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## TAXATION IN MISSOURI— INHERITANCE TAXATION\*

HENRY T. LOWE\*\*

The inheritance tax is a neglected child. Born when the family budget was small, it has grown up in a period of dramatic change amid burgeoning domestic demands for money, demands which necessarily have looked for satisfaction to the younger, more productive members of the family. And we should not be surprised to find that as the revenues it produces become less and less significant,<sup>1</sup> so attempts to keep the law current by amendments<sup>2</sup> and significant interpretations by the appellate courts are more and more infrequent; and although any lack of effort be entirely unconscious, perhaps the administration of the law no longer has the vitality, the parental solicitude and interest, so requisite for sound growth, health, and domestic prosperity.

These are thoughts suggested by two recent decisions on significant and interesting inheritance tax questions, decisions which focus our attention on two quite different dimensions of a common problem.

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\*This article contains a discussion of selected Missouri court decisions reported in volumes 333-345, South Western Reporter, Second Series.

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1. The statistics are interesting; in 1920 inheritance tax receipts were \$1.408 million out of total revenue receipts of \$9.519 million or almost 15% of the total; in 1930 inheritance tax receipts were \$3.841 million out of total revenue receipts of \$15.591 million or almost 25%; in 1940 inheritance tax receipts were \$1.961 million out of total revenue receipts of \$43.350 million or approximately 4.5%; for fiscal year 1949-1950 inheritance tax receipts were \$2.675 million out of total revenue receipts of \$115.362 million or slightly less than 1.5%; and for fiscal year 1960-1961 inheritance tax receipts were \$5.494 million out of total revenue receipts of \$213.123 million or approximately 2.5%. These figures were taken from The Biennial Reports of the State Treasurer of Missouri for the respective periods; for the fiscal year 1960-1961 the figures were taken from the Annual Report of the Department of Revenue.

2. The basic substantive law provisions are found in §§ 145.010-.040, RSMo 1959. Originally the law was enacted in 1917, Mo. Laws 1917, at 114, § 1-33; and the following are the principal amendments to the substantive law. In 1931 provisions now found in § 145.020-1(4), RSMo 1959, were added; these pertain to certain lifetime transfers. Mo. Laws 1931, at 130, § 1. In 1941 exemptions were added for employee pension and similar type plans and intangibles owned by non-residents; these are now found in § 145.020-3(1) and (2), RSMo 1959. Mo. Laws 1941, at 280, § 1, and 281, § 1. The exemption for life insurance proceeds, now found in § 145.020-3(3), was added in 1943. Mo. Laws 1943, at 309, § 1. The exemption for property passing to a surviving spouse and children, now found in § 145.020-3(4) was added in 1957. Mo. Laws 1957, at 780, § 1.

CONTEMPLATION OF DEATH: OSTERLOH'S ESTATE<sup>3</sup>

The inheritance tax<sup>4</sup> is a tax on certain transfers<sup>5</sup> of property, a levy imposed on the privilege of receiving property which traces its incidence to the death of the transferor. Not limited to transfers by testate or intestate succession, it reaches out to embrace many common forms of lifetime disposition, such as transfers where the donor has reserved the income for his life or the right to designate who shall possess or enjoy the property or the income and transfers intended to take effect in possession or enjoyment at or after the death of the donor.<sup>6</sup> And, of course, as any scheme of death taxation is ineffective if a person may avoid the tax by giving his property away just before his death, from the outset transfers in contemplation of death (whatever that elusive language may mean in a particular context) have been subject to the tax.<sup>7</sup> But, unlike many states, Missouri has no gift tax law, and hence in the administration of the inheritance tax the role of contemplation of death must be central if the tax is to retain its integrity.

Thus it comes as a distinct surprise to find that a person may avoid the inheritance tax altogether, even at the twenty-third hour, by the simple expedient of establishing joint ownership. We now learn that the creation of a joint tenancy in personal property within two years of death is not a statutory transfer, and since jointly owned property is not subject to tax<sup>8</sup> the property passes to the surviving joint owner free of tax. What is the basis for this conclusion? The reasoning proceeds like this: the principal characteristic of a joint tenancy is the right of survivorship; Missouri imposes no tax on property passing by right of survivorship; the interest which passed to the survivor in this case did so by virtue of one owner outliving the other; hence there was no statutory transfer when the joint estate first came into being. And we are left with this pleasant fiction, the right of survivorship, a right which is at best a tentative, halting type of interest, one which must bide its time and wait patiently for the expiration of the other interest, a death watch, however, which may end in tragedy for the observer.

But if the right of survivorship is a tentative, halting type of interest, there are other interests of a joint owner which are not. A joint tenant

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3. *Estate of Osterloh v. Carpenter*, 337 S.W.2d 942 (Mo. 1960).

4. C. 145, RSMo 1959.

5. § 145.020-1, RSMo 1959.

6. § 145.020-1(3) and (4), RSMo 1959.

7. § 145.020-1(3), RSMo 1959.

8. *Estate of Gerling v. Department of Revenue*, 303 S.W.2d 915 (Mo. 1957).

shares the fruits of ownership<sup>9</sup> (rents, profits, dividends and interest) and without the consent of his co-owner may sever the tenancy;<sup>10</sup> by a simple sale or other assignment of his interest he may realize presently its full economic benefit. One would like to think in the mid-twentieth century that revenue laws should be construed in a manner consonant with the economic substance of the transaction and that the niceties of the property law, whatever their significance may be in other contexts, should defer here to a more sturdy, direct approach. May we not assert with some suasion that it does no violence to the term "transfer" to say that it embraces a transaction of this nature? Indeed comparable legislation has been so construed for years.<sup>11</sup> And certainly it involves no more of a logical inconsistency to say that while jointly held property is not subject to the inheritance tax, the creation of a joint tenancy in contemplation of death is, than to say a completed lifetime gift is not subject to the tax but the same gift if made in contemplation of death is. In either case there is a transfer, and the questions for determination are the amount<sup>12</sup> of the transfer and the state of mind of the donor at the time of the transfer.

The parties stipulated the salient facts, but curiously, they did not mention some things we would like to know: Did the decedent retain pos-

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9. As it did in the *Osterloh* case, the Missouri Supreme Court has repeatedly recognized that a joint tenancy in personal property is permissible under Missouri law. Recently the court discussed the subject at some length in *Longacre v. Knowles*, 333 S.W.2d 67 (Mo. 1960), where it points out that a joint tenant in personalty has equal rights to share in the enjoyment of the property while both joint owners are alive.

10. Apparently there is no Missouri case which holds that a right of severance exists with respect to a joint tenancy of personal property. This would seem to follow, however, since the right clearly exists with respect to real property, *McClendon v. Johnson*, 337 S.W.2d 77 (Mo. 1960); and the rules for joint tenancies of personal property in other respects are the same as those that pertain to real property. See *Longacre v. Knowles*, *supra* note 9 and, *Johnston v. Johnston*, 173 Mo. 91, 73 S.W. 202 (1903).

11. This reference is to the provisions of the federal gift tax law, where similarly the incidence of taxation is traced to a "transfer." INT. REV. CODE OF 1954 §§ 2501 and 2511; Treas. Reg. § 25.2511-1(h)(5) (1958). Prior to the enactment of Section 2515 of the Internal Revenue Code of 1954 the creation of a tenancy by the entirety where husband furnished all the consideration was held to constitute a transfer from husband to wife for gift tax purposes. *Commissioner v. Hart*, 106 F.2d 269 (3d Cir. 1939); *Commissioner v. Logan*, 109 F.2d 1014 (3d Cir. 1940); *Lilly v. Smith*, 96 F.2d 341 (7th Cir. 1938). Of course the entirety cases did not turn on a right of severance but rather on the likelihood of the wife outliving the husband, but the basis for holding a transfer took place at the time of creation of the tenancy is similar in the two cases.

12. The regulations under the federal gift tax law provide that the amount of the transfer is one-half the value of the property where one of two joint owners furnishes all the consideration. Treas. Reg. § 25.2511-1(h)(5) (1958).

session of the stock certificates until her death? Did she share the income receipts with her co-owner during her lifetime? Did she pay income tax on the entire receipts or only on one-half? Apparently the parties believed these facts were unimportant and the court was content to decide the case on the ground a joint estate was created. But it is not at all unlikely that questions like these will assume some importance, for in future cases the courts may be called upon to decide if the donor created a joint estate before death; and the Director, instead of conceding the battle, will probably retreat to the inner fortress where "intention" and "delivery" are very effective close range weapons.

What is the significance of this for one who plans with an eye to saving taxes? For the large estate subject to the federal estate tax, there may be little since jointly held property is subject to the federal estate tax,<sup>13</sup> considerations other than death taxes will likely dictate the form of disposition, and in most cases the plan has been shaped before contemplation of death becomes a serious problem. But even here where age, and hence contemplation of death, is a problem substantial tax savings may be possible. And in smaller estates one may hazard a prediction that planning to save inheritance taxes undertaken at the twenty-third hour will become an increasingly popular activity.

#### POWERS OF APPOINTMENT: TOMPKINS ESTATE<sup>14</sup>

Here A, who died in 1913, established a trust in her will for the benefit of certain named relatives of whom B, a niece, was one. In addition to an income interest, B had an unlimited testamentary power to appoint a share of the corpus of the trust. In 1942 B partially released her power by restricting it to her own descendants and their spouses; and when she died in 1951 she exercised the power in favor of her grandchildren and her daughter-in-law. The Director successfully contended that B's exercise of the power was a taxable transfer.

Beyond a skillful and elaborate piece of statutory interpretation there is nothing in the decision particularly novel, and to this writer the result seems proper, indeed necessary. B's executrix resisted on two grounds, one that the ultimate recipients were taxed twice on their receipt of the property,

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13. INT. REV. CODE OF 1954 § 2040 (inclusion is based on the consideration furnished by the decedent).

14. *Estate of Tompkins v. Carpenter*, 341 S.W.2d 866 (Mo. 1960).

and the other that due to a peculiarity of the wording of the statute the legislature did not accomplish what it obviously had intended to do, which was to treat the exercise of a power of appointment as a taxable transfer.

The argument on double taxation proceeded on this basis: an inheritance tax is a levy imposed on the right to receive property; A's estate paid inheritance taxes when she died in 1913; at least some of B's appointees were named by A as takers in default of appointment and thus were like contingent remaindermen; and to tax these appointees on B's death in 1951 would be to impose two taxes on their receipt of a single property. Of course the argument ignores the significance of the unlimited power B had, which she voluntarily restricted in 1942, and for this reason the court quite properly rejected it.

The other defense, based on the wording of the statute, presented a rather more sophisticated challenge. Originally enacted in 1917, and carried forth since then unchanged, the section on powers of appointment provides that an exercise of a power shall be deemed a "transfer." Not satisfied with this statement the draftsmen added a descriptive clause; the exercise of the power is a transfer "taxable . . . in the same manner as though the property [subject to the power] . . . belonged absolutely to the *donee of such power* and had been bequeathed or devised by *the donor* by will . . ."<sup>15</sup> Here is an ambiguity of the first order. Do the words, the "donee of the power" and "the donor," refer to the same or different people? If they refer to the same person, what a curious use of language to impute to the legislature, at one point to refer to the decedent B as the donee of the power and in the same breath refer to her as the donor! But if the terms refer to different persons, then B is the donee of the power and A is the donor and the statute becomes meaningless, for the exercise cannot be a taxable transfer by B if it is to be treated as a bequest or devise by A. The court did the only decent thing and preserved the statute; the "donee of the power" and "the donor" are the same person.

While interesting in view of the grammatical difficulties this decision probably does not merit extended comment. The decision is noteworthy because it focuses our attention on the statutory section<sup>16</sup> on powers of appointment. Surely all will agree that few areas of the law are more recondite and unintelligible than that relating to the common law of powers of appointment. Here subtle difficulties abound; and the tyro ventures

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15. § 145.030, RSMo 1959. (Emphasis added.)

16. § 145.030, RSMo 1959.

into these gloomy regions only with feelings of deepest anxiety. General and special powers—powers collateral, appendant and in gross—exclusive and nonexclusive powers—these and a host of other complications people this strange land.<sup>17</sup>

But regardless of their antecedents we can hardly exaggerate the present importance of powers of appointment, an importance which is traceable in large measure to the increasing use of trusts in lifetime and testamentary estate planning. By a judicious use of powers in a trust an owner of property may plan his disposition far into the future without being forced to predict or anticipate with any degree of certainty the course of future events; in short he introduces flexibility into his plan without disturbing his basic goals. And if properly advised he can at the same time effect substantial savings under the federal revenue laws.<sup>18</sup> Unquestionably the current federal legislation promotes the wide and varied use of powers in inter vivos trusts and wills, and where the impact of the federal tax laws is so much greater than the impact of local revenue legislation the lawyer planning for the future disposition of his client's wealth will look first and primarily to the federal law where the guide lines are rather precisely stated.

In the light of recent experience under the federal law our 1917 statute poses some obvious and fundamental questions: What is a power of appointment for inheritance tax purposes? Is there any distinction to be drawn between a general power and a special power, such as we find in the common law and by definition in other schemes of death taxation?<sup>19</sup> If not, at what point does a special power cease to be a power at all for inheritance tax purposes? Does the statute apply only to individuals or can a corpora-

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17. For one anxious to explore these mysteries in any detail a good starting point is 5 *AMERICAN LAW OF PROPERTY* §§ 23.1-23.13 (Casner ed. 1952).

18. The Internal Revenue Code of 1954 has detailed provisions on powers of appointment for the income, estate and gift tax areas. For the income tax consequences of the use of powers in trusts see *INT. REV. CODE OF 1954* §§ 671-78 and particularly §§ 674, 676, 677 and 678; for the estate tax provisions see *INT. REV. CODE OF 1954* § 2041; and for the gift tax provisions see *INT. REV. CODE OF 1954* § 2514.

19. The power in *Tompkins* at the time of B's death was a limited and thus probably a special power, but the power originally was general. The distinction between a general and special power is made in the federal law, *INT. REV. CODE OF 1954* § 2041, and in several state inheritance tax statutes: *ARIZ. REV. STAT. ANN.* § 42-1511 (1956); *DEL. CODE ANN.* tit. 30, § 1304 (1953); *HAWAII REV. LAWS* § 122-4 (1955); *ME. REV. STAT. ANN.* ch. 155, § 6-A (Supp. 1961); *MISS. CODE ANN.* § 9262-04 (Supp. 1960); *N.Y. TAX LAWS* § 249-r; *N.D. REV. CODE* § 57-37-07 (Supp. 1961); *OKLA. STAT. ANN.* tit. 68, § 989e (Supp. 1961); *ORE. REV. STAT.* § 118.010(5) (Supp. 1961); *TEX. REV. CIV. STAT. ANN.* tit. 122A, art. 14.01 (1959); *Wis. STAT. ANN.* § 72.01(5) (1959).

tion be subject to tax?<sup>20</sup> What is the effect of the release or exercise of a power if made in contemplation of death?<sup>21</sup> What is the effect of disclaimer, renunciation or lapse?<sup>22</sup> Apparently, nonexercise is treated in the same manner as an exercise<sup>23</sup> but how is nonexercise distinguished from disclaimer, renunciation or release? Is the inter vivos exercise of a power a transfer if the donee thereby reserves a life estate, the power to designate who shall enjoy the property or other incidents of ownership and control?<sup>24</sup>

I haven't the temerity to suggest answers to these questions,<sup>25</sup> but it goes without saying that these and untold other questions lurk menacingly within the four corners of the hundreds of wills and trust instruments executed weekly. Why aren't these questions raised and litigated? One may only surmise, but in any assessment neglect would play an important part; and we are constantly reminded that today's child of neglect may be the occasion for tomorrow's crusade.

The statute on powers is a good example of the neglect from which the inheritance tax law suffers. In itself this is quite a minor tragedy; the music

20. The section on powers expressly provides: "Whenever any person or corporation shall exercise the power of appointment . . . such appointment shall be deemed a transfer . . ." § 145.030, RSMo 1959. The language is curious; and the legislative intent is far from clear.

21. The federal estate tax law refers expressly to the exercise or release of a general power of appointment in contemplation of death. INT. REV. CODE OF 1954 § 2035(b); and a number of state inheritance tax statutes have similar references: ARIZ. REV. STAT. ANN. § 42-1511 (1956); HAWAII REV. LAWS § 122-4(a) and (b) (1955); MISS. CODE ANN. § 9262-04 (Supp. 1960); N.Y. TAX LAWS § 249-r; N.D. REV. CODE § 57-37-07 (Supp. 1961); OKLA. STAT. ANN. tit. 68, § 989e (Supp. 1961).

22. The federal estate tax law has express provisions concerning renunciation, disclaimer and lapse, INT. REV. CODE OF 1954 § 2041; and some state statutes have similar provisions: ARIZ. REV. STAT. § 42-1511 (1956); N.Y. TAX LAWS § 249-r; R.I. GEN. LAWS ANN. § 4422-7 (Supp. 1960).

23. The Missouri statute on powers provides that to the extent of the omission or failure to exercise a power of appointment "a transfer . . . shall be deemed to take place." § 145.030, RSMo 1959.

24. Certain lifetime dispositions, *supra* note 6, may be taxable transfers. § 145.020(3) and (4), RSMo 1959. The federal estate tax law specifically provides that an inter vivos exercise of a power may cause the property to be a part of the gross estate, if a transfer of owned property in the same circumstances would be subject to section 2036 (transfers with retained life estates), section 2037 (transfers taking effect at death) or section 2038 (revocable transfers). INT. REV. CODE OF 1954 § 2041. Some states have enacted similar provisions: ARIZ. REV. STAT. ANN. § 42-1511 (1956); N.Y. TAX LAWS § 249-r; N.D. REV. CODE § 57-37-07 (Supp. 1961).

25. Apparently no one has attempted a detailed analysis of this statute. The section is only mentioned in passing in a recent article on powers of appointment which emphasizes drafting problems. Allen, *Powers of Appointment and the Drafting of Missouri Wills*, 1954 WASH. U.L.Q. 408.



of these particular spheres is not particularly pleasing to our ears, when we listen; ordinarily it is not loud enough to arrest our attention; and any disharmony here we tolerate in comfort. Nevertheless the section on powers, and for that matter the entire inheritance tax law, can and should be improved; and as we cast about for new sources of revenue we should not overlook the opportunities in an existing scheme which can do a good deal more than we have asked of it, if we will only take the time and interest