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Inheritance Taxation - Selected Provisions of Michigan, Illinois and Ohio - A Study in Application and Justification

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COMMENTS

INHERITANCE TAXATION—SELECTED PROVISIONS OF MICHIGAN, ILLINOIS AND OHIO—A STUDY IN APPLICATION AND JUSTIFICATION— If there is one guiding principle in the field of state death taxation it is the acknowledgment that the tax is not on property but is in nature an excise or privilege tax. Inasmuch as the ability to transmit or receive property through devise or descent is a statutory privilege and not a natural right, it is a proper subject of taxation.[1] This is true even though the value of the property passing from the decedent is used to measure the tax.[2] Thus, the state has broad power in determining both the form of taxation and the existence of any allowance of preferential treatment among beneficiaries.

Generally the form of the tax will take one of two approaches. An "inheritance" tax may be imposed upon the beneficiary's right to receive the decedent's property, or an "estate" tax may be levied against the estate because of the decedent's privilege of transmitting his property, either by will or intestate succession.[3] Michigan, Illinois and Ohio, similarly situated from an economic and geographic standpoint, selected the inheritance tax, substantially modeling the forerunners of their present-day statutes after an earlier New York law.[4] In addition, the respective state courts have felt somewhat committed to accept as strong precedent prior

1 "The laws of descent and devise being the creation of the statute law, the power which creates may regulate and may impose conditions or burdens on a right of succession. . . ." Kochersperger v. Drake, 167 Ill. 122 at 125, 47 N.E. 321 (1897). Cf. Estate of Ogg, 262 Wis. 181, 54 N.W. (2d) 175 (1952).

2 In re Fish's Estate, 219 Mich. 369, 189 N.W. 177 (1922).

3 Thirty-seven states have chosen to adopt an inheritance tax, ten states an estate tax, one state both, and one state imposes no death tax at all. See 4 CCH INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., ¶1100. Usually accompanying either form is an "additional tax" to absorb the credit against the federal estate tax allowed by I.R.C., §2011. For development of this additional tax, see Cogburn, "The Credit Allowable Against the Basic Federal Estate Tax for Death Taxes Paid to State Statutes Enacted To Take Advantage Thereof—Constitutional Difficulty and Some Suggested Solutions," 30 N.C. L. REV. 123 at 130 (1952).

4 In 1885 New York adopted what basically, with amendments, was to remain its inheritance tax laws. N.Y. Laws (1885) c. 483. However, the inheritance tax was repealed in New York in 1930 and an estate tax was enacted. N.Y. Laws (1930) c. 710. The statute copied almost verbatim the federal estate tax as it stood in 1926, and the New York provisions have been amended numerous times to keep up with changes in the federal law. See Kassell, "Introduction to the Tax Law of New York," 59 N.Y. Consol. Laws (McKinney, 1954) p. IX.

judicial interpretations of the New York legislation.[5] One might accordingly expect to find the death tax law of the three states virtually identical. Because of statutory amendments, court decisions, and administrative practices, however, there is today considerable variation.

This comment will explore the existing variations in four commonly encountered areas: joint interests with rights of survivorship, contingent remainder interests, powers of appointment, and life insurance proceeds. Emphasis will also be placed on treatment accorded the surviving spouse and children and the implicit relationship between such treatment and some of the above areas. The essence of this examination will be to inquire whether adoption of an estate tax would be a more suitable vehicle for implementing a local death tax program.

I. *Policy Toward the Family*

At the outset it should be recognized that although the motives of death tax legislation may be influenced by ideas of social reform and redistribution of wealth, the predominant purpose today is to raise revenue.[6] All three states, however, show a definite pattern of favoring certain beneficiaries, particularly the spouse and children of the decedent.[7] Evidence of this policy may be seen in the tax rates and exemptions applicable to such beneficiaries and the taxation of the dower interest.

A. *Rates and Exemptions.* In each state, beneficiaries are divided into various classes depending upon their degree of blood or marital relationship to the decedent. The classes are taxed at different and progressive rates, the rates applicable to spouses and children generally being lower than rates on other relatives and strangers in blood.[8] Further, exemptions of various amounts are given to some of the classes, the highest exemptions going to the class in which the wife and children are found. Illinois gives

[5] E.g., People v. Carpenter, 264 Ill. 400 at 405, 106 N.E. 302 (1914); In re Stanton's Estate, 142 Mich. 491 at 495, 105 N.W. 1122 (1905); Wellman v. Cleveland Trust Co., 107 Ohio St. 267 at 276, 140 N.E. 104 (1923).

[6] See Oakes, "Development of American State Death Taxes," 26 IOWA L. REV. 451 at 460, 463 (1941).

[7] Also favored are charities, bequests to which are exempt from taxation. Ill. Rev. Stat. (1957) c. 120, §401; Mich. Comp. Laws (1948; Mason's Supp. 1956) §205.201; Ohio Rev. Code (Baldwin, 1958) §5731.09.

[8] Undoubtedly one underlying purpose behind such differentiation is to encourage the disposition of property to these beneficiaries.

these parties an additional tax advantage by, in effect, taking the exemption off the top of the progressive rate scale. Michigan shows its additional favoritism by taxing real estate left to the wife, children and certain relatives at only three-fourths the regular rate.[9]

B. *Dower.* While statutes in each of the three states specifically grant dower,[10] there is no provision explicitly taxing this interest, which, in many instances, is of considerable value. However, a clause is found in the tax statutes of each state reading somewhat as follows:

> A tax is hereby imposed upon the transfer of [or succession to] any property or of any interest therein: (1) when the transfer [or succession] is by will or by the intestate laws of this state.[11]

The Ohio courts decided that, under strict property theory, the wife's dower interest was a right accruing by operation of law as a result of the marriage rather than an interest received from her husband by succession and was not, therefore, subject to the inheritance tax.[12] The Supreme Court of Illinois took a different view. It held that, inasmuch as there were no laws in Illinois specifically designated as "intestate laws," the clause in question must refer to all laws governing intestate devolutions, including the dower law which governs, regulates and controls the interest which the widow receives.[13] The Michigan Supreme Court has as yet not been presented with this issue. But in two non-tax cases this court defined the dower interest in property terms very similar to those used by the Ohio court.[14] Some writers have seized upon this as authority that dower is not taxable in Michigan.[15] Yet the State Revenue Department takes a contrary view and continues to levy a tax upon the wife's receipt of this interest.

9 See generally, Ill. Rev. Stat. (1957) c. 120, §375; Mich. Comp. Laws (1948) §205.202; Ohio Rev. Code (Baldwin, 1958) §§5731.09, 5731.12.

10 Ill. Rev. Stat. (1957) c. 3, §170; Mich. Comp. Laws (1948) §558.1; Ohio Rev. Code (Baldwin, 1958) §2103.02.

11 Ill. Rev. Stat. (1957) c. 120, §375; Mich. Comp. Laws (1948) §205.201; Ohio Rev. Code (Baldwin, 1958) §5731.02.

12 Tax Commission v. Reeves, 11 Ohio Abs. 154 (1931), rehear. den. 11 Ohio Abs. 574 (1931).

13 Billings v. People, 189 Ill. 472, 59 N.E. 798 (1901), affd. 188 U.S. 97 (1903).

14 Needham v. Belote, 39 Mich. 487 (1878); Cummings v. Schreur, 239 Mich. 178 at 182, 214 N.W. 199 (1927).

15 Dexter, "The Michigan Inheritance and Estate Tax—Legal and Constitutional Aspects in Light of Other Death Duties," 27 MICH. ST. B. J. 12 at 13 (August 1948); 13 CALLAGHAN'S MICHIGAN PLEADING AND PRACTICE §108.07 (1948).

If presented with the question today, the Michigan court might be somewhat influenced by a New York decision not many years after Michigan copied the New York law, interpreting that state's inheritance tax statute as not requiring taxation of a dower interest.[16]

C. *Comment.* There seems to be no real objection in the three states to providing more favorable tax treatment for certain beneficiaries. The problem lies in determining the best method of accomplishing it. Under the estate tax approach, the tax rates on all beneficiaries are the same, with the spouse getting favored treatment through a marital deduction.[17] Not only could the present policy of favoring the spouse be retained under an estate tax scheme, but that of favoring the children could be continued through creation of a filial deduction similar to the marital deduction. An estate tax would resolve the argument over the proper status of dower in the inheritance tax structure, through inclusion in the gross estate of all the assets of the decedent. And to the extent that a marital deduction is enjoyed under an estate tax plan, there is not much need for a dower exemption. While the dower problem could also be remedied by a clarifying amendment to the present tax statutes, it would seem that a more uniform program for benefiting the spouse could be worked out under an estate tax structure.

II. *Joint Interests with Rights of Survivorship*

When, upon the death of one of two persons holding property jointly with rights of survivorship, the other party becomes sole owner a logical reaction might be that a taxable event has occurred. This is not necessarily the result, however, under the existing laws.

A. *Michigan.* The Michigan statute has remained consistently silent on the taxation of the survivor's rights in joint property. Although it could be argued that a creation of joint tenancy is a "transfer . . . intended to take effect in possession or enjoyment at or after death"[18] and thus taxable under the statute, this would be acceptable only if the deceased joint tenant were the grantor

[16] In re Weiler's Estate, 122 N.Y.S. 608 (1910), affd. 139 App. Div. 905, 124 N.Y.S. 1133 (1910) (dower not subject to inheritance tax).

[17] See I.R.C., §2056; 59 N.Y. Consol. Laws (McKinney, 1954) §249-s(4). New York also grants exemptions to the spouse and children. Id., §249-q.

[18] Mich. Comp. Laws (1948) §205.201.

or donor of the property.[19] Certainly a taxable transfer would prospectively occur where the decedent, in contemplation of his death, created the joint tenancy between himself and another.[20] But often the tenancy results from the purchasing of property in joint names from a third party. In this situation, imposition of a tax would have to be justified under the statutory provision taxing transfers of property by will or under the intestate laws of the state.[21] The Attorney General of Michigan early advised the state examiners that there was no authority under any of the statutory provisions giving them the right to impose a tax under this provision.[22] This opinion was influenced by prior judicial interpretations of the parent New York legislation to the effect that, since both tenants were vested and seized of the whole estate under the instrument creating the tenancy, no additional interest was acquired by survivorship and no tax was due.[23]

Nevertheless, the question was apparently unsettled in Michigan as late as 1953, as the Michigan Department of Revenue, bolstered by an unpublished opinion of the state attorney general rendered that year,[24] sought to levy an inheritance tax upon the survivor's right to the proceeds of a joint bank account originally created by the decedent. Furnished with the opportunity to pass upon this problem for the first time, the Michigan Supreme Court held that estates by the entirety and joint estates with full right of survivorship are not taxable as transfers intending to take effect in possession or enjoyment at or after death because there is no *transfer*.[25] Finding as a general rule of inheritance law

19 Two early Michigan attorney general's opinions suggested application of the inheritance tax upon the death of the husband where the husband previously put his own property into his and his wife's name. MICH. ATTY. GEN. BIENNIAL REP. 338 (1923-24); MICH. ATTY. GEN. BIENNIAL REP. 77 (1925-26). The Michigan court, however, has since held to the contrary. See note 25 infra.

20 In re Potter's Estate, 351 Mich. 326, 88 N.W. (2d) 452 (1958), reaffirmed 355 Mich. 403, 94 N.W. (2d) 813 (1959).

21 See note 11 supra.

22 MICH. ATTY. GEN. BIENNIAL REP. 72 (1921-22).

23 Matter of McKelway, 221 N.Y. 15, 116 N.E. 348 (1917), interpreting Matter of Klatzl, 216 N.Y. 83, 110 N.E. 181 (1915). In 1915, the New York statute was amended specifically to impose a tax in instances where intangible property was held in joint names or similarly deposited in banks. New York Laws (1915) c. 664. This provision was later amended to cover all property subject to the inheritance tax. New York Laws (1925) c. 143.

24 See Supreme Court Records and Briefs, 338 Mich. 347, Appellee Brief 48 (1953); id., Appellant Reply Brief 18.

25 In re Renz' Estate, 338 Mich. 347, 61 N.W. (2d) 148 (1953). The court expressly

that an estate in possession is an estate in present enjoyment, the court decided that the joint property becomes the property of the survivor not by descent, distribution, or transfer, but simply by right of survivorship. Thus, the Michigan court exhibited an inclination to follow strict property law, rather than further the general notion of "completeness" implied in general tax legislation. As a result of this decision, the Michigan Department of Revenue officially reversed its stand in this area[26] and resolved the issue for all practical purposes.

B. *Illinois.* This state avoided the overall interpretative problem faced in Michigan by the passage in 1919 of an amendment expressly taxing the acquisition of property by survivorship, specifically including joint bank accounts payable to either the depositor or survivor.[27] This provision did not, however, resolve a further problem. If property was purchased in joint names with rights of survivorship and one joint tenant supplied more of the purchase price than the other, how much of the property should be used as a basis for taxing the survivor? The Illinois statute read, in part, as follows:

> ". . . [T]he right of the surviving joint tenant . . . to the immediate ownership . . . of such property shall be deemed a transfer . . . in the same manner as though the whole property . . . was owned by said parties as tenants in common and had been bequeathed to the surviving joint tenant . . . by such deceased joint tenant . . . by will."

In a case arising under this provision where a mother paid one-third and a daughter two-thirds of the consideration for corporate stock taken jointly, the Illinois Supreme Court decided that the statute as written imposed a tax only on the contributive share of the decedent. Thus it held the surviving daughter taxable only on one-third the value of the property.[28] In answer to the argument that the legislative intent was to tax one-half

adopted earlier opinions by the attorney general as well as New York precedent. See also KIDDER, STATE INHERITANCE TAX AND TAXABILITY OF TRUSTS 114 (1934).

26 Mich. Dept. Rev. Ruling (Jan. 22, 1954) CCH INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., ¶18,135. But the department refused to acquiesce in the nontaxability of jointly held government bonds "payable on death" because of the unsettled property law interpretations on the rights of the named payees. See In re De Waters' Estate, 338 Mich. 457, 61 N.W. (2d) 779 (1953), where the court was equally divided.

27 Ill. Laws (1919) p. 757 at 758.

28 People v. Varel, 351 Ill. 96, 184 N.E. 209 (1932).

the property, the court responded that if the legislature meant one-half, it should have used language which clearly stated that position.[29]

Apparently taking the court at its word, the legislature clarified its policy by amending the statute to read that the tax should be computed by dividing the number of joint tenants into the value of the property with the resulting amount deemed bequeathed by the deceased joint tenant to the survivor(s) by will.[30] According to one state official, the amendment merely restated the law as it had been construed and enforced prior to the supreme court decision.[31]

C. *Ohio.* Unlike Michigan or Illinois, Ohio from the outset of its revised inheritance tax policy adopted an express provision taxing jointly-held property.[32] This provision stated broadly:

> "Whenever property is held by two or more persons jointly, so that upon the death of one of them the survivor has a right to the immediate ownership or possession and enjoyment of the whole property, the accrual of such right by the death of one of them shall be deemed a succession taxable under this section, in the same manner as if the enhanced value of the whole property belonged absolutely to the deceased person, and he had bequeathed the same to the survivor by will. . . ."[33]

Clearly and purposefully drawn, this provision was apparently meant to eliminate the problem regarding the amount of survivorship property subject to tax, for it plainly said *all* such property was to be taxed. Nevertheless, it created a new ambiguity. What was meant by *jointly held* property? Ohio law did not recognize the common law joint tenancy although it did recognize the contractual validity of a survivorship provision in a deed. Thus a grant of real estate to "*A* and *B* and to the survivor of them" created in Ohio a tenancy in common with a contingent remainder in fee to the survivor. Early attorney

29 Id. at 104.

30 Ill. Laws (1933) p. 889 at 890; now Ill. Rev. Stat. (1957) c. 120, §375.

31 KERNER, ATTORNEY GENERAL REGULATIONS IN RE ILLINOIS INHERITANCE TAX AND PROCEDURE 4 (1934), cited in comment, 32 ILL. L. REV. 57 at 69, n. 92 (1937).

32 The provision was modeled after New York legislation enacted four years earlier, although broadened to encompass all property and not just intangibles. 1 OHIO ATTY. GEN. OP. 473 at 478 (1920). Cf. note 23 supra.

33 Now Ohio Rev. Code (Baldwin, 1958) §5731.02.

general opinions stated that the tax provision applied only to common law joint tenancies and that, since none existed in Ohio, the legislative intent was to limit its coverage to property located in Ohio but owned by out-of-state persons whose state did recognize joint tenancies.[34]

This advice, however, did not withstand the test of later reflection. In 1929 the Ohio Supreme Court modified the attorney general's interpretation in the area of joint bank accounts with right of survivorship contracts. Since either party had the right to withdraw any amount up to the whole deposit prior to his death, the death of one was said to create a new right in the other, i.e., an *exclusive* right to the entire fund, and this right was held properly subject to taxation.[35] Finally in 1941, the attorney general flatly rejected the previous opinions of his office and ruled that a statute taxing jointly held property, passed almost a century after Ohio courts had said technical joint tenancies did not exist in that state, could not have been meant to exclude the Ohio citizen. On the contrary, it was enacted to prevent circumvention of the inheritance tax through the creation of survivorship agreements.[36]

While the provision, as quoted above, indicated the tax was to be applied as if the deceased tenant owned all the property in the joint estate, statutory language was disregarded in practice. Possibly it was felt unfair to tax the surviving tenant on the value of the whole property if he had in fact originally contributed a portion of the purchase price. In its 1929 decision[37] the Ohio Supreme Court suggested and applied a tax on only the decedent's contributive share. The solution worked out by the Ohio Department of Taxation was to levy on the full value of the property pursuant to the statute, but allow the survivor to raise the question of contribution in the probate court and carry the burden of proof.[38] This apparently remains the law of Ohio with one major exception: the provision in question was amended in 1957 to presume conclusively a taxable suc-

[34] 1 OHIO ATTY. GEN. OP. 473 at 479 (1920); 2 OHIO ATTY. GEN. OP. 1001 (1922).

[35] Tax Commission v. Hutchison, 120 Ohio St. 361, 166 N.E. 352 (1929).

[36] OHIO ATTY. GEN. OP. 164 (1941).

[37] Note 35 supra.

[38] Letter, Tax Dept., dated Nov. 1, 1940, referred to in 3 CCH INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., OHIO ¶1570.

cession of only one-half the value of the property whenever title was held jointly by husband and wife.[39]

D. *Comment.* It is difficult to avoid the conclusion that the principal function of survivorship rights is the alteration of property interests in a certain manner upon the occasion of death. Thus it would seem that survivorship interests have a place within the general framework and purpose of death tax legislation. It appears unwarranted to apply strict property principles created in a non-tax setting in determining whether these interests are the proper subject of taxation. There is apparently no consistent policy among these three states with regard to tax treatment of survivorship interests. Whenever the survivor receives tax-free an amount exceeding his proportionate contribution, some form of discrimination exists. Since survivorship interests are most commonly created between spouses, the Ohio statute, which conclusively presumes a one-half contribution by the surviving spouse, may be justified in light of the acknowledged policy favoring such person. The Illinois provision, however, in conclusively presuming a contribution equal to the survivor's fractional share in all cases, can apparently be justified only on grounds of administrative convenience. Moreover, Michigan's refusal to levy any tax on the survivor can be supported only on strict property analysis.

The only appropriate way to tax in this area is through application of the proportionate contribution rule. While this method could be worked out within an inheritance tax scheme, it is the method used under the federal[40] and New York[41] estate tax structures. If an estate tax were to be adopted, uniform benefits to surviving spouses could be provided through operation of the marital deduction or through an increased exemption.

III. *Contingent Remainder Interests*

Since the nature of an inheritance tax is to measure the levy by the share each legatee or heir receives, a difficult problem

39 127 OHIO LAWS (1957) p. 102. In 1951, the Department of Taxation began to employ a presumption of equal contribution whenever survivorship property was owned by husband and wife. However, this practice was abandoned four years later when it was discovered that the surviving husband much too often ignored the presumption and claimed full contribution. Tax Dept. Prob. Ct. Bul. No. 8 (July 8, 1955), CCH INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., ¶18,459.

40 I.R.C., §2040.

41 59 N.Y. Consol. Laws (McKinney, 1954) §249-r(5).

is presented when the gift is one of a contingent remainder. The recipient of such interest may never acquire enjoyment or possession of the estate, and yet the property (in the normal case) belonged to the decedent at his death and should be amenable to tax under some provision in the statutory scheme.

Valuation is generally not difficult where the remainder is indefeasibly vested, and so it is not unreasonable to find in Illinois, Michigan and Ohio that the tax on such interest is due immediately even though possession and enjoyment are postponed.[42] The first hint of difficulty comes when the remainder is vested but subject to defeasance. The Ohio courts prefer to treat this as any other vested remainder but allow for a refund if necessary,[43] while in Illinois it is taxed under the rules applicable to contingent remainders.[44] In Michigan there is no problem, for, by statute, any vested remainderman may elect to defer payment of the tax until he should come into possession.[45]

As might be expected, the Michigan, Illinois and Ohio treatments of the problem arising with contingent remainders differ markedly. Basically, this is because each state adopted the New York legislation in different years and either failed to keep up with New York amendments or added embellishments of its own.

A. *Michigan.* The original New York legislation of 1885, providing for no taxation until and unless the contingency occurred, was taken over by Michigan without the corresponding adoption of later New York amendments.[46] The result, of course, is of great benefit to remaindermen, many of whom might attempt to evade the tax by not reporting the vesting of their interests. The burden is not on them to pay a tax and then apply for refund. Rather it is on the state to enforce payment as each contingency occurs. While this is one state's answer to the problem, it is hard to say whether the loss in tax revenue or the cost of vigilance is more expensive.

B. *Illinois.* Under provisions similar to the original New

42 Ayers v. Chicago Title and Trust Co., 187 Ill. 42, 58 N.E. 318 (1900); Tax Commission v. Oswald, 109 Ohio St. 36, 141 N.E. 678 (1923); MICH. ATTY. GEN. REP. 84 (1902).

43 Tax Commission v. Oswald, 109 Ohio St. 36, 141 N.E. 678 (1923).

44 People v. Donohue, 276 Ill. 88, 114 N.E. 513 (1916).

45 Mich. Comp. Laws (1948) §205.207.

46 See Mich. Comp. Laws (1948) §205.203. For New York amendments, see notes 48 and 53 infra, and accompanying texts.

York and Michigan acts, the tax authorities in Illinois attempted to tax contingent remainder interests immediately upon the decedent's death. This position was soon held untenable by the Illinois courts since contingent remaindermen could not be considered "identifiable" for purposes of tax until the condition precedent occurred.[47] In 1909, the statute was amended to tax contingent estates at the highest rate possible, i.e., to tax as if the estate had vested immediately in the remainderman who would have to pay the highest tax.[48] If the tax later proved to be excessive, a refund would be allowed. Although this shifted the burden of vigilance to the ultimate vested remainderman, the Illinois procedure proved to be quite harsh in application[49] and led to another amendment in 1929 permitting the local judge to fix a tentative tax on the *likely* result of the contingency if the executor so requests.[50] This tax is paid out of the estate along with a deposit to secure, until the remainder vests, the difference between the tentative tax and the tax under the highest rate possible. The income from the securities on deposit accrues to the estate. The 1929 amendment was repealed in 1933,[51] but was substantially re-enacted in 1945.[52]

C. *Ohio.* In Ohio the executor of an estate has an election between two taxes.[53] The tax is normally assessed at the highest

47 Billings v. People, 189 Ill. 472, 59 N.E. 798 (1901), affd. 188 U.S. 97 (1903).

48 Ill. Laws (1909), p. 311 at 320, now Ill. Rev. Stat. (1957) c. 120, §398. This copied an earlier New York amendment. N.Y. Laws (1899) c. 76.

49 In one case where the decedent created a life estate with the remainder to be divided among any of forty-one nephews or nieces who survived the life tenant, the tax on the remainder was immedately assessed as though all but one of the remaindermen died before the life tenant, thus computing the tax on the full remainder interest in order to apply a higher progressive rate while allowing only one exemption. People v. Freese, 267 Ill. 164, 107 N.E. 857 (1915). See also People v. Linn, 357 Ill. 220, 191 N.E. 450 (1934), and People v. Hulburd, 327 Ill. 72, 158 N.E. 373 (1927).

50 Ill. Laws (1929) p. 613 at 615.

51 Ill. Laws (1933) p. 889.

52 Ill. Laws (1945) p. 1239 at 1240. The amount of the required deposit was set at 150% of the difference between the two taxes.

53 Under New York's inheritance tax statutes of 1885, no tax was collected until the contingency occurred and the courts refused to allow a deposit to be collected in the interim. This method apparently proved undesirable, and the statutes were amended in 1899 (see note 48 supra) to presume an immediate vesting at the highest rate possible. But, according to New York officials, this resulted in "almost unlimited" litigation and often much hardship on the preceding life estates. As a result, the statutes were again amended in 1911 to call for payment under a temporary order of the lowest tax possible [N.Y. Laws (1911) c. 800]. See Oakes, "Development of American State Death Taxes," 26 IOWA L. REV. 451 at 465 (1941); Matter of Parker, 226 N.Y. 260, 123 N.E. 366 (1919). After New York finally worked out what it then thought to be the most equitable solution, the

rate possible, with a refund allowed if the most taxable contingency does not occur.[54] But if the executor requests, the *lowest* possible rate will be determined and paid, and the difference between this and the highest tax will held in trust, again with current income accruing to the estate.[55]

D. *Comment.* The taxation of contingent remainder interests has long been one of the most troublesome problems of the inheritance tax approach.[56] Certainly the Michigan procedure of wait-and-see is outmoded in its adherence to the idea of postponing, until possession or enjoyment accrues, the power of the state to identify a taxable recipient upon whom it can levy. It is inconsistent with any sound administrative program for implementing revenue legislation. Although the Michigan statute could be amended to conform to the Illinois or Ohio solutions, perhaps a better answer for all three states lies in the estate tax. As a practical matter, an inheritance tax is paid out of estate funds before distribution is made to the respective beneficiaries, although the amount of the tax is determined by the share each receives. When some of the beneficiaries are contingent remaindermen, a tax paid on their share computed at the highest possible rate decreases the amount of property left for the accompanying life estate. When a security deposit is employed, the government bonds required are purchased out of the life estate funds. Thus the Illinois and Ohio procedures are merely the result of compromise between the interests of the state in collecting the full tax due without wasteful expense and those of the life tenant in desiring maximum and unrestricted enjoyment of his life estate. Neither is fully satisfied, for the tax collection methods employed often mean years of open files and supervision by probate courts until the remainder

Ohio legislature in 1919 adopted these ideas completely (see notes 54 and 55 infra, and accompanying texts), although Ohio tax officials now consider them unfortunately outmoded. Tax Dept. Prob. Ct. Bul. No. 13 (May 24, 1955) 3 CCH INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., OHIO, ¶2110.50.

54 Ohio Rev. Code (Baldwin, 1958) §§5731.28, 5731.29.

55 Ohio Rev. Code (Baldwin, 1958) §5731.30. The required deposit is 110% of the difference between the two taxes.

56 Cf. Stevens, "The Illinois Inheritance Tax—Explanation and Suggested Improvements," 51 N.W. UNIV. L. REV. 693 at 698, 716-717 (1957); Dexter, "Legal Aspects of the Michigan Inheritance and Estate Taxes," PAPERS IN PUBLIC ADMINISTRATION, BUREAU OF GOVT., UNIV. OF MICH. 117 at 150 (1948-49); note 53 supra.

vests.[57] An estate tax avoids both the theoretical and administrative difficulties by measuring the tax according to the value of the decedent's estate regardless of how it is to be distributed. The simplicity of an estate tax, which is unconcerned over who the ultimate recipient will be[58] and which settles accounts between the above competing interests with comparative swiftness and finality, seems appealing.

IV. *Powers of Appointment*

Under strict property law theories of powers of appointment, the appointee's title comes directly from the donor.[59] Therefore, it should be the appointee who is subject to an inheritance tax and not the donee, since the latter never acquires title to the property. However, it is often many years after the donor's death before the donee designates who the appointee will be. Further, the donee might not appoint at all, allowing instead the property to pass to the taker-in-default. Since rates and exemptions under an inheritance tax are determined by the relationship of the recipient to the decedent, property subject to a power of appointment creates the same taxation problem found with contingent remainders, i.e., that of determining the recipient at the time of the decedent's death.

Often the appointee is not as closely related to the donor as he is to the donee, and the appointee may even feel the inheritance is actually bestowed upon him by the donee since that person has the ultimate power over selection of the donor's beneficiaries. Possibly for these reasons New York decided in 1897 to treat successions due to an exercise or non-exercise of a power as if the donee had bequeathed the property by will.[60] No dis-

[57] In cases where the highest tax has been paid, the court may close its files and shift to the taxpayer the burden of seeking a redetermination of the tax when the remainder vests, a situation which is equally unsatisfactory.

[58] Marital deductions (and filial deductions, if adopted) would not be given for gifts of contingent interests.

[59] See SIMES AND SMITH, FUTURE INTERESTS, 2d ed., §911 (1956).

[60] N.Y. Laws (1897) c. 284. In 1911, however, New York repealed the provision applying to the non-exercise of the power [N.Y. Laws (1911) c. 732], returning the critical relationship in instances where the power was not exercised to that of the donor and the taker-in-default, analogous to the treatment of contingent remainders. Moreover, the 1897 provisions concerning powers apparently would not apply if the donee rejected the power (he then has never "acquired" the power), or if the appointee renounced the gift.

tinction was made between general and special powers. Thus the critical relationship, tax-wise, became that of the donee and appointee (or taker-in-default). Michigan, Illinois and Ohio adopted the 1897 New York amendment but from there went their separate ways.

A. *Michigan.* The Michigan provision in this area was adopted in 1919,[61] and, in treating property subject to a power as belonging to the estate of the donee, it disregarded an amendment passed by New York in 1911 under which that state returned to treating the property as coming from the donor in cases where the donee failed to appoint.[62] With but one exception, the original Michigan approach has survived, and no attempt is made to levy a tax at the time of the donor's death. The exception was made in 1945 when, in an act dealing with the right of a donee to release the power in his lifetime, a provision was inserted saying that a release would not be construed as a non-exercise of the power under the inheritance tax statutes.[63] This must be interpreted to mean that, even though the tax is still postponed until release, the idea of fictitious ownership by the donee no longer applies, and the rates and exemptions are based on the relationship between the donor and the taker-in-default.

B. *Illinois.* Although Illinois in 1909 also adopted the New York provision of 1897, taxing the property as if it had been owned by the donee whether or not he exercised the power, a problem arose where the donor named a taker-in-default and thus created an interest which could be defeated if the donee-life tenant exercised his power to dispose of the fee. The Illinois tax authorities felt this interest was a transfer dependent upon a condition and thus subject, at the donor's death, to immediate taxation under the provisions taxing contingent remainders. In 1934, however, the Illinois Supreme Court rejected this contention in holding that the transfer to the taker-in-default did not occur until the death of the donee, the "owner."[64] The prospect of this decision must have led to an amendment of the Illinois statute one year earlier to conform to the New York 1911 amendment repealing that part of the powers provisions

[61] MICH. PUB. ACTS (1919) No. 148, now Mich. Comp. Laws (1948) §205.20.
[62] See note 60 supra.
[63] Mich. Pub. Acts (1945) No. 296, now Mich. Comp. Laws (1948) §556.105.
[64] People v. Linn, 357 Ill. 220, 191 N.E. 450 (1934).

dealing with the non-exercise of the power.[65] This statutory change was interpreted to mean that since the donor-recipient relationship would now be looked to if there should be a non-exercise of the power, the contingent remainder provisions allowed the state to *assume* the power would not be exercised and to levy a tax on the remainderman in the manner that would produce the highest tax.[66] Of course, should the donee exercise the power at some later time, the first tax would have to be rebated and a new tax levied on the appointee.

C. *Ohio.* In its general tax legislation of 1919, Ohio adopted the same powers provisions that Michigan and Illinois had copied from New York, again without the corresponding New York repeal of the portion covering an omission to exercise.[67] And while Ohio does tax contingent remainder interests without postponement until vesting, it did not follow Illinois' example of later modifying the powers statute to legalize a similar tax enforcement program in the two areas. Instead, the Ohio Tax Department became worried about the loss of tax revenues through administrative non-vigilance in three particular settings where, in each, the donor-recipient relationship might still become significant many years after the donor's estate had been closed. First, the donee might release his power.[68] While a release might be interpreted as merely another form of failure to exercise the power, the Ohio officials are now of the belief that the power provisions would be inapplicable here and that the donor relationship would control.[69] Second, the appointees might renounce. Finally, if the donee had a general inter vivos power, he might appoint to himself, thus taking title not fictitiously from himself under the powers provisions but from the decedent-donor. Where any of these possibilities exist (and the second one will always be present), the Ohio officials feel the tentative tax arrangements imposed at the time of the decedent's death under the contingent remainder provisions should be applied.[70]

65 Ill. Laws (1933) p. 889 at 890.

66 People v. Metropolitan Trust Co., 369 Ill. 84, 15 N.E. (2d) 729 (1938).

67 Ohio Rev. Code (Baldwin, 1958) §5731.02.

68 Unlike its Michigan counterpart, the Ohio statute allowing a donee to release is silent regarding its impact on the inheritance tax statutes. Ohio Rev. Code (Baldwin, 1958) §1339.16.

69 Tax Dept. Bul. No. 15 (July 17, 1957) 3 CCH INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., OHIO, ¶1540.50.

70 See notes 54 and 55 supra, and accompanying texts.

Aware of prior Illinois litigation over this matter,[71] and admitting that the tentative payment provisions would be illegal if applied as a tax assessment in this setting, it is their position that such payments may be demanded on the prospective recipient's share purely as a procedural and security device.[72] Whether this contention will be upheld by the Ohio courts remains to be seen.

D. *Comment.* Each of the three states has adopted a basic approach of disregarding common law in the area of powers and of creating, for death tax purposes, fictitious title in the donee. This approach has merit to the extent the donee controls the course of the decedent's gift.

With regard to tax enforcement, however, the states differ. Michigan again takes the wait-and-see approach, and the opportunities for evading payment of the tax are great.[73] In Ohio, tax officials would solve the Michigan problem through use of security devices, the legality of which has not yet been tested in the courts. And Illinois, in an effort to validate its enforcement procedure, lost sight altogether of its basic approach in this area when it began taxing on the *donor*-recipient relationship in instances where the donee of a general, as well as of a special, power omitted to appoint. Certainly, when a general power is given, it is still the donee's desires that control the choice of the ultimate recipient of the property and it should make no difference tax-wise whether he appoints to those who would otherwise take in default or declines to appoint and lets the property go to those same individuals.

Some question might also be raised as to why no overall distinction is made between general and special powers.[74] While there is justifiable reason for cloaking the donee with fictitious title when he has a general power, in some instances a special power may restrict his freedom of choice so closely that the donor ought to be regarded as the one making the gift. The New York and federal estate tax provisions recognize this distinction. Property subject

[71] Note 64 supra, and accompanying text.

[72] Note 69 supra.

[73] If the donee exercises an inter vivos power many years before his death and the appointee fails to report his gift to the state authorities, it would take constant periodic rechecking of open files before the state would discover the evasion.

[74] See People v. Cavenee, 368 Ill. 391, 14 N.E. (2d) 232 (1938). There are no cases in Michigan or Ohio on point; but see Dexter, "The Michigan Inheritance Tax—Legal and Constitutional Aspects in Light of Other Death Duties," 27 MICH. ST. B. J. 12 at 13 (August 1948); and see note 69 supra (Ohio).

to a power, be it general or special, is included in the donor's gross estate. Such property is included in the donee's gross estate, however, only if his power is general.[75] Moreover, while discovery of an inter-vivos appointment of a general power may also be difficult under the estate tax approach, a state would not lose out completely for it would at least be assured of a tax levy on the donor's estate.

V. *Life Insurance Proceeds*

If the proceeds of the decedent's life insurance are made payable to his estate and are so paid, they are a proper subject of tax as they will be distributed either by will or intestate succession. Moreover, it is generally accepted that if the decedent names a beneficiary other than his estate and makes this designation irrevocable, the beneficiary's right to the proceeds arises by contract and there is no inheritance taxation. The problem arises where the insured names a beneficiary other than the estate but reserves the unrestricted right to change this beneficiary.

A. *Michigan.* The Michigan legislation is silent on this point, and there has been no supreme court decision on the question. While the parent New York legislation was similarly silent, the precise issue was presented to a New York court shortly after Michigan had copied the New York statutes, in a case where the insured had changed the beneficiary from his estate to his wife. Holding that the assignee under the contract obtained *immediate* title and right to enjoy the insurance proceeds when they became payable, even though her title might be later divested by another change in beneficiary, the court found no transfer intended to take effect in possession or enjoyment at or after death, and thus there was nothing to tax.[76] The court went on to say that the state

> "favor[s] and encourage[s] insurance for the benefit of a wife, and the state is at a disadvantage when it seeks to tax such a provision for her. . . ."[77]

The Michigan law was somewhat clarified in 1909 by an attorney general's opinion agreeing with the New York courts in

[75] I.R.C., §2041; 59 N.Y. Consol. Laws (McKinney, 1954) §249-r(7).

[76] Matter of Parsons, 117 App. Div. 321, 102 N.Y.S. 168 (1907). See also Matter of Voorhees, 200 App. Div. 259, 193 N.Y.S. 168 (1922).

[77] Matter of Parsons, 117 App. Div. 321 at 323, 102 N.Y.S. 168 (1907).

exempting named beneficiaries from the tax.[78] Except in instances where a trustee was named as beneficiary,[79] this ruling remained unchallenged until 1940. At that time, in a case dealing with the taxation of proceeds paid to a trustee, a probate court declared in dictum that where the policy has a cash surrender value and the right to re-designate the beneficiary is retained by the insured, the proceeds are subject to tax as a transfer to take effect at death, regardless of whether the policies are payable to beneficiaries indirectly through the trust or directly from the insurer.[80] The case never reached the supreme court, possibly because the legislature shortly thereafter added a new provision to the tax statutes specifically exempting proceeds of insurance payable to a trustee for the benefit of named beneficiaries.[81] This statute might be interpreted as a tacit acceptance of the non-taxability of proceeds paid directly to a named beneficiary. Such an interpretation is even more reasonable in light of the aforementioned New York decision which is in accord. However, a recent Michigan Supreme Court decision implies a caveat. In a case holding taxable the proceeds paid upon death to a named beneficiary from an employee profit-sharing plan under which the decedent had the right to change his beneficiary,[82] the court said:

> "In addition, we are pressed with the argument that this case is analogous to life insurance and the proceeds here involved should not be taxed under the act for the same reason that life insurance is not taxed. As to the latter, we will only say that we will meet the life insurance case when it arises and the instant case will be decided on its own merits."[83]

Some concern is created by this decision over what facts the Michigan court will recognize as analogous to the insurance area and, indeed, over what the court will say when an actual insurance case does present itself.

B. *Illinois*. The issue over proper taxation of life insurance proceeds in Illinois developed in much the same way as in Michi-

78 MICH. ATTY. GEN. REP. 89 (1909). *Accord:* MICH. ATTY. GEN. BIENNIAL REP. 332 (1923-24); ibid. 357.

79 MICH. ATTY. GEN. BIENNIAL REP. 519 (1937-38).

80 Estate of Purves, Prob. Ct., Oakland County, April 24, 1940, cited in Thompson, "Life Insurance Trusts and Taxability of Life Insurance Passing to a Trustee for Named Beneficiaries," 19 MICH. ST. B. J. 617 at 619 (1940).

81 MICH. PUB. ACTS (1941) No. 302, now Mich. Comp. Laws (1948) §205.201.

82 Supreme Court Records and Briefs, 342 Mich. 195, Record on Appeal, p. 69 (1955).

83 Smith, J., in In re Brackett Estate, 342 Mich. 195 at 202, 69 N.W. (2d) 164 (1955).

gan, i.e., an interpretation of legislative silence to mean non-taxation. It is today generally agreed, though without the benefit of a state supreme court decision, that the proceeds of the decedent's life insurance are taxable under the Illinois statutes only if they are payable to his estate or to his executors or trustees for the benefit of his estate.[84]

C. *Ohio.* The early years of legislative silence in Ohio produced a similar interpretation of the issue.[85] Any doubt on the question was removed in 1931 when the statutes were amended expressly to exempt life insurance proceeds payable other than to the estate of the insured.[86]

D. *Comment.* When viewed in perspective with other forms of transmitting property at death, the purchase of life insurance, with the right to change the beneficiary being retained, is merely another form of planned apportionment of assets at death, functioning somewhat similar to a will. The estate tax approach recognizes this and taxes the proceeds when the decedent retains control over the policy during his life.[87] A similar procedure could as easily be incorporated into inheritance tax statutes. Moreover, to the extent that a state policy exists in favor of certain beneficiaries, it would not necessarily be frustrated if such a procedure would be adopted.[88]

VI. *Conclusion*

Although several consistent policies will be found in the tax provisions of Michigan, Illinois and Ohio, e.g., progressive rates, a favoring of the family and charity, and an apparent unwillingness to tax insurance proceeds, the existing divergence of approach with regard to taxability of certain interests and enforce-

[84] See CASTLE, ILLINOIS INHERITANCE TAX MANUAL 17 (Jan. 1, 1958); Stevens, "The Illinois Inheritance Tax—Explanation and Suggested Improvements," 51 N.W. UNIV. L. REV. 693 at 710 (1957).

[85] See 2 OHIO ATTY. GEN. OP. 1142 (1919).

[86] 114 OHIO LAWS (1931) p. 94, now Ohio Rev. Code (Baldwin, 1958) §5731.06.

[87] See I.R.C., §2042; 59 N.Y. Consol. Laws (McKinney, 1954) §249-r(9). One variation in this area, as applied by New York, is to exempt such proceeds up to $100,000 while subtracting any personal deductions or exemptions allowed to prevent the doubling up of benefits. This exemption is given to all beneficiaries. Id., §249-q(d).

[88] If the policy of favoring the spouse is the force behind the refusal of the legislature to bring life insurance proceeds within the tax, this position becomes unnecessary, for adequate protection of the spouse could be acquired through use of the marital deduction or higher exemptions.

ment procedures generally would seem to warrant a fresh look at each state's overall death tax program. While a sensible revision of property concepts and some attempt at administrative efficiency could be made entirely within the inheritance tax framework,[89] enforcement difficulties would still remain in the contingent interest and power areas because of the very nature of the inheritance tax. Also, each legislature would be required to take greater initiative than it has shown in the past in keeping the tax up to date.

On the other hand, to the extent that the above mentioned policies are desirable, they can easily be preserved under the structure of an estate tax. Moreover, the advantages which can be derived from such a tax scheme seem to warrant thorough consideration. An estate tax modeled after existing federal law would provide the following benefits: (a) ease the burden of the estate planner through synchronization of federal and state tax provisions so that the threat of divergent tax consequences is minimized,[90] (b) provide a state statute with "built-in" case law because of the existing comprehensive interpretations of the federal provisions, thereby affording the administrator and the practitioner certainty and predictability, (c) eliminate enforcement difficulties otherwise inherent in assessing contingent interests,[91] and (d) reduce the administrative policing load and cost of collection through coordination with federal enforcement.[92] In addition, enactment of the estate tax requires little fundamental change from the present method of tax assessment.[93]

89 See, e.g., Stevens, "The Illinois Inheritance Tax—Explanation and Suggested Improvements," 51 N.W. UNIV. L. REV. 693 at 716-718 (1957); Cook, "Federal and Colorado Death and Gift Taxes—A Comparison," 35 DICTA 105 at 113 (1958).

90 E.g., while the federal provisions encourage the use of special powers of appointment (see note 75 supra), such powers are nevertheless included within the state inheritance tax. Although synchronization may not be perfect at all times, for the most part the respective laws would be identical. For a discussion of the analogous difficulties involved in keeping the New York personal income tax current with federal amendments, see Miller, "Proposal for a Federally-Based New York Personal Income Tax," 13 TAX L. REV. 183 at 185 (1958).

91 To the same effect, see REPORT, REVENUE LAWS COMMISSION, STATE OF ILLINOIS 441-445 (1949).

92 The estate tax scheme has been enjoying a certain amount of recent popularity. See, e.g., Savage, "The Proposed Virginia Estate Tax," 44 VA. L. REV. 1009 (1958); Healey, "A Proposed Estate Tax for Massachusetts," 26 BOST. BAR BUL. 171 (1955). See also Dexter, "Legal Aspects of the Michigan Inheritance and Estate Taxes," PAPERS IN PUBLIC ADMINISTRATION, BUREAU OF GOVT., UNIV. OF MICH. 117 at 149-153 (1948-49).

93 Under the estate tax the tax would be calculated on the net estate and the executor could be allowed to assess it pro-rata among the beneficiaries. Compare this with

A change to the estate tax, however, would necessitate a policy of keeping abreast of federal amendments. Some concern may thus arise regarding a surrender of state power to the federal government. While it is true that legislative modification in this area would usually originate with Congress, it should be clear that ultimate *control* over all state tax provisions would remain with each state legislature. Accordingly, the estate tax could be supplemented by any local policies which require preservation.

Since there should be no question regarding the constitutionality of an estate tax,[94] since there need be no additional overall tax burden on death,[95] and in light of the advantages to be gained from a conversion, retention of the inheritance tax demands strong justification.

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the present computation of the inheritance tax according to the amount to be received by each beneficiary and, in practice, requiring the executor to pay the total tax out of the estate before distribution. In fact, one reason for the federal change from the inheritance tax to the estate tax in 1916 was to eliminate the necessity of determining the relationship of the beneficiary to the decedent. In this respect, see Matter of Hamlin, 226 N.Y. 407, 124 N.E. 4 (1919). To the effect that this determination is in many cases an unreasonably expensive administrative problem for the state under the Michigan inheritance tax, see Schroeder, "Some Aspects of the Administration of the Michigan Inheritance Tax Act," MICH. CERT. PUB. ACCT. 14 at 18 (Sept. 1956).

94 See note 1 supra.

95 The rates, deductions and/or exemptions of an estate tax could be geared to raise approximately the same amount of revenue now provided under the inheritance tax.