Michigan Law Review

Volume 39 | Issue 5

1941

TAXATION - DEATH TAXES - GIFTS IN CONTEMPLATION OF DEATH

Kenneth J. Nordstrom
University of Michigan Law School

TAXATION — DEATH TAXES — GIFTS IN CONTEMPLATION OF DEATH — The problem arising when estate and inheritance taxes reach out and attempt to include transfers which have been completed inter vivos are of current importance in state and federal litigation.[1] A survey of the cases shows that the courts and legislatures are making a constant effort to fix and determine a workable rule for the application of a tax on transfers which have been made in life under circumstances so closely related to death that they may, in nature and effect, be properly classified as transfers made in contemplation of death. The problem is of no small moment, for perplexing and divergent views are to be found in the vast body of litigation that has arisen under both the state and federal statutes. Moreover, there appears to be a trend to extend the scope of the tax on transfers in contemplation of death, resulting in proposals for clarification and modification of this part of the tax structure. The aim and purpose of this comment will be: (1) to ascertain the present rule for classifying transfers inter vivos as being made in contemplation of death; (2) to determine if there is any present trend towards a broader interpretation of the tax; (3) to present modifications that have been suggested to remedy the difficulties in the application of this feature of the tax law. No attempt will be made to discuss the closely related questions of gifts not absolutely completed during the life of the transferor, or transfers to take effect in possession and enjoyment at or after the transferor's death.

[1] See Nicholas v. Martin, (N. J. L. 1940) 15 A. (2d) 235, where at the date of the gifts, the transferor was seventy-four years of age and was and had been in excellent health unusual for his years. The gifts were made by transferor to his two daughters to allay their fears of losing, as a result of the father's contemplated remarriage, the testamentary gifts which they expected at his death. Two years later the father died, and the court decided that this inter vivos gift was taxable as having been made in contemplation of death, notwithstanding an entire absence of any actual apprehension of death. See also In re Harnischfeger's Will, 208 Wis. 317, 242 N. W. 153, 243 N. W. 453 (1932); Purvin v. Commissioner of Internal Revenue, (C. C. A. 7th, 1938) 96 F. (2d) 929.

I.

Discussion in every contemplation of death tax case must necessarily involve a clear understanding of what transfers this provision of the estate tax statute intends to reach. Consequently the meaning of this concept becomes relevant. The federal estate tax statute and most of the state acts simply tax transfers "in contemplation of death," without further definition or explanation, and consequently the theory and application of that phrase should and most often does become the same in all jurisdictions.[2] Two schools of thought predominate: the first regards the tax as justified because a transfer of this character is equivalent to a transfer by will or intestacy; the second regards the taxation of such transfers as justified in order to prevent evasion of the inheritance or estate tax.[3] Although the latter of the two theories is often cited by the courts in sustaining the tax,[4] and although it is obvious that without a contemplation of death statute inheritance and estate taxes could be easily avoided, the first view seems preferable because it appeals to common sense and is not limited to cases where there is an active intent to avoid the tax. Whether a court gives lip service to one rule of justification or the other in a particular case, it seems clear that regardless of whether a transfer is made in good faith or bad, or with or without knowledge that a tax will be imposed, the test is whether the gift is in fact testamentary in character.[5]

But a mere statement of the theory of the taxing statutes will not suffice to comprehend the difficulties involved in their interpretation and application in the federal and state courts. It is apparent that every

[2] HUGHES, THE FEDERAL DEATH TAX, § 70 (1938). A typical statute on taxation of transfers in contemplation of death is that of New Jersey, N. J. Rev. Stat. (1937), § 54:34-1c, which imposes a tax: "Where real or tangible personal property within this state of a resident of this state or intangible personal property wherever situate of a resident of this state . . . is transferred . . . in contemplation of the death of the grantor, vendor or donor, or intended to take effect in possession or enjoyment at or after such death.

"A transfer by deed, grant, bargain, sale or gift made without adequate valuable consideration and within two years prior to the death of the grantor, vendor or donor of a material part of his estate or in the nature of a final disposition or distribution thereof shall, in the absence of proof to the contrary, be deemed to have been made in contemplation of death within the meaning of . . . this section."

[3] An excellent treatise on this general subject is to be found in 604 C. C. H. IHERITANCE, ESTATE AND GIFT TAX SERVICE, ¶¶ 1550-1552 (1936).

[4] Schweinler v. Martin, 117 N. J. Eq. 67, 175 A. 71 (1934), affd. 13 N. J. Misc. 722, 180 A. 774 (1935); United States v. Wells, 283 U. S. 102, 51 S. Ct. 446 (1931).

[5] United States v. Wells, 283 U. S. 102, 51 S. Ct. 446 (1931). For a discussion of the various fact situations that influence the courts in these decisions, see MONTGOMERY, FEDERAL TAXES ON ESTATES, TRUSTS, AND GIFTS, 1938-39, p. 179 et seq. (1938).

case will differ in respect to such circumstances as the age, physical condition, and motive of the transferor. Furthermore, how can either the taxpayer or the taxing body find satisfactory evidence of the "motive" of the transferor,[6] which usually lies peculiarly within his own mind? So while there has been much discussion and many litigated cases on the subject, the practical problems that beset parties concerned with transfers in contemplation of death are those of fact and not of law. However, that does not mean that there has been no effort to establish any criterion or test as to what facts shall be deemed sufficient to make a particular transfer taxable as in contemplation of death. Originally the term "contemplation of death" was used to cover a class of transfer not much greater in extent than gifts causa mortis.[7] Subsequently the coverage was extended to irrevocable gifts inter vivos, and it has now been expressed by statutory provision in California that the term "contemplation of death" shall not be limited or restricted to gifts causa mortis.[8] In addition, in an endeavor to avoid administrative difficulties in the tax as well as to fix and define a period in which a transferor might contemplate death, certain statutory presumptions have been enacted to apply to gifts made a definite period before death.[9] But even without aid of statutory presumptions, the courts have laid down certain tests by which it was hoped that some of the uncertainties arising from the variety of fact situations surrounding transfers inter vivos might be removed. The cases seem to rely on one of two theories, or a combination thereof, in respect to the meaning of the phrase "contemplation of death":[10] (1) that it relates to the physical condition of the decedent, i.e., to a gift made when death is believed to be imminent; (2) that it relates to a gift which is testamentary in character, that is, that it be practically the same as a final distribution of the estate.

For a practical definition of the phrase "contemplation of death" we must turn to a considered examination of the cases. The leading and

[6] Many cases require that the thought of death be the impelling motive for the transfer. See, for example, Colorado Nat. Bank v. Commissioner of Internal Revenue, 305 U. S. 23, 59 S. Ct. 48 (1938), noted in 37 MICH. L. REV. 338 (1938).

[7] The term was first used in the New York Transfer Tax Statute of 1891. N. Y. Laws (1891), c. 215. See historical discussion in 604 C. C. H. INHERITANCE, ESTATE AND GIFT TAX SERVICE, ¶ 1550B (1936).

[8] Cal. Gen. Laws (Deering, 1937), Act 8495, § 2(4).

[9] See statute in note 2, supra.

[10] For a discussion of recent developments away from the thought that the inter vivos transfer must bear a reasonable relationship to transfers at death, see Knouff, "Death Taxes on Completed Transfers Inter Vivos," 36 MICH. L. REV. 1284 at 1286 (1938).

most widely accepted decision is that in *United States v. Wells*,[11] where the Supreme Court stated:

> "While the interpretation of the phrase [in contemplation of death] has not been uniform, there has been agreement upon certain fundamental considerations. It is recognized that the reference is not to the general expectation of death which all entertain. It must be a particular concern, giving rise to a definite motive. . . . The statutory description embraces gifts *inter vivos* despite the fact that they are fully executed, are irrevocable and indefeasible. . . . The dominant purpose is to reach substitutes for testamentary dispositions and thus to prevent the evasion of the estate tax. . . . The words 'in contemplation of death' mean that the thought of death is the impelling cause of the transfer, and while the belief in the imminence of death may afford convincing evidence, the statute is not to be limited, and its purpose thwarted, by a rule of construction which in place of contemplation of death makes the final criterion to be an apprehension that death is 'near at hand.'
>
> "If it is the thought of death, as a controlling motive prompting the disposition of property, that affords the test, it follows that the statute does not embrace gifts *inter vivos* which spring from a different motive."[12]

This view has been adopted by the United States Board of Tax Appeals, by the lower federal courts, and by most of the state courts.[13] A few states, notably New Jersey[14] and Wisconsin,[15] seemingly have departed from the federal view; reference to the decisions of these states will be made later in this discussion.

Aside from the cases, the term "in contemplation of death" will be made somewhat clearer if it is borne in mind that the phrase "in contemplation of" has an accepted though not precisely delimited meaning. Thus the phrases "in contemplation of bankruptcy" or "in contemplation of marriage" indicate or import an event which is impend-

[11] 283 U. S. 102, 51 S. Ct. 446 (1931).

[12] Id., 283 U. S. at 115, 116, 116-117, 118.

[13] HUGHES, THE FEDERAL DEATH TAX 114 et seq. (1938); Purvin v. Commissioner of Internal Revenue, (C. C. A. 7th, 1938) 96 F. (2d) 929; Nevin v. Commissioner of Internal Revenue, 16 B. T. A. 15 (1929), affd. Commissioner of Internal Revenue v. Nevin, (C. C. A. 3d, 1931) 47 F. (2d) 478, cert. den. Burnet v. Nevin, 283 U. S. 835, 51 S. Ct. 485 (1931); In re Culver's Estate, 185 Wash. 54, 53 P. (2d) 302 (1936).

[14] Schweinler v. Martin, 117 N. J. Eq. 67, 175 A. 71 (1934), affd. 13 N. J. Misc. 722, 180 A. 774 (1935).

[15] In re Harnischfeger's Will, 208 Wis. 317, 242 N. W. 153, 243 N. W. 453 (1932).

ing, imminent, and expected, and not something problematical or remote. But under present decisions, there is no escape from the necessity of careful scrutiny of the circumstances of each case to detect the dominant motive of the donor in the light of his bodily and mental condition, and of thus giving practical effect to the statute.[16]

2.

From a survey of recent state and federal decisions and statutes, there is indication that the courts, legislatures, and administrative taxing officials have been extending the scope of the tax on transfers in contemplation of death—meeting with varying degrees of success. The result has been much litigation and sometimes an overzealous attempt by taxing officials to extend this provision of the tax law beyond its normal scope.[17] As indicated heretofore, the earlier statutes merely taxed transfers which took effect at death. Later the statutes sought to include transfers in contemplation of death. Since the burden of proof is on the state, and since in many cases the elements essential to an application of the tax are very difficult if not impossible to prove, nearly thirty-five states[18] have adopted prima facie presumptions to the effect that all transfers made a limited period before the transferor's death are in contemplation of death. These presumptions are generally limited to apply to gifts made within a period before death of the transferor ranging from three years in some states to ninety days in others. The South Carolina statute has extended the presumption so that gifts made within five years prior to death of the transferor to persons related by blood or marriage are presumed to be transfers in contemplation of death.[19] Another instance of a legislative extension of the tax is the California inheritance law of 1935, repealing a former law which stated that transfers made more than four years before the donor's death were not made in contemplation of death.[20] Beyond this point of prima facie presumptions the "contemplation of death" estate taxes have encountered constitutional difficulties. In *Heiner v. Donnan*[21]

[16] United States v. Wells, 283 U. S. 102, 51 S. Ct. 446 (1931).

[17] See 604 C. C. H. INHERITANCE, ESTATE AND GIFT TAX SERVICE, ¶ 1550F (1936). For a review of the extensive federal litigation, see HUGHES, THE FEDERAL DEATH TAX 133 (1938).

[18] Colorado, Connecticut, Delaware, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin.

[19] S. C. Code (1932), § 2480 (c).

[20] See note 8, supra.

[21] 285 U. S. 312, 52 S. Ct. 358 (1932).

the Supreme Court held unconstitutional, as a denial of due process guaranteed by the Fifth Amendment, the provision of the Revenue Act of 1926[22] creating a conclusive presumption that all inter vivos transfers made within two years of death were made in contemplation of death. Similarly dealt with under the Fourteenth Amendment was a six-year conclusive presumption created by a state act.[23] The Supreme Court in the *Heiner* case followed the well-established rule that the thing taxed under the federal estate tax was "the transmission of property from the dead to the living"[24] and held that the statute did not include gifts purely inter vivos. The Court reasoned that the intent to enact it as an incident to a death tax was clear, and if construed as a death tax it would violate the due process clause of the Fifth Amendment because the tax was levied not upon the value of the gift at the date of the transfer, but upon the value of the transferor's property at the date of his death. Such an imposition of the tax was held so arbitrary as to be in conflict with the Fifth Amendment.

Any further extension of the tax upon transfers in contemplation of death would, under the above doctrine, be precluded, but a complete change of attitude by the Court appears to have opened the door again to conclusive presumptions. The first important step in this regard was the case of *Helvering v. City Bank Farmer's Trust Co.*,[25] where the Court upheld the validity of a tax classifying inter vivos gifts with transfers at death. The Supreme Court decided that:

> "A legislative declaration that a status of the taxpayer's creation shall, in the application of the tax, be deemed the equivalent of another status falling normally within the scope of the taxing power, if reasonably requisite to prevent evasion, does not take property without due process. But if the means are unnecessary or inappropriate to the proposed end, are unreasonably harsh or oppressive . . . or arbitrarily ignore recognized rights to enjoy or to convey individual property, the guarantee of due process is infringed."[26]

Subsequently, in *Helvering v. Bullard*,[27] the power of Congress to subject completed non-testamentary transfers to the death tax was tested

[22] 44 Stat. L. 70, § 302 (c) (1926), 26 U. S. C. (1935), § 411 (c).

[23] Schlesinger v. Wisconsin, 270 U. S. 230, 46 S. Ct. 260 (1926).

[24] Heiner v. Donnan, 285 U. S. 312 at 322, 52 S. Ct. 358 (1932). For a general discussion, see Knouff, "Death Taxes on Completed Transfers Inter Vivos," 36 MICH. L. REV. 1284 (1938).

[25] 296 U. S. 85, 56 S. Ct. 70 (1935).

[26] Id., 296 U. S. at 90.

[27] 303 U. S. 297, 58 S. Ct. 565 (1938).

and upheld. The Supreme Court went even beyond the contentions of the government in holding that:

> "Since Congress may lay an excise upon gifts it is of no significance that the exaction is denominated an estate tax or is found in a statute purporting to levy an estate tax. Moreover, Congress having the right to classify gifts of different sorts might impose an excise at one rate upon a gift without reservation of a life estate and at another rate upon a gift with such reservation. Such a classification would not be arbitrary or unreasonable."[28]

Although these decisions rested on statutes which specifically designated certain types of inter vivos gifts as taxable under the death tax, the Court has intimated that it is no violation of due process to classify all types of gifts inter vivos with transfers at death, and commentators[29] agree that the case overrules and repudiates the reasoning of the *Heiner* case.[30] These decisions suggest a change of judicial attitude toward taxation of transfers in contemplation of death, and point to the possibility of a widened application of this provision of the estate tax.

Administrative agencies have not been unaware of the possibilities of greater revenue to be derived from a broader interpretation of the tax on transfers in contemplation of death. For example, the recent regulations of the treasury department, adopted and approved on March 5, 1940, substituted a broader definition of taxable transfers for the prior definition.[31] The revised regulations, in part, now provide that:

> "A transfer in contemplation of death is a disposition of property prompted by the thought of death (though it need not be solely so prompted). A transfer is prompted by the thought of death if it is made with the purpose of avoiding the tax, or as a substitute for a testamentary disposition of the property, or for any other motive associated with death."[32]

[28] Id., 303 U. S. at 301.

[29] Altman, "Combining the Gift and Estate Taxes," 16 TAX MAG. 259 at 260 (1938); Lowndes, "The Tax Decisions of the Supreme Court, 1938 Term," 88 UNIV. PA. L. REV. 1 at 32 (1939).

[30] 285 U. S. 312, 52 S. Ct. 358 (1932).

[31] The revised regulations may have been the result of the decision in Farmers' Loan & Trust Co. v. Bowers, (C. C. A. 2d, 1938) 98 F. (2d) 794, where the court adopted a doctrine which appears to be an extension of the definition found in the Wells case. The court, using language much like that found in the subsequently amended regulation, stated that a transfer is taxable if there is present a substantial motive to avoid estate taxes, notwithstanding the presence of other motives to escape other kinds of taxation.

[32] 75 T. D., No. 37, p. 9, Decision No. 4966 (1940).

Previous regulations had required that the thought or contemplation of death must have been the dominant or impelling motive of the transferor.[33]

A broadened application of the "contemplation of death" concept is evident in the decisions of some state courts. In New Jersey, under the court's analysis in *Schweinler v. Martin*,[34] it is hard to conceive how any sizeable gift, even by a young man, could escape taxation. In that case the donor transferred almost all of his property, including his business, to his family, but continued as president of the business. In very broad terms the court stated that the New Jersey tax statute, which is worded like the federal estate tax statute, intended to treat as a testamentary transfer every transfer by which the transferor sought to accomplish as nearly as practicable the same or similar results as in the case of a testamentary or intestate transfer. By means of the construction in that case, the state court would apparently restore the conclusive presumption striken down by *Heiner v. Donnan*. Again, in Wisconsin, with a statute taxing transfers in contemplation of death in general terms, the same as provided in the federal estate tax statute, the court in *In re Harnischfeger's Will*[35] departed from the federal rule on this subject. In that case the decedent was in excellent health and habitually made gifts to his family. He reorganized his business to provide working capital, and as a result found himself with an abundance of liquid assets, with which he increased the amount of his distributions. The court was impressed sufficiently that this was decedent's "putting his house in order" to sustain the exclusion of a physician's testimony as to the decedent's good health and buoyant spirits at the time of the transfers, thus making these transfers taxable.

It is evident that the exact meaning of the phrase "in contemplation of death" has not been established. So difficult has been the problem that a few states have attempted to provide a statutory definition, this generally taking the form that contemplation of death means that expectancy of death which actuates the mind of a person making a will.[36] The difficulty with such definition is that it is broad enough to include young persons as well as old, regardless of the health of the transferor, and it does not distinguish between the unascertainable and greatly differing expectancies actuating young and old persons in executing a will. But the statutes do serve as evidence of the tendency of taxing bodies to extend the application of the estate tax on transfers in contemplation of death.

[33] Treas. Reg. 80, art. 16 (1937).

[34] 117 N. J. Eq. 67, 175 A. 71 (1934), affd. 13 N. J. Misc. 722, 180 A. 774 (1935).

[35] 208 Wis. 317, 242 N. W. 153, 243 N. W. 453 (1932).

[36] California, Ohio, South Dakota, and Tennessee.

3.

It is apparent from the foregoing discussion that the tax on inter vivos transfers made in contemplation of death, by its very nature, has been a difficult concept for the courts, legislatures, and administrative tax commissions to handle. As one writer sums it up:

> "The provision in the federal estate tax taxing transfers in contemplation of death, although manifestly a necessary detriment to tax avoidance, continues to constitute an administrative bugbear. Despite the fact that this clause has been in the federal estate tax since its inception in 1916, the courts are still groping for a clear and workable definition of what it means."[37]

Consequently, it seems pertinent to inquire what reforms or modifications could be utilized to remedy the situation.

The Supreme Court in *United States v. Wells*[38] adopted a pessimistic attitude toward the hope of a more adequate standard for the tax by saying that there could be no escape from carefully scrutinizing the circumstances of each case to give effect to the statute. However, by virtue of developments since the *Wells* case, it would seem that the best solution of this problem would be secured by a statute establishing a conclusive presumption of the type whose constitutionality was condemned by *Heiner v. Donnan.*[39] Although that case has not been explicitly overruled, the Court in *Helvering v. Bullard*[40] made it clear that it was no violation of due process to classify completed inter vivos gifts with transfers at death. The problem is so pressing and the position of the *Heiner* case so dubious that it would appear that Congress and the several state legislatures would be fully justified in attempting once more to solve this problem by a conclusive presumption. As one writer stated, after reviewing the decision of *Helvering v. Bullard,*

> "There is no need any longer to make the statute a book of synonyms and to reduce the courts to seminars of medieval schoolmen, who debated whether ten or a hundred angels could dance together on the head of a pin. If gifts *inter vivos* and transfers at death may be classified together then let the distinction be cast aside and reason be returned to the law."[41]

[37] Lowndes, "The Tax Decisions of the Supreme Court, 1938 Term," 88 UNIV. PA. L. REV. 1 at 31 (1939).

[38] 283 U. S. 102, 51 S. Ct. 446 (1931).

[39] 285 U. S. 312, 52 S. Ct. 358 (1932).

[40] 303 U. S. 297, 58 St. Ct. 565 (1938).

[41] Altman, "Combining the Gift and Estate Taxes," 16 TAX MAG. 259 at 260 (1938). It has been suggested that the state or federal government might, in lieu of the suggested conclusive presumption statute, impose a single tax combining gifts inter

A conclusive presumption that all gifts made a certain period of time before the transferor's death were made in contemplation of death would greatly simplify and render more effective the tax picture. This point was forcibly projected by Justice Stone's dissent in *Heiner v. Donnan*, where he related that in the one hundred and two cases deciding the question whether a gift had been made in contemplation of death, only twenty cases involving gifts of approximately $4,250,000 were successful on the part of the government. In three cases it was partially successful, and in seventy-eight cases involving gifts in excess of $120,000,000 it was unsuccessful. In fifty-six of the total of seventy-eight cases decided against the government, the gifts were made within two years of the death of the transferor. From the decision in *Heiner v. Donnan* to the year 1937, there have been reported forty-eight cases in which the issue was whether the transfer was made in contemplation of death, the government losing thirty-four and winning fourteen. Surprisingly enough, most of the cases lost involved transfers made when the grantor was over seventy years of age.[42] These figure adequately present the argument for adoption of the conclusive presumption. The existing tax structure attempts to reach all transfers in contemplation of death, with ineffective results. The suggested modification would obviate this objection, for it would include only those transfers which, considered from any fair point of view, are taxable under conditions which bear the clear indicia of their taxability.

Finally, there may be stated the alternative plan of abolishing the tax on transfers in contemplation of death entirely, and simply subjecting such transfers to the existing inter vivos gift tax. However, the federal inter vivos gift tax rate is substantially lower than the "death tax" rate, and consequently there is little likelihood that such a plan would be adopted by a tax attentive Congress. Nor would the solution lie in the establishment of equivalent rates for inter vivos and testamentary transfers. If it be the policy of legislative bodies to encourage and accelerate a wider distribution of property in praesenti, there is a

vivos and death transfers. However, this could not have greater efficiency than the conclusive presumption test, because of the difficulties in tracing and valuation beyond the period which a conclusive presumption transfer tax would reach. Any practical scheme for combining all gifts inter vivos with transfers at death under one tax would have to place the valuation of any property and the assessment of the tax with respect thereto at the same or nearly the same period. That date, moreover, in order to avoid the difficulty of tracing the property over a long period, would have to be close to the date of the transfer. Note the comments on the injustice that may arise under a combined inter vivos and death tax in Nichols v. Coolidge, 274 U. S. 531 at 542, 47 S. Ct. 710 (1927).

[42] These last figures are from HUGHES, THE FEDERAL DEATH TAX 133 (1938).

sound and logical basis for a lower tax rate on transfers which are non-testamentary in character. The existence of a general inter vivos tax may afford a basis for a narrowed construction of the phrase "transfers in contemplation of death" than where the transfer is taxable only, if at all, under the death tax statute. It is evident that such reasoning will influence a court in a borderline case, but the argument is of little value in effectuating a clarification of this part of the tax structure.

Kenneth J. Nordstrom