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Taxation-Due Process-Gifts in Contemplation of Death

TAXATION—DUE PROCESS—GIFTS IN CONTEMPLATION OF DEATH—On March 1, 1927, John Donnan, by complete and irrevocable gift *inter vivos*, transferred, without consideration, certain securities to trustees for his

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[8] *Westport Stone Co. v. Thomas* (1910), 175 Ind. 342, 94 N. E. 406.

[9] *Great Western Natural Gas and Oil Co. v. Hawkins* (1903), 30 Ind. App. 557, 66 N. E. 765.

[10] *Sexauer v. Star Milling Co.* (1909), 173 Ind. 342, 90 N. E. 474.

[11] *Westport Stone Co. v. Thomas* (1910), 175 Ind. 342, 84 N. E. 406.

[12] *Bradley v. Degnon* (1918), 224 N. Y. 60, 120 N. E. 89.

[13] *Hatfield v. Straus* (1907), 189 N. Y. 208, 82 N. E. 172.

[14] *Mester v. Morman* (1924), 227 Mich. 364, 198 N. W. 927; *Butler v. F. R. Penn Co.* (1910), 152 N. C. 416, 68 S. E. 12.

[15] *Bedford Quarries Co. v. Chicago, etc., Ry.* (1910), 175 Ind. 303, 94 N. E. 326.

four children, and advanced a sum of money to his son. Donnan died less than two years later. A tax was, accordingly, imposed under the provision of the Federal Revenue Act which provides that such transfers, made within two years prior to the death of the donor shall "be deemed and held to have been made in contemplation of death."[1] Donnan's executors paid this tax under protest, and then sued to recover the amount of the tax attributable to the property so given and so advanced. The trial court found that neither the transfer nor the advancement was made in contemplation of death. The question involved is whether or not the provision of the tax creating a conclusive presumption that transfers made within two years prior to death are made in contemplation thereof, is constitutional. *Held,* in a majority opinion written by Mr. Justice Sutherland, that the provision in question is unconstitutional because it violates the due process clause of the Fifth Amendment.[2]

The majority reasoned that the tax here is a death transfer tax laid on property shown not to have been transferred in contemplation of death. Complete title to said property had passed to the donee during the lifetime of the donor, and yet the tax laid, not on the transfer of the gift, or in respect of its value, but on the transfer of the estate of the decedent—the value of which estate is enhanced by the fictitious inclusion of the gift, and the estate made liable for a tax computed on that value. The result is that the burden of a tax measured in part by property which comprises no part of the estate is imposed upon those who succeeded to said estate. Plainly, Justice Sutherland says, this is measuring the tax on A's property by imputing to it the value of B's property, and so is contrary to due process of law.[3] The majority opinion concluded with the statement that the tax could not be upheld as a gift tax in view of the provisions of the statute that the value of the property transferred shall be determined as of the time of death, without regard to its value at the time of the transfer; and the fact that the ax falls upon the decedent's estate and not upon the gift, and is computed not upon the value of the gift, but by progressively graduated percentages upon the value of the entire estate.

The minority opinion, written by Justice Stone, views the situation from the practical viewpoint of the necessity of taxing these gifts without encountering the administrative difficulties of providing the donor's intent. The dissent reasons that in taxing gifts *inter vivos* as though they were legacies, it can be of no consequence whether the enactment says that all gifts within two years of the death of the donor are irrebuttably presumed to be in contemplation of death, or whether more directly, it imposes the tax on all gifts made within two years of the donor's death. In either case, the question is as to the power of the legislature so to tax, and not as the particular choice of words by which the legislature has expressed its purpose. The question is whether Congress has the power to supplement an estate tax by a tax on gifts made within two years of the donor's death at the same rate and in the same manner as though the gifts were made at death.

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[1] No. 302 (c) of the Revenue Act, Ch. 27, 44 Stat. at L. 9, 70.

[2] *Heiner v. Donnan* (1922), 52 Sp. Ct. 358, affirming 48 Fed. (2) 1058.

[3] *Knowlton v. Moore* (1900), 178 U. S. 41; *Schlesinger v. Wisconsin* (1926), 270 U. S. 230; *Hoeper v. Tax Com. of Wisconsin* (1931), 52 Supreme Ct. Rep. 120.

It would seem that the fact that gifts made shortly before death, regardless of motive, chiefly contribute to the withdrawal of property from the operation of the estate tax is enough to justify the selection of this class of gifts for taxation. The Supreme Court has held that the due process clause does not forbid the selection of subjects for one form of taxation for the reason that they may not be effectively reached by another tax which it is the legislative policy to maintain.[4] Such is the object here—to protect the revenue to be derived from the estate tax—and it is not imperative that the motive of the donor be made the exclusive basis of the selection of these gifts for taxation. Further, the Supreme Court has held that Congress has the power to select certain gifts to be taxed as estates are taxed, even though the title to the gifts taxed was not transferred by the death—as in the case of a tax on the value of property held by the decedent and another as tenants by the entirety.[5] The only requisite is, to quote the language of the court in *Tyler v. United States*, "where the attempt and legitimate aim of Congress is to prevent an avoidance of the estate tax by this method of distribution—and the provision under review is an adjunct of the general scheme of taxation of which it is a part, it is entirely appropriate as a means to that end." Here, the gifts taxed may have no relation to the death, but they are directly connected with the policy of taxing the estates of decedents at death, for which would otherwise be taxed is, by the gift, withdrawn from the operation of the tax unless the act which impairs it—the giving away of property *inter vivos*—is itself taxed. The history of litigation over gifts made in contemplation of death shows that this tax imposed on all gifts made within two years of death is attached to a legitimate legislative object—that of preventing an enormous revenue loss due to evasion of the estate tax by including in the estate tax all gifts made within two years of death. The line had to be drawn somewhere, and Congress can not be held rigidly to a choice between taxing all gifts or taxing none, regardless of the practical necessity of preventing tax avoidance, and regardless of experience in administering the tax. The very power to classify involves the power to distinguish differences in degrees between those things which are near and those which are remote from the object aimed at.[6]

The facts in the present case are very similar to those present in the case of *Schlesinger v. Wisconsin*, with the exception that in the *Schlesinger case*, the statute provided for taxing all gifts made within *six* years of death as though they had been made in contemplation thereof. In that case, the six-year period seemed too long, and the decision that the classification of gifts made within that period as gifts *causa mortis* was arbitrary and contrary to due process of law is sustainable. But, as Justice Holmes said in his dissent to the opinion in that case, "The law allows a penumbra to be embraced that goes beyond the outline of its object in order that the

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[4] *Watson v. New York* (1920), 254 U. S. 122; *Clement National Bank v. Vermont*, 231 U. S. 121.

[5] *Tyler v. United States* (1930), 281 U. S. 497.

[6] *Citizens Telephone Co. v. Fuller* (1913), 229 U. S. 322.

object may be secured. A typical instance is the prohibition of the sale of non-intoxicating malt liquors to make effective a prohibition of the sale of beer. When the means are not prohibited and are calculated to effect the object, we ought not to inquire into the degree of necessity for resorting to them. If the term here were six months instead of six years—I hardly think that the power of the State to pass the law would be doubted, as the difficulty of proof would warrant making the presumption absolute."

The two-year term provided for in the statute in question appears to be a reasonable one, as evidenced by the number of large gifts made within two years of the donor's death—and in view of the difficulty of proving intent, and of the necessity for protecting the revenue to be derived from the estate tax—the argument seems persuasive that the statute should have been upheld.

L. J. H.

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[7] *Schlesinger v. Wisconsin* (1926), 270 U. S. 230.