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Tennessee Death Taxes

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TENNESSEE DEATH TAXES

The leading articles in this symposium stress the problems which federal death duties create in the planning of estates. The purpose of this note is to discuss the Tennessee Inheritance Tax,[1] and to indicate how its treatment of particular types of property and forms of ownership differs from the federal succession tax.

The federal tax poses no problem to the Tennessean of moderate means in planning his estate. By some elementary advance planning, all but very substantial estates may be made free of federal tax. In no event will an estate be subject to federal tax which is valued at less than $60,000 [2] after authorized deductions.[3] This specific exemption of $60,000 is now only the starting point. The Revenue Act of 1948 has included an additional deduction where property passes to a surviving spouse.[4] By use of this "marital deduction" there is a splitting of ownership for estate tax purposes.

A similar drastic change was made in the federal gift tax. Under prior law the donor could make annual gifts of $3,000 to any number of donees.[5] In addition to these annual exclusions, the donor had a specific exemption of $30,000.[6] This amount could be given in any one year or spread over several years. The 1948 Act has provided that a married donor under certain circumstances may avail himself of his spouse's exemptions and exclusions.[7] This doubles the amount of property of which such donor may divest himself free of tax.

The full impact of these changes is best illustrated by taking a typical family group: husband, wife and two children. The husband has an estate of $200,000. He may give his wife $6,000 and each child $36,000. This will exhaust his specific exemption, his wife's specific exemption and the annual exclusions of each for the current year. His assets are immediately reduced by $78,000, leaving $122,000. If he makes these gifts within a calendar year, he will be subject to a Tennessee gift tax of $1,365. This tax may be avoided by spreading these gifts over an eight-year period.[8] If on his death 50% of the

1. TENN. CODE ANN. §§ 1259-95 (Williams 1934).
2. INT. REV. CODE § 935(c).
3. These include: (1) funeral expenses, (2) administration expenses, (3) claims against the estate, (4) unpaid mortgages upon, or any indebtedness in respect to, property where the value of decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate, and (5) amounts reasonably required and actually expended for the support during the settlement of the estate of those formerly dependent upon the decedent. INT. REV. CODE § 812(b).
4. *Id.* § 812(e).
5. *Id.* § 1003(b). Thus, if the taxpayer makes gifts of $3,000 each to 25 persons, the $75,000 is free of federal gift tax.
6. *Id.* § 1004(a)(1).
7. *Id.* § 1004(a)(3).
8. TENN. CODE ANN. §§ 1328.1-1328.21 (Williams 1934). The gift tax statute divides donees into two categories. Class A includes "Husband, wife, son, daughter, lineal ancestor

remaining $122,000 is left to his wife, the "marital deduction" will be $61,000. This added to the $60,000 specific exemption and normal deductions will free the estate of any federal tax.

TENNESSEE INHERITANCE TAX [9]

The Tennessee inheritance tax includes within its scope not only property transferred by will or intestacy but also (1) interests vesting by way of dower and curtesy, (2) gifts in contemplation of death, (3) transfers to take effect in possession or enjoyment at or after death, (4) revocable trusts, (5) powers of appointment, (6) jointly owned property, and (7) life insurance.

The statute divides beneficiaries into two categories. Class A includes "Husband, wife, son, daughter, lineal ancestor or lineal descendants, legally adopted child and lineal descendant of such adopted child." Class B includes all other beneficiaries.[10] In arriving at the net estate a single exemption of $10,000 is permitted to Class A beneficiaries and a single exemption of $1,000 to Class B beneficiaries.[11] There is no marital deduction. However, the value of all property transferred to the United States or to the State of Tennessee or any political subdivision of Tennessee or any charity therein is deductible from the net estate.[12]

SUBSTANTIALLY IDENTICAL PROVISIONS

To a considerable extent the Tennessee inheritance tax provisions and the federal estate tax provisions are substantially identical. This is true with respect to dower and curtesy, property transferred in contemplation of death, transfers to take effect in possession or enjoyment at or after death and revocable trusts.

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or lineal descendant, legally adopted child and lineal descendant of such adopted child." Class B includes all other donees. *Id.* § 1328.4. Exemptions of $10,000 to Class A and $5,000 to Class B are allowed during any calendar year. *Ibid.* Rates of taxation on gifts to Class A donees range from 1% to 7% and the rates as to Class B range from 5% to 15%. *Id.* § 1328.5. For a comparison of state gift taxes and their relation to death duties, see Brandis, *State Gift Taxes—Their Relation to Death Taxes*, 26 IOWA L. REV. 479 (1941).

9. In addition to the inheritance tax, Tennessee has an estate tax. TENN. CODE ANN. §§ 1296-1315 (Williams 1934). It is designed to insure that the state receive not less than the 80% credit allowed under federal law. INT. REV. CODE § 813(b); TENN. CODE ANN. § 1297 (Williams 1934). The estate tax is measured by the difference in the state inheritance tax and the federal credit. The inheritance tax rates are such that in nearly every instance the tax under them exceeds the federal credit. TENN. CODE ANN. § 1267 (Williams 1934) (inheritance tax rates). The net federal estate must exceed approximately $3,250,000 before tax collected under Class A inheritance tax rates falls below the federal credit—and as to Class B beneficiaries, the fignre required to bring the Tennessee estate tax into play is fabulous. Under present conditions, since the Tennessee estate will rarely if ever come into operation it is not discussed in this note. See REPORT OF THE TAX REVISION COMMISSION OF THE STATE OF TENNESSEE, November 1, 1948, pp. 25-6.

10. TENN. CODE ANN. § 1266 (Williams 1934).

11. *Ibid.*

12. TENN. CODE ANN. § 1265 (Williams 1934).

Some state inheritance tax laws were originally held not to apply to dower and curtesy.[13] Tennessee formerly adhered to such a view,[14] but now follows the federal rule.[15]

The term, gifts in contemplation of death, seems to have crept into the early succession tax laws without statutory definition. Prior to its incorporation into the Federal Estate Tax Law of 1916, there was authority for interpreting it as synonymous with gifts *causa mortis*.[16] The broad interpretation of the Supreme Court in *United States v. Wells*[17] has resulted in an expansion of the concept in state law. The Tennessee statutory provision substantially incorporates the definition in the *Wells* case,[18] together with the federal rebuttable presumption that a gift made within two years of death is made in contemplation thereof.[19]

In dealing with transfers to take effect in possession or enjoyment at or after death, the federal cases first emphasized technicalities of property law.[20]

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13. *In re* Inheritance Tax of Strahan's Estate, 93 Neb. 828, 142 N. W. 678 (1913) (statutory interest of widow not taxable); *In re* Starbuck's Estate, 137 App. Div. 866, 122 N. Y. Supp. 584 (1910) (2d Dep't), *aff'd*, 201 N. Y. 531, 94 N. E. 1098 (1911) (curtesy).

14. State *ex rel.* McCabe v. Clayton, 162 Tenn. 368, 38 S. W. 2d 551 (1931) (dower and homestead not taxable under former law); Crenshaw v. Moore, 124 Tenn. 528, 137 S. W. 924 (1911) (under then existing inheritance tax law dower not taxable).

15. Section 811(b) of the Internal Revenue Code makes it clear that nothing is to be excluded from the gross estate because it represents an interest such as dower and curtesy. See also Mayer v. Reinecke, 130 F. 2d 350 (C. C. A. 7th 1942) (dower), *cert. denied*, 317 U. S. 684 (1942); Empire Trust Co. v. Comm'r, 94 F. 2d 307 (C. C. A. 4th 1938) (testamentary disposition in lieu of dower). See Lowndes, *The Constitutionality of the Federal Estate Tax*, 20 Va. L. Rev. 141, 146-8 (1933).

The present Tennessee statute states that the "vesting in a wife of a dower interest upon death of her husband, or in the husband of an interest as tenant by the curtesy upon the death of his wife or his right to succeed to the personal property of his wife dying intestate leaving no descendants surviving her, or any transfer of property in any other manner by operation of law upon the death of any person, shall be . . . taxable." Tenn. Code Ann. § 1264 (Williams 1934). But the vesting of statutory exemptions in widow on death of husband is not a taxable transfer. Collins v. McCanless, 179 Tenn. 657, 169 S. W. 2d 850 (1943).

16. *In re* Spaulding's Estate, 49 App. Div. 541, 63 N. Y. Supp. 694 (4th Dep't 1900), *aff'd* 163 N. Y. 607 (1900).

17. 283 U. S. 102, 51 Sup. Ct. 446, 75 L. Ed. 867 (1931). The Court said that gifts in contemplation of death do not refer "to the general expectation of death which all entertain. It must be a particular concern, giving rise to a definite motive. The provision is not confined to gifts *causa mortis*, which are made in anticipation of impending death, are revocable, and are defeated if the donor survives the apprehended peril. . . . The dominant purpose is to reach substitutes for testamentary dispositions and thus prevent the evasion of the estate tax." *Id.* at 115-17. See generally, Montgomery, Federal Taxes—Estates, Trusts, and Gifts 1946-47, 421-443 (1946); Pavenstedt, *Taxation of Transfers in Contemplation of Death: A Proposal for Abolition*, 54 Yale L. J. 70 (1944); Polisher, *Transfers in Contemplation of Death*, 2 Vand. L. Rev. 195 (1949). For a discussion of the decisions under state courts see, Harris, *Gifts in Contemplation of Death*, 19 Taxes 151, 152-4 (1941).

18. "Contemplation of death . . . shall be taken to include that expectancy of death which actuates the mind of a person on the execution of his will, and in no wise shall said words be limited and restricted to that expectancy of death which actuates the mind of a person in making a gift causa mortis; and it is declared to be the intent and purpose of this statute to tax any and all transfers which are made in lieu of or to avoid the passing of the property transferred by testate or intestate laws." Tenn. Code Ann. § 1260(c) (Williams 1934).

19. Int. Rev. Code § 811(c).

20. May v. Heiner, 281 U. S. 238, 50 Sup. Ct. 286, 74 L. Ed. 826 (1930).

This emphasis has been discarded. If the grantor holds any sort of "string" on the assets transferred, the full value of such property is now includible in his gross estate.[21] Tennessee adheres to the same rule.[22]

No cases on revocable trusts in Tennessee have been found; however, the Tennessee statute [23] is similar to the federal provision.[24]

SUBSTANTIALLY DIFFERENT PROVISIONS

There are, however, substantial variations between the federal and state treatment of life insurance, jointly owned property, and powers of appointment.

A. *Life Insurance.*

Under federal law all proceeds from life insurance are taxable where the policy was owned by the decedent or where he paid the premiums. No distinction is made between war risk insurance and other types.[25] Tennessee exempts all war risk insurance, whether World War I or II, where the policies are payable by the Government of the United States.[26] In addition, the Tennessee law contains a $40,000 exemption [27] where the insurance is payable to Class A beneficiaries.

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21. Helvering v. Hallock, 309 U. S. 106, 60 Sup. Ct. 444, 84 L. Ed. 604 (1940), 53 HARV. L. REV. 884 (1940); Note, 49 YALE L. J. 1118 (1940). See generally Rottschaefer, *Taxation of Transfers Taking Effect in Possession at Grantor's Death,* 26 IOWA L. REV. 514 (1941).

22. Baker v. McCanless, 177 Tenn. 571, 151 S. W. 2d 1082 (1941). Compare Section 811(c) of the Internal Revenue Code with Section 1260(a),(e),(g) of the Tennessee Code. Some of the terminology differs but it is in substance the same.

23. "The gross estate . . . shall include property . . . transferred by the decedent by deed of trust wherein he reserved to himself . . . , alone or in conjunction with others, powers of revocation, alteration or amendment, upon the exercise of which such property would revert to the decedent, to the extent of the value of such property subject to such powers and with respect to which such powers remain unexercised." TENN. CODE ANN. § 1262 (Williams 1934).

24. INT. REV. CODE § 811(d). See also Lowndes, *Tax Avoidance and the Federal Estate Tax,* 7 LAW & CONTEMP. PROB., 309, 316-19 (1940).

25. In United States Trust Co. v. Helvering, 307 U. S. 57, 59 Sup. Ct. 692, 83 L. Ed. 1104 (1939), the Court held that the proceeds of war risk insurance were subject to the estate tax although legislation establishing it provided that such "insurance . . . shall be exempt from all taxation." 43 STAT. 613 (1924). The Court said: "An estate tax is not levied upon the property of which an estate is composed. It is an excise imposed upon the transfer of or shifting in relationships to property at death. The tax here is no less an estate tax because the proceeds of the policy were paid by the Government directly to the beneficiary; the taxing power was nevertheless exercised upon 'the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another.'" *Id,* at 60. National Service Life Insurance has received similar treatment by Treasury Dept. 3 P-H 1948 FED. TAX SERV. ¶ 23, 886.2.

26. ". . . there shall be exempt from the provisions of this law the proceeds of policies, irrespective of the amount thereof, upon the life of any person who was at the time of death, or prior thereto had been, a member of the armed service of the United States, where such policies are payable by the government of the United States." TENN. CODE ANN. § 1261a (Williams Supp. 1948). See Nutting, *Life Insurance Proceeds in State Inheritance and Estate Taxation,* 26 IOWA L. REV. 579 (1941).

27. TENN. CODE ANN. § 1261a (Williams Supp. 1948). Formerly, the federal act contained a $40,000 exemption. This was eliminated in 1942 but Tennessee retained the provision when Section 1261a was amended. Tenn. Pub. Acts 1943, c. 119, § 1.

There is a marked difference in the treatment of insurance payable to the executor or estate. The federal law includes in the gross estate all proceeds from insurance payable to the executor or estate.[28] But under Tennessee law if a husband makes his life insurance payable to his estate, it nevertheless inures to the benefit of his wife and children.[29] This is true regardless of the amount of the insurance or insolvency of the husband.[30]

For example, if a husband leaves $40,000 in life insurance payable to his estate rather than to his wife and children, the executor must pay the proceeds to the wife and children according to the statutes of descent and distribution. As they are Class A beneficiaries, this $40,000 in insurance proceeds is exempt from the state inheritance tax.

B. Jointly Owned Property

For federal estate tax purposes the value of *all* property held by a decedent as a joint tenant or tenant by the entirety is included in his estate in the absence of proof that some part of the consideration was furnished by the surviving owner. Nor is it enough that the survivor prove contribution in the acquisition of the property. He must show that no part of such consideration was ever received from the decedent.[31] The burden of proof is on the taxpayer.

The Tennessee inheritance tax law in speaking of joint tenancies and tenancies by the entireties says that "there shall be included for taxation such part as may be clearly shown to have belonged to decedent . . ." [32] This places the burden squarely on the taxing authorities. In the absence of such proof, the amount to be included in the decedent's estate is determined by dividing the total value of the property by the number of persons in whose joint name it was held.[33] However, a contrary presumption arises if the joint property is "money, or other evidence of indebtedness . . . subject to the individual control, or to the appropriation or use by the decedent prior to death . . ." [34] In that event the entire value of the jointly owned property is taxable to the decedent unless the survivor sustains the burden of proving his contribution.

The wide divergence of treatment under state and federal rules may be illustrated by an example. Suppose a husband, vice-president of a bank for 40 years, had annual earnings ranging from $5,000 to $12,000. His wife, early in their married life, obtained a patent on a household fixture. This netted her $3,000 the first year, $5,000 the second and $8,000 the third. Then she patented a second fixture and her earnings soared until they reached $30,000 per year.

28. INT. REV. CODE § 811 (g) (1).
29. TENN. CODE ANN. § 8456 (Williams 1934).
30. *Ibid.*
31. INT. REV. CODE § 811 (e) (1).
32. TENN. CODE ANN. § 1261 (Williams 1934).
33. *Id.* § 1261 (a).
34. *Ibid.*

From the time of their marriage they deposited all their funds in a joint bank account. They drew from this account for all joint and individual expenses. No record of individual contributions or withdrawals was kept. Over the 40-year period they invested the excess—$125,000—in stocks and real estate. There being no method of tracing the source of the funds used to purchase this property to husband or wife, all is subject to tax on the death of either under federal rule; under the Tennessee rule only one-half would be taxable on the death of either.

Thus the need for keeping accurate records is less vital for the Tennessean with a moderate estate. Indeed, the failure to keep accounts would seem to operate to the advantage of the taxpayer.

C. *Powers of Appointment.*

Generally a power of appointment [35] is the right to designate by deed or will the person or persons who are to receive property of a prior decedent. The person who confers the power is called a donor; the recipient, the donee. While the donee is generally the life tenant, this is not a requirement. He may be a stranger to the property. Powers are divided into two classes, general and special. The donee of a general power of appointment may designate any person to take the property without restriction. If he must designate a person or persons within a limited group or class, it is a special power.

For federal tax purposes the value of all property subject to a power of appointment, whether exercised or not, other than a power for the benefit of an extremely limited class is included in the taxable estate of this donee of such power. The test of taxibility is determined by the extent of the class.[36] Tennessee, on the other hand, taxes all *exercised* powers.[37] Here the test is not the extent of the group but the exercise of the power. Though coverage of the respective taxing act is different, this difference will not normally be a factor in planning an estate since the use of powers of appointment is generally confined to substantial estates.

CONCLUSION

The above resumé of the Tennessee Inheritance Tax Law indicates some variation between state and federal succession taxes. But estate plans, even for persons of moderate means, will be shaped in large part by the limitations which considerations of federal taxing policies suggest.

35. See generally Griswold, *Powers of Appointment and The Federal Estate Tax*, 52 HARV. L. REV. 929 (1939); Leach, *Powers of Appointment*, 24 A. B. A. J. 807 (1938); Thompson, *State Death Taxes and Powers of Appointment*, 26 IOWA L. REV. 549 (1941).

36. INT. REV. CODE § 811(f).

37. "Transfers under powers of appointment shall be taxable in like manner and to the same extent as if property of the testator or donor was transferred." TENN. CODE ANN. § 1260(h) (Williams 1934).

The provisions relating to dower and curtesy, transfers in contemplation of death, transfers to take effect in possession and enjoyment at and after death, and revocable trusts are substantially identical. The variations in the approach to the problems of jointly owned property and life insurance suggest almost exclusive attention to the federal rules. The different treatment of powers of appointment will rarely be significant in determining the use of powers and the extent of the group since, if a power is desired, it will generally be preferable to restrict it to the permissible federal class. And in view of the flexibility a power provides in the ultimate distribution of trust assets and the relatively moderate Tennessee tax rates such limited powers will usually be found desirable.

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