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# TAXATION-FEDERAL ESTATE TAX-JOINT TENANCY-RETROACTIVITY

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TAXATION—FEDERAL ESTATE TAX—JOINT TENANCY—RETROACTIVITY—The recent decision by the Supreme Court in *United States v. Jacobs*[1] deals with the troublesome issue of retroactivity under the federal estate tax law. The decedent whose estate was involved in this case had paid the entire consideration for certain real estate which was conveyed to himself and his wife as joint tenants. This transaction took place in 1909. The decedent died in 1924, shortly after the effective date of the Revenue Act of that year. The Commissioner of Internal Revenue included the entire value of the real estate in the decedent's gross estate. The executors paid the tax under protest and sued to recover. The district court held that only half the value of the real estate could be included in the gross estate. The circuit court of appeals affirmed. On certiorari to the Supreme Court, it was held, with three justices dissenting, that the judgments below should be reversed; that the tax should be measured by the entire value of the real estate, and that so applied it was not invalid under the due process clause on the ground that it was retroactive.

It is generally assumed that inter vivos gifts made in contemplation of death or to take effect in possession or enjoyment at or after death are immune in some degree from death transfer taxes where the gifts are irrevocable and have been effected before enactment of the taxing law. The extent of this immunity is described in the decisions of the Supreme Court beginning with *Nichols v. Coolidge*.[2] In that case the transferor had created an irrevocable trust, reserving a life estate for herself and creating for her children a vested remainder subject to be divested if they predeceased her. The Court held that a tax on the transfer, imposed by a law enacted after the transfer but before the transferor's death, was fatally retroactive.[3] It was thought for some time that the reason for the Court's conclusion was the fact that the original transfer was irrevocable and beyond recall when the taxing law was passed, that it would be manifestly unfair to the tax-

[1] 306 U. S. 363, 59 S. Ct. 551 (1939), motion to set aside judgment denied, 306 U. S. 620, 59 S. Ct. 640 (1939).

[2] 274 U. S. 531, 47 S. Ct. 710 (1927).

[3] The tax was levied under the Revenue Act of 1919, 40 Stat. L. 1097. A like conclusion was reached in Coolidge v. Long, 282 U. S. 582, 51 S. Ct. 306 (1931), where a retroactive tax was sought to be imposed on the same transfer under Mass. Gen. Laws (1932), c. 65, § 1.

The Revenue Act of 1926, 44 Stat. L. 70, § 302 (c), has been construed as not imposing the federal estate tax on inter vivos transfers under which the transferor has retained for his life the income from the property. May v. Heiner, 281 U. S. 238, 50 S. Ct. 286 (1930). It was not until the Joint Resolution of 1931, 46 Stat. L. 1516, was passed, that such transfers were taxable. The Joint Resolution of 1931, as re-enacted in the Revenue Act of 1932, 47 Stat. L. 279, § 803 (a), has been construed as inapplicable to irrevocable transfers made prior to the passage of the resolution. Hassett v. Welch, 303 U. S. 303, 58 S. Ct. 559 (1938).

payer to permit the tax in this situation.[4] But in *Binney v. Long*[5] the decedent had transferred property in irrevocable trust, reserving a life estate for himself and creating contingent remainders in the alternative for his children and their children, and the Court sustained a tax on the transfer, imposed by a law enacted after the transfer but before decedent's death. The Court said that the tax was valid, because the interest of the transferees had not become vested before passage of the taxing law. Except for the fact that in *Nichols v. Coolidge* the transferees took a vested remainder subject to be divested, while in *Binney v. Long* they took contingent remainders in the alternative, the two cases are substantially alike. It is fairly clear now that the immunity from tax adduced in *Nichols v. Coolidge* is based on legal rather than practical considerations.[6] In the light of *Binney v. Long*, *Nichols v. Coolidge* stands for the proposition that a tax on an irrevocable transfer is fatally retroactive only where the interest of the transferee has become vested before enactment of the taxing law.[7]

However, there is at least one situation in which the Court reached a conclusion inconsistent even with this interpretation of *Nichols v. Coolidge*. In *Third National Bank & Trust Co. v. White*,[8] the Court

[4] 45 HARV. L. REV. 156 at 158 (1931); Surrey and Aronson, "Inter Vivos Transfers and the Federal Estate Tax," 32 COL. L. REV. 1332 at 1367 (1932); Lowndes, "A Day in the Supreme Court with the Federal Estate Tax," 22 VA. L. REV. 261 at 281 (1936).

[5] 299 U. S. 280, 57 S. Ct. 206 (1936), noted in 50 HARV. L. REV. 785 (1937) and 36 MICH. L. REV. 167 (1937).

[6] "Having relied on legal rather than practical considerations to invalidate the tax in *Coolidge v. Long*, it would be inconsistent here to rely on practical rather than legal considerations to invalidate the same tax." Binney v. Long, 299 U. S. 280 at 288, 57 S. Ct. 206 (1936).

The validity of other legislation under the due process clause has been tested by these same "legal considerations." Thus statutes frequently provide for judicial sale of land affected with a future interest, upon application of any party in interest or of any party having a present interest. Such statutes are held to be unconstitutional when applied to vested future interests created before the statutes were enacted. See Schnebly, "Power of Life Tenant or Remainderman to Extinguish Other Interests by Judicial Process," 42 HARV. L. REV. 30 at 62-70 (1928). But see 1 SIMES, FUTURE INTERESTS, § 66 (1936).

[7] However, some degree of retroactive taxation is permitted in connection with irrevocable transfers, even though the interest of the transferee has become vested before enactment of the law under which the tax is sought to be imposed. Thus, if at the time of the transfer a statute was already in force describing the transfer as one upon which a death tax would be imposed, the transfer may be taxed according to the schedule of rates in force at the time of the transferor's death, though that schedule is higher than it was when the transfer was made. Milliken v. United States, 283 U. S. 15, 51 S. Ct. 324 (1930); Phillips v. Dime Trust & Safe Deposit Co., 284 U. S. 160, 52 S. Ct. 46 (1931).

[8] 287 U. S. 577, 53 S. Ct. 290 (1932), affirming (D. C. Mass. 1930) 45 F. (2d) 911. The same conclusion was reached in Helvering v. Bowers, 303 U. S. 618, 58 S. Ct. 525 (1938), reversing (C. C. A. 7th, 1937) 90 F. (2d) 790.

sustained a tax measured by the entire value of property held by decedent and spouse as tenants by the entirety, where the estate had been created prior to enactment of the taxing law. Had the Court followed *Nichols v. Coolidge*, the transfer would not have been taxable at all, because creation of the tenancy accomplished an immediate and irrevocable transfer of a vested interest in the entire property.[9] But three years later *Nichols v. Coolidge* received unqualified recognition by the entire Court in *White v. Poor*[10] and *Helvering v. Helmholtz.*[11] Since that time it has been taken for granted that *Third National Bank & Trust Co. v. White* was a narrow decision on tenancies by the entirety and had detracted nowise from the authority of *Nichols v. Coolidge.*[12]

These were the various decisions exerting the force of their logic in *United States v. Jacobs.*

The Revenue Act of 1916 was the first federal law to impose a death transfer tax on a gift effected during the life of the transferor through the creation of a joint tenancy. It provided that the entire value of all property held by decedent and any other person as joint tenants, except such part thereof as may be shown to have belonged originally to such other person, should be included in the decedent's gross estate for the purpose of computing the federal estate tax.[13] At first this provision was not specifically retroactive, and it was construed as requiring that only half the value of the property be included in the measure of the tax where the joint tenancy had been created prior to 1916, even though the decedent had supplied the whole consideration for the property.[14] The provision was made retroactive by the

[9] Each tenant is seised of the whole estate, and the survivor is entitled to the whole of the property. Neither tenant can alienate his interest and defeat the right of survivorship unless the other tenant joins in the conveyance. 1 TIFFANY, REAL PROPERTY, § 194 (1920).

[10] 296 U. S. 98, 56 S. Ct. 66 (1935).

[11] 296 U. S. 93, 56 S. Ct. 68 (1935).

[12] See Lowndes, "A Day in the Supreme Court with the Federal Estate Tax," 22 VA. L. REV. 261 at 279-284 (1936). Perhaps the explanation of Third Nat. Bank & Trust Co. v. White is that, though by reference to the "amiable fiction" of the common law, creation of a tenancy by the entirety effects an irrevocable transfer of the whole property, nevertheless in view of the intimate relationship between the tenants—a tenancy by the entirety can be created only in favor of husband and wife—the spouse who had created the tenancy still retains a practical control over disposition of the property; and this makes it impractical to treat creation of the tenancy as an irrevocable transfer of the whole property for purposes of retroactive taxation and to hold the transfer entirely exempt from tax under the doctrine of Nichols v. Coolidge.

[13] 39 Stat. L. 777, § 202 (1916): "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, real or personal, tangible or intangible . . . (c) To the extent of the interest therein held jointly or as tenants in the entirety by the decedent and any other person. . . ."

[14] Knox v. McElligot, 258 U. S. 546, 42 S. Ct. 296 (1922). The same result

Revenue Act of 1924.[15] Thereafter it was held that half the value of the property might be included under the 1924 law, where the tenancy had been created prior to 1916 and the survivor had supplied half the consideration.[16]

The *Jacobs* case was the first to raise the question whether the entire value of the property might be included under the 1924 law, where the tenancy had been created prior to 1916 and the decedent had supplied the whole consideration.[17] The difficulty was that by including the entire value of the property in the measure of the tax, a tax was imposed upon an irrevocable transfer of a vested half interest in the property made in 1909, and this was at variance with *Nichols v. Coolidge.* But the Supreme Court made no mention of *Nichols v. Coolidge,* and sustained the tax measured by the entire value of the property. The taxable event, the Court said, was not creation of the joint tenancy, but the shift in economic benefits at decedent's death after the effective date of the Revenue Act of 1924. It relied on *Third National Bank & Trust Co. v. White,* and on the fact that joint tenancies and tenancies by the entirety are similar in nature. Justices McReynolds, Butler and Roberts dissented, urging (1) that the tax measured by more than half the value of the property was retroactive according to *Nichols v. Coolidge,* and (2) that similarity between joint tenancies and tenancies by the entirety is reason enough for treating these estates alike where they have been created after enactment of the taxing law and different treatment would afford opportunity for tax evasion, but not where they have been created before the law was passed and at a time when tax evasion could not have been a motive for their creation. The logic employed by the Court in the *Jacobs* case —namely, that viewing the shift in economic benefits at decedent's death as the taxable event, the tax was prospective—did not dispose of *Nichols v. Coolidge.*[18] *Binney v. Long, Third National Bank & Trust*

was reached in Cahn v. United States, 297 U. S. 691, 56 S. Ct. 384 (1936), reversing (Ct. Cl. 1935) 10 F. Supp. 577.

[15] 43 Stat. L. 304, § 302 (1924): "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, real or personal, tangible or intangible . . . (e) To the extent of the interest therein held as joint tenants by the decedent and by any other person. . . . (h) Subdivisions . . . (e) . . . of this section shall apply to the transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after the enactment of this Act."

[16] Gwinn v. Commissioner, 287 U. S. 224, 53 S. Ct. 157 (1932).

[17] The Court had already decided that the tax might be measured by the entire value of the property, where the joint tenancy had been created after 1916 and the decedent had supplied the whole consideration. Foster v. Commissioner, 303 U. S. 618, 58 S. Ct. 525 (1938), affirming (C. C. A. 9th, 1937) 90 F. (2d) 486.

[18] The decedent's executors also argued that even this logic was not enough to justify measuring the tax by more than half the value of the property, because there

*Co. v. White*, and cases permitting retroactive taxation of revocable transfers[19] stand on this logic, but *Nichols v. Coolidge* does not. If this logic had been employed in *Nichols v. Coolidge*, the tax involved there would have been valid, since a shift in economic benefits had occurred at the transferor's death. That case, if it is still good law, represents the one situation in which this logic is considered of insufficient force to sustain a retroactive tax. It may be that the Court, in ignoring *Nichols v. Coolidge*, meant to take a step in the direction of overruling the case once and for all. If that was not its intention, the *Jacobs* case merely adds to the confusion created by the earlier decisions. The similarity between joint tenancies and tenancies by the entirety would seem to have no bearing whatever upon the question whether the tax was fatally retroactive.

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was a shift in economic benefits at decedent's death with respect to only a half interest in the property (the half interest which accrued to the survivor by right of survivorship) and not with respect to the other half. Their argument seems to have been this: the survivor took a half interest in the property when the joint tenancy was created in 1909; the survivor could have alienated her interest and have converted the estate into a tenancy in common at any time; the only shift in economic benefits to the survivor at decedent's death, with respect to that interest, was that death removed the hazard that the decedent might take it as survivor; that shift in economic benefits was only theoretical, not real, considering that before decedent's death the survivor already had power to remove the hazard by conveyance.

[19] Reinecke v. Northern Trust Co., 278 U. S. 339, 49 S. Ct. 123 (1929); Gwinn v. Commissioner, 287 U. S. 224, 53 S. Ct. 157 (1932).