

EFFECT OF UNITED STATES INHERITANCE TAX LAWS ON PROPERTY TRANSFERRED UNDER VOLUNTARY TRUSTS

It is proposed to consider to what extent present United States inheritance tax laws affect trusts created by instrument (other than a will) conveying or transferring property to trustees for the use of designated individuals. Such trusts are sometimes referred to as "voluntary trusts," because created by voluntary act of a donor, or "living trusts" because established by indenture executed between living persons, as distinguished from trusts of similar purposes created by will of a decedent.

Voluntary trusts have been known for centuries, and long before income or inheritance tax laws. The fundamental idea of such trusteeships is to create an estate, the net income of which is to be applied for, or paid to, designated beneficiaries, the fund finally to be distributed as directed. By creating such trusts, a donor may delegate to another the care of an estate or place property in the hands of a trustee for women, minors and others who may be inexperienced in the care and investment of funds, and so as to protect such beneficiaries against the evil intentions of designing persons, placing the responsibility for the care and management of the estate in the hands of trustees of wide and tried business experience.

PROVISIONS OF INHERITANCE TAX LAWS

Present Federal inheritance tax laws of course do not affect voluntary trusts created before the enactment of the laws, and where the donor died before the enactment. Such laws expressly exclude conveyances and transfers to trustees that are made in case of a bona fide sale of property for a fair consideration in money or money's worth.

The Act provides, among other things, for the purpose of assessment of inheritance taxes, that the value of the gross estate of a decedent shall be determined by including the value at the time of his death of all property with respect to which he has (a) at any time created a trust in contemplation of death, or (b) intended to take effect in possession or enjoyment at or after his death, and (c) that any transfer of a material part of his property, in the nature of a final disposition or distribution thereof, made within two years prior to his death, without a fair consideration in money or money's worth, unless shown to the contrary, shall be deemed to have been made in contemplation of death, within the meaning of the Act.

(A) It is submitted that under the terms of the Act, any transfer in trust at any time made in contemplation of death, is subject to the inheritance tax, whether the transfer be made within two years of the death of the donor or at any time before, and no matter how long before; that in any given case where the conveyance shows that the transfer in trust is made in contemplation of death, the tax must be paid, although the donor reserves no interest in the estate for himself, and retains no power to revoke or amend the trust or control its devolution. The only doubt in the matter would be on the conclusiveness of evidence to prove the required fact. The burden of this proof would be on the Government.

(B) It is submitted that under the terms of the Act, any transfer in trust, intended to take effect in possession or enjoyment at or after the death of the donor, is likewise subject to the tax; as where the donor reserves the right to revoke or amend the trust, or control the devolution of the estate, or where, under the reserved right so to do, he provides for the final distribution of the estate by his last will. In such a case, no evidence would be required beyond the legal effect and intent of the trust instrument.

(C) It is submitted that any transfer in trust by a donor of a material part of his estate, in the nature of a final distribution, made within two years prior to his death, without a fair consideration, will be deemed to have been made in contemplation of death; and in such case the burden to prove the contrary will rest on the executor or administrator of the donor, the Act shifting the burden of proof to such representative.

RULINGS OF UNITED STATES TAX COMMISSIONER

The rulings of the Commissioner on the questions at issue closely follow the language of the Act, and are in accord therewith. Such rulings, of course, stand until revoked by him or his successor, or until final judicial determination to the contrary of any such ruling in a proper proceeding in the United States Court having jurisdiction of the given case.

Some of the rulings are as follows: (1) A transfer made by a decedent in his life-time, if made by way of gift, is taxable when made (a) in contemplation of death, or (b) intended to take effect in possession or enjoyment at or after death of the donor.

(2) No distinction is made between ordinary transfers and transfers involving the creation of a trust.

(3) Where a transfer constitutes a bona fide sale at a fair consideration in money or money's worth, it is not taxable. In order to constitute such a bona fide sale, there must be a valuable consideration, as distinguished from love and affection.

(4) A sale implies the receipt of a price in money or thing of value. The release of an existing claim, by way of accord and satisfaction, is not sufficient.

(5) The price must be a fair equivalent for the property transferred. Where the price is not a fair one, the sale will not be considered to have been bona fide.

(6) Transfers in contemplation of death do not refer to the general expectation of death which all persons entertain. A transfer is made in contemplation of death whenever the person making it is influenced to do so by such an expectation of death as arises from bodily or mental conditions that prompt persons to dispose of their property to those whom they deem proper objects of their bounty. Such a transfer is taxable although the decedent parts absolutely and immediately with his title to, and possession of, the property.

(7) Transfers made within two years of the decedent's death are presumed to be taxable, if they are of a material part of his property and are in the nature of a final disposition thereof.

(8) The executor must return transfers by the decedent of a material part of his estate to relatives, though made more than two years before his death, but need not list them as taxable if he contends otherwise.

(9) The fact that a gift was made as an advancement, to be taken into account upon final distribution of the decedent's estate, is not enough, standing alone, to establish taxability; but it is a circumstance to be considered in determining whether the transfer was made in contemplation of death.

(10) A transfer is taxable where the grantor reserves to himself during life the income of the property transferred. In such case the transfer of the principal takes effect in possession after the death of the grantor, and the value of the entire property should be included in the tax return of the gross estate.

(11) Where the grantor reserves a proportionate part of the income, only a corresponding proportion of the property should be included in the tax return of the gross estate, unless the transfer was made in contemplation of death.

(12) The principal of a trust fund, which takes effect at or after the decedent's death, is taxable, although the income during the decedent's life is payable to someone other than himself.

(13) A transfer by way of trust is taxable, where the grantor reserves the power of revocation, even though he does not reserve any interest in the trust created.

(14) A transfer by way of a trust is also taxable where the grantor reserves power to control the administration of the trust, as by reserving power to change the trustee, the trust period, the trust property, or the respective interests of the beneficiaries in such property.

DECISIONS BY STATE COURTS ON QUESTIONS OF TRANSFERS IN CONTEMPLATION OF DEATH

There has been considerable litigation in the States of California, Illinois, New York and Wisconsin, under their respective inheritance tax laws, containing provisions somewhat similar to the provisions of the United States Inheritance Tax Laws, on questions of transfers in contemplation of death. It cannot be said that the decisions in any of the respective States mentioned agree with the decisions of the other States, nor even that the decisions of any one of the States are uniform within such State.

The State courts mentioned admit that the question cannot be answered in any general way and therefore refuse to give a general definition of what is a transfer in contemplation of death; such courts hold that the answer depends upon the facts in each individual case, and whether there is a gift in contemplation of death is uniformly treated as a question of fact. Formerly the trend of the decisions was that only gifts made in view of impending death were made in contemplation of death; but the later decisions indicate that gifts made without fear of early demise nevertheless may

be made in contemplation of death, within the legal meaning of the term.

REVIEW OF A NUMBER OF CASES

It is beyond the scope of this paper to review the cases or to endeavor to reconcile or differentiate them, but to give an idea of both lines of cases, we refer to a number, to-wit:

(1) In re: Kelley, 213, Ill., 509: A conveyance by a man sixty-nine, of about one-half of his property, not made while in immediate apprehension of death, for the declared purpose of enabling his son to live in a manner called for by his station in life, was held not to be a transfer in contemplation of death.

(2) In re: Klein, 156 N. Y. Supp., 585: Gifts of money extending over a long period of years, not near time of death, were held not to have been made in contemplation of death.

(3) In re: Price, 116 N. Y. Supp., 283: A transfer of real estate of considerable value by a man seventy-six, who was in ill health, to an adopted son, was held to be a transfer in contemplation of death.

(4) In re: Hodges, 215 N. Y., 447: A transfer six months before death, of securities, by a husband to his wife, to supplement provisions in his will for her, was held to be a transfer in contemplation of death.

(5) In re: Bullen, 143 Wis., 512: An assignment of a large estate in trust by the owner, who was in ill health, made six years before his death, was held to be a transfer in contemplation of death. Owner had reserved the right to revoke and vacate the trust at any time during his life-time, but the securities constituting the trust had remained with the trustee.

(6) In re: Danks, 289 Ill., 542: The appraised value of the estate at death of owner was \$89,000. Maud Danks,

residuary legatee, received \$67,000. She also, prior, in November, 1915, received assignment of mortgage notes amounting to \$44,000, but decedent reserved interest thereon for life. It was admitted that the two items of \$67,000 and \$44,000 were subject to inheritance tax. In March, 1915, deceased conveyed to his daughter lands valued at \$31,000, and in November, 1915, lands valued at \$37,000. The deeds were absolute conveyances, and delivered at the times made. At times deeds were made, the grantor was sickly. On facts in the case, the court held inheritance tax was promptly levied also on the real estate conveyed by the two deeds, although absolute in form.

(7) *In re: Porter*, 287 Ill., 401: If a transfer is in contemplation of death, it is subject to the tax, though no evidence of that motive appears in the instrument affecting the transfer.

DECISION BY UNITED STATES COURT ON QUESTION OF TRANSFERS
IN CONTEMPLATION OF DEATH

The only reported United States Court decision on question of what is a transfer in contemplation of death, under present Federal law, appears to be in suit from Michigan, decided December 10, 1920, by United States Circuit Court of Appeals, 6th Circuit, in case of *Schwab, Executor, v. Doyle*, collector, in which the Court of Appeals holds, on the facts of the case, that the transfer in question was made in contemplation of death, notwithstanding the transfer was irrevocable and without reservation to the donor of any interest in the income or principal of the property transferred in trust.

It appears that a donor transferred \$1,000,000 personal property to the Detroit Trust Company, as trustee, by instrument absolute in form, in trust to pay the income and principal to certain beneficiaries, with no reservation in favor of donor; transfer took effect immediately, and was accom-

panied by delivery of property transferred; the trust was purely voluntary, and without consideration in money; 18 months afterward, donor died, possessed of an estate valued at \$800,000, upon which United States Inheritance Tax was paid; that tax was not involved in the suit.

In addition, the Collector, under Act of 1916, claimed inheritance tax on the amount placed in trust, as upon a transfer made in contemplation of death. The executor contended (a) that the United States Inheritance Tax Law was not intended to reach absolute conveyances in contemplation of death executed before passage of the Act; (b) that if so intended, the law is unconstitutional; (c) that there was no substantial evidence that the transfer was made in contemplation of death within the meaning of the statute. The District Court held the statute valid, and submitted to the jury the question whether the transfer was made in contemplation of death. Judgment in the District Court was rendered in favor of the Collector.

In review, the Court of Appeals points out that the statute makes taxable (a) property held by a decedent at the time of his death, subject to payment of debts and expenses of administration; (b) property of which the decedent has at any time made a transfer, or with respect to which he has created a trust, in contemplation of, or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for a fair consideration in money or money's worth.

SCOPE OF COURT OF APPEALS DECISION

The Court of Appeals expressed the opinion (1) that the statute evidences an intent on the part of Congress to make the tax apply to all transfers in contemplation of death, whether made before or after the passage of the Act, provided the donor's death occurred after the Act took effect; (2) that the Act declares any transfer of a material part of his estate, in the nature of a final disposition or distribution,

made by a decedent within two years prior to his death, without a fair consideration in money or money's worth, unless shown by evidence to the contrary, shall be deemed to have been made in contemplation of death, within the meaning of the Act; (3) that the transfer is taxed only at the death of the donor, no matter how long the transfer may precede his death; (4) that in the absence of substantial evidence to the contrary, it must be held Congress included, for purpose of inheritance tax, transfers made in contemplation of death * * * (there is no limit as to time when made); (5) that Congress intended one taking a conveyance of a testamentary character, entirely without consideration, should do so at the risk of having to pay a transfer tax, as would be the case where the transfer be by will or conveyance taking effect at or after the donor's death; (6) that the remaining estate of the decedent is primarily liable for the tax, and it is only when the remaining estate proves insufficient for the purpose, that resort may be had to the personal responsibility of the transferee, or the property transferred.

The Court of Appeals approves the instructions given by the District Court to the jury, in its consideration of the evidence submitted, to-wit: (1) By the term "in contemplation of death" is not meant on the one hand the general expectation of death, which is entertained by all persons; * * on the other hand, the meaning of the term is not necessarily limited to the expectancy of immediate death or a dying condition; (2) a transfer may be said to be made in contemplation of death if the expectation or anticipation of death, in either the immediate or reasonably distant future, is the moving cause of the transfer.

As the Court of Appeals views the transfer mentioned in the suit, it was an absolute gift *inter vivos* (between living persons), claimed by the Government to have been testamentary in character, and the Court holds that the ultimate question concerns the motive which actuated the donor, and it was open to inference by the jury that the transfer was

intended by decedent as part of a general testamentary disposition of property of the donor.

CONCLUSIONS

From the foregoing review of the law, rulings, State court decisions and the one United States Court decision, it appears to us that the following general principles may be said to bear directly on the question we are considering, to-wit:

(1) Any transfer to a trustee for individual beneficiaries, (a) actually admitted to have been made in contemplation of death, (b) or where evidence is produced reasonably to satisfy a jury as to such fact, will be subject to the tax;

(2) That the period of time to be taken into consideration is not limited to two years prior to the death of the donor; if the period of time is less than two years, the legal representative of the deceased donor has the burden of proving that the transfer of a material part of the donor's estate is not taxable; if the period of time is more than two years, the Government has the burden of proving the taxability of the transfer;

(3) The meaning of the words "in contemplation of death" is not necessarily limited to the expectancy of immediate death or to cases where the donor is in a dying condition;

(4) The ruling on the question in each case depends on the facts of the individual case, and the question whether a transfer in a particular case was made in contemplation of death, is uniformly treated as a question of fact;

(5) A transfer in trust that on its face is to take effect in possession or enjoyment at or after the death of the donor, is taxable, and no evidence is required beyond consideration of the terms of the instrument of transfer;

(6) Although a transfer be irrevocable and without reservation in the donor to control the estate, or amend or revoke the trust, or to receive any benefit from the trust, the question of fact must nevertheless be considered;

(7) Whether the estate transferred in trust is personally or realty is immaterial;

(8) The transfer in trust is taxed only at the death of the donor, no matter how long before death the transfer may have been made;

(9) The remaining estate of the donor is primarily liable for the tax, but if insufficient, recourse may be had against the transferee of the property or to the property transferred.

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