THE VALUATION OF FUTURE INTERESTS IN ESTATE AND INHERITANCE TAXATION

The determination of market value is at best a pragmatic conjecture. Oftentimes, in suits between private parties, the uncertainty is so apparent that the courts will deny the plaintiff compensatory recovery, even though a right to it admittedly exists, rather than fix damages on the basis of uncertain or speculative market values. But when values must be ascertained for purposes of taxation, the practical necessity for collecting revenue has generally outweighed any judicial distaste for guesswork. Particularly in the valuation of conditional interests under death taxes, courts and legislatures are faced with the prophetic task of fixing market values on unmarketable interests.

Death taxation in the United States takes the form either of an inheritance tax or an estate tax. Under inheritance tax laws the levy is theoretically against each beneficiary's privilege to receive property passing after death. Consequently, each distributive share must be valued separately to ascertain


2. Since the real desideratum for taxation purposes is the possession of tax-accessible property, it has not been deemed necessary to plunge this Comment into the much-disputed terminology of future interests. "Conditional" is used to describe (1) those interests in property of which the coming into possession is subject to conditions precedent other than the natural termination of a preceding life estate or term for years, or (2) interests already in possession but the continuance of which is subject to conditions subsequent other than their natural termination. All other interests will be termed "vested". This classification corresponds in general with the all-important distinction in estate and inheritance taxation between interests presently capable of valuation by reference to actuarial data, and interests to which actuarial data is deemed inapplicable. See note 13, infra.


The Federal government and the following states have an estate tax: Ariz., Fla., Miss., N. D., N. Y., Okla. and Utah.

Alabama and Georgia have an estate tax only for the purpose of absorbing the 80% credit permitted on the federal tax for taxes paid under state inheritance or estate tax laws.

The following states have an additional estate tax which applies only when the tax under the state law is less than the 80% federal credit, in which case the tax is increased by this statute until it equals the maximum amount of credit allowed under the federal estate tax law: Cal., Colo., Conn., Del., Ind., Iowa, Kan., La., Me., Md., Mass., Mich., Minn., Mo., Mont., Neb., N. J., N. Y., N. C., Ohio, Pa., R. I., Tenn., Tex., Vt., Va., Wash., W. Va. and Wis.

Nevada has no death duties of any kind.
the amount of tax to be assessed against it.\textsuperscript{5} This value is determined by an appraisal taken usually as of the date of decedent's demise,\textsuperscript{6} though some jurisdictions provide for consideration of depreciation or appreciation during a designated period after death.\textsuperscript{7} The tax is payable either by the beneficiary prior to distribution, or by the executor or administrator from the corpus of the interest.\textsuperscript{8} The presence of divided interests in property, such as a life estate and remainder, accentuates the problem of valuation and assessment. Both of these interests are virtually unsaleable because of the indefinite postponement or uncertainty in duration of actual enjoyment,\textsuperscript{9} and, at best, a true "market value" can be obtained only when each interest takes effect in possession.\textsuperscript{10} These factors notwithstanding, inheritance taxes almost uniformly provide for immediate valuation of so-called "vested" future interests,\textsuperscript{11} except in a few states where appraisal and taxation of a future estate is held in abeyance until the remainderman or reversioner comes into possession.\textsuperscript{12} Taxation of conditional interests is generally deferred and treated specially under separate statutory provisions.\textsuperscript{13}

\textsuperscript{5} See Kidder, \textit{State Inheritance Taxation and Taxability of Trusts} (1934) 16 et seq.

\textsuperscript{6} \textit{E.g.}, Wash. Rev. Stat. Ann. (Remington, Supp. 1937) §11211-a ("... valued and appraised at the fair market value thereof on the day of the death of the decedent owner thereof"); cf. U. S. Treas. Reg. 80, Art. 10(a). Where the statute contains only a provision fixing accrual of the tax as of date of death, the courts have construed this as fixing the date of valuation as well. See Kidder, \textit{op. cit. supra} note 5, at 329.

\textsuperscript{7} \textit{E.g.}, Vt. (one year); N.D. (six months); N.M. (as of date of appraisal). See \textit{Federal and State Death Taxes} (1933) 125 [Reports to the Joint Committee on Internal Revenue Taxation Pursuant to Sec. 1203(b)(6), Revenue Act of 1926, Vol. II, Part 2 (1933).]

\textsuperscript{8} The executor or administrator is usually made personally liable if he fails to deduct the amount of the tax from each share before distributing to the beneficiary. A majority of the inheritance tax statutes also make the tax a lien upon the property transferred until paid. See Kidder, \textit{op. cit. supra} note 5, at c. XIX.

\textsuperscript{9} See William Korn, 35 B. T. A. 1071, 1078 (1937) (testimony of experts); 2 Bonbright, \textit{Valuation of Property} (1937) 695.

\textsuperscript{10} Most of the statutes are silent as to the meaning of value. But see definition in U. S. Treas. Reg. 80, Art. 10(a), "the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell."


\textsuperscript{13} See p. 1360 \textit{infra}. The technical distinction between vested and contingent remainders causes much confusion in the law of future interests. But the tax problem has not broken along the lines of this technical distinction. A typical statute considered to include technically contingent interests is phrased so as to tax the transfer of "rights,
In estate taxation the levy is theoretically upon the decedent's privilege of post-mortem disposition, with the result that the tax is assessed upon the decedent's net estate as a whole, rather than upon the amount received by each beneficiary. Consequently, problems of evaluating divided interests arise much less frequently than under inheritance tax statutes, and create difficulties in only two situations. The first occurs whenever the decedent's estate includes remainder or reversionary interests which will not come into possession until the termination of precedent interests. The second is encountered when decedent's testamentary act has created future interests in close relatives entitled to tax exemptions or in charitable organizations entitled to tax deductions.

To determine the net taxable estate, the value of the exempt or deductible interest must first be calculated and then subtracted from the decedent's gross estate. Estate tax statutes usually provide for the immediate valuation of vested future interests, but contain no detailed provisions for the special treatment of conditional interests either as owned by decedent at his death and included in his estate, or as newly created by his testamentary interests or estates dependent upon contingencies or conditions whereby they may be wholly or in part created, defeated, extended, or abridged. Such wording is construed to include vested interests subject to divestment as well as so-called contingent interests. See People v. Hulburd, 327 Ill. 72, 158 N. E. 373 (1927); In re Sperling's Estate, 133 Misc. 834, 234 N. Y. Supp. 119 (Sur. Ct. 1928).


15. E.g., Decedent acquires from his father's estate a remainder to take effect in possession upon termination of a life estate to B, and B is still living at decedent's demise. Another example is found when decedent grants B a life estate, and dies during B's lifetime. U. S. Treas. Reg. 80, Art. 13 and Art. 10(i).

16. N. Y. Tax Law § 249q: "The tax ... shall not be payable with respect to (a) The amount of the net estate not exceeding twenty thousand dollars transferred to a husband or wife; (b) The amount of the net estate not exceeding five thousand dollars in each instance, transferred to a lineal ancestor or descendant ..." See also N. D. Session Laws (1927) c. 267 § 3(2a); Okla. Stat. (Harlow, Supp. 1936) § 12469d.

The federal law and the laws of Ariz., Fla., and Miss. grant only a flat exemption regardless of who are the beneficiaries. See 49 Stat. 1022, 26 U. S. C. § 535(c) (Supp. 1936) ($40,000 allowed).

Most of the state laws are almost identical in every other aspect, being patterned after the federal statute in an effort to achieve uniformity. Montgomery and Magill, Federal Taxes on Estates, Trusts, Gifts (1935) 103.


18. N. Y. Tax Law § 249(v); U. S. Treas. Reg. 80, Art. 10(i).

In order to avoid the hardship of immediate payment of the tax on remainders and reversions, both the federal and New York laws give the executor an option to postpone payment of the tax until six months after the termination of the preceding interests provided he post a bond in an amount determined by the Commissioner. 47 Stat. 284 (1932), 26 U. S. C. § 525-527 (1934); U. S. Treas. Reg. 80, Art. 82(b); N. Y. Tax Law § 249(z).

19. U. S. Treas. Reg. 80, Art. 13 contains only the following statement: "Nothing should be included, however, on account of a contingent remainder in the case the con-
act and entitled to an exemption or deduction.\(^{20}\) In the evaluation of conditional future interests which are already part of the decedent's estate, this omission has caused relatively little hardship since a large percentage of such interests are so restricted in duration as to cease on the death of their owner.\(^{21}\) Yet this legislative omission necessitates judicial legislation to provide treatment both for conditional future interests in decedent's estate which do not cease on his demise,\(^ {22}\) and for all conditional interests newly-created by decedent's will, and subject to possible exemptions or deductions.

Under both estate and inheritance statutes the value of a vested future interest, such as a remainder after a life estate, is generally computed by breaking down the appraised value of the underlying property into the separate values of the divided interests through the application of actuarial science.\(^ {23}\) Several methods are employed. The life estate may be valued as an annuity certain for the period of the life tenant's expectancy under mortality tables. The resulting sum is then deducted from the appraised value of the whole estate to give the present value of the remainder.\(^ {24}\) Such a valuation is not technically accurate, however, since a life estate is not for a period certain, equal to the life tenant's expectancy, but is subject each year to an increasing risk that the income will be cut off by the life tenant's death.\(^ {25}\)

\(^{20}\) U. S. Treas. Reg. 80, Arts. 44 and 47 give some general indication, however, of the treatment to be accorded charitable bequests.

\(^{21}\) 2 Restatement, Property (1936) §§164, 165. For a general discussion of the alienability of conditional interests, see Comment (1937) 22 Iowa L. Rev. 696.

\(^{22}\) E.g., Remainder subject to partial defeasance; remainder after a life estate coupled with power of consumption; remainder subject to open to let in after-born children. No indication as to the treatment of these interests can be obtained from the Treas. Dept. "The underlying facts involving tax liability frequently differ so materially and the liability for tax so often depends upon a factor which cannot always be foreseen that the Bureau has been constrained to adopt a policy of refraining from expressing any opinion relative to the character or extent of tax liabilities involved in prospective or supposititious conditions and of restricting its opinions to consummated transactions." Communication to the Yale Law Journal from the Chief Counsel, Bureau of Internal Revenue, May 13, 1938.

\(^{23}\) A typical statute reads: "The value of every future or limited estate, income, interest or annuity dependent upon any life or lives in being, shall be determined by the rule, method, and standard of mortality and value employed by the commissioner of insurance in ascertaining the value of policies of life insurance and annuities for the determination of liabilities of life insurance companies, except that the rate of interest for making such computations shall be 5% per annum." Minn. Stat. (Mason, 1927) §2294. Rates of interest vary from 3\%\% to 6\%.

The one exception to the use of actuarial tables is Maryland where a system of fractional scales is employed. The value of the life estate of a healthy tenant for life under 40 years of age is \(\frac{3}{7}\) of the principal; between 40-45, \(\frac{2}{5}\); 45-51, \(\frac{3}{8}\), etc. See Wolfe, op. cit. supra note 11, at 216.


\(^{25}\) Bonbright, op. cit. supra note 9, at 739.
For that reason most states use insurance annuity tables which are adjusted for the risk of the life tenant’s dying before termination of his expectancy. Some jurisdictions determine the value of the remainder without reference to the value of the life estate by means of “single premium” tables which calculate the present value of the payment of the principal sum at the end of the year of the putative death of the life tenant. By thus presuming that all property earns a fixed rate of income and that the mortality of the individual taxpayer is equivalent to the average mortality of that part of the population which purchases annuities, actuaries can fix an immediate value on a great many divided interests.

Unfortunately, any values based on these presumptions are likely to be highly unrealistic. In the first place, the corpus itself may decrease in value during the passage of a few years. The self-evident truth of this phenomenon was poignantly realized by those whose estates were valued just prior to 1929, while assessments had to be paid from a depreciated corpus in the years following. A few states have removed this element of uncertainty by the use of statutes holding taxation of the remainder in abeyance until it takes effect in possession, at which time a second appraisal of the value of the corpus is made.

A further uncertainty arises from the fact that mortality tables, based on averages, may often be a very poor indication of the expectancy of any given beneficiary. Yet in almost all states the use of the tables is considered mandatory, and only a few jurisdictions will allow the tables to be supplemented by competent evidence as to the health, habits, constitution, and occupation of the life tenant.

26. Id., at 740. The difference is not insignificant. For instance, at 5% interest the life estate in a $100,000 corpus of a 21 year old beneficiary with an expectancy of 41 years is worth $79,000 according to the American Experience Table. As an annuity certain for 41 years, however, the value is $86,472.

27. Some slight discrepancy may exist between the value calculated by this method and the value calculated by deducting the worth of the life estate from the corpus. See Wolfe, op. cit. supra note 11, at 5. But the fact that the value of the life estate plus the value of the remainder does not exactly equal the value of the whole principal will not invalidate the computation. In re Failing’s Estate, 144 Ore. 127, 24 P. (2d) 1 (1933).

28. See Wolfe, op. cit. supra note 11, at 47 et seq.
29. See In re Cox’s Estate, 193 Pa. 100, 44 Atl. 256 (1899).
32. Bonbright, op. cit. supra note 9, at 741.
33. Colo. Comp. Laws (1921) § 6536; N. C. Code Ann. (Michie, 1935) § 1790; Professor Richard R. Powell notes that in other types of litigation although many courts say they will take these circumstances into consideration, in only one case was valuation actually changed by such evidence: Steiner v. Berney, 130 Ala. 289, 30 So. 570 (1901). Restatement, Property, Explanatory Notes (Tent. Draft, No. 3, 1931)
when the actual duration of the life estate is known before appraisal, as
where the life tenant dies a few days after the testator. Such a practice seems
indefensible. The resort to averages is only an attempt to create a make-
shift certainty in default of any better evidence, and the continued use of
tables in the face of absolute certainty as to duration of life seems to nullify
all efforts at accuracy in valuation. Since the fact of the life-tenant's death
is known before appraisal, there is no basis for the objection of administra-
tive inconvenience, which might apply to the admission of controversial evidence
as to health and occupation. The justification used is the highly legalistic
argument that value is required to be as of the date of death of decedent,
and that subsequent facts cannot, therefore, be elements of value as of that
time. Although the federal law now attempts to mitigate somewhat the
evils of death-date appraisal by giving the executor the option to use the
value as of a date one year after testator's death, it is doubtful that this
provision will permit the use of actual duration of life when the life tenant
dies within the year.

The futility of the pursuit of accuracy through these unrealistic assump-
tions is further accentuated by the method of payment employed in most
states. Since the beneficiary receives a property interest which is practically
unsalable and unavailable as security for a loan, the hardship of making him

---

222. See 13 O. Dep. Rep. 397, 399 (1921) (life tenant on his death-bed with incurable
disease).

34. In re White's Estate, 208 N. Y. 64, 101 N. E. 793 (1913) (life tenant died
eight months after testator and a half before probate of the will); Ithaca
Trust Co. v. United States, 279 U. S. 151 (1929) (six months after testator). Even
in those states which hold the taxation of remainders in abeyance, and make an appraisal
of the property on the date of the life tenant's death, the taxable value is still reached
by deducting from the principal value of the estate not the value of the life estate based
(Purdon, 1930) § 2304; In re Rowell's Estate, 315 Pa. 181, 173 Atl. 634 (1934). The
earlier federal cases, however, held that the propriety of using theoretical tables ceased
when the facts were known. Union Trust Co. v. Heiner, 19 F. (2d) 362 (W. D. Pa.
1927); Herold v. Kahn, 159 Fed. 608 (C. C. A. 3d, 1903). And Cal., Colo., Idaho,
and Ky. use actual duration of life when life tenant dies before determination of the


has been applied to deny deductions for conditional bequests to charity even though by
the time of assessment the conditions had been fully performed. United States v.
Fourth Nat. Bank, 83 F. (2d) 85 (C. C. A. 10th, 1936); Mississippi Valley Trust Co.
v. Commissioner of Int. Rev., 72 F. (2d) 197 (C. C. A. 8th, 1934); St. Louis Union
Trust Co. v. Burnet, 59 F. (2d) 922 (C. C. A. 8th, 1932); cf. Brown v. Commissioner,
50 F. (2d) 842 (C. C. A. 3d, 1931).


38. U. S. Treas. Reg. 89, Art. 11. Montgomery and Magill, op. cit. supra note 30,
at 204.
pay a tax out of possibly non-existent personal funds is avoided by requiring payment out of the corpus.\(^{39}\) This results in diminishing the income of the life tenant by the amount which would be derived from the tax payable for the remainder; and also diminishes the principal sum which the remainderman will eventually receive by the amount of tax payable for the life estate.\(^{40}\) When the property is held in trust, the trustee would seem entitled to restore that part of the corpus diverted to pay the tax on the life estate by deducting from payments of income to the life tenant amounts representing amortization of the death tax on the life estate.\(^{41}\) By the end of the life estate, the amounts thus retained would tend to restore the remainder to its full principal value less only its proper share of the tax. But even under the trust device there is no apparent way to prevent the life tenant's loss of the income from the amount of the corpus paid out in death taxes on the remainder; and employment of the trust device as a means of protecting the remainderman evidently occurs only in New York\(^{42}\) under the provisions of the old inheritance tax statute.\(^{43}\) Consequently, in most instances the mathematical precision of actuarial valuations is just an idle gesture toward accuracy.

Even greater difficulties of computation arise in the valuation of remainders or reversions, enjoyment of which is subject to conditions precedent other than the natural termination of a preceding estate, and in the valuation of possessory estates subject to divestment upon occurrence of an uncertain event. It is impossible presently to ascertain the eventual identity and number of remaindermen under remainders to a class, since the members of the class vary according to the outcome of unpredictable events. Uncertainty as to the number of transferees creates obvious difficulties in the application of a graduated tax, as does uncertainty of identity in the appli-

\(^{39}\) *In re Tracy*, 179 N. Y. 501, 72 N. E. 519 (1904); *Wellman v. Cleveland Trust Co.*, 107 Ohio St. 267, 140 N. E. 104 (1923); *People v. Lowenstein*, 284 Ill. 126, 119 N. E. 917 (1918).

\(^{40}\) Early Pennsylvania decisions, for this reason, required the tax on the life estate to be paid out of the income as it accrued from time to time. *In re Brown's Estate*, 208 Pa. 161, 57 Atl. 360 (1904); *Henri's Estate*, 53 Pa. Super. 633 (1913).


\(^{43}\) N. Y. TAX LAW, Art. 10. The estate tax law replaces the inheritance law only as to persons dying since 1930. N. Y. TAX LAW § 249 mm. Prior to 1930 the state of New York had tried out almost every conceivable method of taxing future interests. See *Salomon v. State Tax Comm.*, 278 U. S. 484 (1929); *Mannix, Inheritance Taxation of Estate Remainders* (1936) 63 TRUST COMPANIES 31, 36.

The decisions under these former laws are no longer precedent in New York except in the treatment of refunds. They have been cited in this Comment, however, not only because they represent a rich source of judicial experience with a difficult problem, but because they are likely to carry weight before other tribunals enforcing similar statutes.
cation of exemptions depending on the degree of relationship of the transferee to the testator. Likewise, unpredictables may determine the length, and, therefore, the value, of interests vested subject to be divested by an event uncertain to occur, such as estates for widowhood and defeasible fees. Fortuitous future events may also determine the value of executory limitations, such as remainders or reversion after the afore-mentioned interests. In addition, unpredictables will be determinative of the separate values of a life estate and a vested remainder when the life tenant holds the power of invasion. The valuation of all these interests usually involves a calculation of probabilities upon which there is no evidence and to which actuarial data may not practicably be applied. In the absence of statutory provisions, courts have usually deferred the taxation of these interests until they come into possession.

Most jurisdictions, however, have given legislative consideration to the valuation of conditional interests, and the creation of a variety of statutory methods of treatment has resulted. One method frequently employed is to hold taxation of a conditional future interest in abeyance until it takes effect in possession. Prior to the final determination of the tax, the executor or beneficiary is usually required to deposit a bond or securities to insure payment. When the interest comes into possession, its value may be ob-

44. See Humes v. United States, 276 U. S. 487, 491 (1928).
45. Vanderbilt v. Eidman, 196 U. S. 480 (1905); In re Curtis, 142 N. Y. 219, 36 N. E. 887 (1894); People v. McCormick, 203 Ill. 437, 70 N. E. 359 (1904).
obtained by deducting the value of the preceding estate from the principal.\(^4\)

This system deprives the state of the use of the tax on the remainder during the period of the life estate, to the benefit of the life tenant, a result converse to that reached under the treatment of vested remainders. In order to prevent loss of this revenue to the sovereign,\(^4\) most states provide for the computation of conditional remainders at the full undiminished value of the corpus, without the reduction for the value of the preceding estate which is granted in computing the value of a vested remainder.\(^6\) This seeming discrimination against contingent remaindermen is justified\(^1\) on the rationale of a mathematical equivalency between the revenue gained by a tax levied at the time the remainder vests in possession and assessed on the full value of the corpus, and that gained by a tax levied at the time of the testator’s death and assessed on the value of the corpus less a deduction for the postponement of enjoyment before the remainder vests in possession.\(^2\) This deduction is taken as equal to the value of the life estate.

not less than three times amount of tax, plus sureties, and void if not renewed every five years). Wis. Stat. (1937) § 72.09 (same).


50. N. Y. Tax Law § 230. The identical provision has been adopted in the statutes of Cal., Colo., Conn., Idaho, Ill., Ind., Iowa, Kan., Minn., Mo., Mont., Ohio, R. I., S. D., Wash. and Wis.

51. In re Hecht’s Estate, 127 Misc. 211, 216 N. Y. Supp. 321 (Sur. Ct. 1926), aff’d, 219 App. Div. 656, 220 N. Y. Supp. 325 (1st Dep’t 1927); In re Wysong’s Estate, 130 Misc. 298, 224 N. Y. Supp. 287 (Sur. Ct. 1927), aff’d, 248 N. Y. 595, 162 N. E. 539. These decisions arose under the 1925 amendment to §§ 230 and 241 of the N. Y. Transfer Tax Law but their reasoning applies wherever taxation is held in abeyance and undiminished value is used. Under the 1925 Amendment, although securities or cash were immediately payable, the income was paid back to the estate so that except for the fact that private fiduciaries might invest more profitably, the effect on valuation is the same as where payment is held in abeyance. See Comment (1929) 29 Col. L. Rev. 180, 183.

52. On the assumption of a corpus of $100,000, a 21 year-old life tenant who dies at the exact termination of his expectancy of 41 years, a 5% interest rate, and a 5% flat rate tax, the theory operates as follows:

<table>
<thead>
<tr>
<th>REM. TAXED</th>
<th>REM. TAXED</th>
</tr>
</thead>
<tbody>
<tr>
<td>ON PRESENT</td>
<td>ON UNDIMINISHED</td>
</tr>
<tr>
<td>VALUE</td>
<td>VALUE</td>
</tr>
<tr>
<td>------------</td>
<td>------------</td>
</tr>
<tr>
<td>Tax on life estate ..........................</td>
<td>$ 4,323.59</td>
</tr>
<tr>
<td>Tax on remainder ...........................</td>
<td>676.41</td>
</tr>
<tr>
<td>Interest on tax on life estate ..............</td>
<td>27,636.37</td>
</tr>
<tr>
<td>(compounded for period of tenant’s life)</td>
<td></td>
</tr>
<tr>
<td>Interest on tax on remainder ................</td>
<td>4,323.61</td>
</tr>
<tr>
<td>(compounded for period of tenant’s life)</td>
<td></td>
</tr>
</tbody>
</table>

Total revenue acquired by the state as of tenant’s death .................................. $36,959.98 $36,959.96
Total corpus received by remainderman .................................................. $95,000.00 $90,676.41

For simplicity’s sake, an annuity table for a period certain was used to compute the value of the life estate. See note 26, supra.
The purported mathematical accuracy of the equation apparently is only an argumentative device, and not actual since life tenants do not ordinarily die at the precise termination of their expectancies. Consequently, it is seldom that the value of the life estate exactly represents the value of postponed enjoyment.53 Also, since the tax is graduated, a higher rate than that presently applicable to the vested remainder may well apply on the higher valuation later placed on the conditional remainder.54 Despite these objections, "due process" and "equal protection" attacks upon undiminished value statutes have been repulsed by the rationale of mathematical equivalency, and its demonstration that the state theoretically receives the same revenue whether the remainder is treated as vested or conditional.55

The argument, however, fails to take cognizance of the resulting inferiority of the tax position of the contingent remainderman to that of the vested remainderman. A life tenant before a vested remainder loses the income from the amount of the corpus used to pay the tax on the remainder. On the other hand, a life tenant before a conditional remainder enjoys the income from this portion of the corpus, and the remainderman is forced to pay an added amount of tax equal to the amount of this income, through increased valuation of his interest. Though the state may theoretically receive the same total revenue from life tenant and remainderman whether the remainder is taxed on its present value or in futuro on its undiminished value, the remainderman under the latter treatment, both theoretically and practically, pays a higher proportion of that total revenue than he would under the former.

Statutes holding taxation in abeyance are not only subject to the possible criticism of discrimination against the contingent remainderman, but also suffer from administrative difficulties in application. The state has encoun-

53. If the facts used in note 52, supra, were altered by assuming the life tenant to reach the age of 72, ten years beyond the termination of his expectancy, the mathematical equivalency would be upset by a change of the interest on the tax on the remainder presently valued from $4,323.61 to $7,468.11 without any corresponding change in the total revenue gained by taxing the undiminished value of the remainder.

54. Application of the graduated rates of the Kansas statute [KAN. GEN. STAT. ANN. (Corrick, 1935) §79-1501] to the facts assumed in note 52, supra, gives the following results:

<table>
<thead>
<tr>
<th>Description</th>
<th>Present Value</th>
<th>Undiminished Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on life estate</td>
<td>$6,762.18</td>
<td>$6,762.18</td>
</tr>
<tr>
<td>Tax on remainder</td>
<td>676.41</td>
<td>8,125.00</td>
</tr>
<tr>
<td>Interest on tax on life estate</td>
<td>43,243.85</td>
<td>43,243.85</td>
</tr>
<tr>
<td>(compounded for period of tenant's life)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on tax on remainder</td>
<td>4,323.61</td>
<td></td>
</tr>
<tr>
<td>(compounded for period of tenant's life)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total revenue acquired by the state</td>
<td>$55,006.05</td>
<td>$58,131.03</td>
</tr>
</tbody>
</table>

tered no end of trouble in keeping track of bondsmen who post security for payment of the tax during the period of suspension, and has found it practically impossible to maintain careful surveillance of all conditional interests in order to ascertain when the estates vest in possession and become taxable. Because of these administrative difficulties, it is not unusual for conditional remainders to escape taxation completely. Moreover, postponement is undesirable from the viewpoint of both the executor, who remains personally liable to the state until the tax is paid, and the remainderman, who must suffer the added expense of a bond running for a long period of years. Abeyance statutes have by no means proved to be a panacea for the problems involved in evaluating conditional future interests.

To provide the sovereign greater certainty of collection, many legislatures have required assessment of the tax as of the decedent's demise, but at the highest rate which could possibly apply upon any hypothetical occurrence of the contingencies. The tax rates are graduated according to the beneficiary's degree of relationship to the testator and to the size of the legacy. If the estate ultimately vests in a beneficiary chargeable at a lower rate, or in one entitled to an exemption, the excess in taxation is refunded him with or without interest.

56. "Our experience has been that the matters become lost or hidden away in the files and are never brought to light, so I think we may say that it is an undesirable and impractical means of tax collection." Communication to the YALE LAW JOURNAL from the Attorney for the Inheritance Tax Commission of Kansas, Feb. 3, 1938. See GLEASON & OTIS, INHERITANCE TAXATION (4th ed. 1925) 506.


58. "The principal reasons for immediate settlement are that the Department always makes a determined effort to suggest a compromise tax, the immediate payment of which will be to the advantage of the estate and to the state, the avoidance of the filing of the surety company bond, which in many cases might involve considerable expense, the issuance of waivers permitting the transfer of assets and the elimination of the continuing personal liability of the executor or administrator." Communication to the YALE LAW JOURNAL from the Supervisor of New Jersey Transfer Inheritance Tax Bureau, Jan. 12, 1938. See also Osgood, Federal Inheritance Taxation from the Trust Executives' Viewpoint (1935) 61 TRUST COMPANIES 149, 151; Barkdoll, Inheritance Tax Procedure (1937) 10 OHIO BAR 221, 224.

59. CAL. GEN. LAWS (Deering, Supp. 1935) Act 8495, § 8; CONN. GEN. STAT. (Supp. 1935) § 492(c); ILL. ANN. STAT. (Smith-Hurd, Supp. 1937) c. 120 § 398; IND. STAT. ANN. (Burns, 1933) § 6-2405 (legal interest); IOWA CODE (1935) § 7397; KY. STAT. ANN. (Carroll, 1936) § 4281a-23; MINN. STAT. (Mason, 1927) § 2294 (3% interest); MO. STAT. ANN. (1932) § 597; S. D. COMP. LAWS (1929) § 6844 (3%); WASH. REV. STAT. ANN. (Remington, 1932) § 11206 (2%).

Two states allow a refund only if the property goes to an exempt beneficiary: N. H. PUBLIC LAWS (1926) c. 72, §§ 9, 10 (3% interest); S. C. CODE (1932) § 2481.

In Delaware the refund is granted only on recommendation of the state tax department. DEL. LAWS (1937) c. 8 (4% interest).

Both Colorado and North Carolina tax at the highest rate but make no provision for a refund. COLO. SESSION LAWS (1933) c. 106 § 2; N. C. CODE ANN. (Michie, Supp. 1937) § 7880.
to mean vesting in possession on the termination of the preceding estate and not vesting in interest on the happening of the contingency. When the value of the remainder is large and the probable rate of taxation lower than the highest possible rate, this method of assessment imposes a hardship on the life tenant by depriving him of the income on the excess amount of taxation. The refund fails to alleviate this hardship since it is granted to the remainderman after the life tenant's death. Nor does the remainderman always receive advantage of the provision for refund, since frequently through death, absence, or oversight, after the passage of many years, no attempt is made to obtain repayment. To remedy this situation, some statutes impose the tax at the lowest possible rate, requiring security to be given for the difference between the lowest and the highest possible tax. The actual tax is determined when the estate vests in possession. Ohio gives the executor the alternative of paying at the highest possible rate or paying at the lowest and giving bond or security for the difference. The old New York law probably went furthest to balance the security of the state with fairness to the taxpayers. A temporary order levied the tax at the maximum rate, as of the decedent's demise, and at the same time determined the minimum rate. The amount computed at the minimum rate was immediately and finally payable, but the difference between that and the computation under the maximum rate was invested in a trust company by the Tax Commissioner and the income paid over to the life tenant. At the life beneficiary's demise, a final order fixed the tax according to the actual outcome of the contingencies, unless the refund statute provides for payment of interest on the refunded amounts, none is allowed. See Kinder, op. cit. supra note 5, at 473.


62. See In re Brez's Estate, 172 N. Y. 609, 64 N. E. 958 (1902); In re Vanderbilt's Estate, 172 N. Y. 69, 64 N. E. 782 (1902).

63. See Robinson, Mitigating Burdens of Taxation in the Preparation of Wills and Trusts (1931) 52 Trust Companies 187; Mannix, Inheritance Taxation of Estate Remainders (1936) 63 Trust Companies 31.


and any consequent refund was paid over to the remainderman. Thus the life tenant before a conditional remainder was saved the loss of income on the excess put up to secure the risk of the remainder vesting at a higher rate. And the state lost its rightful use of this excess only insofar as the estate eventually did vest at the highest rate. Though this procedure was reasonably equitable to all concerned, it proved extremely expensive and burdensome to the state because of the excessive administration and accounting necessitated. The State of Washington uniquely taxes at the highest "probable" rate with a refund in case the remainder vests at a lower rate. Although this method avoids conditional payment of too unlikely a sum, it causes the state to risk a loss of revenue should the remainder vest at a higher rate than that which is most probable. Most statutes entailing a refund are subject to the objection that they do not provide a fund for the repayment of excessive taxes. As a result, in many states, unless the legislature makes a special annual appropriation for repayments, the provision for the refund is an empty gesture.

Many of the states provide an opportunity for avoidance of the confusion surrounding taxation of conditional interests by allowing the taxes to be compromised. Compromise agreements may be left to negotiation between the executor or administrator and the taxing authorities, or resolved in accordance with standard forms. Where taxation of remainders is held in abeyance, 

66. See the opinion of Cardozo, J., in Matter of Parker, 226 N. Y. 260, 123 N. E. 366 (1919) for a clear exposition of this method and its rationale.

67. After the 1925 amendment, the Tax Commission also handled the interest on the "undiminished value" tax. By 1930, when the estate tax was adopted, there was on deposit with the N. Y. Tax Commission approximately $35,000,000 in securities and over $5,000,000 in cash. REPORT OF COMMISSION TO INVESTIGATE DEFECTS IN THE LAWS OF ESTATES, SECOND SUPPLEMENTAL REPORT [LEGIS. DOC. No. 69 (1930)] 196.

68. WASH. REV. STAT. ANN. (Remington, 1932) § 11206.

69. See Kidder, op. cit. supra note 5, at c. XX.

70. At one time in Illinois there were 87 approved claims for refunds totalling $735,213 upon which no payments could be made because the appropriation of several years back had been exhausted. Bloomenthal, Tax Refund in Illinois (1936) 14 TAX MAGAZINE 654.

71. CAL. GEN. LAWS (Deering, Supp. 1935) Act 8495, § 8(5); COLO. SESS. LAWS (1933) c. 106 § 2(7); CONN. GEN. STAT. (Supp. 1935) § 492(c); DEL. REV. CODE (1935) § 138; IND. STAT. ANN. (Burns, 1933) § 6-2428; MASS. ANN. LAWS (1933) c. 65, § 14; ME. LAWS (1933) c. 148 § 12; MONT. REV. CODES ANN. (Anderson & McFarland, 1935) § 10400.41; N. H. PUB. LAWS (1926) c. 72 § 63; N. J. REV. STAT. (1937) tit. 54, § 36(6); R. I. PUBLIC LAWS (1929) c. 1355 § 17; TENN. CODE ANN. (Williams, 1934) § 1272; VA. CODE ANN. (Michie, appendix 1936) § 106; WASH. REV. STAT. ANN. (Remington, 1932) § 11215; WIS. STAT. (1937) § 72.21. In the absence of statute, see State v. Young, 44 Wyo. 6, 7 Pac. (2d) 216 (1932).

72. Communications to the YALE LAW JOURNAL from the Inheritance Tax Commissions of Cal., Colo., Tenn. and Wis., Dec. 7, 1937 to Feb. 9, 1938.

73. In every case involving the taxation of conditional interests the Conn. Tax Dept. submits to the taxpayer a uniform offer of compromise in an amount halfway between the highest possible tax and the lowest possible tax. Communication to the YALE LAW
ance, an immediate compromise and payment of the tax deprives the life tenant of the income on the amount of tax compromised, but an executor who compromises against the wishes of the beneficiary is committing no breach of fiduciary duty. Other states have completely avoided the valuation and taxation of divided interests where the transfer is in trust by assessing the entire tax against the trustee on the legal fiction that he holds title to an estate in fee. This does violence to the concept that the tax follows beneficial enjoyment, but it would seem to be a happy simplification. Despite these attempts at circumvention, the problem of valuing conditional interests still looms large. The complexities of the problem can best be appreciated by reviewing the treatment of some of the more common conditional interests.

**Power of Invasion**

An intricate problem is presented when a life tenant is granted the power of invading the corpus of the estate. This power is often unlimited, allowing the life tenant to consume the entire corpus at his discretion. On the other hand, it may be so curtailed that only a stipulated amount of the corpus is subject to invasion, or the right of invasion may be conditioned upon the income from the estate becoming insufficient to provide for the tenant's needs and comfort. In any event, exercise of the power will reduce the value of the remainder. Under estate tax statutes this raises the question of whether the statutory exemptions usually granted on remainders to charities or close relatives should be permitted, inasmuch as the remainder may be defeated in part or in whole by the tenant's consumption of the corpus. The New York courts have ruled that no deduction or exemption whatsoever will be allowed for such remainders, and, so far, have not considered whether the facts under a restricted power indicate no real possibility of invasion. More liberal treatment is accorded exemptions under the federal tax. When the power is subject to a restriction, such as economic need, and a factual showing is made that the beneficiary's circumstances will never

---


require invasion of the corpus, the federal courts hold the possibility of exercising the power to be so remote as to have no effect on the value of the remainder which is treated as ascertainable by actuarial data and hence, when the remainderman is a charitable institution, deductible from the gross estate.\footnote{77} Likewise, upon evidence that the beneficiary's circumstances will require invasion of a fixed amount ascertainable at the death of the decedent, the possibility of exercising the power is held to have a certain and ad-measurable effect on the value of the remainder.\footnote{78} By basing recognition of the exempt remainder on requirements of probability instead of certainty, the federal courts seem to have reached a fair result in accord with legislative intent to exempt charitable bequests from taxation. This encouragement of charities would seem to outweigh the concomitant danger of loss of revenue to the government by virtue of its forbearance to tax bequests which will become taxable if the life tenant's circumstances change sufficiently to empower him to consume the corpus.

Under inheritance tax statutes, the expedient of ignoring the possibility of a remainder has seldom been employed since the primary problem is the valuation of each bequest instead of the recognition of exemptions.\footnote{79} Consequently, the judicial task of valuation is even more burdensome here than under estate tax statutes. Jurisdictions holding taxation of conditional interests in abeyance have taxed the legacy to the primary beneficiary as a simple life estate, and postponed any taxation of the remainder until the death of the life tenant, when the amount unconsumed, if any, could be ascertained.\footnote{80} Though, at first blush, both simplicity of administration and accuracy of valuation were greater under inheritance statutes, the upshot is that under the estate tax the remainder is in effect taxed when the power to consume is exercised.

\footnotetext{77}{Deductible: Ithaca Trust Co. v. United States, 279 U. S. 151 (1929); First Nat. Bank v. Snead, 24 F. (2d) 186 (C. C. A. 5th, 1928) (beneficiary 68 years old with $16,000 annual income from own property); Millard v. Humphrey, 8 F. Supp. 784 (W. D. N. Y. 1934) (income of $10,000); Michigan Trust Co., 27 B. T. A. 556 (1933) ($6,000 income to beneficiary whose husband was a prosperous business man); Benjamin B. Sanderson, 18 B. T. A. 221 (1929) ($400,000 estate to 83 year old beneficiary who released right to invade and had died before assessment); Marion M. Jackson, 18 B. T. A. 875 (1930) (mother of beneficiaries had income of $22,000).

\footnotetext{78}{Not deductible: McDonald v. Welch, 17 F. Supp. 549 (Mass. 1936) ($78,000 estate for support of 5 beneficiaries, 2 unemployed and without other income); Mead v. Welch, 13 F. Supp. 981 (S. D. Cal. 1936); Philip W. Blood, 22 B. T. A. 1000 (1931) (no evidence of beneficiaries' circumstances presented); W. C. Knoernschild, 35 B. T. A. 886 (1937).

\footnotetext{79}{Herron v. Heiner, 24 F. (2d) 745 (W. D. Pa. 1927) (beneficiaries both in insane asylum; maximum cost of care fixed at $100 per month).

\footnotetext{80}{Under inheritance statutes taxation of conditional interests is generally deferred until the interest vests in possession. Hence, no doubt can arise as to recognition of an exempt remainder.

\footnotetext{80}{Appeal of Lauman, 131 Pa. 436, 18 Atl. 900 (1890); Commonwealth v. Cambron's Ex'x, 158 Ky. 577, 165 S. W. 979 (1914); In re Babcock's Estate, 37 Misc. 445, 75 N. Y. Supp. 926 (Surr. Ct. 1902); In re Granfield's Estate, 79 Misc. 374, 140 N. Y. Supp. 922 (Surr. Ct. 1913).}
computation might seem to recommend this procedure, upon a closer inspection the accuracy afforded is clearly more apparent than real. If the life tenant consumes an appreciable amount of the corpus, the state is placed in the dilemma either of losing the revenue obtainable from taxation of the consumed portion, or of taxing the remainderman for receipt of a portion of the corpus which will never reach him. As a matter of practice most states have evidently preferred to sustain the loss themselves. But when the question was judicially raised for the first time in 1936, a New York Surrogate chose the other alternative. Although the state is thus saved its tax, unfair discrimination against the remainderman, to the benefit of the life tenant, results. For as the amount the life tenant consumes is increased, the greater is the amount he takes tax-free. On the other hand, as the amount received by the remainderman decreases, the greater is the proportion of the tax he has to pay to the amount of corpus he receives. This procedure is subject to the further objection that it provides no method of collecting the tax on the "invasion" when the entire corpus has been consumed.

One attempted solution of these difficulties is present taxation of the primary beneficiary's interest on the value of the life estate, with further assessments from time to time to cover the amounts he receives by virtue of his invasion of the principal. This procedure not only induces administrative difficulties, but also increases the cost of collection out of all proportion to the benefits received. One court, seemingly of the opinion that the cost of collection would exceed the revenue obtained, allowed the "power of invasion" to go tax-free. To avoid this loss of revenue and simplify collection, the New York courts at one time considered the interest passing to the recipient of a life estate plus an unlimited power of invasion as amounting to absolute ownership, or a base fee, and taxed him on the principal value of the estate. In this way the necessity of valuing the remainder interest was abolished. This procedure presumably finds support in the customary statutory provision that no allowance be granted persons receiving possessory estates for any contingency upon which those estates may be diminished or

81. Gleason & Otis, op. cit. supra note 56, at 501 (Mr. Gleason was one-time counsel to the N. Y. Comptroller); see Matter of Cager, 111 N. Y. 343, 18 N. E. 866 (1888); In re Bergen's Estate, 157 Misc. 313, 283 N. Y. Supp. 549 (Surr. Ct. 1935).
82. In re Miles' Estate, 158 Misc. 398, 287 N. Y. Supp. 30 (Surr. Ct. 1936). The taxing order on decedent's death in 1907 had taxed the value of the life estate but held taxation of the remainder in abeyance. By the time the life tenant died in 1934 she had consumed two-thirds of the corpus. The surrogate ordered the tax on both the two-thirds of the corpus consumed and the one-third remaining to be paid out of the remainder interest of one-third of the original corpus.
84. In re Clark's Estate, 270 Mo. 351, 194 S. W. 54 (1917).
defeated. The rationale employed considers the primary beneficiary as holding the entire estate subject to the contingency that he may fail to dispose of it. This method of taxation would also appear to be proper under the highest possible rate statutes on the theory that the power to consume raises the life estate to a fee. By refusing to recognize the possibility of a remainder, the New York courts achieved a desirable simplicity of administration and a reasonably fair allocation of the tax, assuming that no tax will be levied on the remainder if any actually passes to the remainderman. When a portion of the principal escapes invasion, the remainderman indirectly bears his proper share of the tax burden, since the assessment is paid out of the corpus in the first instance. This procedure, however, may be attacked on three scores. In the first place, it deprives the life tenant of the income on the amount of tax covering the remainder interest; secondly, it subjects the estate to a higher rate of taxation since it consolidates both interests in one person; and thirdly, it would seem to present no solution in cases where the power of invasion is qualified with the result that it cannot be considered as raising the life estate to a fee.

The absolute fee theory was subsequently discarded by New York, and has received no support from other states taxing at the highest possible rate, presumably because the tax statutes were considered as requiring an additional tax on the remainder in case any property eventually came into possession of the remainderman. This possible danger of double taxation was accentuated by the passage of a statute in New York and other states requiring a conditional remainder on which taxation is held in abeyance to be taxed at its full value undiminished by the value of the preceding estate. Under this provision, if the life tenant consumed a portion of the corpus, the remainderman would be taxed on the undiminished value of the residue of the corpus, but if the life tenant failed to exercise his power of invasion, the corpus passing on his death would be subject to a levy computed on its

86. See note 60, supra.
87. The statutes are usually worded so as to impose the highest tax against “interests . . . dependent upon contingencies or conditions whereby they may be wholly or in part created, defeated, extended or abridged . . . ” See note 59, supra.
88. Even where the primary estate is taxed as one for life, the same consolidation may be reached under the highest possible rate statutes on the theory that the value of the remainder should be added to the value of the life estate since both may ultimately go to the primary beneficiary. In re Howland's Estate, 109 Misc. 169, 178 N. Y. Supp. 368 (Surrt. Ct. 1919). It would seem that as the principal is invaded the income will decrease so that the total income received would be less than a life estate. But the courts have decided it is possible that the life tenant might hold off and consume the total amount of the principal just before he died, thus acquiring the total value of both interests. In re David's Estate, 133 Misc. 12, 231 N. Y. Supp. 46 (Surrt. Ct. 1928).
91. See note 50, supra.
full value. Thus the estate might very well be depleted within a short period by two taxes, each computed on the full value of the estate. Though the consequent levy would seem exceedingly burdensome, it may not be entirely unreasonable. It is arguable that each beneficiary has received an estate amounting to a fee, and that the tax on the double passage of the fee should not be diminished simply because the primary beneficiary failed to exercise his power to dispose of the property.

The prevailing procedure under the highest rate statutes is to tax the primary beneficiary's interest as a life estate, and the value of the remainder at the highest possible rate.\footnote{92. Talbot v. People, 339 Ill. 333, 171 N. E. 183 (1930); People v. Freese, 267 Ill. 164, 107 N. E. 857 (1915), (1915) 10 Ill. L. Rev. 301; In re Kellogg's Estate, 139 Misc. 662, 249 N. Y. Supp. 146 (Surr. Ct. 1931); In re Neher's Estate, 158 N. Y. Supp. 454, 95 Misc. 68 (Surr. Ct. 1916).} A refund is allowed in accordance with the actual vesting in possession of the remainder. If the corpus is totally consumed, a real problem arises as to the proper disposition of this refund. Although the courts speak with precision of the presence of a right to a refund in such situations,\footnote{93. In re Kenly's Estate, 133 Misc. 718, 233 N. Y. Supp. 681 (Surr. Ct. 1929).} they shed but little light on the identity of the proper recipient. One tribunal has said that the whole amount of the tax previously assessed on the remainder should be refunded to the remainderman.\footnote{94. Tax Commission v. Oswald, 109 Ohio St. 36, 141 N. E. 678 (1923).} This treatment reaches the absurd result of depriving the state of its tax on the consumed corpus to the benefit of a remainderman who should receive nothing, since his total interest was defeated by the authorized actions of the life tenant. A more equitable solution would be to refund to the primary beneficiary, as soon as the corpus is totally consumed, an amount equal to the excess of the tax paid over the tax which would apply on an outright gift of a fee.\footnote{95. Talbot v. People, 339 Ill. 333, 171 N. E. 183 (1930).} In this way revenue would be saved for the state, and a refund representing the over-taxation would be returned the life tenant who, presumably, would have consumed it along with the rest of the corpus if it had not been withdrawn on the assumption, now proven erroneous, that it was payable by a remainderman taxable at a higher rate. One court sagely avoided this entire problem of refunds by construing the remainder not as conditional, but as vested subject to divestment, and, therefore, taxable presently and finally under the statutory provisions covering vested remainders.\footnote{96. People v. People's Savings Bank & Trust Co., 314 Ill. 529, 145 N. E. 597 (1924).}

**Alternative Remainders Conditioned on Survivorship**

Frequently a remainder is granted to vest in possession only on the happening of a designated condition precedent in addition to the termination of the preceding estate or estates. Trouble arises in estate taxation if the...
remainderman is an exempt charity or relative. Occurrence of the condition will vest the estate in the exempt remainderman, and, thereby, warrant a deduction of the value of the remainder from the testator's taxable estate. On the other hand, non-occurrence of the condition will vest the estate in the taxable life tenant or in taxable remaindermen, and any deduction of the value of the interest will become improper. Since the estate tax is levied as of the date of testator's death, and before the occurrence of the condition, the courts are faced with the necessity of an immediate recognition or non-recognition of the exemption without the alternative of awaiting the outcome of the contingency. The complexities surrounding this determination vary, of course, with the predictable nature of the uncertain event.

Possibly the most frequent condition is the absence of living issue of the life tenant at the time of his death. The presence of this condition compels a determination both of the possibility that the tenant will produce issue and of the possibility that the issue to be born will survive the tenant. With a commendable desire for greater reality, the Supreme Court has decided that for the purpose of applying this tax, the gallant legal presumption that a woman is capable of bearing children as long as she lives is rebuttable. But in the absence of evidence of physical deformity or of old age showing total incapacity to reproduce, the federal courts will recognize the possibility of the life tenant having issue and the possibility of the survival of the hypothetical issue. This mere possibility of living issue is sufficient to defeat recognition of an exemption of the conditional remainder to charity. By refusing a deduction when there is no factual showing that the charitable remainder is certain to take, the federal courts are following the policy set forth in the Treasury Regulations of enhancing the sovereign's revenue in all doubtful cases. In the absence of any feasible yardstick to calculate the probable outcome of the event upon which the remainder is conditioned, as in the situation under discussion, obeisance to this policy is entirely reasonable. In

97. This immediate finality of computation is one of the principal advantages of the estate tax over the inheritance tax. REPORT OF THE NATIONAL COMMITTEE ON INHERITANCE TAXATION (New Orleans, 1925) 34 et seq.


Possibility recognized: Humes v. United States, 276 U. S. 487 (1928) (15 year old girl); Chicago Title and Trust Co. v. United States, 15 A. F. T. R. 929 (N. D. Ill. 1933).

100. U. S. Treas. Reg. 80, Art. 44 and Art. 47.
such instances, recognition of the exemption would only result in confusion, since the unpredictable nature of the conditional event obviates any possibility of placing a reasonably accurate value on the exempt interest. The federal courts, however, have at times carried this policy past the limits justified by the necessity of a reasonably certain basis for valuation. Recognition has been completely denied exempt remainders which were certain to vest in possession simply because they were subject to partial defeasance by certain small gifts to surviving issue of the life tenant.\footnote{101} Rather than run the risk of a slight percentage of error in estimating the number and amount of the conditional gifts, the courts refused to recognize as ascertainable the value of the large portion of the remainder which was almost certain to go to charity. Such a refusal of recognition seems totally unwarranted.

Although the New York courts have followed the federal treatment of remainders conditioned upon default of issue,\footnote{102} they seem to be disposed to a more liberal policy in the treatment of an exemption on a remainder to an existing relative of the testator, conditioned on the relative's survival of the life tenant. At first it was held that the survivorship of the testator's exempt relatives was too speculative to warrant recognition of the interest and consequent reduction of the estate tax.\footnote{103} Later, the court realized the inconsistency in declaring that a computation of life expectancy was too uncertain for the purpose of determining whether the remainderman would outlive the life tenant in this situation, but sufficiently certain to warrant the valuation of a life estate on the basis of expectancy. Consequently, the Court of Appeals recently ruled that actuarial data should be applied, and the exemption granted where the expectancy of the remainderman is greater than that of the life tenant.\footnote{104} The state runs the risk of foregoing proper taxation if the exempt remainderman later predeceases the life tenant and the remainder passes to a taxable beneficiary. It would seem equitable for the state to bear this risk where the probabilities point toward ultimate possession of the interest by the exempt remainderman. Recognition should not be based on the requirement of certainty, but on the presence of a reasonable standard

\footnote{101. Pennsylvania Annuities Co. v. Brown, 6 F. Supp. 582 (E. D. Pa. 1933), aff'd, 70 F. (2d) 269 (C. C. A. 3d, 1934) (4 life tenants aged 57, 56, 51 and 45; 5 living issue at time of assessment; gifts of $5,000 each to all surviving issue out of an estate of over $325,000); Boston Safe Deposit & Trust Co., 30 B. T. A. 679 (1934) ($3,000 gifts out of estate of over $400,000. Court refused suggested $200,000 deduction calculated on basis of each life tenant having 10 children surviving). But see E. H. Hallet, 29 B. T. A. 494 (1933).


by which the probabilities of the exempt remainderman taking can be computed, and the value of the exempt remainder ascertained.

The treatment of remainders conditioned on survivorship varies under the inheritance statutes. Where taxation is held in abeyance the tax commissioner simply awaits the termination of the primary estate to determine the rate and possible exemptions applicable to the remainder. As has already been noted, this indefinite suspension of taxation carries with it the danger that the remainder will ultimately escape taxation completely. If, as often happens, the remainder is to a class of relatives, it is possible to avoid this danger through present taxation. One jurisdiction has ruled that a remainder to a class was a legacy to the class as an entity and not to the possible individual beneficiaries. Since the rate applicable to the particular class of relatives was certain and there was no possibility of exemptions, the remainder was taxed presently as vested in the class instead of in futuro as if conditioned upon the survivorship of individual members of the class. This treatment places an unfair burden on the ultimate remaindermen. Since the class as an entity was treated as the beneficiary, the tax was levied on the full value of the remainder taken as a unit, regardless of the probabilities that several beneficiaries would ultimately take separate shares, making a much lower set of rates applicable because of the graduated nature of the tax law. Simplicity of administration would not seem to justify the imposition of such a tax burden by the use of a legal fiction in the absence of legislative sanction.

Under the highest possible rate statutes, the rule is well established that the sequence of events will be presumed which will result in the greatest revenue to the state, regardless of how improbable the presumed occurrences may be on the basis of the actual facts. Where a remainder is in equal shares to a certain class of beneficiaries, such as surviving issue or next of kin, no matter how many beneficiaries exist at the time of the testator's death, or how probable it is that they will all outlive the life tenant, or that others will be born to enlarge the class, the tax will be assessed as if only one will survive the life tenant. In this way the maximum rate and the

---

105. Mitton v. Burrill, 229 Mass. 140, 118 N. E. 274 (1918); Harrison v. Johnston, 109 Tenn. 245, 70 S. W. 414 (1902); McLemore v. Raine's Estate, 131 Tenn. 637, 176 S. W. 109 (1915); State ex rel. Basting v. Probate Court, 132 Minn. 104, 155 N. W. 1077 (1916); In re Fratt's Estate, 60 Mont. 526, 199 Pac. 711 (1921); In re Coxe's Estate, 193 Pa. 100, 44 Atl. 256 (1899); Billings v. People, 189 Ill. 472, 59 N. E. 798 (1901).

106. See note 57, supra.


109. People v. Freese, 267 Ill. 164, 107 N. E. 857 (1915) (40 remaindersmen alive at decedent's death); People v. Byrd, 253 Ill. 223, 97 N. E. 293 (1911).
minimum exemption is attained. If the remainder is to go to a charitable institution on default of issue, the tax will be levied on the assumption that one child will survive the life tenant. The remainder will always be assumed to vest on the happening of that chain of events which will result in the fewest possible beneficiaries of the remotest possible relationship to the decedent, so that not only may the highest rate depending on relationship be used, but also the highest bracket of the rate graduated according to the size of the legacy. If the remainder ultimately vests at a lower rate, the provision for a refund will prevent, to some degree, unfairness to the ultimate beneficiaries; the life tenant, however, will have been deprived of the use of the excessive amount of taxation, and the refund of that amount to the remaindermen after the life tenant's death fails to rectify the injustice. A few New York decisions have attempted to alleviate this burden on the life tenant by construing the statutory phrase "highest rate possible on the happening of any contingency" to include those contingencies presently possible but not those only remotely possible. Such a construction approximates the Washington method of taxing at the highest "probable" rate. This method results in a fairer result from the point of view of the life tenant, but it allows the state no remedy in the unlikely event that the remainder ultimately vests at a rate higher than the most probable.

A difficult problem is presented by the very common legacy giving the income from a corpus to X until he attains a designated age, at which time he is to receive the corpus itself in fee, but should he die prior to attaining the specified age, the corpus is to go to Y. Jurisdictions possessing no specific statutory provisions for the treatment of conditional interests have evidently taxed the estate immediately as if a fee simple were granted to X, and have done so even in cases where Y was an exempt charity. States operating under the abeyance type statute have not found the problem so simple of solution. The grant to X cannot be construed as either a fee or as an estate

---

111. In re Zborowski's Estate, 213 N. Y. 109, 107 N. E. 44 (1914); In re Parker's Estate, 226 N. Y. 260, 123 N. E. 366 (1919). Of course the converse of this rule applies under the lowest rate type of statute. In re Phillips' Estate, 133 Wash. 41, 233 Pac. 27 (1925). See note 64, supra.
112. In re Upjohn's Estate, 108 Misc. 495, 178 N. Y. Supp. 626 (Surr. Ct. 1919) (remainder to go to the taxable beneficiary only on dissolution of every one of 17 charitable remaindermen); In re Hathaway's Estate, 103 Misc. 360, 171 N. Y. Supp. 190 (Surr. Ct. 1918).
113. In re Eaton's Estate, 170 Wash. 280, 16 P. (2d) 433 (1932); In re Waterman's Estate, 173 Wash. 101, 22 P. (2d) 53 (1933).
for years because of the possibility that it may be cut short by X’s early demise. Consequently, the tax must be postponed on the primary estate as well as the remainder. In order that the government should not be completely deprived of taxation upon X’s beneficial user in the event of his death before the specified age, each payment of income may be considered as a separate legacy and taxed upon its receipt. This procedure not only creates administrative problems, but also may deprive the state of revenue. Under the graduated provisions of the tax laws, the separate periodic payments of income may be subject to a much lower rate of taxation than would be the value of the estate if taxed as a whole. Though it would be contrary to the tenor of the abeyance type of statute to tax X presently as receiving a fee on the basis of actuarial probabilities that he will reach the specified age on which the remainder is conditioned, little justification can be found for failure to use actuarial data in order to tax X on his primary interest as a term for years. Since, in most instances, X’s life expectancy is much greater than the term specified, it seems particularly inconsistent for the state to bear the risk of his failure to live out his term in this instance on the rationale of protecting him against too great a possibility of excessive taxation, and yet to refuse to bear the much greater risk of a life tenant not living out his complete expectancy. Failure to employ actuarial statistics is, perhaps, attributable to an emotional bias against placing risks on beneficiaries which is caused by adherence to the abeyance type statute. One jurisdiction has partially overcome this apprehension of over-taxation, and has taxed X’s primary legacy as a term for years applying only one half of the required rate. When the remainder came into X’s possession the other half of the tax was added to the tax on the remainder. Obviously, if X dies just before the vesting age, the state will lose this second half of the tax on the term for years, since it cannot properly be levied on Y.

Under the highest possible rate statutes, the primary estate is taxed either as a life estate or as a term for years. The tax on the remainder is

116. State ex rel. Hale v. Probate Court, 100 Minn. 192, 110 N. W. 865 (1907).
118. In re Seligmann’s Estate, 170 App. Div. 837, 156 N. Y. Supp. 648 (1st Dep’t 1915); In re Dickey’s Will, 174 App. Div. 467, 160 N. Y. Supp. 646 (2d Dep’t 1916); People v. Northern Trust, 266 Ill. 139, 107 N. E. 190 (1914); Tax Comm. v. Commerce Guardian Trust & Savings Bank, 24 Ohio App. 331, 157 N. E. 423 (1926). The argument for taxing as a life estate runs as follows: If X dies before the designated age he will have enjoyed a life estate; if he dies after, he will get the entire principal; so in no case does X get less than a life estate. See In re Lande’s Estate, 149 Misc. 203, 266 N. Y. Supp. 879 (Surr. Ct. 1933).

However, where Y is taxable at a higher rate than X, and where the life estate is greater than the term, it would seem that deducting only a term will give the highest possible tax. See In re May’s Estate, 127 Misc. 542, 217 N. Y. Supp. 312 (Surr. Ct. 1926).
computed on the presumption that the estate will pass to the remainderman subject to the highest rate.\textsuperscript{120} If \( Y \) is an exempt relative or a charity, the interest is taxed as passing to \( X \);\textsuperscript{121} but if \( Y \) is a more remote relative of the testator than \( X \), then the remainder is taxed as if passing to \( Y \).\textsuperscript{122} The fact that the remainder ultimately vests in the primary beneficiary, \( X \), has not prevented its valuation on the basis of its undiminished value in one highest possible rate jurisdiction, and in states which hold taxation in abeyance.\textsuperscript{123} In such a situation, although \( X \) gets a fee in practical effect in the first instance, the presence of the contingency will cause him to pay a tax on the value of the fee plus the value of the term for years. The justice of this result is highly debatable.

**Power of Appointment**

When remainders are subject to divestment by exercise of a power of appointment, uncertainty as to the identity of the eventual remaindermen causes difficulty in taxation under inheritance statutes.\textsuperscript{124} The primary estate is taxed as usual, but most states have avoided the necessity of presently valuing the remainder interest by specifically postponing its taxation until the transfer resulting from the exercise or non-exercise of the power. The tax then levied is not a death tax upon the estate of the testator, but a transfer tax upon the estate of the donee of the power.\textsuperscript{125} In the absence of this special treatment of the power of appointment, which abrogates the common law rule that the appointee takes under the will and not through the donee of the power,\textsuperscript{126} the estate passing after the primary estate is taxable as a con-

\textsuperscript{119} Communication to the *Yale Law Journal* from State Tax Commission of Delaware, Nov. 29, 1937; State *ex rel.* Smith v. Probate Court, 136 Minn. 392, 162 N. W. 459 (1917).

\textsuperscript{120} This presumption was carried so far in one instance that it caused the court to ignore entirely \( X \)'s interest and tax the whole estate as if passing to \( Y \). Wonderly v. Tax Comm., 112 Ohio St. 233, 147 N. E. 509 (1925).

\textsuperscript{121} \textit{In re} Rice's Estate, 164 Minn. 139, 204 N. W. 543 (1925).

\textsuperscript{122} \textit{In re} Zborowski's Estate, 213 N. Y. 109, 107 N. E. 44 (1914); \textit{In re} Ogden's Estate, 103 Misc. 529, 170 N. Y. Supp. 630 (Surr. Ct. 1918).


\textsuperscript{124} In estate taxation it is well-settled that no deduction will be allowed for charitable remaindermen who are to take in default of the exercise of a power of appointment. Davison v. Commissioner, 81 F. (2d) 16 (C. C. A. 2d, 1936) (not deductible even though donee of the power of appointment executed instrument to commissioner renouncing her power). For treatment of related problems in taxation of powers of appointment, see generally Hughes, *Federal Death Tax* (1938) § 46 et seq.; Kidder, *op. cit. supra* note 5, at 38 et seq.


\textsuperscript{126} United States v. Field, 255 U. S. 257 (1921).
ditional remainder, since it is subject to be divested by the donee's exercise of his power of appointment. 127 Assessment is either held in abeyance 128 or levied at the highest possible rate, 129 which is on the assumption that the appointee will be a stranger to the blood of the testator. In some jurisdictions, the special treatment outlined above taxes only the transfer resulting from an exercise of the power and not that arising from its non-exercise. 130 In these states it is necessary to tax the remainder as a conditional interest under inheritance tax statutes in order to prevent its transfer from escaping taxation completely in the event the donee fails to appoint the remainderman. If the power is exercised, the contingency occurs which renders the remainder exempt from inheritance taxation, as its transfer is then taxable in the estate of the donee under the special provisions, and any tax assessed and paid out of the estate of the testator is refunded. 131

SECONDARY LIFE ESTATES

Valuation problems are also encountered when two life estates precede a vested remainder. Many inheritance statutes could be construed as providing for the present calculation of the value of all three interests. 132 Actuarial tables could be used to calculate the value of the second life estate as a deferred or reversionary annuity, and the value of the remainder as "last survivor" insurance. 133 The courts, however, have generally preferred to consider the second life estate conditional for taxation purposes, and it is taxed under the special provisions. 134 The decisions emphasize the uncer-

127. Handy, Inheritance and Other Like Taxes (1929) 137.
129. In re Kinsella's Estate, 293 Mo. 545, 239 S. W. 818 (1922). In Illinois, the special provision is ignored if the testator leaves a trust coupled with a power in the trustee. When the trustee is under a duty to appoint but is given discretion to select the appointees, the estate will be presently taxable as creating a conditional devise of the remainder to a class, the members of which are as yet undetermined. People v. Kaiser, 306 Ill. 313, 137 N. E. 826 (1923).
132. It would seem immaterial whether the secondary life estate is conditional or vested since many statutes provide for the use of actuarial tables to obtain "the value of every future, contingent or limited estate, income, interest or annuity for any life or lives in being." Ark. Dig. Stat. (Pope, 1937) § 14014. Almost identical language is used in the statutes of Cal., Col., Conn., Idaho, Ind., Ky., Mo., Tenn. and Wyo.
133. Wolfe, Inheritance Tax Calculations (1937) 37, 38.
tainty presented by the possibilities that the first life tenant will die at once, permitting the second life tenant to take immediately, or that the second tenant will predecease the first so that the remainderman will enter into enjoyment of the property immediately after the death of the first tenant. This uncertainty seems no more forceful an argument against the use of actuarial data in this instance than in the problem of recognition of an exemption on a remainder conditioned upon survivorship—a problem to which actuarial statistics recently have been applied by New York under its estate tax statute. New York's reliance on actuarial statistics, as providing a reasonably accurate comparison of the length of two lives, may be the forerunner of a similar trend in the treatment of secondary life estates by inheritance tax jurisdictions desirous of administrative simplicity at the expense of absolute certainty. But at present the secondary life estate is usually brought within the terms of abeyance and highest possible rate provisions despite consequent difficulties.

**Possessory Interests Subject to Divestment**

Frequently valuation must be made of interests already in possession but of uncertain duration. Typical of these are determinable fees and estates for life subject to an earlier termination by an act of the life tenant. An estate given to a widow for life or until remarriage is illustrative of the latter type of interest. Under the inheritance statutes of most of the states, such an estate is taxed as if it were an estate for life. Support for this treatment is found in the provision present in most statutes that where an estate for life or for years can be divested by an act of the legatee, it will be taxed


136. See note 104, supra.

137. Bailey v. Drane, 96 Tenn. 16, 33 S. W. 573 (1895); In re Roosevelt's Estate, 143 N. Y. 120, 38 N. E. 281 (1894); Westcott's Estate, 11 Misc. 589, 33 N. Y. Supp. 426 (Surr. Ct. 1895).


139. Stengel v. Edwards, 98 Atl. 424 (N. J. Sup. 1916); In re Hogg's Estate, 156 App. Div. 301, 141 N. Y. Supp. 119 (2d Dep't 1913); In re Plum's Estate, 37 Misc. 466, 75 N. Y. Supp. 940 (Surr. Ct. 1902); In re Baugham's Estate, 172 N. C. 170, 90 S. E. 203 (1916) (market value as a life estate based on fact that a prudent purchaser would pay no more for the remainder than the value of the corpus less the full value of the life estate).
as if there were no possibility of such divesting.\textsuperscript{140} Other states hold the taxation in abeyance as with any conditional interest, usually requiring security for the period of postponement.\textsuperscript{141}

Under the New York Estate Tax the question has been raised whether or not exemptions should be allowed to a widow given income for life or until remarriage. In one case an exemption was granted;\textsuperscript{142} in another, it was denied because the value of the estate was considered unascertainable.\textsuperscript{143} Certainly, however, such interests have some value, and their treatment by the English courts shows that this value can be judicially determined. Under the British Estate Duty the practice is to reduce the value of a life interest which will cease on remarriage by a statutory percentage taken from a scale graduated so as to require a smaller percentage of reduction the older the beneficiary is.\textsuperscript{144} Moreover, under the English Bankruptcy laws, claims involving contracts for life annuities so long as the annuitant remained unmarried, or chaste, or abstained from cohabitation with her husband have all been held ascertainable and provable against the bankrupt;\textsuperscript{145} and they were calculated either by an actuary or left to the jury as being no more difficult of ascertainment than damages for any breach of contract.\textsuperscript{146}

Estate tax treatment of the valuation of a determinable fee or of a possibility of reverter seems based on the belief that the best way to solve a valuation problem is to avoid it. The federal courts, in line with their policy of enhancing revenue, have simply refused to allow any deductions from the taxable estate for interests bequeathed to charity which are to continue so long as certain conditions exist, irrespective of the unlikelihood that those conditions will ever terminate.\textsuperscript{147}

Under the inheritance tax statutes, however, gifts with such limitations have been exempt from taxation, and the valuation of the possibility of reverter to the heirs must be postponed until they come into possession.\textsuperscript{148}

\begin{flushright}
140. See \textit{Ohio Gen. Code Ann. (Page, 1938)} § 5344. Identical provisions are found in the statutes of \textit{Mo., Mont., R. I., S. D., Wash. and Wisc}. In the following states the provisions apply to any estate or interest: \textit{Cal., Colo., Conn., Idaho, Ill., Ind., Iowa, Ky., Minn., Ore. and Tenn.}


144. \textit{Green, Death Duties (1936)} 191. For instance if the widow is 20 years old or under the reduction is 65%; 40, 28%; 60, 10%; 93, 1%.


146. \textit{Ex parte Neal}, L. R. 14 Ch. D. 579, 582 (1880).

147. \textit{Delaware Trust Co. v. Handy}, 53 F. (2d) 1042 (Del. 1931) (annuity of $3,000 per year to church so long as it does not reduce rector's salary).

\end{flushright}
In one interesting case where the fee was determinable on failure of issue, the court ignored the possibility of reverter altogether and taxed the principal amount presently and finally. That the reverter interest is not wholly impossible to evaluate is evidenced by a decision of the House of Lords under eminent domain proceedings to the effect that the reversioner of a fee determinable upon failure of issue has an interest possessing market value, which though small, is estimable.

**Conclusion**

Any definitive appraisal of the present methods of valuation and taxation of future interests must await legislative articulation of the social basis upon which death taxation rests. In any event, whether death taxes be considered a means of redistributing wealth or a charge by the state for granting the privilege to bequeath, their primary function is to collect revenue. Using as a criterion their effectiveness as a means of imposing a levy upon transfers taking place at death, some useful conclusions can be drawn.

The foregoing survey would seem to indicate first and foremost the utter futility under the inheritance type statute of attempting to allocate the burden of a death transfer tax equitably among the transferees according to the fair market value of the beneficial interest received by each transferee. Since future interests, conditional or vested, are unsaleable and have no present market value, complete obeisance to the concept of market value requires suspension of taxation until the interest actually comes into the transferee’s possession. Such a practice has proven to be replete with administrative difficulties, and despite its purpose of equitably apportioning the tax burden, seems inevitably to entail discrimination against some class of transferees. Immediate valuation by actuarial data is at best an incomplete and unsatisfactory substitute for awaiting the actual occurrence of the contingencies. No science can calculate the probability of such future events as birth of issue or remarriage; and even in the valuation of interests to which scientific data is applicable, the mathematical precision of actuarial calculations is only a futile pretense at accuracy of valuation. That state tax commissions are

149. Simmons v. South Carolina Tax Comm., 134 S. C. 261, 132 S. E. 37 (1926). Taxing as a fee would seem in accord with the statutes providing that where an interest is in possession no allowance shall be made for any conditions upon which it may be defeated. See note 60, supra.


151. The Joint Congressional Committee reported twelve different economic theories for death taxes. See FEDERAL AND STATE DEATH TAXES, op. cit. supra note 7, at 93.

152. European states have long since ceased the pursuit of accuracy. Early statutes taxed the life estate on half the value of the corpus and the remainder on the other half. Now most continental states value the life estate by over-simplified fractional scales somewhat in the manner of the Maryland statute [see note 23, supra]. SCHULTZ, THE
apparently realizing the futility of the pursuit of a phantom accuracy is
evidenced by the growing importance of compromise agreements. These
agreements seem to be rapidly superseding use of the elaborate statutory
methods as a means of assessing the tax against conditional interests.163 Any
attempts to value and tax each beneficiary's interest separately inevitably
results in inaccuracies and burdens the state with the confusion which must
arise from an attempt to fix values on unmarketable future interests. The
only way of escaping this confusion is to discard the inheritance method of
taxation and the separate valuation of each legacy which that system entails.

Substitution of an estate tax for the ill-conceived inheritance levy seems
most desirable. The primary purpose of death taxation is to collect revenue,
maintaining meanwhile a reasonable balance between simplicity of adminis-
tration and fairness to the taxpayer. The estate tax eliminates much admin-
istrative difficulty, for it obviates the necessity of valuing future interests,
except when those interests are entitled to exemptions or included in the
decedent's gross estate. Some unfairness, by way of discrimination among
the beneficiaries, may result from the fact that the tax is payable generally
out of the residuary estate,164 and the residuary legatees may bear the entire
tax burden. The prejudice is more apparent than real, however. Residuary
legatees occupy their residuary position by deliberate mandate of the testator,
who may reasonably be presumed to have drawn his will with the tax statute
in mind, and to have intended to sacrifice the residuary legacies first. Had
he desired the tax to be proportionately borne by all the beneficiaries, he
could have so provided in his will.165 Possible unfairness to residuary bene-
ficiaries is far outweighed by the simplicity of administration obtained in
exchange. Moreover, a uniform system of estate taxation would ease the
task of the executor or administrator of an estate now subject not only to
the divergent systems of death taxation of state and federal governments, but
also, if the property is geographically scattered, to the divergent systems of
two or more states.166 In this way only would it seem possible to bring order
out of the present chaos.

TAXATION OF INHERITANCE (1926) 231. In Germany the tax on the life estate is based
not on the tenant's life expectancy, but on the full capital value of the interest, and
on the transfer of the property to the remainderman a new tax must be paid on the full
value of the corpus he receives. Germany: Law of August 22, 1925, 1925 REICHSGESETZ-
BLATT I, 320 § 7.

153. "...at least 90% of all such taxes are compromised." Communication to the
YALE LAW JOURNAL from State Tax Department of California, Feb. 9, 1938.

supra note 30, at 296.


156. FEDERAL AND STATE DEATH TAXES, op. cit. supra note 7, at iv.