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Taxation - Federal Estate Tax - Possession and Enjoyment Clause

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TAXATION — FEDERAL ESTATE TAX — POSSESSION AND ENJOYMENT CLAUSE

On January 17, 1949, the Supreme Court of the United States clarified some of the uncertainties of the "possession and enjoyment" clause of the gross estate tax provisions of the Federal Estate Tax Statute [1] in the companion cases, *Spiegel's Estate v. Commissioner of Internal Revenue* [2] and *Commissioner of Internal Revenue v. Church's Estate.*[3]

In the *Spiegel Case* the decedent, a resident of Illinois, in 1930 had made an irrevocable transfer in trust to himself and another as trustees, the trust income to be divided among his three children, or their surviving issue, during the settlor's lifetime. Upon the settlor's death the trust corpus was to be divided equally among his three children or the surviving issue of any decedent children should they predecease the settlor. The trust instrument failed to provide specifically for distribution of the corpus should the settlor survive the named remaindermen, his children and grandchildren. The Supreme Court, following the ruling of the Court of Appeals [4] that under Illinois law the property might revert to Spiegel should he outlive all the beneficiaries, upheld the Commissioner's contention that the value of the trust corpus should be included in the decedent's gross estate. The interest retained was no greater than a possibility of reverter arising by operation of law, but the Court held that the transfer was not so complete, final, absolute and irrevocable as to remove the property from the operation of 811(c).

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[1] 26 U.S.C.A. 811(c). Transfers in contemplation of, or taking effect at death. "To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death. or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration of money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof made by the decedent within two years prior to his death without such consideration shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this subchapter; ..."

[2] 335 U.S. 701, 69 S.Ct. 301 (1949).

[3] 335 U.S. 632, 69 S.Ct. 322 (1949).

[4] Commissioner v. Spiegel's Estate, 7 Cir., 159 F. 2d 257 (1947).

The trust transfer in the *Church Case* was similar to that involved in the *Spiegel Case,* except that in the former the settlor reserved the income from the trust corpus to himself for life. The trust was created in 1924, prior to the joint resolution of Congress [5] which rendered trusts includable in the gross estate where the decedent settlor retained a life interest in the corpus.[6] The government contended that the possibility of reverter plus the retention by the settlor of the trust income brought the trust property within the decedent's gross taxable estate. *Held* that the trust agreement, because it reserved a life income in the property, was intended to take effect in possession or enjoyment at the settlor's death.

To better understand the impact of these two decisions, a review of the cases leading to this point is appropriate. The federal estate tax, as distinguished from a succession, or inheritance tax,[7] is levied on the *transfer* of something of economic worth from the decedent to the living.[8] In *May v. Heiner,*[9] where the grantor had made an *inter vivos* transfer in trust with a life estate reserved, a unanimous Supreme Court held that there was not such a "transfer of an estate" upon the settlor's death as to subject the trust corpus to the tax under the statute.[10] The Court construed the "interest" necessary to be legal title, disregarding the passage of the beneficial interest in the property. This position was reaffirmed later in three per curiam decisions [11] which precipitated the

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[5] Joint Resolution of March 3, 1931, 46 Stat. 1516, 1517.

[6] February 28, 1938, the Supreme Court held that neither the passage of the resolution nor its later inclusion in the 1932 Revenue Act was intended to apply to trusts created before its passage. Hasset v. Welch, (Helvering v. Marshall), 303 U.S. 303, 58 S.Ct. 559 (1938).

[7] May v. Heiner, 281 U.S. 238, 50 S.Ct. 286 (1930); Reinecke v. Northern Trust Co., 278 U.S. 339, 49 S.Ct. 123 (1929); Nichols v. Coolidge, 274 U.S. 531, 47 S.Ct. 710 (1928); Y.M.C.A. v. Davis, 264 U.S. 47, 44 S.Ct. 291 (1924).

[8] Ray, *The Estate Tax on Transfers Intended to Take Effect in Possession or Enjoyment At or After Death: Helvering v. Hallock,* 29 GA. L. J., 943, 944 (1941); Note, 34 ILL. L. REV. 867 (1940).

[9] 281 U.S. 238 (1930).

[10] "... the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property ... (c) to the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust in contemplation of or intended to take effect in possession or enjoyment at or after his death. . . ." Revenue Act of 1918, Sec. 402(c).

[11] Burnet v. Northern Trust Co., 283 U.S. 782, 51 S.Ct. 342 (1931); Morsman v. Burnet, 283 U.S. 783, 51 S.Ct. 343 (1931); McCormick v. Burnet, 283 U.S. 784, 51 S.Ct. 343 (1931).

joint resolution of Congress on March 3, 1931, blocking this portal to tax avoidance.[12]

In *Klein v. United States* [13] the Court ruled that where the grantor conveyed a life estate with a contingent remainder, retaining the fee subject to divestment, the trust corpus was taxable as part of the estate of the settlor. In spite of Mr. Justice Sutherland's statement in the majority opinion that "nothing is to be gained in multiplying words in respect to the various niceties of the art of conveyancing or the law of contingent and vested remainders," four years later in *Helvering v. St. Louis Union Trust Co.*[14] and *Becker v. St. Louis Trust Co.*[15] the Supreme Court decided that where the grantor reserves but a possibility of reverter the trust corpus was not taxable to the grantor's estate.[16] The net effect of these decisions placed a premium on the words used in the conveyance, that is on the nature of the common law interest created thereby,[17] rather than upon the existence of any interest which by its passage or destruction upon the death of the grantor operated to enlarge the estate of the recipient.

Helvering v. Hallock [18] helped to remove some of the nebulous, historical disparities imposed on the estate tax law by the juxtaposition of the *Klein* decision and the *St. Louis Trust Cases*. The trust instruments in question provided expressly for a possibility of reverter in the settlor upon contingencies which would terminate only at his death. A divided Court held that the entire trust corpus should be included in the gross estate. The distinctions in the common law denomination of the interest retained were no longer conclusively adopted as

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[12] See note 6, *supra*.

[13] 283 U.S. 231, 51 S.Ct. 398 (1931).

[14] 296 U.S. 39, 56 S.Ct. 74 (1935).

[15] 28[illegible] U.S. 48, 56 S.Ct. 78 (1935).

[16] Mr. Justice Stone, in the dissenting opinion, 296 U.S. 39, 47, following the spirit of the *Klein Case*, said, ". . . it would seem to be of no consequence what particular conveyancer's device—what particular string—the decedent selected to hold in suspense the ultimate disposition of his property until the moment of his death. In determining whether a taxable transfer becomes complete only at death we look to substance, not to form." Chief Justice Hughes, Justices Brandeis and Cardozo joined in the dissent.

[17] This result might have been foreshadowed by the *per curiam* decision in Helvering v. Duke, 290 U.S. 591, 54 S.Ct. 95 (1931), upholding decisions of the Board of Tax Appeals, 23 B.T.A. 1104, and of the Court of Appeals, 62 F. 2d 1057 (C.C.A. 3d 1933) that the express retention of a possibility of reverter in the trust instrument did not bring the trust corpus within the gross taxable estate.

[18] 309 U.S. 106, 60 S.Ct. 444 (1940).

a test of taxability; if something of economic value passed at death, the *inter vivos* transfer was testamentary in character. The Court suggested that the possession and enjoyment clause "deals with property not technically passing at death but interests theretofore created. The taxable event is a transfer *inter vivos*. But the measure of the tax is the value of the transferred property at the time when death brings it into enjoyment." This suggestion was authoritatively applied in *Fidelity-Philadephia Trust Co. v. Rothensies* [19] and construed to mean that "those property interests the ultimate possession and enjoyment of which is held in suspense until the moment of the grantor's death or thereafter" must be included in his gross taxable estate.

While vigorously reaffirming the Supreme Court's previous holding that the estate tax should not be governed by the "recondite niceties" of common law property concepts, the *Hallock Case* did leave several questions unanswered. The first of these, as to what property value is to be taxable to the decedent's estate, is definitively answered in the *Fidelity Trust Company Case*: "The value of the property subject to the contingency, rather than the actuarial or theoretical value of the possibility of the occurrence of the contingency, is the measure of the tax." [20]

The remaining questions still undecided after the *Hallock Case* were: (1) Did *May v. Heiner* survive *Helvering v. Hallock?* (2) Does section 811(c) apply to a possibility of reverter arising by operation of law, as opposed to such an interest created by the express intention of the grantor at the time of the conveyance? (3) Is the mere shifting of an economic interest upon the death of the grantor sufficient to make the property to which it is annexed taxable to his estate where nothing shifts from the grantor?

(1). Since the trusts involved in the *Hallock Case* were created in 1919, the governing statute [21] was like that applied in *May v. Heiner*. The exact status of the latter case was not certain since there was no definite statement by the court as to its intention, although the language of Mr. Justice Frank-

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[19] Where the decedent made a transfer in trust retaining a life estate and a power of appointment. 324 U.S. 108, 65 S.Ct. 508 (1945).

[20] *Id.* at 112, also Commissioner v. Estate of Field, 324 U.S. 113, 116, 65 S.Ct. 511 (1945).

[21] Revenue Act of 1918, Sec. 402(c); see note 10, *supra*.

furter in the majority opinion was certainly broad enough to express indirectly the intention to overrule *May v. Heiner.*[22] The lower courts, however, had frequently cited *May v. Heiner* as controlling.[23] For instance, in *Helvering v. Proctor*[24] Judge Learned Hand, speaking for the preponderate of the court, said, "The opinion of the majority in *Helvering v. Hallock* did not explicitly, or by inference from anything said declared that *May v. Heiner* was no longer law." Recent decisions of the Tax Court reveal that the law of *May v. Heiner* was still being applied by that tribunal.[25] So a reasonable conclusion would appear to be that *May v. Heiner* did in fact survive *Helvering v. Hallock.*[26]

(2). That the uncertainty expressed in question (2) was somewhat obviated by the Supreme Court in the *Fidelity Trust Case*[27] and the *Field Case*[28] is indicated by the Circuit Court decisions which relied thereon in holding that a possibility of reverter arising by operation of law brought the value of the property to which it was annexed into the decedent's taxable estate.[29] The Treasury Department incorporated this construc-

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[22] 309 U.S. 106, 111, 117, 60 S.Ct. 444 (1940).

[23] Blakeslee v. Smith, 110 F. 2d 364, 366 (C.C.A. 2d 1940). In U.S. v. Brown, 134 F. 2d 372, 373 (C.C.A. 9th 1943), the majority opinion states, "As late as 1938 the court, in *Hassett v. Welch,* appears to have regarded *May v. Heiner* as subsisting authority. The court did not expressly or by necessary implication overrule it in *Helvering v. Hallock.*"

[24] 140 F. 2d 87, 88, 55 A.L.R. 845 (C.C.A. 2d 1944). However, Judge Frank argues in his dissenting opinion that Helvering v. Hallock overruled May v. Heiner by clear implication.

[25] Estate of Hughes, 7 T.C. 1348 (1946); Estate of Friedman, 8 T.C. 68 (1947); Estate of Cochran, 9 T.C. 242 (1947).

[26] Nevertheless, the Supreme Court in the period since the *Hallock Case* cited May v. Heiner only twice, both times by Mr. Justice Douglas in concurring opinions, Fidelity Trust Co. v. Rothensies, 324 U.S. 108, 65 S.Ct. 108 (1945) and Commissioner v. Estate of Field, 324 U.S. 113, 65 S.Ct. 511 (1945), dissenting opinion of Judge O'Connell in Commissioner v. Church's Estate, 161 F. 2d 11, 13, n. 8 (C.C.A. 3d 1947).

[27] "It is enough if he (the settlor) retains some contingent interest in the property until his death or thereafter, delaying until then the ripening of full dominion over the property by the beneficiaries." 324 U.S. 108, 112, 65 S.Ct. 508 (1945).

[28] "It makes no difference how vested may be the remainder interests in the corpus or how remote or uncertain may be the decedent's reversionary interest." 324 U.S. 113, 116, 65 S.Ct. 511 (1945).

[29] Commissioner v. Bank of California, 155 F. 2d 1 (C.C.A. 9th 1946); Commissioner v. Bayne's Estate, 155 F. 2d 475, 167 A.L.R. 436 (C.C.A. 2nd 1946); Beach v. Busey, 156 F. 2d 496 (C.C.A. 6th 1946), *cert. denied,* 329 U.S. 802; Thomas v. Graham, 158 F. 2d 561 (C.C.A. 5th 1946).

tion into its tax policy by Treasury Regulation.[30] While a holding that such a possibility of reverter swept the entire corpus into the taxable gross estate was not directly within the scope of the *Hallock Case*, it did initiate the trend which was culminated by the *Spiegel* decision.

(3). To illustrate the problem in question (3), assume that *A* grants to *B* and his heirs a life estate for the life of *A*, remainder over to *C* in fee. Upon the death of *A* the possession or enjoyment of the property shifts from *B* or his heirs to *C*; although nothing of economic consequence passes from *A* or his estate, the time of vesting is conditioned on *A's* death.[31] The estate tax being levied on transfers at death,[32] it would seem an extreme interpretation of the statute to hold it applicable when the interest transferred had been completely and finally severed from the decedent. In *Reinecke v. Northern Trust Co.*[33] the Court stated, "One may freely give his property to another by absolute gift without subjecting himself or his estate to a tax, but we are asked to say that this statute means that he may not make a gift *inter vivos*, equally absolute and complete, without subjecting it to a tax if the gift takes the form of a life estate in one with a remainder over to another at or after the donor's death. It would require plain and compelling language to justify so incongruous a result and we think it is wanting in the present statute." It is submitted that the *Hallock Case* did not overrule the *Reinecke Case* directly, nor did it give rise to a reasonable inference that it was overruled. At any rate, the most recent test still relies on the presence of an interest in the grantor to determine taxability.

This was the state of the law from the time of the *Hallock* decision to the *Spiegel* and *Church Cases;* the uncertainties

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[30] A transfer of property by decedent during his life is intended to take effect in possession or enjoyment at or after his death, and such property is includable in his gross estate if "... (2) the decedent or his estate possesses any right or interest in the property (whether arising by the express terms of the instrument of transfer or otherwise)." U.S. Treas. Reg. 105, Sec. 81.17 (as amended by T. D. 5512, May 1, 1946).

[31] Problematic transfers of intermediate concern are those where the death of the grantor may determine when the benefits will shift, as in question (3), and may also determine who will benefit, as in question (2), e.g., A conveys to B for life, if A predeceases B, remainder to B in fee; but if B predecease A, remainder to C in fee.

[32] Cf. Y.M.C.A. v. Davis, 264 U.S. 47, 50, 44 S.Ct. 291 (1924); Edwards v. Slocum, 264 U.S. 61, 62, 44 S.Ct. 293 (1924); N. Y. Trust Co. v. Eisner, 256 U.S. 345, 349, 41 S.Ct. 506 (1921).

[33] 278 U. S. 339, 347, 49 S.Ct. 123 (1929).

stated above had been inconsistently treated by the lower federal courts, and a uniform rule of treatment was desirable.

CONCLUSIONS

Question (1), above, is directly answered by the *Church* decision, holding that *May v. Heiner* and the *Hallock Case* are in irreconcilable conflict and that the latter controls. This judicial construction is retroactively applied by the Court, and it is distinguished from their earlier refusal to allow the retroactive operation of the resolution and amendment in the *Hassett* and *Marshall Cases*.[34] As a result any transfer in trust by which the settlor retained a life estate, regardless of the time of creation, will subject the entire trust corpus to inclusion in the decedent's taxable estate under section 811(c).

Question (2) is affirmatively answered by the *Spiegel* decision: " . . . it is immaterial whether such a present or future interest, absolute or contingent, remains in the grantor because he deliberately reserves it or because, without considering the consequences, he conveys away less than all of his property ownership and attributes, present or prospective."[35] Any interest, thread or tie remaining in the grantor, no matter how remote, will operate to bring the whole of the property into his gross estate under 811(c).[36]

Neither the *Spiegel* nor the *Church Case* has changed the status of the problem posed in question (3). The *Spiegel Case* holds, that to avoid the incidence of the estate tax, there must be a bona fide transfer in which the grantor 'absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property."[37] A transfer that would raise question (3) would certainly meet this test. But the conclusion that such a transfer is beyond the reach of estate taxation under the present statute anticipates no further extension of the logic of the *Spiegel Case*. It is submitted that although a donor divest himself of all rights, interests and incidents in property by an *inter vivos* transfer, the conveyance

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[34] Note 6, *supra*.

[35] 335 U.S. 701, 69 S.Ct. 301, 303 (1949).

[36] The Court refused to apply the maxim of *de minimus non curat lex* despite its forceful presentation by Mr. Justice Burton in his dissent. 335 U.S. 701, 69 S.Ct. 301, 303 (1949).

[37] 335 U.S. 701, 69 S.Ct. 301, 303 (1949).

might be interpreted as testamentary in character if the death of the grantor effects a shift in possession or enjoyment of the property to a remainderman. When studied in the light of its historical interpretation by the Supreme Court, the estate tax law could inevitably reach this extreme result if it is to achieve the ultimate objective: "to subject all property to a death duty once in a generation." [38]

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[38] GLEASON AND OTIS, INHERITANCE TAXATION p. 9 (4th ed. 1925).