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THE VALIDITY OF A STATE TAX UPON THE COMING INTO POSSESSION AND ENJOYMENT OF A VESTED REMAINDER

The United States Supreme Court has recently decided in *Coolidge v. Long*[1] that a state may not impose an inheritance tax upon the coming into possession and enjoyment, through the death of the life tenant, of a remainder previously vested. The decision, while actually passing only upon the Massachusetts inheritance tax, has a very wide effect since the vast majority of the states purport to impose exactly this sort of tax,[2] and all these laws must now be regarded as invalidated.

The case passed upon by the Supreme Court arose as follows: A husband and wife created a trust estate, the income to be paid to themselves and to the survivor of them for life, and on the death of the survivor the principal was to be divided among their five sons equally, the share of any previously deceased son to go to his estate. At the time of the creation of the trust estate there was no law of Massachusetts, the domicile of all the parties, imposing a tax upon the succession of such an estate. Subsequently, however, and long before the death of either of the parents, such a statute was passed.[3] Later the parents assigned all their interest in the trust estate to the sons, but the state court decided that this did not give the sons any right to put an end to the trust.[4] Upon the death of the husband

[1] 51 Sup. Ct. 306 (Feb. 24, 1931).

[2] Over 40 states and territories have statutes purporting to impose such a tax. For the Indiana statute to this effect, see Burns' 1929 Supp., Sec. 14389.

[3] The trust was created in 1907, whereas the first statute purporting to tax such a transfer in pursuance of a gift made before its enactment was passed in 1912. The wife died in 1921 and the husband in 1925.

[4] *Coolidge v. Loring*, 235 Mass. 220, 126 N. E. 276 (1920).

(who survived the wife) the five sons received the corpus of the trust estate, and the state exacted from them an inheritance tax in accordance with the statute. Claiming that the tax law was unconstitutional, the sons brought suit to recover the tax so paid. The Supreme Judicial Court of Massachusetts sustained the validity of the tax and so denied recovery.[5] As already said, the Federal Supreme Court reversed this decision. The latter court declared the tax contrary to the United States Constitution on two grounds: (1) That it was an impairment of the obligation of the contract represented by the trust agreement, and (2) that it deprived the plaintiffs of property without due process of law. The opinion was written by Mr. Justice Butler. However, it was only a 5-4 decision, Justices Roberts, Holmes, Brandeis, and Stone dissenting. Mr. Justice Roberts wrote an elaborate dissenting opinion.

It seems clear that the contention of the majority that such a tax violates the contracts clause of the Federal Constitution is not to be taken seriously. A state tax is never regarded as an impairment of the obligation of a contract unless the contract itself contains or implies a clear promise to absolve one party from taxation—and therefore unless the state itself, or one of its subdivisions is a party to the contract.[6] This was clearly not the case here. Even when the state is a party to the alleged contract an exemption from taxation is not readily inferred, and will not be considered to exist without express language or at least a more than usually clear implication.[7]. We are therefore thrown back upon the usual recourse in such matters, the due process clause of the Fourteenth Amendment, which, like charity, covers a multitude of sins—including, it is to be feared, certain intellectual misdeeds of our highest judicial tribunal.

In considering this matter, we may pass for the time being the question of the desirability of this result, and begin with the authorities. And it must be said that there are several states, led by New York,[8] that are committed to the position taken by

[5] *Coolidge v. Commissioner*, 167 N. E. 757 (1929).

[6] *Kehrer v. Stewart*, 197 U. S. 60 (1905); *Lake Superior Mines v. Lord*, 271 U. S. 577 (1926).

[7] *Providence Bank v. Billings*, 4 Pet. (U. S.) 514 (1830); *No. Missouri Railroad Co. v. Maguire*, 20 Wall. (U. S.) 46 (1873); *People v. New York*, 199 U. S. 1 (1905). In very rare instances, however, a contract with the state may be held to necessarily imply an exemption from taxation, even though not expressed. *Murray v. Charleston*, 96 U. S. 432 (1877); *Stearns v. Minnesota*, 179 U. S. 223 (1900).

[8] *Matter of Pell*, 171 N. Y. 48, 63 N. E. 789 (1902).

the court in this case—that an inheritance tax upon the coming into possession of a vested remainder by reason of the death of the life tenant is unconstitutional, as taking of property without due process of law. But such state authorities, even if they were in the majority, which does not seem to be the case, are not binding on the Federal courts. It seems in fact that such Federal cases as are analogous to the one under discussion favor a result contrary to that here reached by the court.

The majority contends that the tax is retroactive because the trust was created before the tax on the succession to the remandermen was imposed. It is true that an excise tax otherwise valid may be overthrown if so seriously retroactive as to be regarded as unfair.[9] But the Supreme Court has sustained a number of excise taxes which were avowedly retroactive.[10] The test is really one of fairness.[11] It is submitted that the tax in issue in the principal case was really not retroactive, as it applied only to the coming into actual possession and enjoyment of the trust property by the remaindermen, which occurred long after the passage of the law imposing the tax. But admitting that it is retroactive, it seems nevertheless fair, and so should have been sustained, at least on this point.

It is also entirely clear that the Supreme Court has itself construed various Federal and state tax laws as applying only upon the actual coming into possession of the property, and by permitting the enforcement of such laws has inferentially sustained them. It is of course true that a distinction may be and frequently is made for tax purposes between vested and contingent remainders.[12] Generally, too, there is the same tendency

[9] *Blodgett v. Holden*, 275 U. S. 142 (1927); *Untermeyer v. Anderson*, 276 U. S. 440 (1928). For similar reasons, a tax law will be construed, if possible, as only prospective in effect. *Schwab v. Doyle*, 258 U. S. 529 (1922); *Levy v. Wardwell*, 258 U. S. 542 (1922). See also *Lewellyn v. Frick*, 268 U. S. 238 (1925).

[10] *Brushaber v. Union Pacific R. Co.*, 240 U. S. 1 (1916); *Billings v. United States*, 232 U. S. 261 (1914); *Cooper v. United States*, 280 U. S. 409 (1930).

[11] This is brought out very clearly in *Milliken v. United States*, 51 Sup. Ct. 324, a decision promulgated only one week later than that of the principal case. This case upheld a federal estate tax imposed so as to include a gift made in contemplation of death before its passage, but when a previous tax law imposing lower rates was in effect. The court stated that it would be quite unfair to impose a new and unheard-of form of taxation upon the estate of the decedent, but that it was not unfair to regard him as having anticipated the chance of increased rates for an existing tax.

[12] *Salamon v. New York*, 278 U. S. 484 (1929).

in tax cases as in all others to construe doubtful limitations as vested rather than contingent,[13] though there seem to be some exceptions to this rule where the court believes that the legislature has used these words in other than their usual sense.[14] And there is no dispute that the vesting of a clearly contingent remainder is taxable.[15] But the distinction between a vested and a contingent remainder is a matter of great technicality and one which has very little relation to the actual control of or benefit from the property, or the value of the interests under consideration.[16] It is therefore hardly surprizing that there has been a considerable tendency in drawing tax statutes to ignore the technical distinction between vesting and contingency and emphasize rather the more practical considerations. Thus the Federal inheritance taxes at both the time of the Civil war and the Spanish war taxed the coming into possession rather than the vesting of remainders.[17] State statutes have been drawn on a similar basis and have been so construed by the Supreme Court.[18] While these cases deal with the construction rather than the constitutionality of these statutes, yet they are quite inconsistent with the apparent idea of the majority of the court in the principal case that the taxation of the coming into possession of a remainder already vested is such an extraordinary and unprecedented procedure as to cast suspicion upon the basic validity of the law.

More nearly in point are the cases involving situations where the power of revocation or of change of beneficiary is retained by the creator of the trust. It is clear that this does not invalidate the trust or make it less binding.[19] Yet it is held that

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[13] *McArthur v. Scott*, 113 U. S. 340 (1885); *United States v. Fidelity Trust Co.*, 222 U. S. 158 (1911).

[14] It has been held that a federal statute providing for the refund of taxes on interests "vested" before a certain date did not apply to residuary legacies unless the estate was fully settled by that date, on the ground that the amount of such legacies was not yet determined. *United States v. Jones*, 236 U. S. 106 (1915); *McCoach v. Pratt*, 236 U. S. 562 (1915). See also, *Henry v. United States*, 251 U. S. 393 (1920). There is no doubt that the mere uncertainty of amount does not ordinarily prevent the vesting of an interest in an estate; but the court construed the Congressional intent as requiring a different interpretation of this statutory language.

[15] *Wright v. Blakeslee*, 101 U. S. 174 (1879).

[16] See Burdick on Real Property, pp. 356-361.

[17] *Clapp v. Mason*, 94 U. S. 589 (1876); *Mason v. Sargent*, 104 U. S. 689 (1881); *Vanderbilt v. Eidman*, 196 U. S. 480 (1905).

[18] *Keeney v. New York*, 222 U. S. 525 (1912).

[19] *Jones v. Clifton*, 101 U. S. 225 (1879).

the retention of such a power by the settlor makes the property a part of his estate in such sense that an inheritance tax can validly be imposed at his death.[20] Indeed this feature of the Massachusetts law itself was recently sustained by the Supreme Court, which explicitly conceded that the interest of the beneficiary was technically "vested."[21]

Still more pertinent in this connection is the recent decision that the property held by a husband and wife in tenancy by the entireties may, on the death of the husband be subjected to inheritance tax.[22] It was here unsuccessfully argued in behalf of the wife that she already had full ownership in the property and therefore received nothing through her husband's death. The court conceded that this argument was technically sound, but sustained the tax on the ground that the wife received an important practical benefit in the cutting off of her husband's equal right in, and to control, the property. This coming into exclusive possession and enjoyment was held to be taxable as a transfer by death. The same decision has been made with respect to California community property.[23] These cases are indubitable authorities in favor of sustaining an inheritance tax upon the actual coming into the enjoyment of property as the result of the death of another, even though the person thus benefited was already the owner of an interest in the property regarded by the law as vested.

Even more leeway has been given to the states. Thus a state inheritance tax may be imposed upon the estate of a person who has died before its enactment, provided the estate is not completely settled before the tax is imposed.[24] In these cases it makes no difference that the remainders are already vested at the time the tax is imposed, or even that no remainder is provided for.[25]

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[20] *Chase National Bank v. United States*, 278 U. S. 327 (1929); *Reinecke v. Trust Co.*, 278 U. S. 339 (1929). See also *May v. Heiner*, 281 U. S. 238 (1930).

[21] *Saltonstall v. Saltonstall*, 276 U. S. 260 (1928).

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

[23] *Moffit v. Kelly*, 218 U. S. 400 (1910).

[24] *Carpenter v. Pennsylvania*, 17 How. (U. S.) 456 (1854). (While this case was decided before the adoption of the 14th Amendment, it was held in *Orr v. Gilman*, 183 U. S. 278 (1902) to have been correctly decided even under the restrictions of that amendment); *Nickel v. Cole*, 256 U. S. 222 (1921).

[25] *Cahen v. Brewster*, 203 U. S. 543 (1906).

But the clearest of all the authorities for permitting a state to lay a tax under the circumstances of the principal case are the cases relating to general powers of appointment. It has been held that a state may impose an inheritance tax upon the exercise of a general power of appointment to take effect on the death of the donee of the power, notwithstanding the fact that no inheritance tax was imposed at the time of the creation of the power.[26] It is impossible to have a more direct defiance of the technical rules of property law, since it is settled that the beneficiary takes from the donor not the donee of the power.[27] From a strictly legal standpoint, therefore, there is nothing to tax, and the court admits as much. The tax is sustained in view of the practical fact that the death of the donee of the power is the "generating fact" which puts the beneficiary into possession and enjoyment of the estate.

It seems clear, therefore, that the previous decisions of the Supreme Court would have led to a fairly confident prediction that the Massachusetts tax involved in the principal case, as well as the similar taxes imposed by nearly all the states, would have been sustained. Two cases were, however, relied on to prove the contrary. These are *Shukert v. Allen*,[28] and *Nichols v. Coolidge*,[29] the latter being of especial importance because involving the same trust estate as that under consideration in the principal case. In the *Shukert* case it was held that where a testator created a trust, the income to accumulate for thirty years and then the principal and accumulated income to be divided among his children, the estate was not subject to Federal taxation at his death during the thirty-year period, because the trust took effect at once and there was nothing left in his estate to tax. In the *Nichols* case, similarly, it was held that no Federal estate tax could be imposed on the death of one of the two creators of the trust.

It might seem, then, that these two cases are authorities against the validity of the imposition of a tax upon a vested estate merely because it has through the death of another person come into possession and enjoyment of the beneficiaries. But a distinction must be noted between two kinds of inheritance taxes. There may be a tax upon the passing of the decedent's

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[26] *Chanler v. Kelsey*, 205 U. S. 466 (1907); *Orr v. Gilman, supra*, note 24.

[27] Tiffany, Real Property (2d ed.), p. 1048.

[28] 273 U. S. 545 (1927).

[29] 274 U. S. 531 (1927).

estate (a transfer tax) or it may be levied upon the receipt of property from the estate by the beneficiary (a succession tax). The Federal Government has levied both sorts of taxes,[30] but the one now in effect is clearly a transfer tax and is measured by the amount of the estate of the decedent.[31] A state may also levy inheritance taxes on either or both of these theories,[32] but the majority of the states levy succession taxes—and such is the case with Massachusetts. No doubt the court was right when it decided in the *Nichols* case that the trust property was no longer owned by the creators of the trust so as to be subject to the Federal estate tax; but it by no means follows that there was nothing passing to the beneficiaries upon the death of the surviving parent.[33] If there was, Massachusetts purported to tax such succession, and was entitled to do so.

It is apparent therefore that an opposite decision of the principal case, permitting the states to impose an excise tax upon the coming into possession and enjoyment of even vested interests, would have been much more consistent with the previous decisions of the Supreme Court itself. It is submitted also that this would have been a more desirable result. However strong was the technical legal position of the beneficiaries of this trust before the death of both of their parents, the actual effect of such deaths was to change their financial status with respect to the trust property from a mere hopeful anticipation to an actual realization and enjoyment. Indeed, they themselves realized their as yet lack of tangible advantage by attempting to put an end to the trust—an attempt which was unsuccessful in spite of the cooperation therein of the parents themselves.[34] To say that the event which gave these sons the actual possession and enjoyment of the property which they had been unable to obtain previously even by court proceedings, is not within the control or taxing power of the state, seems a bit ludicrous—and yet this is the only way in which the Supreme Court can reach its result. Taxation is, or should be, a practical rather than a technical legal matter; and as has been seen, the Supreme Court has tended to take this position, especially with

[30] *Knowlton v. Moore*, 178 U. S. 41, 77 (1900).

[31] *Edwards v. Slocum*, 264 U. S. 61 (1924).

[32] *Stebbins v. Riley*, 268 U. S. 137 (1925).

[33] See *Saltonstall v. Saltonstall, supra*, note 21.

[34] *Coolidge v. Loring, supra*, note 4. In this case the parents were the formal plaintiffs; but they of course acted in the interest of their sons.

regard to inheritance taxes.[35] The present decision seems to be an unfortunate departure from the previous positions of the court—a position buttressed not only by preponderant authority, but also by sound reasoning and practical desirability.

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[35] See cases cited *supra*, notes 20 to 26. See also, *United States v. Perkins*, 163 U. S. 625 (1896), and *Plummer v. Coler*, 178 U. S. 115 (1900), which are decisions to the same effect, but involve intergovernmental relations. But cf. *Nielson v. Johnson*, 279 U. S. 47 (1929)