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Undergraduate News: Inheritance Tax

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UNDERGRADUATE NEWS

ROUND TABLE

INHERITANCE TAX *

John J. Flavin ¹

Although the law is commonly denominated an Inheritance Tax Law, the tax is not limited to property received by inheritance. In addition to dispositions by will and intestacy, the Act imposes a tax on any transfer or disposition of property that partakes of the nature of a testamentary disposition.

Unlike the Federal Estate Tax Law, technically speaking, the Illinois Act is not a tax upon the estate nor on the property, but rather on the right to transfer or succeed to property by will, intestacy or by any mode of disposition that is of a testamentary nature. The state's right to the tax is predicated on the theory that the right to transmit property is one of statutory creation; that, but for the statute, the right would not exist, and that the power that grants the privilege may deny it or impose conditions upon that right.

The laws of descent are, likewise, creatures of the statute, and may be altered or even withdrawn at the will of the law-making body. In other words, if there was no Wills Act or Descent Statute, all property would, upon the death of its owner, escheat to the state. Consequently, the sovereign power of the state may attach conditions to the privilege thus accorded.

The first Inheritance Tax Law of Illinois was enacted in 1895. With but slight changes it remained in force until 1909, when it was completely revised and the present law enacted. Comparatively few estates were affected by the 1895 law, and the revenue derived by the state from that source was inconsequential.

Under the old law, property passing in trust for the benefit of a surviving spouse or lineal descendants for life was exempt to the extent of the value of the life estates in those cases where the remainder was devised or bequeathed to collateral heirs. Furthermore, the 1895 law did not provide for taxing contingent interests in property inherited by will until the distributee or

* This was an address given before Round Table, the honor society of Chicago-Kent College of Law. Because of its general interest, it was decided to publish this address at length.

¹ Assistant Attorney General, State of Illinois.

beneficiary was definitely ascertained. That necessitated the postponement of the tax in all cases where the amount that the ultimate beneficiary was to receive was not capable of being ascertained, or where the person to receive the property was not definitely known.

A good illustration on that point is the estate of the late Marshall Field, the pioneer Chicago merchant, who died while the 1895 Inheritance Tax Law was in force. By the terms of his will his property was conveyed in trust with directions to pay certain portions of the income and principal of his estate to given named persons, with the provision that if they died prior to the receipt by them of their distributive share, the property was to pass to others. The persons ultimately to receive this property could not be ascertained at the time of his death. In fact, a great many of them were not in being at that time, inasmuch as he made provisions for the issue of his grandchildren. Under that state of facts the tax on the bulk of his estate had to be postponed. The amount received by the state in the first instance amounted to \$112,167.38, while under the present law the tax would have amounted to several million dollars.

In order to remedy that situation and to prevent a great deal of property from escaping taxation, the Legislature in 1909 enacted the present Inheritance Tax Law. Under it the Attorney General is designated as the supervising official over the assessment and collection of inheritance taxes. All inheritance tax proceedings are instituted in the county court, which court is vested with exclusive jurisdiction over such matters. The Attorney General designates Inheritance Tax Attorneys in the various counties throughout the state to represent him in inheritance tax matters.

Approximately 90 per cent of the tax collected in Illinois is derived from Cook County estates. For the two-year period of 1929 and 1930, the Cook County Inheritance Tax Office, located in the City of Chicago, collected in excess of \$23,000,000.

All property of Illinois residents passing by will or under the intestate laws of this state is subject to inheritance taxation, with the exception of real estate located outside of Illinois and tangible personal property, such as household furniture, automobiles, jewelry, and the like, situated without the state. It is a fiction of law that the situs of intangible personal property is where the owner thereof is domiciled at the time of his death, while the situs of real estate and tangible personal property is where it is actually located. Since the jurisdiction of the state is limited to its boundary lines, property that has no situs in Illinois is not subject to its laws, and for that reason real estate

and tangible personal property located outside of Illinois is not subject to inheritance taxation.

The personal property of non-resident decedents—other than tangible personal property having an actual situs in this state—is not taxable in Illinois if the decedent at the time of his death was a resident of any state or territory of the United States which at the time of his death did not impose a transfer or inheritance tax in respect to similar property of residents of this state, or if the laws of the state of residence of the decedent at the time of his death contained a reciprocal provision whereby non-residents were exempted from taxation.

In addition to taxing property passing by will and intestacy the Inheritance Tax Law taxes every conceivable transfer where the property passes upon, as a result of, or is in any wise connected with, the death of its owner. In that category are included: (a) gifts made in contemplation of death; (b) transfers intended to take effect in possession and enjoyment at or after the donor's death; (c) real estate, stocks, bonds, and moneys in bank, held in joint tenancy, that is in the joint names of the decedent and others, with the right of survivorship; (d) property which the decedent had the power to dispose by will regardless of whom it belonged to.

In class (a) fall all gifts made in anticipation or contemplation of one's death as the term is used in the statute. "Contemplation of death" has been defined as not referring to the general expectancy of all rational mortals that they will die sometime. The courts have construed the term "contemplation of death" to refer to an apprehension of death which arises from some existing infirmity or impending peril. That provision of the statute has given rise to considerable litigation, and while no general rule can be laid down that will fit all cases, nevertheless, the age of a person making the gift, his physical condition, any action contemplated to be taken by him with respect to his health, and the length of time he survived the making of the gift, are material elements considered in determining whether the gift is or is not taxable.

The law does not aim to reach gifts from parents to children, or for that matter to strangers, if they are not made in anticipation of death, whether outright or in the form of a trust. There is no prohibition so far as the inheritance tax law is concerned against persons making gifts, no matter how large, so long as it is not done with a view of evading the tax. However, in order to make a gift taxable, it is not necessary that the donor of the gift be in a dying condition, or for that matter in poor health, but it is conceivable that a person of extreme youth and vigor,

in the prime of life and in good health might make a gift that would fall within the purview of the taxing provisions of the law. For example, if Colonel Lindbergh, immediately prior to making the hop in his plane across the Atlantic, had made a gift to his mother, notwithstanding the fact that he made the trip safely and may live to ripe old age, that gift would ultimately upon his death be subject to a tax owing to the great hazard attached to the trip.

On the other hand, John D. Rockefeller, at the age of 90, who has a physician constantly watching him, could give millions away which would not be subject to taxation.

The kind of transfers that fall within class (b) have formed the basis of extensive litigation in both the state and Federal courts in recent years. That is largely due to the fact that persons of wealth, in order to save their estates from the payment of exorbitant inheritance taxes, frequently create living trusts involving large sums of money. It is safe to say, that hundreds of millions of dollars are thus tied up with the large banks and trust companies in this city. The general rule is that trusts are free from taxation if they are set up with no strings attached to them, if they are not made in contemplation of death, and no right, title, interest or control over the trust property is reserved by the donor. It is immaterial to whom the income is paid so long as none of it is received by the creator of the trust. Such trusts are beyond the reach of the law.

How that provision of the statute operates can best be understood by an illustration or two. The late John G. Shedd, head of Marshall Field & Company, who died October 26, 1926, created several trusts during his lifetime involving about \$15,000,000. reserving no power or control of the property transferred and divesting himself of all title and interest thereto and all right ever to revest himself therewith. He was in good health at the time of the transfer and continued actively in business up to his death. The income from the trusts were paid by the trust company in accordance with the directions of the trust instrument to his wife and children. None of the principal or income was ever received by him. Upon his death he left a large estate which passed by his will. None of the trusts were taxed, but the property passing by his will produced a tax of \$1,695,000.

Nettie Fowler McCormick, wife of the Harvester magnate, and mother of Harold and Cyrus McCormick, died July 5, 1923, leaving an estate of about \$10,000,000. In 1918, about five years before her death, she created a trust of International Harvester stock, of the value of approximately \$8,000,000. Under the terms of the trust instrument the income was to be paid by the

trustee for such charitable uses and purposes "as Mrs. McCormick shall during her lifetime designate, with a further provision that if in any year the net income from the property retained by her shall be less than \$250,000, she reserved the right to call on the trust company to pay her out of the trust estate such an amount as would, when added to the income from her individual estate, equal the sum of \$250,000. The trust instrument also provided that from and after her death the income should be distributed by the trustee to each of her three children, Cyrus H. McCormick, Anita M. Blaine, and Harold F. McCormick, so long as they shall severally live, and from and after the death of either of said three beneficiaries his or her share of net income should be paid over to their respective issue, with a further proviso that if Mrs. McCormick survived her three children the trust property should revert to her. She also reserved the right to terminate the trust by an instrument in writing signed by her and any one or more of her three children. During Mrs. McCormick's lifetime her annual income from the property retained by her and not transferred to the trustee exceeded \$250,000. The trustee paid the income derived from the trust property to the charitable institutions that were designated by Mrs. McCormick. Upon her death the state proceeded to tax the trust property as well as the property passing by will, on the theory that Mrs. McCormick did not part with all control of the trust property; that until her death no one could say that the property would not revert to her, and that, although she parted with the title to the property, the beneficiaries had no right to receive any part of the principal or income until after her death, and that the transfer therefore took effect in possession or enjoyment in the beneficiaries when she died and not before. The reservation by her of the powers above enumerated and the right to receive the income, if her income from other sources did not amount to \$250,000 per year, along with the other provision reserving the power of revocation, formed the basis for the state's contention of its taxability. The case was hotly contested by one of the most prominent Chicago law firms, and upon appeal to the Supreme Court of Illinois, the state's right to the tax on the trust property was upheld.²

Ante-nuptial agreements are likewise taxable as transfers taking effect in possession and enjoyment at death. The taxability of ante-nuptial contracts was sustained by the Illinois Supreme Court in the Marshall Field Estate. The late Marshall Field, before entering into a second marriage, entered into a contract with his prospective wife, whereby he agreed that, in the event she survived him, his estate was to pay her \$1,000,000. Subse-

² *The People v. McCormick*, 327 Ill. 547.

quent to his death the widow questioned the state's right to assess a tax on the \$1,000,000 received by her. The matter was taken to the State Supreme Court and the tax was upheld.³

Transfers that fall within class (c) are real estate, where the title thereto is held in the joint names of the decedent and others. Only one-half of the value of the property is taxable to the surviving joint tenant upon the death of either of them. The same is true of bank accounts, stocks, bonds, or other property held in the joint names of two or more persons, and payable to either or the survivor upon the death of one of such persons. To the extent of one-half of the property, the law treats it as though it had been bequeathed or devised to the survivor by will.

Very few transfers fall within class (d). That provision of the statute is intended to cover those cases where there has been no ultimate disposition of property, but the right is conferred upon the decedent to dispose thereof by will. For example if "A" by his will gives a life use in property to "B", with a further provision that upon the death of "B" that property should pass in such manner as "B" shall direct by his last will and testament, and in default of such directions, then over to someone else, although "B" had but a life estate in the property, it would, nevertheless, be subject to taxation at his death under the aforementioned provision of the statute, whether he exercised the power to dispose of the same or failed to exercise the power.

In determining the value of an estate for the purposes of inheritance taxation, all property disposed of by will or passing under the intestate laws of this state, as well as all property passing under any other provision of the statute is included. All valid debts due and owing from the decedent to others, including funeral and burial expenses and costs of administration, are properly deductible. The amount due the Federal Government for Federal Estate Tax is, likewise, deductible from the gross estate. On the other hand, 80 per cent of the amount paid for state inheritance taxes are, likewise, deductible from the gross estate for Federal Estate Tax purposes.

To encourage bequests for charitable, educational, benevolent, and philanthropic purposes, the law exempts from taxation such bequests, provided they are to local institutions, that is, within the State of Illinois. Bequests for educational, charitable, or religious purposes in other states are taxable at the highest rate.

Many cases have come to the attention of the Cook County Inheritance Tax Department where hundreds of thousands of dollars in tax could have been saved by estates if, instead of be-

³ The People v. Estate of Field, 248 Ill. 147.

queathing the property to charities outside of Illinois, the testator had made a local institution his beneficiary.

The case of Edward Rector furnishes a striking example to illustrate the point. Mr. Rector died August 1, 1925, and was one of the prominent patent attorneys of this city. Practically his entire estate, which was close to \$2,000,000, was bequeathed under his will to the DePauw University of Indiana, and a tax of \$464,517.65 was collected by the State of Illinois. Had that property passed to Chicago-Kent College of Law, it would have been exempt from inheritance taxation.

Another example is the Estate of Daniel F. McGuire, who died April 2, 1923. The decedent was a Roman Catholic priest, and had charge of the parish at Garfield Boulevard and Halsted Street. He left an estate of upwards of \$400,000. By his will he gave all of his estate, with the exception of \$16,000, to the Chinese Mission Society of Nebraska. A tax of \$89,626.18 was assessed against his estate, whereas it would have been exempt if the property had been given to an Illinois Roman Catholic organization.

The question of residence often becomes important in connection with the assessment of inheritance taxes. In the Estate of James Deering, a millionaire who died September 21, 1925, the question of his residence played an important part in determining the tax due the state. It developed during the hearing, that several years before his death Mr. Deering got into a controversy with the Cook County Board of Review about his personal property taxes, and thereafter changed his legal residence to Florida, in order to avoid what he termed exorbitant personal property tax. He continued to maintain a residence on Lake Shore Drive and spent considerable time here, but voted in Florida and gave Florida as his residence on all his Income Tax returns. All that the State of Illinois was able to levy a tax on in his estate was his real estate in Chicago, shares of stock in Illinois corporations owned by him, and the contents of his residence on Lake Shore Drive, including many valuable paintings. The tax received by the state in the James Deering Estate amounted to \$224,456.96, whereas it would in all probability have been \$2,000,000 if he was a resident of Illinois.

The case of Norman Bridge might prove of interest. Dr. Bridge, an elderly gentleman, formerly lived in Chicago. For the later years of his life he moved to California and established a residence there. It seems that the California law limits the portion of one's estate that can be bequeathed to charity. When Norman Bridge was informed of that provision in the California

law, he concluded to re-establish his residence in Chicago, and by his will, which was probated here, gave most of his estate, which ran into several millions, to California universities. The state collected a tax of \$743,980.28. Had this decedent given his property to Illinois universities it would have been exempt from taxation.

The late James Patten, the wheat king, who left an estate of about \$20,000,000, gave by his will about \$7,000,000 to Illinois charitable, religious and educational institutions, none of which was subject to a tax. The state, however, received \$1,600,000 in inheritance tax on the property passing to his wife and children.

One of the innovations in the 1909 Inheritance Tax Law was the provision relating to the mode of taxing contingent interests. Instead of postponing the tax until the beneficiary received the property, as under the 1895 law, the law now provides for the taxing of all property upon a person's death whether the interests of the beneficiaries or distributees are vested or contingent. As the law now stands, all property transferred or limited in trust or otherwise, where the rights or interests of the transferees or beneficiaries are dependent on conditions or contingencies whereby they may be wholly or in part created, defeated, extended, or abridged, is taxable upon its owner's death at the highest rate, which on the happening of any condition or contingency, would be possible.

For example, a decedent with an estate of \$1,000,000 leaves a will creating a trust for the benefit of a son, with a proviso that the income be paid to the son until he attains the age of twenty-five years, at which time he is to receive the principal, and in the event of his death prior to the period of distribution, to the son's children, and if the son dies leaving him no children surviving, then to such persons as would be the decedent's heirs-at-law, at the time of such distribution. Under that state of facts the law would assume that the son would die before the period fixed for distributing the estate leaving no children him surviving, and that the entire estate would pass to a nephew or niece of the decedent, producing a tax of \$150,000. The estate is obliged under the law to pay that amount of tax immediately. The law also provides that when the time for final distribution arrives and the contingencies contemplated in the original assessment of the tax do not occur, in other words, if the son in the instant case survives the period of distribution and receives the entire estate, a redistribution of the tax is made, the tax reassessed, and a refund is made by the state for the difference between the amount of \$150,000 originally paid, and \$103,200 being the tax against a child, or the sum of \$46,800, together

with interest thereon at the rate of 3% per annum from the date of such payment until the refund is made.

The law does not contain any provision for segregating the moneys paid to the State Treasurer on estates where the tax was assessed at the highest rate as aforementioned. The tax so collected is treated as revenue, whereas a large portion of it is merely a deposit in the nature of security for the tax.

During the biennium of 1926-1928, close to \$3,000,000 was paid to the State Treasurer under the provision in the statute for the taxing of contingent interests. Many millions of dollars have been paid to the State Treasurer since the passage of the Act in 1909 that will ultimately have to be refunded. The money so received has been appropriated by the state and consumed for various state purposes.

The procedure for obtaining a refund of inheritance taxes after an order of re-assessment is entered in the county court, is to present a claim therefor to the Court of Claims, and after the claim is allowed by the Court of Claims, to obtain an appropriation from the State Legislature for such payment.

This section of the law was further amended at the last session of the Legislature, which amendment became effective July 1, 1929, so that now, instead of paying the tax assessed on contingent interests in full immediately, the estate is permitted to pay part of the tax, and deposit approved securities for the balance to guarantee the ultimate payment of the tax. The income derived from those securities is paid to the annuitant or life beneficiary. By this method, the life tenant is not deprived of the income on the amount that may ultimately be refunded. In this respect the present law eliminates the hardships that many estates were confronted with by being obliged to sacrifice securities to pay the tax immediately.

FRATERNITY AVERAGES

In the battle waged for the scholarship cup Phi Delta Phi emerged on top last semester, thus earning the right to retain the cup during the first semester of the 1931-32 year. Some of the other fraternities changed their standing markedly. Delta Chi rose from sixth to second and Delta Theta Phi from seventh to fourth. The averages of the fraternities for the second semester of 1931, together with their standing the previous semester are as follows: Phi Delta Phi, 1.775 (first); Delta Chi, 1.695 (sixth); Nu Beta Epsilon, 1.430 (second); Delta Theta Phi, 1.361 (seventh); Alpha Sigma Iota, 1.317 (fifth); Phi Alpha Delta, 1.239 (third); Kappa Beta Pi, 1.047 (eighth).

Sigma Delta Kappa, who had previously stood fourth, was omitted from last semester's list for lack of a sufficient number of members.

DEBATE

During the last two semesters the Chicago-Kent College of Law completed a successful debating schedule, which included the following opponents and subjects: Garrett Biblical Institute, which took the negative of the subject, "Resolved, that Religious Broadcasting is detrimental to churches"; University of Oklahoma, which took the negative of the subject, "Resolved, that the U. S. should purchase and reforest sufficient farm land to eliminate crop surpluses"; Northwestern University, which took the negative of the subject, "Resolved, that intercollegiate athletics as they are now conducted are detrimental to the student and to the school"; University of Notre Dame, which took the affirmative of the subject, "Resolved, that the several states should enact legislation providing for compulsory insurance of motor vehicles"; De Pauw University, which took the affirmative of the subject, "Resolved, that capital punishment should be abolished"; Lake Forest University, which took the affirmative of the subject, "Resolved, that an educational requirement should be attached to the right of suffrage"; University of Kansas, which took the negative of the subject, "Resolved, that judges should be elected by members of the bar"; Colgate University, which took the affirmative of the subject, "Resolved, that all colleges and universities should abolish the distinction between amateurism and professionalism in all sports to which admission fees are charged"; Creighton University, which took the negative of the subject, "Resolved, that the several states should adopt a system of compulsory unemployment insurance contributed to by employes"; Marquette University, which took the affirmative of the subject, "Resolved, that industry should be required by law to observe a five day week labor schedule"; University of Indiana, which took the negative of the subject, "Resolved, that the Eighteenth Amendment should be so modified as to permit government distribution of light wines and beer"; and Loyola University, which took the affirmative of the subject, "Resolved, that the jury should be abolished in criminal trials."

Early in the season the College arranged with radio station W L S for the initial broadcast. Later a permanent arrangement was made with W G N, the Chicago Tribune Station, which proved advantageous in every respect. Our debate department received fine co-operation from W G N, which has always sponsored an educational type of program, and we are pleased to

announce that the ensuing season's schedule will be broadcast over that station.

Since these broadcasts are for the benefit of the public in general, it has been sought to select topics of timely and wide-spread interest, and not to limit them to highly technical and legal subjects.

The following men were awarded debate keys at the June commencement: Kenneth E. Becker, Robert N. Bishop, Windham Bonham, Richard G. Finn, Morton B. Hochberg, and Horace G. Marshall. The latter was elected captain of next year's team. The activities were well directed by Edmund W. Burke, and it is hoped that he will be able to continue to direct next year's activities.