TAXATION--ESTATE TAX--TRANSFERS TAKING EFFECT AT DEATH--HALLOCK DOCTRINE

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TAXATION—ESTATE TAX—TRANSFERS TAKING EFFECT AT DEATH—HALLOCK DOCTRINE—In 1925 and 1926 decedent and his wife created two trusts, decedent contributing 80 per cent, and his wife 20 per cent. Each trust provided for income to the wife during decedent’s life, and on his death income was to be divided between the wife and a daughter or go to the survivor for life. On the death of the survivor of the wife and daughter the corpus was to be distributed “According to the Statutes of descent and distribution of the State of Ohio, to the heirs at law of [decedent] and [wife], providing the heirs of [decedent] and [wife] are the same persons. Should [the decedent and wife] leave no lineal descendants of their direct line, and the next of kin of each were collaterals then said trust fund shall upon termination of this trust be distributed . . . to the collaterals of [the decedent and wife ratably].” There were no reservations of powers by the decedent or his wife. On the death of the decedent the collector imposed and the executor paid a deficiency assessment on the corpus of the trusts. The executor’s claim for refund was refused and he sued in the federal district court to recover. The district court held that the value of the property transferred into the trusts by the decedent was includible in decedent’s taxable estate under section 811(c) of the Internal Revenue Code as a transfer “intended to take effect in possession or enjoyment at or after his death.” On appeal, held, affirmed. Beach v. Busey, (C.C.A. 6th, 1946) 156 F. (2d) 496.

The confusion and inconsistencies in reasoning found in the United States Tax Court’s and the circuit courts’ opinions in this field are excellent indications of the fact that all of the implications of the Hallock doctrine are not yet clear, and the opinion in the principal case supports such a conclusion. It is felt by writers who have made a careful analysis of the decision in the Hallock case and the decisions on which it was based that two, or possibly three, elements (depending upon their classification), must be present in order to invoke the doctrine of the Hallock case and thus subject a trust to inclusion in the settlor’s taxable estate. The elements are: the creation of a reversion or a possibility of

reverter in the settlor at the time the trust is set up, the extinction of that interest at his death, and the enlarging of the estate of another by his death. This might be called the original or conventional interpretation. This is the most conservative interpretation of the doctrine, and was adopted by the Treasury Regulations at that time as the test to be applied in subjecting a trust to taxation.\footnote{Regulation 105, § 81.17 prior to amendment by TD 5512 dated May 1, 1946.} However, the government soon indicated that on the basis of its interpretation of the case the test for inclusion of the corpus of a trust in a taxable estate was the first element alone, i.e., the existence of a reversion or possibility of reverter.\footnote{Eisenstein, "The Hallock Problem," 58 Harv. L. Rev. 1141 at 1146 (1945); PAUL, FEDERAL ESTATE AND GIFT TAXATION (1946 Supp.) 194.} Recently the Treasury has taken the position that the element to be stressed is the requirement that the taker survive the settlor, though it does make mention of the interest of the decedent as a requirement.\footnote{Regulation 105, § 81.17 as amended by TD 5512 dated May 1, 1946.} Thus a court may follow any one of three interpretations in reaching a decision. Consequently, the court in the principal case may find some justification for its broad interpretation of the doctrine based on its analysis of the Goldstone case\footnote{Goldstone v. United States, 325 U.S. 687 at 692, 65 S.Ct. 1323 (1945).} or for the standard it appears to set up as a basis for testing the facts of the principal case.\footnote{The court considered the essential element to be "the decedent's possession of a reversionary interest at the time of his death," but in so doing, it neglected the important qualifying clause of the sentence which read, "delaying until then the determination of the ultimate possession or enjoyment of the property."} However, it is submitted that the decision can well be justified on the basis of the conservative interpretation and such an approach appears to be preferable to the one actually used.\footnote{This standard appears to be set out in the following language: "The problem posed for us in the present appeal is whether by the terms of two trust instruments... all possibility of reversion of interest therein upon any contingency, was successfully excluded." Principal case at 497.} It is clear from an analysis of the contingencies which might have arisen during the decedent's life that he possessed a possibility of reverter. It was possible that the wife and daughter might have predeceased him and that he would outlive all of the common heirs (which the court construed to mean lineal descendants of the marriage),\footnote{Supra, note 8.} and all persons who might be his heirs at law—a very remote possibility, but sufficient to constitute the first element of the doctrine. It was also possible that he might survive the wife, or that they might be divorced, and that he would remarry and have children. Then should there be a failure of common heirs the children of the subsequent marriage, who would be his lineal descendants, would be next of kin superior to his collateral heirs. On occupying that status they would prevent the collaterals from taking, since the condition set forth in trust instrument, namely, that next of kin should be collateral heirs, would not be satisfied, inasmuch as the next of kin in this

\footnote{Principal case at 499.}
case would be lineal descendants. Therefore, there would be a failure of takers and the corpus would revert to his estate. Again it is a case of a very remote possibility, but sufficient to constitute the first required element. In each of these situations the settlor's death cuts off the possibility of reverter by termination of the contingencies; and it enlarges the interests of the takers because his death before his wife's would set the outer limit of the class of common heirs, and her death before his would allow his death to ripen the beneficiaries' interests. Thus the second required element (or second and third depending upon their classification) is present, and the Hallock doctrine can therefore be invoked. By reference to this interpretation, rather than one based on the possibility of reverter alone, or the element of survivorship alone, the decision escapes the criticism that has been leveled at the Tax Court and certain of the circuit courts for misinterpreting the Hallock case. It is interesting to note that since the trust effected a distribution to the settlor's "heirs," the court considered the possibility of the existence of a reversionary interest in the settlor, by reference to the doctrine of worthier title. However, the court did not base its decision on the existence of a reversion. It is submitted that the court followed a sound course in this respect since the doctrine of worthier title applies only when a grantor attempts to create a remainder in his heirs. Such was not the case here because the remainder was to the common heirs of two persons; therefore the doctrine is not applicable. In any event, the question may be raised whether a reversion to a settlor resulting from application of the doctrine of another title is not more properly taxable under section 811(a).  

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11 Supra, note 5.
12 Property Restatement, § 314 (1940); Simes, Future Interests, §§ 144-148 (1936).
13 Property Restatement, § 314c (1940).
14 It seems that a reversion, which is a vested interest, should be included in a decedent's taxable estate under 811(a) as is all other property subject to probate. Yet the government has argued, and the Tax Court has held, in Estate of Bertha Low, 2 T.C. 1114 (1943), affirmed, (C.C.A. 2d, 1944) 145 F. (2d) 832, that the trust is subject to taxation under 811(c). The only apparent explanation for the government's argument is that the Supreme Court has never made a clear pronouncement of what is to be the basis for determining value in this situation. The result is that the commissioner subjects the corpus of the trust, minus the value of the outstanding life estate, to taxation under 811(c). But if he were to proceed under 811(a) the only thing he could tax would be the value of the reversion held by the decedent, based on actuarial tables, and this would be small compared to the value of the corpus minus the outstanding life estate. See Everett, "Valuation of a 'Possibility of Reverter' Under the Hallock Case," 18 Taxes 611 (1940).