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Taxation - Federal Estate Tax - Effect of Presidential Freezing Orders on the Creation of Excludable Bank Deposits for Nonresident Aliens

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TAXATION—FEDERAL ESTATE TAX—EFFECT OF PRESIDENTIAL FREEZING ORDERS ON THE CREATION OF EXCLUDABLE BANK DEPOSITS FOR NONRESIDENT ALIENS—Decedent, a citizen and resident of France, was the sole income beneficiary of a trust fund held in New York by the plaintiff as trustee. An executive order,¹ issued pursuant to the Trading with the Enemy Act,² prohibited remittance of trust income to the decedent from 1940 to the time of her death in 1946. As this income accrued, the plaintiff's trust department transferred it to the plaintiff's general banking department in its own name as trustee and subject to its order out of current banking funds.³ In an action by the executor of the decedent-beneficiary's estate to recover an amount paid as an estate tax deficiency on the money so deposited, *held*, recovery granted. The impounded income, being "moneys

¹ Executive Order No. 8389, April 10, 1940, 12 U.S.C. (1958) §95a. The order continues in force to date, but has been periodically amended to vary the particular nations covered by it at any given time according to the exigencies of intervening international realignments. France was placed on the list in 1940 and was removed on June 27, 1953 by General License No. 101 [8 C.F.R. §511.101 (1958)], which removed restrictions against all but certain Iron Curtain nations. The order is now administered under the Attorney General's Regulations, 8 C.F.R. §511 (1958).

² 40 Stat. 411 (1917), as amended, 48 Stat. 1 (1933), 12 U.S.C. (1958) §95a.

³ Under New York law, a trust company is permitted to deposit accumulated trust income in its own general banking department. ⁴ N.Y. Consol. Laws (McKinney, 1950) §100-b.

deposited . . . by or for a nonresident not a citizen" within the meaning of section 863 (b) of the 1939 Internal Revenue Code,⁴ was not property within the United States for federal estate tax purposes. *City Bank Farmers Trust Company v. United States*, (S.D. N.Y. 1959) 174 F. Supp. 583.

Intra-bank transfers of this nature involving the funds of foreign beneficiaries, when made during a period in which the owner's control over his funds is unimpaired, have been properly held to result in "moneys deposited" within the meaning of section 863 (b).⁵ The transfer involved in the principal case, however, was made during a period in which banking transactions involving foreign owned funds were greatly restricted by the executive order. The court dismissed this factual distinction by saying, "a bank deposit *remains* a bank deposit even though the Government has forbidden the bank to act on its customer's instructions."⁶ But an entity must *attain* a given status before it can remain in that status, and so the more basic question is whether the transferred income in the principal case ever *became* such a bank deposit.

Exclusions of otherwise taxable property are granted in a revenue code to attain ends deemed by Congress to outweigh the consequent loss of tax revenue. It follows that an exclusion should be allowed only to the extent that the policy on which it is based is served. The language "moneys deposited" used in section 863 (b) is patently ambiguous, and it is settled that not every form of deposit is excludable.⁷ The reason for placing this exclusion in the code was to enhance the competitive position of American banks vis-à-vis foreign banks in attracting deposits by nonresident aliens.⁸ But global tension in 1940 caused a complete reversal of this congressional policy.⁹ The executive order implementing the Trading with the Enemy Act provided, inter alia, that funds belonging to nationals of certain warring states could not be brought into, sent out of, or transferred between

⁴ Now I.R.C., §2105 (b), substantially unchanged.

⁵ In *Bank of New York v. United States*, (S.D. N.Y. 1957) 174 F. Supp. 911, the trustee bank deposited excess trust income which had been held back to cover trust expenses. (The executive order was in effect at the time of these deposits but the decedent, a British citizen, was unaffected thereby.) The income so deposited was correctly held excludable under I.R.C. (1939), §863 (b).

⁶ Principal case at 586. Emphasis added.

⁷ See, e.g., *City Bank Farmers Trust Co. v. Pedrick*, (2d Cir. 1948) 168 F. (2d) 618 (money deposited with a bank trustee, with the beneficiary not having unqualified control over or right to the funds).

⁸ See S. Rep. 275, 67th Cong., 1st sess., p. 25 (1921). The exclusion was first enacted as §403 (b) (3) of the Revenue Act of 1921, and has been reenacted continuously to date. Revenue Act of 1924, 43 Stat. 307, §303 (e); Revenue Act of 1926, 44 Stat. 73, 74, §303 (e), as amended by Revenue Act of 1934, 48 Stat. 753, §403 (d), which replaced the phrase "nonresident decedent" with the phrase "nonresident not a citizen of the United States," the language used in subsequent codes; I.R.C. (1939) §863 (b); I.R.C., §2105 (b). For a judicial restatement of the congressional policy, see *Estate of Oei Tjong Swan v. Commissioner*, (2d Cir. 1957) 247 F. (2d) 144.

⁹ Immediately after issuance of the executive order, it was "approved and confirmed" by Congress. See 54 Stat. 179 (1940). So, although the restrictions emanated from the executive, they reflected then current congressional policy.

American banking institutions,¹⁰ thus in effect destroying precisely that competitive position which the exclusion was enacted to enhance. Congress could not have intended that an exclusion of certain deposits from gross estate, designed to attract foreign deposits, should also encompass an intra-bank transfer of funds effected during a period in which Congress itself has declared that there shall be no such deposits. When read in the context of existing law in this area, the result in the principal case would lead to the rule that the taxability of impounded trust funds would depend solely upon which of its internal departments the trustee bank chose to be the repository of the funds. If placed in a general deposit, as in the principal case, such funds would be exempt, but if placed in a special deposit¹¹ or in a safety-deposit box,¹² they would be taxable; yet none of these internal transfers of the funds would alter their essential nature as impounded funds. When a nonresident alien can direct, authorize, or at least acquiesce in a disposition made of his funds, such disposition may result in a bank deposit within the intent of section 863 (b), and any subsequent freezing of the funds merely preserves the status quo, leaving their character as an excludable deposit unimpaired.¹³ However, while the executive order is in force as to him, the nonresident alien has no control over, or even knowledge of, any disposition made, for only the bank has power to deal with his funds. Funds placed by an American bank in a deposit account during a period in which it has exclusive control over those funds cannot create a deposit within an exclusion designed to encompass a deposit created by the actions of nonresident aliens.¹⁴ It follows that all funds accruing in the United States since 1940 to nonresident aliens while such funds are subject to the executive order should not be excluded, under section 863 (b),¹⁵ from the gross estates of those dying while the order is in effect.¹⁶

¹⁰ See note, 41 *Col. L. Rev.* 1039 (1941) for a detailed treatment of the presidential freezing order.

¹¹ *GCM* 22419, 1940-2 *Cum. Bul.* 288.

¹² *Rev. Rul.* 55-143, 1955-1 *Cum. Bul.* 465.

¹³ *Cf.* *F. Herman Gade*, 10 *T.C.* 585 (1948) [income from an agency agreement deposited in an account created by the decedent prior to the freezing of funds, held excludable under *I.R.C.* (1939), §863 (b)].

¹⁴ But see, in accord with the principal case, two Tax Court cases: *Irene de Guebriant*, 14 *T.C.* 611 (1950) and *Lina Joachim*, 22 *T.C.* 875 (1954). No appellate court has been presented with a similar fact situation.

¹⁵ Such deposits might possibly be found to be non-taxable on grounds apart from §863 (b). Only that portion of a nonresident decedent's estate which "is situated in the United States" is taxable; *I.R.C.* (1939), §861; *I.R.C.*, §2103. The words "situated in" refer to a situs concept, which is not necessarily synonymous with actual physical presence. Thus, the jewels carried by a nonresident alien who died while passing through the United States en route to another country were held to be not "situated in the United States" for tax purposes. *Delaney v. Murchie*, (1st Cir. 1949) 177 *F.* (2d) 444. Since, but for the actions of the United States, funds such as those in the principal case would not have been physically present in this country, a court might well hold them to be beyond the taxing power of the United States as a matter of elementary fairness, by finding that the funds had gained no situs here.

¹⁶ The precise dates in any given case will depend on the nationality of the decedent involved. See note 1 *supra*.

In view of the number of countries and the lengths of time involved, it is apparent that an erroneous exclusion of such funds could involve a significant loss of tax revenue.

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