RETROSPECTIVE SUCCESSION TAXES.

By Robert Walston Chubb.

"Every law that takes away or impairs rights vested agreeably to existing laws, is retrospective and is generally unjust and may be oppressive; and it is a good general rule that a law should have no retrospect."[1] If this wholesome advice of Justice Chase in 1798 had been more generally observed, much litigation would have been avoided, and fewer issues raised to impede the administration of revenue laws. For the construction and the validity of laws actually or apparently retroactive in operation has many times been before the courts, and perhaps more frequently in the case of inheritance taxes than any other.

The cases clearly attest the wisdom of the rule above cited. The same attitude is evinced in one of the familiar maxims of statutory construction. In *U. S. v. Heth*,[2] the court said:

> "Words in a statute ought not to have a retrospective application unless they are so clear, strong and imperative that no other meaning can be annexed to them, or unless the intention of the legislature cannot otherwise be satisfied."

And the courts have gone to great lengths in applying this rule, both to ordinary excise taxes and to successive taxes.[3]

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1. *Calder v. Bull* (1798), 3 Dallas, 386, 391.
2. 3 Cranch 399.
3. See *U. S. v. Burr*, 159 U. S. 78, and *U. S. v. American Sugar Refining Company* (1905), 202 U. S. 563. In *Schwab v. Doyle*, 258 U. S. 529, the Supreme Court refused to hold that transfers made "at any time" included transfers made prior to the passage of the law. See also *Lewellyn v. Frick* recently decided in the Supreme Court (May 11, 1925).

One of the interesting problems in the present application of the federal estate tax law and state inheritance tax laws which has recently been much discussed[4] is the question of just how long the Supreme Court will be willing to limit to a rule of construction its evident repugnance to retroactive laws, and just how far it will extend the "limited retroactivity" heretofore approved in the income tax cases. The problem is a recurrent one and is likely to come up in the near future. Every one of the states (with the exception of Florida) now has on its books a succession tax law in some form, many of them retrospective; and notwithstanding the views of our chief executive, the federal law, historically a war measure, seems to remain a more or less permanent part of the structure of the internal revenue laws.

Most of the litigation has arisen over the provisions of the statutes which attempt to include in the estate, or tax as an inheritance, property transferred and vested prior to the passage of the law. The general disapproval of the courts, which has been noted above, has been brought to bear on such provisions many times. Mr. Justice McKenna in *Shwab v. Doyle*[5] directed his criticism at the Commissioner rather than at the legislature. The case involved the construction of the first of the present series of federal laws. This law included in the gross estate, transfers made at any time, when in contemplation of death or intended to take effect in possession or enjoyment upon death. The court said, referring to the Commissioner: "He fixes no period to the retrospect which

4. See Amberg, "Retroactive Excise Taxation," 37 Harvard Law Review, 691. See also note on "Retrospective Operation of Succession Tax," 26 A. L. R. 1461.

5. 258 U. S. 529, at p. 536.

he declares, but reserves, if he be taken at his word, the transfers of all time to the demands of revenue. In this there is much to allure an administrative officer. Indeed its simplicity attracts anyone. It removes puzzle from construction and perplexity and pertinence, on account of the distance of the death from the transfer, risking no chances of courts or juries, in repugnance or revolt, taking liberties with the act to relieve from its exactions to the demands of revenue."

Evidently there was "much to allure" Congress also in this construction, for in passing the law of 1918 the interpretation of the Commissioner was approved if not confirmed by a declaration in the law which expressly included all such transfers whether made before or after the passage of this act.[6] The latter clause has not yet been passed upon by the Supreme Court.

Furthermore the Congress seems to tend toward an extension of the retroactive principle. No further back than 1924 Congress forestalled the decision of the Supreme Court in the recent case of *Lewellyn v. Frick* (decided May 11th, 1925) by enacting a special section giving retroactive effect to the provision which includes in the gross estate proceeds of insurance payable to a named beneficiary.[7]

As a constitutional question, it is difficult to determine just how far the Supreme Court would go in upholding retroactive succession taxes. Unlike many state constitutions,[8] the Federal constitution contains no express prohibition against retrospective laws, except in the case of criminal

6. Revenue Act of 1918, Sec. 402 (c).
7. Revenue Act of 1924, Sec. 302 (h).
8. See Constitution of Missouri 1875, Art. II Sec. 15.

laws.[9] The contention that the clause of the Constitution prohibiting ex post facto laws, extended to inheritance tax laws was hazarded in *Carpenter v. Pennsylvania*[10] with the usual result. But the case was of importance in establishing the rule that an inheritance tax law may be retroactive in the limited sense hereafter discussed.

In order to understand the extent of the doctrine in *Carpenter v. Pennsylvania* it is necessary to consider at the outset the nature of the succession tax in its various forms. *Knowlton v. Moore*[11] is of course the leading case on this subject. In tracing the American legislation to the English and continental death duties, Mr. Justice White furnished a sound basis for the distinction, which has since held good, between legacy or inheritance taxes, as imposed by most of the states in this country, and probate or estate taxes, which are exemplified by our federal law. The case settled definitely that both of these taxes are to be regarded as excise taxes, upon the transmission and receipt of property by will or intestacy or their equivalents. The estate tax, which originated in a stamp tax upon letters of probate is regarded as a tax levied on the occasion of death at the beginning of the process of devolution, and measured by the interest of the decedent thereby transmitted. The legacy or inheritance tax was stated to be a tax levied upon the occasion of the receipt of property by the living from the dead and measured by the amount received. The power to transmit and the right to receive are conceived of as the privileges taxed.

Keeping this distinction in mind it will be seen that *Car-*

9. U. S. Constitution, Art. I Sec. 9 (3).
10. (1855) 17 How. (U. S.) 456.
11. (1900) 178 U. S. 41.

penter v. Pennsylvania, and similar cases upheld an application of inheritance laws, which was not retroactive in any accurate sense of the word. It was attempted in this case to tax an inheritance under a Pennsylvania statute enacted after the death of the testator, but before the legacy had been paid. The executor relied upon the fact that the legacy had, technically, vested and was not at that time taxable. The court held the legacy taxable, admitting that in some senses the rights of the legatees were vested, but added: "The rights of the donee are subordinate to the conditions, formalities, and administrative control prescribed by the state in the interests of its public order, and are irrevocably established upon its abdication of this control at the period of distribution. If the state, during this period of administration and control by its tribunals and their appointees, thinks fit to impose a tax upon the property, there is no obstacle in the Constitution and laws of the United States to prevent it."

Such also is the effect of the decision in *Cahen v. Brewster,*[12] which upheld a law imposing an inheritance tax upon successions and legacies wherever the estate was not settled at the time of the passage of the law.

In these cases the property was still *in gremio legis* and the cases make the point that since the tax is on the right to receive and not on the property, it might be imposed at any time before the succession was completed by final settlement. The distinction is made clear in Stauffer's Succession[13] which arose in the same jurisdiction as *Cahen v. Brewster.* In this case the legacies had not only vested in law but had also

12. (1906) 203 U. S. 543.
13. (1907) 119 La. 66, 43 So. 928.

been received by the legatees, by delivery from the executors. And it was held that in such case the tax could not be imposed where both the delivery and vesting was complete prior to the passage of the law.

It is accordingly believed that the question is still an open one: May Congress or the states tax successions which have completely vested at the time that the statute is enacted? The cases most frequently arise, as above stated, under the provisions which provide that transfers intended "to take effect in possession or enjoyment at or after death," or transfers made "in contemplation of death" shall be included as taxable parts of the estate or inheritance. The issue is not always clearly defined in these cases. The courts have not agreed as to the meaning of either of the phrases. Under the federal law alone, one line of authority holds that when Congress referred to possession and enjoyment it meant the actual "tradition" of the property, and would include as taxable transfers all vested remainders limited upon the life estate of the grantor.[14] The other line of cases represented by *Girard Trust Co. v. McCaughn*[15] considers that the words refer to the vesting in possession and enjoyment of the *interest* in the property which is acquired by the transfer.[16] The distinction is of course important where the retroactivity of the statute is made the ground for contesting its validity. If the privilege taxed is the privilege of actually receiving the property in possession, undelayed by the intervention of any inter-

14. *Shukert v. Allen* (U. S. D. C. Nebr. 1924), (300 Fed. 754), states this view with clearness and force.

15. 3 Fed. (2d) 618 (D. C. Pa. 1925), See also *Lynch v. Congdon* (1924), C. C. A. 8th Circ. F. (2d) 133.

16. This view seems decidedly strained. For the traditional use of the words "possession and enjoyment" see Blackstone, Bk. II Chap. 11.

mediate estate, then a law which is in force and imposes the tax upon the occasion of the termination of the intermediate estate would not be retroactive. If, on the other hand, the technical "vesting" of the estate (even an estate in expectancy) is the occasion for the tax, thereafter enacted, then no privilege or power remains to be exercised upon the termination of the intermediate estate and a tax upon the vesting would be retroactive.

A number of cases have considered the validity of retroactive application of inheritance or transfer taxes to transfers intended to take effect in possession or enjoyment at or after death. The case of *Hunt v. Wicht*[17] goes further than any other, by holding that a conveyance of the fee by deed placed in escrow, to be delivered upon the grantor's death, can not be taxed under a statute that was not in force at the date of the deed even though it was in force at the time of the grantor's death, and which expressly included transfers made before the passage of the act. The court took (somewhat questionable) the view that the whole interest vested at once at the time of the delivery of the deed,[18] but on principle concluded that it could not be taxed. This case followed a series of New York cases.

Granting that in *Hunt v. Wicht* the court's view of the occasion for the tax is correct, as a matter of construction, this line of authority would support the view that taxing of vested interests is invalid. The cases are not explicit as to the principles on which they are based. A recent writer on retro-

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17. (1917) 174 Calif. 205.

18. *Matter of Pell* (1922), 171 N. Y. 48. *In re Craig*, (97) App. Div. 289 affd. without opinion—181 N. Y. 551.

active taxation[19] has made the point, citing the New York cases and other authorities; that the laws, being fundamentally excise laws, cannot be applied to tax a privilege which has already been exercised. "If the taxpayer has already completed the transaction, a tax upon the privilege of consummating it is a contradiction in terms." The same reasoning appears in the New York case of *In re Craig*,[20] where the court said:

"The underlying principle that supports the tax is that such right is not a natural one, but is in fact a privilege only, and that the authority conferring the privilege may impose conditions upon its exercise. But when the privilege has ripened into a right, it is too late to impose conditions of the character in question, and when the right is conferred by a lawfully executed grant or contract it is property and not a privilege, and as such is protected from legislative encroachment by constitutional guarantees."

As to Federal taxation which so offends, contentions of its invalidity are based upon the constitutional provision that a direct tax may not be imposed by Congress unless apportioned.[21] Something of the same argument appeared in the lower court's decision in *Lewellyn v. Frick*[22] where the court said that inclusion in the estate of proceeds of insurance assigned prior to the enactment of the law amounted to a tax on property,—"the levying of a direct tax without apportionment as required by the constitution."

19. Julius Amberg, Esq., in 37 *Harvard Law Review*, 691, April, 1924.

20. Supra, footnote (18).

21. Constitution Art. I Sec. 9 (4).

22. (D. C. Pa. 1924) 298 Fed. 803. While affirmed by the Supreme Court, the latter court did not approve this position. Its decision was based on the rule of *Shwab v. Doyle*, that the statute was not clearly retroactive.

The soundness of this line of reasoning seems clear in the case of inheritance taxes. But in the case of estate taxes it is not so clear that the contention is available. It must be admitted that the federal estate tax is an excise tax and only valid as such.[23] However, as a practical matter, it would be difficult to prove in any case that no succession took place upon the death of the decedent. And if such succession is properly the occasion for the tax, the inquiry is more properly as to whether the measure of the tax is reasonable, or arbitrary and confiscatory.

There is some authority to support the contention that it is an unreasonable and arbitrary exercise of the taxing power to include in the measure of an estate tax, property which was transferred prior to the enactment of the law. The case of *Coolidge v. Nichols*[24] recently decided in the U. S. District Court for Massachusetts was a case involving a transfer of the second class, namely, a transfer in contemplation of death. Here the court disposed of the argument above set forth in the following words:

> "It has been stated that the nature of an excise or indirect tax forbids retro-active operation; that to exact a tax upon the privilege of consummating a transfer after it is completed leaves no choice in the taxpayer and the tax becomes an unavoidable and absolute demand, thereby losing its essential characteristics as an excise or indirect tax and becomes in effect a direct assessment upon the property itself simply because of ownership and as such is unconstitutional

23. *N. Y. Trust Co. v. Eisner*, 256 U. S. 345 upholding the state tax law of 1916.

24. 4 Fed. (2d) 112 (D. C. Mass. 1925).

> unless apportioned among the states....But after careful examination of the authorities on this point I am not prepared to state as my opinion that Congress has not authority to give retroactive effect to a law providing an indirect tax."

We are thrown back then, on the contention that the measure of the tax in such cases is arbitrary and unreasonable and a taking of property without due process of law contrary to the Fifth or the Fourteenth Amendment as the case might be. There is some support for this view. It has been stated that regulations are invalid where they are "so beyond all reasonable relation to the subject to which they are applied as to amount to mere arbitrary usurpation of power."[25] It is also established, that while the Fifth Amendment does not limit the taxing power, nevertheless, it applies where a tax is so unreasonable and arbitrary as to amount to a confiscation of property.[26]

This is the position of the court in *Coolidge v. Nichols,* where the court held that a transfer said to be in contemplation of death, which was completed prior to the enactment of the law could not be validly taxed, and said: "I am unable

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25. *Lemieux v. Young,* 211 U. S. 489.

26. *Brushaber v. Union Pacific.* 240 U. S. 1. Cooley, Constitutional Limitations (7th ed.), p. 695. In the Brushaber case, after calling attention to the rule that the Fifth Amendment could not be construed as a limitation on the taxing power, the Court stated that:

> "This doctrine would have no application in a case where, although there was a seeming exercise of the taxing power, the act complained of was so arbitrary as to constrain to the conclusion that it was not the exertion of taxation, but a confiscation of property, that is, a taking of the same in violation of the 5th Amendment; or what is equivalent thereto, was so wanting in basis for classification as to produce such a gross and patent inequality as to inevitably lead to the same conclusion."

to see on what grounds it could be successfully claimed that the transfer in question or the property transferred could be said to bear any reasonable relation to the tax."

> "In every case of transmission by will, intestate laws or transfers to take effect after death or in contemplation of death, a power, right or privilege has been exerted or exercised. When one has availed himself of this privilege, with knowledge of the tax, actual or constructive, he has voluntarily subjected himself to its burden, and a statute which includes in the measure of the tax the value of the property thus transferred may well be deemed to have provided a reasonable classification, and this even if the decedent has entirely parted with all control over, or interest in the property; but when one has, prior to the imposition of the tax, parted with all control over, or interest in the property, the classification becomes arbitrary and unreasonable. Such arbitrary inclusion of the property of others has been held in other jurisdictions invalid as unconstitutional."

In other words, there is no connection between a transfer which has completely vested prior to the passage of the law and an estate or inheritance taxed by such law. If the transfer is included as the equivalent of a testamentary disposition, it must be held that a testamentary devise, completed prior to the enactment of the law, could likewise be taxed by subsequent enactment. It is doubted whether any court would go so far. If the transfer is included merely to prevent eva-

sion of the tax, as has been suggested,[27] it is only necessary to point out that no intent can be found to evade a non-existent law.[28] The transfer bears no relation to the death of the decedent, which is the occasion for the tax.

It remains to dispose of the income tax cases which are so frequently cited as authority for the validity of retroactive laws.[29] The cases referred to, almost without exception, approve the imposition of taxes on the income for a current year, by a law passed in the same year. There are a number of grounds for distinguishing these cases. In the first place, income taxes must, since *Pollock v. Farmers Loan & Trust Company,*[30] be regarded as something more than indirect taxes. Second, the cases all involved taxation of annual income of a year not yet expired, when it could hardly be said that the occasion for the tax (if regarded as an excise) had arisen. These distinctions also apply even where the recipient of the income had died,[31] or its corporate existence term-

27. The Court in the *Coolidge* case suggests that the prevention of evasion is the purpose of inclusion of such transfers:

> "The right to impose a tax carries with it the right to adopt all reasonable measures to prevent an evasion of the tax. On this ground the power to measure an estate tax may properly be extended to gifts in contemplation of death, or gifts to take effect after death, because both are transfers in the nature of testamentary dispositions and could be easily resorted to for the purpose of evading the tax."

28. See *Brown v. Pennsylvania Co.* (Delaware 1924), 126 Atl. 715.

29. *Brushaber v. Union Pacific.* 240 U. S. 1.
Stanton v. Baltic Mining Co. 240 U. S. 103.
Tyee Realty Co. v. Anderson, 240 U. S. 115.
Dodge v. Osborn, 240 U. S. 118 et seq.
See also *Stockdale v. Atlantic Insurance Co.* (1873), 20 Wall. 323, which was decided at a time when the income tax was still regarded as an excise.

30. 157 U. S. 429, 39 L. ed. 759.

31. *Brady v. Anderson,* (C. C. A. 2 Circ.), 240 Fed. 665.

inated[32] prior to the enactment of the law, and even though all of the income had accrued during a portion of the year when no law was in effect. Income taxes in theory must be considered *sui generis* for they are in the nature of direct taxes upon property. Yet the source from which derived is immaterial and no lien attaches to the property for failure to pay the tax.

On the other hand, nothing is better settled than that both estate and inheritance taxes are excise taxes in their nature.[33] Furthermore, in the typical succession tax, while the tax is on the power to transmit or the right to receive, the measure of the tax is specific property. And under the federal law even in the case of transfers vested before any law is in effect, a lien would attach to the property.[34] A case might arise where a decedent had made so many gifts that his entire estate, which we may assume was disposed of by will to deserving objects, would be insufficient to pay the tax, so that it would of necessity be paid out of property long since transferred to others.

In conclusion, it is believed that retroactive application of the estate tax laws will be held unconstitutional, if at all, not because such application results technically, in direct taxation by the federal government, but because of the broader considerations, applicable alike to state and federal legisla-

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32. *U. S. v. Boss & Peake*, 290 Fed. 167.
U. S. v. Updike, 1 F. 2nd 550.
U. S. v. McHatton, 266 Fed. 602.

33. *N. Y. Trust Co. v. Eisner*, 256 U. S. 345.
Knowlton v. Moore, supra.
Magoun v. Illinois Trust & Savings Bank, 170 U. S. 283, 42 Led. 1037.

34. Revenue Act of 1918 Sec. 409. And see similar provisions in subsequent acts.

tion, namely that retro-active taxation is a denial of due process of law. A limited retro-activity may be countenanced, as in the income tax cases. But unless some limit is placed upon retro-activity in succession taxes, it may be confidently asserted that a case will sooner or later arise in which the Supreme Court will set its own limit and decide that a tax upon a succession measured by property transferred before the tax was enacted, is an arbitrary and unreasonable exercise of the taxing power.

That the retro-active application of succession taxes results in injustice cannot be denied. While all men hold their property subject to the right of the state to tax, they should be protected in their acts and in the disposition of their property by a reasonable assurance that the consequences of those acts will be determined by existing law—not by some indeterminable future law. It is enough to hold a man to a knowledge of what the law is, at any given time, (especially if it be the law of taxation); knowing the law, he should at least be enabled to predict with reasonable precision the legal consequences of his own acts. That an individual should act at his own peril as to future laws which may entirely change the color of his act,—is to deny him the security of law, and certainly cannot be within any proper conception of due process of law.