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Taxation - Inheritance Tax - Transfers Subject to Take Effect at or After Death

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TAXATION—INHERITANCE TAX—TRANSFERS SUBJECT TO TAKE EFFECT AT OR AFTER DEATH—Decedent was a participant in a company profit-sharing savings and retirement trust. Under the terms of the plan, the company made deposits with a trustee on an annual basis and relinquished the right to recapture or impair the fund for its own use or benefit. The contributions were to be held for ten years with accrued interest, and then were to be distributed to the employees in three annual instalments. Should an employee leave the company, he was entitled to his share in three instalments; in the event of retirement or illness he was to receive his entire share in one lump sum. The employer was also entitled to name a beneficiary to receive his share of the fund in the event of his death. Decedent's daughter, as the designated beneficiary, contended that there was no property interest in the decedent, no inter vivos transfer, and, therefore, no transfer intended to take effect in "possession or enjoyment at or after death" under the Michigan inheritance tax statute.[1] The probate court determined that there was tax due on the amount paid to the daughter, and the circuit court affirmed. On appeal, *held,* affirmed. By naming a beneficiary during his life, the decedent shifted to her substantial economic benefits which would come into complete enjoyment at the time of his death. Such a transfer is within the terms of the inheritance tax statute. *In re Brackett Estate,* 342 Mich. 195, 69 N.W. (2d) 164 (1955).

Provisions taxing transfers which are intended to take effect in possession or enjoyment at or after death had their origin in the Pennsylvania statute of 1826.[2] Similar provisions are now incorporated in the tax statutes of the federal government[3] and all the states except Louisiana.[4] The word "possession" is equated to legal interests, and the word "enjoyment" to equitable interests.[5] The terms were initially construed to cover inter vivos transfers of title in which the interests became vested, but where the beneficial possession or enjoyment was postponed until the death of the transferor.[6] Today, the scope of this phrase has been broadened to include three classes of transfers. They are (1) transfers in which an interest in the property is reserved by the transferor, (2) transfers which are absolute but where the transferee is not entitled to possession or enjoy-

1 Mich. Comp. Laws (1948) §205.201.

2 See 56 YALE L.J. 176 (1946).

3 I.R.C. (1954), §§2036, 2037.

4 4 CCH, INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., ¶1560.

5 Ibid.

6 Reish v. Commonwealth, 106 Pa. 521 (1884); Estate of Green, 153 N.Y. 223, 47 N.E. 292 (1897); Matter of Brandeth, 169 N.Y. 437, 62 N.E. 563 (1902); In re Estate of Schuh, 66 Mont. 50, 212 P. 516 (1923); Harber v. Whelchel, 156 Ga. 601, 119 S.E. 695 (1923). The Supreme Court in May v. Heiner, 281 U.S. 238, 50 S.Ct. 286 (1930), nullified the federal "take effect" statute by holding that if an interest vested during life it did not take effect in possession or enjoyment at death. Guaranty Trust Co. v. Blodgett, 287 U.S. 509, 53 S.Ct. 244 (1933), held May v. Heiner not binding on state courts in construing their respective statutes. Michigan rejected the May v. Heiner reasoning in In re Kutsche's Estate, 268 Mich. 659, 256 N.W. 586 (1934). Subsequent legislation made it possible for the federal government to reach the retained life estate situations. In Commissioner v. Estate of Church, 335 U.S. 632, 69 S.Ct. 322 (1949), May v. Heiner was overruled.

ment until the death of the transferor, and (3) transfers in which the power to revoke, amend, or alter is retained.[7] However, in Michigan this phrase has kept its original scope in that the only transfer held to be encompassed by the phrase is an inter vivos trust where the income is reserved to the grantor for life and the remainder vested in others.[8] Prior attempts to expand the meaning of the term beyond this have been rejected. Although it is clear that a retained life estate would be taxable in Michigan, when the settlor by later instrument transfers the income to beneficiaries who are entitled to the property upon death, the transfer is not taxable.[9] The Michigan court has likewise refused to include revocable trusts within the purview of its statute,[10] although a majority of states would hold such a transfer taxable.[11] Though property held as tenants in common is clearly part of a decedent's estate,[12] property held in joint tenancy or by the entireties is excluded from a decedent's taxable estate in Michigan.[13] In a recent decision, the Michigan Supreme Court reached the limit of its contraction of the "take effect in possession or enjoyment" clause of the Michigan act, and, in effect, nullified it by refusing to include within a decedent's estate "payable on death" bonds.[14] In the light of these decisions, the principal case appears to be a direct reversal of the former narrow interpretation of the Michigan inheritance tax act. Other states have previously held the proceeds of such profit-sharing plans taxable.[15] By conforming to this liberal approach, the principal case gives life to the Michigan "take effect at or after death" clause. It leaves the future of items formerly held non-taxable in a rather precarious state.

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[7] For a detailed discussion of such transfers, see Rottschaefer, "Taxation of Transfers Taking Effect in Possession at Grantor's Death," 26 IOWA L. REV. 514 (1941); Rottschaefer, "Taxation of Transfers Intended to Take Effect in Possession or Enjoyment at Grantor's Death," 14 MINN. L. REV. 453, 613 (1930). See also 6 A.L.R. (2d) 223 (1949).

[8] People v. Welch's Estate, 235 Mich. 555, 209 N.W. 930 (1926); In re Kutsche's Estate, note 6 supra. Apparently this was also the position of the New York decisions for a time subsequent to the adoption of the similar Michigan act in 1899. In re Cochran's Estate, 117 Misc. 18, 190 N.Y.S. 895 (1921).

[9] People v. Welch's Estate, note 8 supra.

[10] In re Rackham's Estate, 329 Mich. 493, 45 N.W. (2d) 273 (1951).

[11] 4 CCH, INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., ¶1565.

[12] See Mich. Comp. Laws (1948) §§205.201, 205.221; 4 CCH, INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., ¶1570.

[13] In re Renz' Estate, 338 Mich. 347, 61 N.W. (2d) 148 (1953) (joint bank deposit excluded). This is also the case in most other states, in the absence of express statutory inclusion. 4 CCH, INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., ¶1570A.

[14] In re DeWaters Estate, 338 Mich. 457, 61 N.W. (2d) 779 (1953). The Michigan Department of Revenue has indicated its intention of limiting the DeWaters decision to the county where the probate determination was originally made. Ruling of the Department of Revenue, Jan. 22, 1954, CCH, INHERITANCE, ESTATE AND GIFT TAX REP., 7th ed., ¶18,135.

[15] Estate of Daniel, 159 Ohio St. 109, 111 N.E. (2d) 252 (1953); Dorsey Estate, 366 Pa. 557, 79 A. (2d) 259 (1951). *Contra*: Hanner v. Glenn, (D.C. Ky. 1953) 111 F. Supp. 52, affd. 212 F. (2d) 483 (1954); Estate of Burke, 85 Pa. D. & C. 56 (1953). On the taxability of benefits paid under pension funds, see 32 CHI.-KENT L. REV. 256 (1954).

The new Internal Revenue Code for the first time exempts the benefits of qualified plans from estate taxation. I.R.C. (1954), §2039.