TAXATION - INHERITANCE TAX - DOUBLE TAXATION OF CONTINGENT FUTURE INTERESTS WHERE EXERCISE OF POWER OF APPOINTMENT IS TAXED TO DONEE'S ESTATE

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TAXATION — INHERITANCE TAX — DOUBLE TAXATION OF CONTINGENT FUTURE INTERESTS WHERE EXERCISE OF POWER OF APPOINTMENT IS TAXED TO DONEE'S ESTATE — Testator had been bequeathed a life interest in the income of certain trusts, and in addition the corpus thereof in case she were living at the termination of those trusts, or, in the event of her death prior to the termination of the trusts, a power to appoint the persons who should receive the income for the remainder of the trust period and the corpus on distribution thereof. Under the then current Wisconsin statutes, this transfer to testator was taxed as if she had received a fee. On appeal, it was held that this was correct but that if the contingent remainder should be defeated by the death of the testator before the expiration of the trust term, the tax might be adjusted. Testator died before the expiration of the trust term, and exercised the power of appointment in her will. The appointees instituted proceedings for a redetermination of the tax on the original transfer, and an order was entered taxing the transfer of a life estate to testator, and of the remainder to her appointees. This redetermination was opposed by the state. In the present

1 "In estimating the value of any estate or interest in property to the beneficial enjoyment or possession whereof there are persons . . . presently entitled thereto, no allowance shall be made in respect . . . of any contingency upon the happening of which the estate or property or some part thereof, or interest therein, might be abridged, defeated, or diminished; provided, however, that . . . in the event of the abridgement, defeat or diminution of such estate or property or interest therein . . . a return shall be made to the person properly entitled thereto. . . ." Wis. Stat. (1919), § 1087-15(6), now found in Stat. (1937), § 72.15(6).

2 In re Estate of Stephenson, 171 Wis. 452, 177 N. W. 579 (1920).
proceeding to determine the inheritance tax payable by the beneficiaries who took under testator’s will, it was ordered that the passage of the remainder to the appointees on the exercise of the power by the testator-donee should be taxed as if the property in question were the donee’s property. The appointees appealed, contending that the transfer was already taxed as coming under the estate of the donor of the power, and that the matter was res adjudicata. Held, that the appointees took as such under the will of the donee, and under the Wisconsin statute such transfer was required to be taxed. *In re Morgan's Will,* (Wis. 1938) 277 N. W. 650.

Where a will provides for a contingent future interest, the uncertain nature of the gift raises problems with reference to the rate at which and the persons against whom inheritance taxes are to be levied. Some states do not attempt to tax the transfer until the interest vests. But in order to insure that a proper tax will be paid to the state, various methods of taxing such interests presently, usually including provisions for adjustment on the happening of the contingency, have been adopted. Where a contingent interest is also the subject matter of a power of appointment, further difficulties arise. The statutes quite commonly provide that the exercise of a power of appointment by will or by an instrument treated by the tax laws as testamentary should be a taxable transfer in the same manner as if the donee were the owner of the property. Under such statutes it has been held that where there is an estate devised or bequeathed which is to pass on the exercise of a power of appointment, there is no transfer until the donee exercises the power, and that the transfer should be taxed only in the donee’s estate, and not in the estate of the donor. This would seem to be a proper holding, since it is desirable not to tax the same transfer both in the donor’s and in the donee’s estate. But if the estate subject to the power is a

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8 “Whenever any person . . . shall exercise a power of appointment . . . such appointment, when made, shall be deemed a transfer taxable . . . in the same manner as though the property to which such appointment related belonged absolutely to the donee of such power, and had been bequeathed or devised by such donee by will; and whenever any person . . . shall omit or fail to exercise the same . . . a transfer . . . shall be deemed to take place to the extent of such omission or failure. . . .” Wis. Stat. (1937), § 72.01(5).

4 Pinkerton and Millsaps, Inheritance and Estate Taxes, § 114 (1926).

5 Some states impose a tax on the basis that the contingency yielding the highest tax will occur. Other states, including Wisconsin, only require the taxpayer to pay a tax on the basis that the contingency requiring the lowest tax will occur. One state, Washington, imposes a tax on the basis of the most likely contingency. For a listing of numerous statutes, see Robinson, Saving Taxes in Drafting Wills and Trusts, 2d ed., § 8 (1933). See also, Pinkerton and Millsaps, Inheritance and Estate Taxes, § 114 (1926).

6 82 Univ. Pa. L. Rev. 39 at 41 (1933); Robinson, Saving Taxes in Drafting Wills and Trusts, 2d ed., § 12 (1933).

7 McDougald v. Low, 164 Cal. 107, 127 P. 1027 (1912).

8 In this sense, double taxation occurs under the federal estate tax statutes. A tax on the donor’s whole estate, including property which is the subject matter of a power of appointment, must be paid, § 302 (a), Treas. Reg. 80, art. 13, and also, property passing by the testamentary exercise of a general power of appointment is
In those states that follow the rule that non-exercise of the power constitutes a taxable transfer, it would seem that in the interest of avoiding double taxation, the contingent transfer section of the statute should not be applied, and that the transfer should only be taxed in the donee’s estate, since it can be there taxed whether the power is exercised or not. But where the power is accompanied by a default clause, and a non-exercise of the power is held not a taxable transfer, or where, as in the instant case, the contingent interest may vest independently of the exercise of the power, to tax only in the donee’s estate may result in the transfer escaping taxation altogether. Thus, if it is to be assured that the state will receive a tax on this sort of transfer, probably the only way that double taxation can be avoided is to allow an adjustment of the tax paid in the donor’s estate should the interest not pass on the contingency, but by the exercise of the power. Under this analysis, it is thought that both transfers were properly taxed in the instant case. But it would seem that an erroneous result was reached in the proceedings for redetermination of the tax on the original transfer. It is clear that since the contingency of survival did not occur, and the remainder never vested in the testator-donee, her tax was properly adjusted so as to tax only a life interest as passing to her. But under the Wisconsin statute providing that a transfer by power of appointment should be taxed as if the donee were the owner of the property passing by virtue of the exercise of the power, the transfer to the appointees should not have been taxed as coming from the donor. The proper place to tax that transfer was in the donee’s estate. However, the error in the redetermination proceedings was not before the court in the instant case, and the court could scarcely avoid the mandate of the statute that the exercise of a power of appointment is a taxable transfer in the donee’s estate.

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regarded as part of the gross estate of the donee, § 302 (f), Treas. Reg. 80, art. 24. The only mitigating factor is the independent provision providing that no tax need be paid on a transfer if it has been taxed previously within five years. § 303 (a), Treas. Reg. 80, art. 41 (1937 ed.). See CCH Federal Tax Service, §§ 3391, 3463, 3519 (1938).

9 See In re Robinson’s Estate, 192 Minn. 39, 255 N. W. 486 (1934); Robinson, Saving Taxes in Drafting Wills and Trusts, 2d ed., § 16 (1933).

10 Pinkerton and Millsaps, Inheritance and Estate Taxes, § 167 et seq. (1926).

11 Robinson, Saving Taxes in Drafting Wills and Trusts, 2d ed., § 16 (1933).

12 See note 3, supra.