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TAXATION - ANNUITY CONTRACTS - FEDERAL ESTATE TAX

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TAXATION — ANNUITY CONTRACTS — FEDERAL ESTATE TAX — The decedent purchased several single-premium annuity contracts, the annuity payments to be made to her for life, and after her death to a designated second annuitant for life. The Board of Tax Appeals ruled that the policy should not be taxed as a transfer to take effect at death.[1] *Held*, on appeal, the interest passing to the second anuitant at the death of the decedent should be included in decedent's gross estate under the federal estate tax, since it falls within the provision taxing transfers intended to take effect in possession and enjoyment at or after the death of the transferor.[2] *Commissioner v. Clise*, (C. C. A. 9th, 1941) 122 F. (2d) 998.

The federal estate tax is a tax imposed upon the privilege of transferring property at death,[3] and the section of the statute taxing transfers intended to take effect in possession and enjoyment at or after the death of the transferor is designed to prevent evasions of the estate tax by inter vivos transfers testamentary in character.[4] The section is unfortunate in its phraseology, for it defies accurate definition or predictable application.[5] In *May v. Heiner*[6] the Supreme

[1] 41 B. T. A. 820 (1940).

[2] 53 Stat. L. 121 (1939), 26 U. S. C. (Supp. 1939), § 811 (c).

[3] Nichols v. Coolidge, 274 U. S. 531, 47 S. Ct. 710 (1927); Reinecke v. Northern Trust Co., 278 U. S. 339, 49 S. Ct. 123 (1929); Greiner v. Lewellyn, 258 U. S. 384, 42 S. Ct. 324 (1922).

[4] Helvering v. Bullard, 303 U. S. 297, 58 S. Ct. 565 (1938). See Knouff, "Death Taxes on Completed Transfers Inter Vivos," 36 MICH. L. REV. 1284 (1938).

[5] In applying the section the courts could examine the actual intent of the transferor in making the transfer, or they could look solely to the objective character of the transfer. Shukert v. Allen, 273 U. S. 545, 57 S. Ct. 461 (1927), would seem to be authority that the subjective approach has been rejected. A further question might be asked as to whether the "taking effect in possession and enjoyment" is a legal concept having reference to the time of vesting in interest or whether it is a layman's concept having reference to the time of the actual physical enjoyment of the property transferred. In Reinecke v. Northern Trust Co., 278 U. S. 545, 59 S. Ct. 123 (1927), a transfer in trust with the income during the life of the settlor given to one beneficiary, and the remainder at his death to another, was held not to be taxable as a gift to take effect at death. It would seem, therefore, that the shifting of physical enjoyment of a transfer at the death of the transferor alone is not sufficient to render the transfer taxable.

[6] 281 U. S. 238, 50 S. Ct. 286 (1930). This case may be overruled today. See Helvering v. Le Gierse, 312 U. S. 531, 61 S. Ct. 646 (1941); Estate of Mary H. Hughes, 44 B. T. A. 1196, No. 184 (1941); 1 PAUL, FEDERAL ESTATE AND GIFT TAXATION, § 7.15 (1942). On facts identical to the ones in the principal case, the Circuit Court of Appeals for the Fifth Circuit in Commissioner of Internal Revenue v. Wilder's Estate, (C. C. A. 5th, 1941) 118 F. (2d) 281, held the annuity taxable under the broad provisions of § 811 (c) "To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise . . . intended to take effect in possession or enjoyment at or after his death."

Court held that the statute, as it then read,[7] was inapplicable to a transfer in trust with a life income retained by the settlor. To avoid the effect of this decision, and three subsequent cases in accord with it,[8] Congress on March 3, 1931, amended this section of the act so as to tax transfers in which the transferor retained an interest.[9] It seems clear that a purchase of an annuity is a "transfer by trust or otherwise" under the act,[10] so that the first real question is whether the purchaser has retained "the possession or enjoyment of, or the right to the income from, the property" (money) given as consideration for the annuity. It has been indicated that the payment of money or other property in consideration for the annuity policy, and the payments received in return are entirely separate, so that the latter are in no way received as income from or enjoyment of the former,[11] although the court in the principal case held contra, saying that in an economic sense the purchaser retained the benefits for her life and at the same time made provision for the objects of her bounty.[12] Although the con-

[7] ". . . 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 . . . intended to take effect in possession or enjoyment at or after his death. . . ." Revenue Act of 1919, § 402, 40 Stat. L. 1097 (1918).

[8] 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).

[9] The section now reads: "To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise . . . 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. . . ." 53 Stat. L. 121 (1939), 26 U. S. C. (Supp. 1939), § 811 (c). Before the passage of this amendment, annuity policies similar to that of the principal case were held not to be taxable. Security Trust & Savings Bank, 11 B. T. A. 833 (1928). See also Chemical Bank & Trust Co., 37 B. T. A. 535 (1938), distinguished by the court in the principal case on the ground that the annuity policies were taken out by the decedent before the passage of the amendment.

[10] Helvering v. Le Gierse, 312 U. S. 531, 61 S. Ct. 646 (1941); Keller's Estate v. Commissioner of Internal Revenue, 312 U. S. 543, 61 S. Ct. 651 (1941); Old Colony Trust Co. v. Commissioner of Internal Revenue, (C. C. A. 1st, 1939) 102 F. (2d) 380. See Meisenholder, "Taxation of Annuity Contracts under Estate and Inheritance Taxes," 39 MICH. L. REV. 856 at 892 (1941).

[11] See In re Honeyman's Estate, 98 N. J. Eq. 638, 129 A. 393 (1925), affirmed sub nom. Bugbee v. Board of Home Missions, 4 N. J. Misc. 99, 131 A. 924 (1926), affirmed 103 N. J. L. 173, 143 A. 915 (1926).

[12] Principal case, 122 F. (2d) 998 at 1003. The commercial annuity in the principal case can be distinguished from the annuity in In re Honeyman's Estate, 98 N. J. Eq. 638, 129 A. 393 (1925). There the transferor gave away real estate and received therefor a promise of annuity payments worth but a fraction of the realty. The argument that there was a gift of the remainder of the property and a retention of a life income and that the gift of the remainder should be taxed as a gift to take

nection between the consideration paid and the installments received is not immediate, still it is sufficiently present to satisfy the statutory language in view of the Supreme Court's tendency to construe the taxing statutes broadly.[13] The court in the principal case also said that since the enjoyment by the second annuitant is contingent upon survival of the first annuitant and the death of the latter removed this contingency, the annuity is taxable under the rule of *Helvering v. Hallock*,[14] which held a transfer by means of an irrevocable trust to be taxable as a transfer intended to take effect at death where the settlor retained a right of reverter if he should survive a named beneficiary. It is not entirely clear that the rule of the *Hallock* case should be applied to the principal case, for while the interest of the second annuitant is conditioned upon survivorship to the same extent as were the contingent interests in the *Hallock* case, here there was no chance that the first annuitant or his estate would be enriched by prior decease of the first annuitant, as was true of the grantor in the *Hallock* case. It would seem that this difference is sufficient to bring a contrary result. However, this money should be taxed on the ground that possession and enjoyment had been retained by decedent during his lifetime.[15]

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effect at death was rejected by the court. There the transfer sought to be taxed was one between the transferor of the property and the transferee, and in the case of a commercial annuity the transfer sought to be taxed is the transfer between the transferor and the second annuitant at the death of the transferor.

[13] With the death of the first annuitant, the enjoyment of the economic benefits is transferred to the second annuitant. The argument might be made that this is a transfer intended to take effect at death (see note 5, supra), but this test seems to be rejected in Reinecke v. Northern Trust Co., 278 U. S. 545, 49 S. Ct. 123 (1927). However, this shifting of economic benefits at death was sufficient to uphold the constitutionality of the section of the statute which taxes insurance policies, the premiums of which have been paid by the decedent who retained no further interest in the policies. Bailey v. United States, (Ct. Cl. 1940) 31 F. Supp. 778.

[14] 309 U. S. 106, 60 S. Ct. 444 (1940).

[15] See Meisenholder, "Taxation of Annuity Contracts Under Estate and Inheritance Taxes," 39 MICH. L. REV. 856 at 904 (1941). See also 1 PAUL, FEDERAL ESTATE AND GIFT TAXATION, § 7.18 (1942).