imposed on any post-1949 policy in which the decedent retains *any* incident of ownership of any kind. The entire analysis proceeds from three premises — (1) that every policy to be taxed must be “taken out by decedent”; (2) that the statute governing pre-1949 policies requires just the two selected incidents of ownership as the touchstones of taxability; and (3) that the criteria of taxability are to be determined as of the date of death. Having arrived at this result, we can only conclude, as did the Board in the *Pearson* case, that if any change is desired in this rule, it should be made through legislation.

Notwithstanding the foregoing analysis and the hints of things to come contained in the *Blue Diamond* opinion, at present the *DeCoster* case stands unrevoked as an example of extreme succession theory. Before *DeCoster* can be undone and the insurance problems all laid to rest, a number of cases presenting different fact situations

48. Some of the usual incidents can be found in the regulations to the Federal Estate Tax sections of the Internal Revenue Code. See Treas. Reg. § 20.2042-1 (1958). Reference may also be had to regulations under earlier federal laws.

49. The foregoing summary ignores the possible effect of transfers of incidents of ownership by the insured in contemplation of death.

will have to come before the court. To get to court, such cases will have to survive the usual factors, hereinabove noted, militating against litigation and appeal. The results of such cases are not certain. Even if they follow the analysis herein offered of Minnesota law, the results will be somewhat out of harmony with results in other states (a somewhat unimportant circumstance) and in the federal jurisdictions (this factor is important—it causes conflicts of rules in the case of every Minnesota decedent who leaves an estate subject to federal taxation). With the increased purchase of business and key man insurance and with the greater volume of assignments of policies which has undoubtedly occurred since the abandonment of the payment of premiums test on the federal level, increased certainty, fairness and simplicity of the governing rules of Minnesota inheritance tax law are urgently needed.

Certainty, fairness and comparative simplicity in our inheritance tax law on insurance can be achieved quickly through legislation adopted at the 1959 session. Such legislation should provide for a tax on proceeds of insurance on the decedent's life payable to named beneficiaries with respect to which the decedent possessed at his death any of the incidents of ownership. In detail, the revised item (1) of section 291.01(5) with a few minor changes, could follow the text of section 2042 of the Internal Revenue Code of 1954. Such legislation, clearly adopting only an "incidents of ownership" test, would abolish the comparatively unimportant distinction which now exists (if the foregoing analysis is correct) between policies issued before and after 1949 and would preserve the essence of existing law. Such legislation should be held constitutional as applied to existing as well as future policies.⁵⁰ It would make immediately available for state use a large body of interpretative cases, regulations and rulings under federal and corresponding state law. It should destroy the annoying differences which exist between federal and Minnesota law, affecting both estate planning and estate practice. No important revenues would be lost through the adoption of such legislation.⁵¹ Accordingly, legislation further harmonizing state and federal tax laws is strongly recommended for adoption by the legislature in 1959.

II. INHERITANCE TAX ON POWERS OF APPOINTMENT

Another example of the succession theory of inheritance taxation can be found in the Minnesota law governing the tax on the transfer

50. See note 21 *supra*.

51. In fact, if the analysis is correct, revenues would be gained in cases involving pre-1949 policies where the cash surrender and beneficiary change rights have been relinquished by a decedent who, however, retains some other incident of ownership.

of property subject to a power of appointment. Before considering the effect of the Minnesota statute attention should be given briefly to the inheritance taxation of powers in the absence of express statute.

According to the common law *property* rule, property subject to a power of appointment is transferred from the *donor* of the power (not the *donee*) to the appointee or taker in default of appointment, the donee of the power being at most the agency whereby the transfer is accomplished.⁵² Under the *ownership* theory this property rule is followed and, therefore, a death transfer tax is imposed on the transfer from the donor to the ultimate recipient of the property at the death of the donor.⁵³ In states imposing an inheritance tax, but having no special provision relating to powers of appointment, the ownership theory of taxing powers has been followed.⁵⁴

By contrast, the Minnesota inheritance tax statute on powers⁵⁵ expressly taxes powers as transfers from the *donee* to the transferee. Powers are taxed either at their exercise or lapse as though the property subject to the power had passed to the appointees or the takers-in-default by will of the donee exercising the power or failing to exercise it, as the case may be. Despite the fact that this statute, taken from the former New York law,⁵⁶ has been in force in substance at one time or another in more states⁵⁷ than any other type of inheritance tax statute dealing with powers, many troublesome problems which can arise remain unsettled.

A most serious problem involves the possibility of a double tax on the transfer to the recipients of property subject to a power. The Minnesota statute clearly imposes a tax on the transfers to the actual recipients of the property at the death of the donee of a testamentary power, whether the power is exercised⁵⁸ or is not

52. *State v. United States Trust Co.*, 99 Kan. 841, 163 Pac. 156 (1917); *Shattuck v. Burrage*, 229 Mass. 448, 118 N.E. 889 (1918); *Matter of Harbeck*, 161 N.Y. 211, 55 N.E. 850 (1900).

53. *Highfield v. Delaware Trust Co.*, 34 Del. 290, 152 Atl. 117 (Super. Ct. 1929), *aff'd*, 34 Del. 306, 152 Atl. 124 (1930); *State v. United States Trust Co.*, *supra* note 52; *Matter of Harbeck*, *supra* note 52; *Morris' Estate*, 42 D. & C. 522 (Orphan's Ct. 1941); see *Helvering v. Safe Deposit & Trust Co.*, 316 U.S. 56 (1942); *United States v. Field*, 255 U.S. 257 (1921).

54. Such states apparently include Indiana, Louisiana, Maine, and Wyoming. See 4 P-H INH. & TRANS. TAX SERV. *Ind., La., Me., Wyo.* ¶ 116. In Connecticut, where a statute like Minnesota's, taxing powers was repealed (Conn. Pub. Acts 1929, ch. 729), the intent was said to be to abolish the tax on powers altogether. 1 CCH INH., EST. & GIFT TAX REP. ¶ 1540.01.

55. MINN. STAT. § 291.01(3) (1957).

56. See *State v. Brooks*, 181 Minn. 262, 232 N.W. 331 (1930).

57. At least a dozen other states have provisions substantially like Minnesota's. At least five previously had similar statutes but have now changed them. See in this connection 1 P-H INH. & TRANS. TAX SERVICE ¶ 116.

58. *In re Estate of Robinson*, 192 Minn. 39, 255 N.W. 486 (1934).

exercised.⁵⁹ Does it also impose the tax at the death of the donor of the power on the theory that the property subject thereto is transferred "by will . . . from any person dying possessed of the property while a resident of the state . . ." ⁶⁰ or transferred in any of the other ways in which the property might be passed subject to tax at the death of a decedent?

A reasonable answer appears to be that the legislature intended, for purposes of the inheritance tax, to abrogate the common law rule and to make a transfer of property subject to a power occur only at the death of the donee. Apparently in this instance a shift from ownership theory to succession theory was clearly intended by the legislature. Under simple succession theory, the ultimate transferee would achieve possession or enjoyment of the property by a transfer (exercise or lapse of the power) of the donee of the power. Likewise, under this statute the property subject to the power would escape tax at the donor's death and would encounter it only at the death of the donee from or through whom the property was received.⁶¹ This normal succession theory result has been obtained under similar statutes in those cases outside Minnesota which have considered the question directly.⁶² These cases all held the property passing under the power taxable at the donee's exercise of the power and *not at the donor's death*. Of course, if the power is coupled with a life estate, this means that only the life estate is taxed at the donor's death (this being an interest not subject to the power) and that the remainder is taxed at the donee's death to the recipients of the property through the exercise or nonexercise of the power.

However, an element of doubt as to the construction of the Minnesota version of this statute was raised by *In re Estate of Robinson*.⁶³ That case quite properly held that under our statute the remainders appointed by a life tenant-donee of the power must be taxed at the donee's death. However, the opinion is more remarkable for what it does not say than for what it holds. It appears clearly from the statement of facts in the *Robinson* case that the remainders as well as the

59. *First Nat'l Bank v. Commissioner of Taxation*, 250 Minn. 122, 84 N.W.2d 55 (1957).

60. MINN. STAT. § 291.01(1)(1) (1957).

61. Or at any other lapse or exercise by the donee.

62. *People v. Linn*, 357 Ill. 220, 191 N.E. 450 (1934); *Matter of Howe*, 86 App. Div. 286, 83 N.Y. Supp. 825 (Sup. Ct. 1903), *aff'd mem.*, 176 N.Y. 570, 68 N.E. 1118 (1903); *In re Tillinghast's Estate*, 94 Misc. 76, 157 N.Y. Supp. 379 (Surr. Ct. 1916), 94 Misc. 50, 157 N.Y. Supp. 382 (Surr. Ct. 1916), *aff'd mem.*, 184 App. Div. 886, 170 N.Y. Supp. 1116 (Sup. Ct. 1918); *Will of Nunnemacher*, 230 Wis. 93, 283 N.W. 326 (1939); *Will of Morgan*, 227 Wis. 288, 277 N.W. 650 (1938), *rehearing denied*, 227 Wis. 294, 278 N.W. 859 (1938). See also *People v. Metropolitan Trust Co.*, 369 Ill. 84, 15 N.E.2d 729 (1938); *People v. Cavence*, 368 Ill. 391, 14 N.E.2d 232 (1938).

63. 192 Minn. 39, 255 N.W. 486 (1934).

life interest had previously been valued and subjected to tax under the familiar "composition agreement" procedure in the estate of the donor of the power. Unless the statute is to be interpreted as creating a double tax on the remainder interest subject to a power, this earlier tax was a wholly unnecessary and improper tax. The court's reasoning in *Robinson* implies that there should be no tax on the remainders in the donor's estate. However, it does not expressly negative the applicability of the tax at the donor's death and fails to comment on the double tax feature. In a similar case arising in Wisconsin, *Will of Morgon*,⁶⁴ the Wisconsin court took occasion to comment specifically on the impropriety of the tax at the donor's death.

Apparently as a consequence of the *Robinson* case in Minnesota, the Commissioner continues at present to assert a tax on the property of the donor even though the property is made subject to a power of appointment by the donor's will or other instrument, which, except for the power, would create a transfer taxable at the donor's death.⁶⁵ This is succession theory gone wild. Ownership theory is first used in applying common law property rules to achieve a tax at the donor's death. At the donee's death the succession theory inherent in the statute is then used to tax the transfer again.

It is submitted that the first tax at the donor's death is unnecessary and improper and creates a double tax situation and that authority, including the *Robinson* case (rightly read), supports levy of an inheritance tax only at exercise or lapse in the hands of the donee.⁶⁶

The principle of taxing power of appointment property in the hands of the donee *only* seems clear enough. Beyond this promontory, however, this writer, at least, finds himself at sea. The subdivision relating to powers is a boundlessly broad statute. Taken

64. 227 Wis. 288, 277 N.W. 650, rehearing denied, 227 Wis. 294, 278 N.W. 859 (1938).

65. In practice, such tax is usually adjusted by the composition agreement proposed by the state as in the *Robinson* case.

66. Unfortunately, we have as yet no absolute judicial assurance that errors of law (as distinguished from mistakes) in the determination of inheritance tax can be corrected via the route of application for refund and suit against the Commissioner in District Court as provided in MINN. STAT. § 291.32 (1957). See, however, Johnson, *Administration Procedures in the Minnesota Department of Taxation*, 41 MINN. L. REV. 435, 449 (1957). If the sole remedy for legal errors turns out to be an appeal to the Board of Tax Appeals, under MINN. STAT. § 271.06 (1957), those desiring redress from a tax at the donor's death on property subject to a power will have to move speedily after the tax order has been issued. A further question which the taxpayer may have to answer in claiming a refund is whether he is estopped by having voluntarily entered into a composition agreement. The taxpayer having attained no advantage in exchange for his promise and the Department having suffered no detriment, it hardly seems that the taxpayer is estopped. The *Robinson* case itself shows that the Commissioner is not estopped by the earlier composition agreement.

literally, the subdivision could create many strange results in particular cases.

For example, the statute says that whenever a power is exercised by the donee or lapses, a transfer subject to inheritance tax occurs. In the usual case, the donee possesses a life estate in the property subject to the power as well as a testamentary power of appointment. In such a case, taxability under the statute is clear.⁶⁷ The same is true if the donee's power is exercisable *inter vivos* by deed which, however, vests the property in enjoyment only at his death. But suppose the donee possesses a power which can be exercised *inter vivos* to take effect at the time of exercise — is the statute literally applicable? Is an inheritance tax due at the exercise or lapse of the donee's power *during his lifetime*?

One possible construction affecting the legal answer to these questions is that subdivision 3 of section 291.01, relating to powers, merely modifies subdivision 1, relating to transfers at death, thus showing the circumstances under which powers will be deemed transfers at death under subdivision 1. If that is correct, only exercise or lapse of the power at the death of the donee or in contemplation of death or as a transfer intended to take effect at or after his death will be subject to tax. However, the provisions as to transfers of joint tenancy property⁶⁸ and of insurance,⁶⁹ both of which are worded in the same manner as the provisions on powers, obviously constitute bases of taxation which are independent of subdivision 1. If the same is true of powers, an inheritance tax could become due at the exercise of a power by the donee *during his lifetime* by deed of appointment "when made." Nothing in subdivision 3 expressly negatives this result; rather, the analogy contained in the subdivision to bequests by will suggests that means of exercising the power other than by will are contemplated.

If an inheritance tax is held capable of being levied on the exercise or lapse of the donee's power even before his death, various further questions arise. How would such a tax be computed, since the further transfers subject to tax at the donee's death would not yet be ascertained? Would it be subject to credit for any gift tax that might result? Could such a tax be enforced as a practical matter, since the act of exercise or lapse could occur at any time and normally an inheritance tax return is called for only at death? Would the limited exemption for property transferred within five years⁷⁰ be applicable where, at the most, only one *decedent* (the donor of the power) was involved?

67. See cases cited notes 58 & 59 *supra*.

68. MINN. STAT. § 291.01(4) (1957).

69. MINN. STAT. § 291.01(5) (1957).

70. MINN. STAT. § 291.06 (1957).

Notwithstanding these difficulties, an inheritance tax has been held applicable, under a statute like that in Minnesota, even to exercise or release of a power during the donee's lifetime.⁷¹ If this somewhat startling result is correct, further problems arise; for example, is there also a gift tax upon such an exercise or lapse? It seems to avoid the greatest number of difficult problems under the Minnesota type of statute if, where a gift tax law is in force, an inter vivos exercise by a donee or a lapse is taxed as a gift rather than as an inheritance.

Another instance of the difficulties encountered in applying this statute relates to the kind of power possessed by the donee. Again there is the familiar case of the donee possessing a life estate and a general power; he can appoint the entire property to his estate. Clearly, such a power should be taxed as though the donee owned the property. Even if the life tenant has power to appoint the property to a limited class only, it seems clear that our statute intends a tax. But suppose the donee has *no* interest in the property but only the naked power to decide who shall take it. In effect, he acts as the donor's agent to regulate enjoyment among the donor's beneficiaries whose way of life the donor can no longer observe after his death. Suppose that the donee is merely a trustee and, to compound the problems, suppose the donee is a corporate trustee having a perpetual charter and a power that lasts as long as the trust. Is the succession of the takers of the property to be taxed at the time of receipt and on the basis of the exemptions and tax rates applicable to strangers (a corporate trustee presumably having no relatives)? If so, the donor is under some tax coercion to select a trustee who is not a stranger but is related to the class of possible appointees or takers-in-default.

In other words, is a mere trustee or other possessor of a naked power to be regarded as the donee of a power with all the tax consequences which follow under the statute? If so, does it matter whether the power is one to select an outright distributee of the principal or is only a power to "sprinkle" income or a discretionary power to invade principal in an emergency? If these discretionary powers are included powers of appointment, it would not appear to be a defense to the tax to say that they were not used, since the lapse of the power as well as its exercise is taxed under the statute.

Some of the more extreme of these suppositions go beyond the line of reason. Yet where is the line to be drawn? The statute does not suggest a line and helpful cases cannot be found in states having

71. *In re Wendel's Estate*, 223 N.Y. 433, 119 N.E. 879 (1918) (exercise); *Westen v. South Carolina Tax Comm'n*, 212 S.C. 530, 48 S.E.2d 504 (1948) (release). In neither New York nor South Carolina was there a gift tax law in effect at the time of the foregoing decisions.

similar acts. The succession theory represented by the Minnesota statute would seem to impose the tax upon the recipients of the property whenever they receive it. Fortunately, the Commissioner has declined the opportunity to insist upon the application of this principle in the more extreme cases.⁷² Some interpretations, limitations and safeguards would doubtless be developed by the Minnesota court if suitable cases presented themselves.

As a matter of principle, however, is a strict succession theory law, even when patched with some exceptions, the most desirable manner of taxing powers? Undoubtedly, the Minnesota type of statute was passed in part for the purpose of simplifying the computation of tax. The purpose is accomplished in part, the reason being that the tax is deferred until the actual takers under the power are known, thus establishing known exemptions, rates and life expectancies.⁷³ On the other hand, the property subject to the power must be valued twice in any case if the donor leaves intervening life estates, since the intervening estates should be taxed at the donor's death, irrespective of the granting of the power. Property subject to the power is perhaps more likely to escape tax inadvertently at the death of the donee than at that of the donor who owned the property.

It is also fairer that the property be deemed transferred, following the common law rule, on the basis of the transferee's relationship to the donor than his relationship to the donee. This is particularly true where the donee is simply a trustee having no interest in the property. No doubt it may be fair that a donee possessing the right to avail himself of the property should be regarded as the owner. But the statute makes no distinction between donees possessing only a power and those possessing a power coupled with an estate or even those possessing the right to appropriate the property at any time.⁷⁴

A statute is needed which will create better lines of demarcation

72. The Commissioner of course still assesses a tax on the property in the donor's estate. By this means, in doubtful cases, only one tax on the power of appointment property is encountered. It is a major thesis of this section of this Article that only one tax is assessable on Minnesota powers in all events—that being one at the donee's death under the present statute.

73. This simplification occurs, however, only if, as above urged, our statute is interpreted as imposing tax only at the exercise or lapse in the hands of the donee and not at the death of the donor.

74. "When any person . . . shall exercise a power of appointment . . . such appointment when made shall be deemed a transfer taxable . . . in the same manner as though the property to which such appointment relates belonged absolutely to the donee of such power and had been bequeathed or devised by such donee by will. . . ." MINN. STAT. § 291.01(3) (1957). *But see In re Bradley's Estate*, 241 Minn. 394, 63 N.W.2d 374 (1954), which indicates that a power to consume during life will amount to ownership by the donee and not to a power of appointment.

between these different types of cases. Under federal law the troublesome problems of determining the identity of the ultimate transferees do not exist, except where marital deduction and appointment to charity are involved. However, the federal law makes a needed distinction between powers exercisable beneficially in favor of the donee (general powers) and those exercisable only in a nonbeneficial manner (special powers). Where an independent trustee, for example, has power to "sprinkle" benefits among members of the donor's family, there is nothing that smacks of inheritance in the exercise or lapse of the power. A mechanism already exists under Minnesota statutes for determining the identity and interest of the takers under the power.⁷⁵

At present, knowledgeable estate planners in Minnesota are often denied the use of what elsewhere is a most valued tool. This is true both because of the troublesome unanswered questions and also because of the administratively imposed double tax. Of course, the familiar power of appointment as an incident of a trust intended to qualify for marital deduction under the federal estate tax law⁷⁶ is in wide use because usually the saving of federal estate tax thereby effected offsets any increased inheritance tax.

The writer's experience is that other powers are used sparingly in Minnesota. For example, giving a life interest to a child in trust with power on his part to appoint by will among his spouse and issue might be regarded as a good solution to the perennial problem of providing for an as yet unmet but possibly worthy spouse of a child. Such a solution would generally be deemed unwise in Minnesota because of the present administrative practice of asserting a tax on the trust remainders both in the donor's estate and in the donee's.

Several of the states which had statutes essentially the same as Minnesota's have now changed or modified them in the direction of closer conformity to the ownership theory. Among these states are Indiana, Illinois, New York and Wisconsin.⁷⁷

A new and much clearer statute on the subject of powers of appointment should also be adopted in Minnesota. Such a statute should return to the principles of the ownership theory in defining taxable transfers and should possess the following features:

(1) The common law rule should be adhered to so that the property subject to the power, like other property possessed by the donor

75. MINN. STAT. § 291.11(5) (1957).

76. INT. REV. CODE OF 1954, § 2056.

77. See cases cited note 62 *supra*; WIS. STAT. ANN. § 72.01(5) (Supp. 1958), § 72.15(8m) (1957); 4 P-H INH. & TRANS. TAX SERV. *Ind.* ¶ 116. Presumably these states would now follow the common law rule which taxes under the ownership theory. See notes 53 & 54 *supra*.

at death, would be taxed to the transferees at his death. The identity of the ultimate transferees is unknown at the donor's death, but the determination of the takers (and consequently of exemptions, rates and life expectancies) can be handled as provided in section 291.11(5).⁷⁸

(2) General powers of appointment should be deemed outright transfers to the donee.

(3) Powers should not be taxed again at the death of the donee, except general powers as to which the property should be deemed owned by the donee and subject to inheritance tax at his death, whether exercised or not exercised. The exercise, release or lapse of a general power during the donee's lifetime should be deemed subject to gift tax but not to inheritance tax unless it qualifies as a transfer made by the donee in contemplation of death or intended to take effect in possession or enjoyment at or after his death.

(4) The transfer of property subject to a general power should be regarded as eligible between donor and donee for the limited exemption for property taxed within five years.

(5) General powers of appointment should be defined as they are in the federal tax law.⁷⁹

(6) The statute should be made effective as to donors and donees of powers dying after passage of the statute. In the case of donees, it need not be material when the power was created, since in terms all powers are taxable to the donees under the present law.

It does not appear that any loss of revenue will result from adoption of such a statute. In fact, if it is assumed that, rightly construed, it is present law that the power is taxed only upon exercise or lapse in the donee's hands, the possibility of double taxation (on general powers) will be enhanced and the time of assessment of the tax will be advanced to the donor's death. At the same time much certainty and fairness will be gained, together with the maximum practicable conformity with federal law. A prime tool of the estate planner will be restored to usefulness in Minnesota.

III. INHERITANCE TAX ON TRANSFERS TAKING EFFECT AT DEATH

Almost without exception, the death tax laws of the United States and of the various states impose a tax in some form on transfers made by a decedent "intended to take effect in possession or enjoyment at or after [his] death."⁸⁰ Minnesota's inheritance tax on trans-

78. This in effect would reverse the *Robinson* case which had held that the "highest rate" statute herein referred to was not applicable to powers.

79. INT. REV. CODE OF 1954, § 2041. Only the post-1942 part of the definition of powers need be used.

80. MINN. STAT. § 291.41(4) (1957). The writer believes that among states having death taxes, only Louisiana has no provision for such a tax. Nevada has no

fers taking effect at death, often called "transfers intended,"⁸¹ like other Minnesota inheritance tax provisions noted, has been interpreted in accordance with extreme succession theory in favor of taxability.

Transfers made during the transferor's lifetime, but taking effect at death, were first subjected to tax in Pennsylvania as early as 1826.⁸² The purpose of the various federal and state statutes on this subject undoubtedly was to prevent an obvious means of circumventing the death tax laws.⁸³ If all transfers made before death escaped the death tax, the wily transferor could avoid the tax by such means as creating living trusts, and still remain the life beneficiary or retain the right of final disposition or of revocation of the trust. The statutes were designed to prevent him from having his cake (enjoying the property during life or reserving the right to dispose of it at death) and eating it too (avoiding the death tax). Since the adoption of gift tax laws by the federal government and by many states, this basic objective might well be thought less important than it originally was, at least as to lifetime transfers which wholly or substantially come within the terms of the gift tax law. However, transfers effective at death continue to be taxed, though perhaps in some instances under more moderate statutes than previously.⁸⁴

Due principally to the preponderance of inheritance tax (as distinguished from estate tax) laws in the states and the undoubted differences between such laws and estate tax laws, the states, in this field at least, have taken the lead from the federal government in widening the areas of taxability. For example, in Minnesota and many other states, an *inter vivos* transfer with reserved life estate

death tax. Other states, such as Florida and Georgia, impose only a "pick-up tax" designed to utilize the credit offered under the federal estate tax law for state death taxes. FLA. STAT. ANN. § 198.02 (1958); GA. CODE ANN. § 92-3401 (1935). The credit against federal estate taxes is provided for in INT. REV. CODE OF 1954, § 2011. The imposition of the federal tax on transfers with a reserved life estate, transfers taking effect at death, and revocable transfers is in INT. REV. CODE OF 1954, §§ 2036-38.

81. See MINN. STAT. § 291.01(1)(3) (1957).

82. See *Commissioner v. Estate of Church*, 335 U.S. 632, 637 (1949).

83. See *Estate of Madison*, 26 Cal. 2d 453, 159 P.2d 630 (1945); *In re Estate of Rising*, 186 Minn. 56, 242 N.W. 459 (1932); *Reish v. Commonwealth*, 106 Pa. 521 (1884).

84. The Internal Revenue Code of 1954 constituted some relaxation of prior rules affecting persons dying subsequent to October 7, 1949, and prior to August 17, 1954, in this field. Compare Int. Rev. Code of 1939, § 811(c) (3) with INT. REV. CODE OF 1954, § 2037. Some states have also recently passed statutes which are less stringent. In New Jersey, for example, the judicial construction strongly favoring taxability in all situations where the interest shifted at the transferor's death was modified in 1955 by the limitation that if the transferor had divested himself of all rights or interests in the property within three years prior to his death, the transfer will escape tax. N.J. STAT. ANN. § 54:34-1.1 (Supp. 1957).

was deemed a transfer effective at death and taxable,⁸⁵ while in the federal field, *May v. Heiner*,⁸⁶ which reached the opposite result, remained good law. At least since *Commissioner v. Estate of Church*,⁸⁷ there seems to be almost universal agreement among both the states and the federal government that transfers with reserved life estate are intended to take effect at death. While there are few state cases relating specifically to transfers with reversionary rights retained, it seems reasonable that such cases would follow the result in the retained life estate cases.⁸⁸ If a beneficial power of revocation or amendment or other power of disposition over the lifetime transfer is reserved by the transferor, the transferred property is also generally agreed to be subject to tax at the transferor's death.⁸⁹ In all of the foregoing types of cases, possession and enjoyment in some measure may return to the transferor up to the time of his death, thus rendering the transfer in effect ambulatory during life. Hence, such transfers may be called "substitutes for wills."⁹⁰ In the case of such transfers, there seems to be no reason for substantial disagreement between state and federal rules irrespective of the type of death tax law in effect.

There remain two important types of transfers taking effect at death in which markedly different results are often obtained under the federal estate tax law and state inheritance tax law. One of these concerns the taxation of annuities and employee death benefits. These are dealt with in section IV of this Article. The other, to be discussed here, involves transfers (or perhaps more accurately, shifts or changes in interests) taking effect at the transferor's death where the transferor, during his lifetime, has parted with *all* rights of enjoyment, of reversion, of revocation or otherwise. Such transfers (if not in contemplation of death) would clearly escape federal tax. They are not ambulatory until the decedent's death, since all rights in or to affect possession and enjoyment of the property have been renounced by the transferor long before death. Under the ownership theory of inheritance taxation, these transfers would escape tax. It is in this type of case that Minnesota again has a far-reaching succession theory decision, holding property so given *inter vivos* taxable at the donor's death.

85. *Guaranty Trust Co. v. Blodgett*, 287 U.S. 509 (1933), *affirming* 114 Conn. 207, 158 Atl. 245 (1932); *In re Estate of Rising*, 186 Minn. 56, 242 N.W. 459 (1932).

86. 281 U.S. 238 (1930).

87. 335 U.S. 632 (1949).

88. This result was securely settled for federal purposes in *Estate of Spiegel v. Commissioner*, 335 U.S. 701 (1949).

89. See *Bullen v. Wisconsin*, 240 U.S. 625 (1916). If the reserved power does not amount to power to revest the property in the donor or substantially to control its enjoyment, the result perhaps should be otherwise. See *Will of Prango*, 201 Wis. 636, 231 N.W. 271 (1930).

90. *Commissioner v. Estate of Church*, 335 U.S. 632, 646 (1949).

In *Chase v. Commissioner of Taxation*,⁹¹ the decedent donor, twelve years prior to her death, had created irrevocable trusts for the primary benefits of each of five children. In each trust the beneficiary was to receive income for the life of the donor and then was to receive distribution of the principal. In the event of death (prior to the donor's death) of one of the children with issue surviving, the income was to shift and be paid thereafter to the issue of the deceased child per stirpes. In the event of the death of a child without issue surviving prior to the death of the donor, apparently the trust assets were to be distributed in accordance with the exercise of a general power of appointment conferred on the deceased child, or in default of the exercise of such a power, were to be divided equally among the trusts for the remaining of the donor's children.⁹² In fact, the donor was survived by all of her children. Upon the donor's death, an inheritance tax on the full amount of the principal distributive share of each child was assessed by the Commissioner. Upon review of this assessment, the Board of Tax Appeals (following ownership theory) determined that no inheritance tax was due because the donor had divested herself of all interest in income or principal of the trust by a transfer antedating the Minnesota gift tax law and not made in contemplation of death. Upon certiorari, the Minnesota Supreme Court reversed the Board's decision. The court, in reaching this result, acknowledged that in the prior Minnesota case where a tax was imposed under this section,⁹³ the donor had retained a life interest. The court reviewed other authorities holding that where the ultimate beneficiary received "final and complete title" at the donor's death as a result of an earlier transfer by the donor, a "transfer intended to take effect in possession or enjoyment" at the donor's death had occurred. The court distinguished the federal cases where the question of taxability turned on the donor's possession of taxable incidents at death rather than upon the realization of the transferee's interest. Under the dicta of the earlier Minnesota decision in *In re Estate of Rising*,⁹⁴ the court felt that it was committed to the theory that a transfer taking effect at death has occurred "when the ultimate complete possession and enjoyment and the final vesting of title of the principal in the beneficiaries is made contingent upon, or takes effect at or after, the death of the donor."⁹⁵ *In re Estate of Marshall*⁹⁶ was distinguished.

91. 226 Minn. 521, 33 N.W.2d 706 (1948).

92. In the case of a daughter, Anna, who, it may be conjectured, had no issue, there were no provisions for continuing the trust for her issue at her death, but otherwise the same plan of distribution obtained.

93. *In re Estate of Rising*, 186 Minn. 56, 242 N.W. 459 (1932).

94. *Ibid.*

95. *Chase v. Commissioner of Taxation*, 226 Minn. 521, 532, 33 N.W.2d 706, 712 (1948).

96. 179 Minn. 233, 228 N.W. 920 (1930).

A few states have succession theory decisions in accord with the *Chase* decision. New Jersey, California and Texas are clearly in accord,⁹⁷ although New Jersey, by recent statute, has permitted the grantor to dispose of his rights and escape tax.⁹⁸ Connecticut apparently is in accord;⁹⁹ New York has conflicting cases;¹⁰⁰ Massachusetts apparently supports the succession theory as applied to this type of transfer.¹⁰¹

An approximately equal number of jurisdictions have ownership theory decisions rejecting the tax if the decedent retained no interests in the subject matter of the transfer at death. Illinois,¹⁰² Ohio,¹⁰³ Pennsylvania,¹⁰⁴ and Delaware¹⁰⁵ are clear ownership theory states. Michigan,¹⁰⁶ Washington,¹⁰⁷ and Wisconsin¹⁰⁸ all seem inclined toward ownership theory. New York, as noted, has decisions both ways.¹⁰⁹

Which line of cases constitutes the more reasonable interpretation of the "transfer intended" section of an inheritance tax law?

97. *Estate of Madison*, 26 Cal. 2d 453, 159 P.2d 630 (1945); *In re Estate of Hollander*, 123 N.J. Eq. 52, 195 Atl. 805 (Prer. 1938); *In re Estate of Hartford*, 122 N.J. Eq. 489, 194 Atl. 800 (Prer. 1937), *aff'd sub nom. Hartford v. Martin*, 122 N.J.L. 283, 4 A.2d 31 (Ct. Err. & App. 1939); *Bethea v. Sheppard*, 143 S.W.2d 997 (Tex. Civ. App. 1940).

98. N.J. STAT. ANN. § 54:34-1.1 (Supp. 1957).

99. *Fabian v. Walsh*, 134 Conn. 456, 58 A.2d 384 (1948); *Bridgeport-City Trust Co. v. McLaughlin*, 9 Conn. Supp. 196 (Super. Ct. 1941); see also *Bryant v. Hackett*, 118 Conn. 233, 171 Atl. 664 (1934). *But see Connelly v. Waterbury Nat'l Bank*, 136 Conn. 503, 72 A.2d 645 (1950).

100. See, e.g., *In re Schweinert's Estate*, 133 Misc. 762, 234 N.Y. Supp. 307 (Surr. Ct. 1929); *In re Kirby's Estate*, 133 Misc. 152, 231 N.Y. Supp. 408 (Surr. Ct. 1928), *aff'd mem.*, 228 App. Div. 640, 237 N.Y. Supp. 812 (1929), *motion for leave to appeal denied*, 228 App. Div. 171, 239 N.Y. Supp. 390 (1930), *aff'd mem.*, 254 N.Y. 624, 173 N.E. 894 (1930); *In re Patterson's Estate*, 127 N.Y. Supp. 284 (Surr. Ct. 1910), *aff'd*, 146 App. Div. 286, 130 N.Y. Supp. 970 (1911), *aff'd mem.*, 204 N.Y. 677, 98 N.E. 1109 (1912); *In re Cruger*, 54 App. Div. 405, 66 N.Y. Supp. 636 (1900), *aff'd mem.*, 166 N.Y. 602, 59 N.E. 1121 (1901).

101. *State St. Trust Co. v. Treasurer & Receiver Gen.*, 209 Mass. 373, 95 N.E. 851 (1911); see also *Coolidge v. Commissioner*, 268 Mass. 443, 167 N.E. 757 (1929), *rev'd sub nom. Coolidge v. Long*, 282 U.S. 582 (1931) (retrospective application held unconstitutional).

102. *People v. Northern Trust Co.*, 330 Ill. 238, 161 N.E. 525 (1928); *People v. Kelley*, 218 Ill. 509, 75 N.E. 1038 (1905); see *People v. McCormick*, 327 Ill. 547, 158 N.E. 861 (1927).

103. *In re Heine's Estate*, 100 N.E.2d 545 (Ohio P. Ct. 1950); *In re Estate of Hazelton*, 148 Ohio St. 127, 73 N.E.2d 799 (1947).

104. *Glosser Trust*, 355 Pa. 210, 49 A.2d 401 (1946); *Townsend Trust*, 349 Pa. 162, 36 A.2d 438 (1944); *Dolan's Estate*, 279 Pa. 532, 124 Atl. 176 (1924).

105. *Highfield v. Equitable Trust Co.*, 34 Del. 509, 155 Atl. 724 (Super. Ct. 1931).

106. *State v. Welch's Estate*, 235 Mich. 555, 209 N.W. 930 (1926); cf. *In re Rackham's Estate*, 329 Mich. 493, 45 N.W.2d 273 (1951).

107. *In re Estate of Molke*, 198 Wash. 6, 86 P.2d 763 (1939); *In re Estate of Sheard*, 181 Wash. 62, 42 P.2d 34 (1935).

108. *Will of Prange*, 201 Wis. 636, 231 N.W. 271 (1930).

109. Cases cited note 100 *supra*.

Both types of decision in most fact situations are logically sound applications of their particular premises and therefore are satisfying in a legalistic sense. Perhaps an answer to the question of the propriety of the rules can most closely be approached through an analysis of the premises on which the succession and ownership theories depend in this type of transfer.

Under both theories it seems necessary to acknowledge that mere rules of property law do not govern the incidence of tax in this sphere. Stated more particularly, the fact that all property interests vest at the time of the original inter vivos transfer by the donor will not of itself prevent the tax at his later death.¹¹⁰ A distinction has to be made between vesting in the property law sense and coming into possession and enjoyment as required by the statutes.¹¹¹ If this were not so, even transfers with reserved life estate would escape taxation at the transferor's death.

This practical test, which looks for a shift of possession or enjoyment of the interest to the ultimate recipient at the transferor's death, is certainly a first step on the road to succession theory. However, the extreme succession theory cases such as *Chase* seem to go back to property law to borrow the next step by which taxation is achieved. Suppose *A* irrevocably conveys property "to *B* for the life of *A*, remainder to *C*." Agreed, at *A*'s death, *C* realizes possession and enjoyment. But apart from property rules, upon the practical tax theory of shifting of enjoyment it appears that *C* obtains his enjoyment from and as successor of *B*. It is only a property law concept that makes *A*, who had divested himself of the enjoyment years before, the transferor. Employing this concept, however (and apparently ignoring the requirement that a transfer be from a transferor), the cases under discussion have held this transmission of property a taxable transfer from *A*. Perhaps this is why the Minnesota court has hinted that our inheritance tax statute taxes both transmission and succession.¹¹² Neither pure ownership theory nor pure succession theory alone seems logically capable of producing

110. *But see In re Estate of Marshall*, 179 Minn. 233, 228 N.W. 920 (1930).

111. Three different senses in which the term "vest" can be used in connection with the taxation of transfers are illustrated by the opinions in *Coolidge v. Commissioner*, 268 Mass. 443, 167 N.E. 757 (1929), *rev'd sub nom. Coolidge v. Long*, 282 U.S. 532 (1931) (retrospective application held unconstitutional). For example, as pointed out by the dissent in *Coolidge v. Long*, a distinction is made in inheritance tax statutes between vesting in the property sense (at the time of transfer and subject to divestiture) and vesting in possession and enjoyment (possibly at the time of the transferor's death). 282 U.S. at 603. For purposes of the "contract" and "due process" clauses, the majority of the Court held that vesting occurred at the date of the initial transfer. The dissent argued that the time of vesting for constitutional purposes was the time of occurrence of the event taxed—that is, the subsequent death of the transferor.

112. See text discussion at note 6 *supra* and cases cited.

taxability in this hypothetical situation—borrowing from the concepts of both to make a logical *mélange* is necessary to secure this result.¹¹³

Viewed from a practical standpoint, the rule of the *Chase* and similar cases also seems unduly to emphasize form rather than substance. Suppose again that A transfers inter vivos “to B for the life of A, remainder to C.” Assume A’s life expectancy is five years. Cannot A accomplish this objective and avoid the tax by transferring to B for five years, remainder to C? Or suppose that A conditions his transfer on the life of some person other than himself? Again the tax is avoided.

Moreover, the rule of these cases apparently leads to possible double taxation of the same transfer. In the situation of A “to B for the life of A, remainder to C,” there is an immediate inter vivos gift of the whole property in two portions, that to B being measured by A’s life expectancy, and that to C accounting for the balance of the value of the property. Both transfers are fully subject to gift tax.¹¹⁴ Upon A’s later death, these cases say that the full value of the property is again deemed transferred, this time all to C. There is, therefore, a full inheritance tax on the same transfer. Again, property rules are used to effect the gift tax and are abandoned in part to secure the inheritance tax.

Of course, a credit against the inheritance tax is given for gift taxes paid.¹¹⁵ Under the statute allowing this credit, a question of interpretation may arise whether any credit would be allowed on the gift tax paid on the transfer of the income interest for the life of A, since the subject of this gift would already have been consumed at A’s death. (In all events, the credit avails little if values of the property have appreciated between the gift and death.)

By contrast, look again at A to C reserving a life estate to A, or look at A to C in trust reserving a right of revocation by A. In these admittedly stronger inheritance tax situations there is universal agreement that an inheritance tax should be paid. A, after all, has “had his cake.” Yet here A is spared from paying gift tax on the value of his reserved life interest or right of revocation,¹¹⁶ and therefore, from having to try to prove his entitlement to the credit on the tax represented by this portion of the gift. It seems likely that less total tax (gift tax plus inheritance tax) will be incurred with respect to these transfers than in the more doubtful *Chase* situation.

113. By contrast, under both theories a tax is properly imposed where A transfers to C reserving a life estate in himself. Under ownership theory A possesses and transmits all rights of enjoyment to C at his death. Under succession theory C succeeds to all rights from A, his immediate predecessor in possession.

114. MINN. STAT. §§ 292.01(1), (3) (1957).

115. MINN. STAT. § 292.14 (1957).

116. MINN. STAT. § 292.01(4) (1957).

The *Chase* case was the logical extension of a succession theory doctrine stated in *Rising*, but unnecessary to the decision of that case. The actual facts of *Chase* showed a much less definite shift of interest than those of the hypothetical cases discussed. In *Chase* there was no shift of possession and enjoyment from *B* to *C* on *A*'s death. There the actual facts were: "A to *B* (income) for the life of *A*, remainder (principal) to *B*." The transfer taxed consisted only of a change in the form of *B*'s possession and enjoyment at *A*'s death from an income interest to a principal interest. Inheritance taxation of an inter vivos transfer, fully subject to gift tax, of property in which the transferor retains no beneficial rights and retains only so tenuous a connection as a shift in the nature of the interest of the transferees at his death seems to be straining the principles of a death tax. It is to be hoped that the less extreme succession theory expressed in *In re Estate of Marshall*¹¹⁷ and hinted at in the *Blue Diamond*¹¹⁸ case will be followed in future cases of transfers taking effect at death. Here again, however, awaiting new case law will not be a sure or speedy solution.

Any statutory re-emphasis of ownership theory, of course, should continue to recognize the basic principle that an inter vivos transferor cannot both keep control of the property or arrange to have it return to him and still avoid tax on the passage of the property to another at his death. In such cases, the transfer is truly a substitute for a will. But, for the reasons noted, if the transferor has parted with *all* rights of enjoyment, control or reversion, it should be recognized that a gift tax, and only a gift tax, is due on the original transfer, notwithstanding that some change occurs at the transferor's death in the nature, possession or enjoyment of the interest of the transferees.

This result can best be achieved if the various types of taxable situations usually thought to be embraced in the phrase "transfer intended to take effect at or after death" are separately enumerated in the statute. This is the method now used in the Internal Revenue Code of 1954. Thus transfers with retained life estate¹¹⁹ and revocable transfers¹²⁰ are each included in a separate section. With few exceptions, the words of these federal statutes could be effectively used in Minnesota.¹²¹

117. 179 Minn. 233, 228 N.W. 920 (1930).

118. 91 N.W.2d 595 (Minn. 1958).

119. INT. REV. CODE OF 1954, § 2036.

120. INT. REV. CODE OF 1954, § 2038.

121. The new statutes of course would have to refer to "a taxable transfer" existing under the conditions stated therein instead of referring to the value of the property transferred being included in the "gross estate." Also, the new statute should be made to apply only to transfers made by decedent dying after the effective date of such new statute.

In the case of transfers effective only through survival of the decedent, the federal section¹²² imposes a tax only where the transferor retains a reversionary interest exceeding five per cent of the value of the property transferred. Adoption of this provision in Minnesota would introduce a rule of greater reasonableness into the type of tax situation presented by the *Chase* case.¹²³

The advantages of uniformity with federal law which have previously been remarked on in the case of other types of transfer, such as greater certainty and fairness than now is the case, immediate availability of more complete precedents and interpretations, and greater comprehensibility by laymen and practitioners alike, are all at least equally applicable to new legislation in the field of transfers taking effect at death.

IV. INHERITANCE TAX ON ANNUITIES AND EMPLOYEE DEATH BENEFITS

A type of property transferable at death which has growing economic importance today is the employee's retirement annuity, pension or profit sharing plan. A related, more conventional type of property—the ordinary annuity contract—may also have increasing future importance under new impetus from two sources. These sources are proposed legislation granting income tax deferment to privately purchased retirement plans of professional and other self-employed persons¹²⁴ and proposals to authorize issuance of so-called "variable annuities."¹²⁵

With increased emphasis on these types of property has come increased tax attention. The federal estate tax law since 1954 contains a section¹²⁶ devoted exclusively to these subjects. Recent changes, both state and federal, have been made in income tax laws relating to annuities and death benefits.¹²⁷ It is appropriate to examine the status of these types of property under Minnesota inheritance tax law.

The Minnesota inheritance tax statute contains no provision expressly dealing with these topics. It is clear, however, that annuities purchased and owned by the decedent in which the unused balance at the decedent's death passes to beneficiaries named by him are subject to Minnesota inheritance tax. In *State ex rel. Thornton v. Probate Court*,¹²⁸ three annuity contracts were purchased by the

122. INT. REV. CODE OF 1954, § 2037.

123. Again, some minor adjustments to suit the language to a transfer tax and to limit the applicability of the statute to future decedents would be needed.

124. The Jenkins-Keogh bill recently failed of enactment, but it promises to be a perennial until passage finally occurs.

125. The friends of such annuities apparently are continuing efforts to clear the obstacles under present legal provisions. See Note, 42 MINN. L. REV. 1115, 1116 n.8 (1958).

126. INT. REV. CODE OF 1954, § 2039.

127. INT. REV. CODE OF 1954, §§ 401-04; MINN. STAT. § 290.26 (1957).

128. 186 Minn. 351, 243 N.W. 389 (1932).

decendent. Upon his death, shortly after the purchase, the single premium paid for each contract, with a slight increase, was paid to the beneficiaries designated by the decendent. The estate representatives argued that the benefits were insurance—insurance at the time not being expressly subject to inheritance tax. The court held that the benefits were not insurance (which it assumed, without deciding, was not taxable) and held them to be taxable. The court failed to state the specific clause in the statute under which the tax was imposed but found the benefits “an estate or property right of . . . [the decendent] to which the beneficiaries named succeeded at his death.” These were not probate assets and there was no discussion in the opinion of a transfer in contemplation of death. Accordingly, the benefits must have been taxed on the theory of a power of appointment or, more probably, as a transfer taking effect at death. The exact language employed by the court suggests ownership theory.

In *Stewart's Estate*, a Board of Tax Appeals case,¹²⁹ the taxation of an annuity was rested more explicitly on the theory of a transfer taking effect at death. The beneficiary here was taxed on only one-half the value of the transfer because she had furnished one-half the original cost.

The law of most other states having comparable statutes likewise taxes ordinary annuities purchased by the decendent and paid to his beneficiaries at his death as transfers taking effect at death.¹³⁰ This result appears valid under either ownership theory or succession theory where the annuity was procured by the decendent. Normally the decendent has a property interest in such annuity contracts which he transfers in one form or another to the beneficiary. He also shifts enjoyment of the death benefit to his transferee at his death so that a transfer cognizable under succession theory takes place.¹³¹

What results should follow in the case of a death benefit under a pension, profit sharing or retirement annuity plan? To the extent that the benefits are paid for by the decendent under a contract existing during his life, it does not appear that there is any important distinction between such death benefits and an ordinary annuity.¹³²

129. Minn. B.T.A., Docket No. 125 (March 7, 1944).

130. Day v. Walsh, 132 Conn. 5, 42 A.2d 366 (1945); Gregg v. Commissioner, 315 Mass. 704, 54 N.E.2d 169 (1944); Bank of New York v. Kelly, 135 N.J. Eq. 418, 38 A.2d 899 (1944); *In re Atkins' Estate*, 129 N.J. Eq. 186, 18 A.2d 45 (1941), *aff'd*, 127 N.J.L. 468, 23 A.2d 284 (1942), *aff'd*, 129 N.J.L. 127, 28 A.2d 174 (1942), *aff'd*, 319 U.S. 94 (1942) (under various names); *In re Bayer's Estate*, 345 Pa. 308, 26 A.2d 202 (1942), *cf.* Succession of Pedrick, 207 La. 640, 21 So. 2d 859 (1945). *But see In re Sweet's Estate*, 270 Wis. 256, 70 N.W.2d 645 (1955).

131. See Chase v. Commissioner, 226 Minn. 521, 33 N.W.2d 271 (1948).

132. *But see In re Sweet's Estate*, 270 Wis. 256, 70 N.W.2d 645 (1955) (holding an employee-contributed annuity nontaxable under an historical construction of the Wisconsin statute).

To the extent that benefits are employer-contributed, however, some obstacles to taxability are immediately raised.

In considering the susceptibility of an employer-contributed death benefit to inheritance tax, an analysis of the particular benefit must first be made. The possibilities run the gamut from a pure gratuity (such as a noncontractual salary continuation payment) at one extreme, to a deposit type of arrangement (such as a profit sharing trust) in which the employee has a full measure of indefeasible rights during his lifetime at the other extreme. Due to the paucity of case authority in this field, the probable results in different species of cases can only be sketched in roughly.

The salary continuation and other after-death gratuity cases may present some tenacious income tax problems,¹³³ but they seem to offer little difficulty under the inheritance tax law. In such cases there is receipt of property by a transferee at the decedent's death, but other essential elements of a taxable transfer are missing: there was no property interest in the decedent and no transfer from him. It is obvious that this lack is fatal under ownership theory. On examination it also appears to be fatal under succession theory. Even in the *Chase* case,¹³⁴ which perhaps represents the high water mark of succession theory, the shift of benefits was taxed at the decedent's death only because during his lifetime he had *owned* and *transferred* the property. No cases have been found which indicate any departure from this analysis.¹³⁵

At the opposite pole are cases where a nonforfeitable fund, account or share created by the employer under a profit-sharing trust or retirement plan based upon contract or custom between the employer and employee was segregated for the employee during his lifetime and was subject to withdrawal or other lifetime use by him. When such a separate fund account or share passes to the beneficiaries designated by the employee, it appears clear that a taxable transfer takes place. There is ample property interest transferred from the decedent to sustain such a holding even in jurisdictions which are committed to the ownership theory in the general case of transfers effective at death. Such was the result in Pennsylvania, an ownership theory state,¹³⁶ in *In re Dorsey's Estate*.¹³⁷ In

133. See *Simpson v. United States*, 7th Cir., November 7, 1958 which, although distinguishable in some respects from cases involving pure gratuities, appears to be at odds with a long line of tax court decisions under the 1939 Code and with the Treasury's own view as now expressed in Rev. Rul. 58-613, 1958 INT. REV. BULL. No. 51, in holding the death benefit subject to income tax.

134. Cited note 131 *supra*.

135. See *Borchard v. Connelly*, 140 Conn. 491, 101 A.2d 497 (1953) (indicating the necessity of some degree of ownership on the part of the employee).

136. See note 104 *supra*.

137. 366 Pa. 557, 79 A.2d 259 (1951).

that case the employer's contributions to the fund amounted almost to a deposit, the court concluding that the decedent's share therein was "his own property." Other cases where the employee had a vested or nonforfeitable right in a share of a profit sharing trust have reached a similar result.¹³⁸

Between cases involving gratuities and those involving deposits lie many variant fact situations. Where the employee acquires no indefeasible or nonforfeitable rights in the plan prior to his death, the element of property necessary to support a transfer is still very weak. Under both ownership and succession theories it seems likely that the nontaxability believed to be inherent in the gratuity cases will carry over.

In fact, in an ownership theory jurisdiction, even where the benefits have ripened during the employee's lifetime to furnish him a retirement income, the remaining guaranteed installments have passed tax-free at the employee's death to his beneficiary.¹³⁹ Apparently, under these cases lifetime powers to appropriate or withdraw the funds are necessary to render the benefits sufficiently nonforfeitable to amount to ownership.

In succession theory jurisdictions, less seems to be required to establish the nonforfeitability needed for a taxable transfer. In one case,¹⁴⁰ where the employee under an insured plan died prior to retirement, the transfer of a death benefit to the beneficiary was held taxable. In this case the decedent had no immediate lifetime rights in any funds and would have lost his ultimate rights in the event of loss of employment; yet vesting and nonforfeitability were found in the employer's surrender of its rights to return of its contributions.¹⁴¹

The cases taxing employee death benefits mainly seem to proceed on the theory of a transfer taking effect at death. In *In re Dorsey's Estate*,¹⁴² the argument that the employee possessed merely a power of appointment over the fund (powers being exempted from the tax) failed because it was held that the employee's interests amounted not merely to a power but to ownership of property. Inherent difficulties of interpretation in the common form of power

138. *In re Brackett's Estate*, 342 Mich. 195, 69 N.W.2d 164 (1955) (an ownership theory case); *In re Daniel's Estate*, 93 Ohio App. 123, 112 N.E.2d 56 (1952), *aff'd*, 159 Ohio St. 109, 111 N.E.2d 252 (1953) (which talks in part the language of succession theory).

139. *Enbody Estate*, 85 Pa. D. & C. 49 (Orphans' Ct.) and *Burke Estate*, 85 Pa. D. & C. 56 (Orphans' Ct.), *exceptions dismissed*, 85 Pa. D. & C. 65 (Orphans' Ct. 1953).

140. *Cruthers v. Neeld*, 14 N.J. 497, 103 A.2d 153 (1954).

141. New Jersey prior to the present 1955 statute was a very strong succession theory state. See note 84 *supra*.

142. Cited note 137 *supra*.

of appointment statutes¹⁴³ may continue to prevent a widespread application of the powers statutes to annuities, at least where "transfer intended" statutes can be used.

While we have no Minnesota cases on employee death benefits, some indication of the probable rules can be found in the cases of other states herein discussed and perhaps, to a degree, in the *Thornton* and *Chase* cases. However, it is the writer's understanding that the general administrative practice of the Department of Taxation is to treat as taxable all death benefits other than out-and-out gratuities.

The present Minnesota case law respecting ordinary annuities seems satisfactory. However, the law concerning employee death benefits is far from clear and apparently is subject to variable results, depending on delicate shades of fact in particular cases.

The new federal estate tax law covering annuities and employee death benefits¹⁴⁴ has some distinct advantages over state inheritance tax law developed under "transfer intended" statutes. First, it is definite, certain and workable. In general it subjects to tax all annuities or other death benefits growing out of contract. However, as an exception to the general rule, benefits paid to a beneficiary other than the decedent's estate, under a qualified employees' trust or retirement plan are exempt from the federal estate tax to the extent of the employer's contribution. Second, contrary to present state law, which most surely taxes the death benefits under those plans which give the employee the maximum in nonforfeitable rights, it offers tax protection and encouragement to the establishment of only those retirement plans which are regulated under federal (and state) law in a manner best designed to safeguard the rights of employees.¹⁴⁵ It seems that in adopting the tax benefits conferred by federal legislation in this field the state should not make an exception of death tax advantages. Third, in denying tax shelter to qualified death benefits paid to the executor of the decedent's estate, it makes a healthy distinction (similar to that between general and special powers of appointment) between what amounts to beneficial ownership of the benefits and the mere power to direct the enjoyment of the benefits by others.

Adoption of a state statute similar to the new federal law¹⁴⁶ will

143. See the discussion of construction problems under the Minnesota statute contained in section II of this article, *supra*.

144. INT. REV. CODE OF 1954, § 2039.

145. Congress in INT. REV. CODE OF 1954, §§ 401-04 and the state legislature MINN. STAT. § 290.26 (1957) have offered the tax advantages of qualified trusts only to plans which are nondiscriminatory in favor of supervisory personnel, which are of widespread application to employees and which create nonforfeitable rights on the part of the employees generally.

146. The state statute should make the change from the concept of inclusion in

clarify Minnesota law respecting employee death benefits and will encourage salutary policies toward employees through fair inheritance taxation of such benefits. Another area of conflict between federal and state tax laws, with the delays and annoyances that almost invariably follow from such a conflict, will disappear.

V. CONCLUSION

Four distinct types of transfer at death have been discussed. In each of them, different lines of state cases can be found falling into two main groups—ownership theory cases and succession theory cases. Minnesota decisions and tax practices, with some indication of possible future relaxation, have tended to be in the vanguard of the succession theory group.

Succession theory decisions and practices, even when they grow logically out of their premises and precedents (and several instances have been pointed out), necessarily create conflicts with federal estate tax rules and practices affecting the same transfers. Such conflicts are costly in terms of time, legal fees and public regard for law and tax administration.

When state inheritance tax rules or practices fail to proceed logically from their premises, or levy unfair taxes or are unformulated or unclear (and it has been argued that each of these conditions has been observed in connection with one or more of the transfers discussed), there is still less justification for maintaining such rules or practices in force. Hence, the thesis has been offered that immediate enactment, preferably at the 1959 session of the Minnesota Legislature, of ownership theory legislation which is as consistent as is feasible with corresponding federal estate tax rules will work no havoc with basic Minnesota tax theory or revenues. Adoption of such measures will, however, abolish the more frequently encountered conflicts between federal and state death tax law, simplify and speed the determination of state taxes, and promote greater logic or fairness in the rules governing the inheritance tax transfers considered.

the gross estate to that of a taxable transfer, should eliminate the date for determining the existence of a contract under which the death benefit exists, and should make certain changes in the internal references to statutory sections defining qualified plans.

