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Harry A. Ash

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INHERITANCE TAXATION

By HARRY A. ASH

Inheritance Tax Attorney for Cook County, Illinois

Inheritance taxes in one form or another have been imposed since very early times, but it was not until 1895 that the first inheritance tax law became effective in the state of Illinois. In that year a law based upon a similar law then in force in the state of New York was passed by the legislature, and with a few amendments that have been added since that time the same law is effective today.

In considering the subject of inheritance taxation it is extremely important to distinguish between this form of taxation and taxation on property. The supreme court of Illinois, as well as practically all courts in this country, both state and federal, has held that the inheritance tax is a tax not upon property, but upon the transfer of property. Generally speaking, the transfer taxed under the law of this state is the transfer of property to a beneficiary, either at the death of the owner of the property or in contemplation of death.

The fact that the inheritance tax is a tax upon the right of succession measured by the value of the property passing and not upon the property itself was early decided by the supreme court of this state in a case which upheld the constitutionality of the inheritance tax law. The court held that the state has the power to impose a tax upon the transfer of property at the death of a person under his will or the laws of descent and distribution. The right of a beneficiary to take property under such circumstances is not an inherent right, but one granted by law. The theory is that what

the law gives it can take away and consequently a statute so restricting the right of inheritance is valid and within the constitutional powers of the legislature.

As indicated above, the basis of the tax is the transfer of property at death or as a result of death. The statute defines the various taxable transfers. Transfers by will, under the laws of descent and distribution, upon the exercise or failure to exercise a power of appointment, upon the death of a joint tenant, in contemplation of death and to take effect in possession or enjoyment at or after death are all subject to tax under Section 1 of the Illinois inheritance tax law.

While the object taxed is a transfer in one of the above enumerated ways, the measure of the tax is the market value of the property at the death of the owner. Market value means the full and fair cash value that could be obtained at an open sale between a willing seller and a willing buyer, each in possession of all the facts. Arbitrary values and stipulated values will not bind the state in making a valuation for inheritance tax purposes. The fair market value will be fixed in the light of all the facts.

An inheritance tax is imposed at the death of a resident of the state upon the transfer of his real and tangible personal property in the state and his intangible personal property of every kind and description regardless of where the actual situs of such intangible is. Intangible personal property of course includes stocks, bonds, notes, mortgages, debts and rights and choses of action of all kinds. Jurisdiction to tax in such case

is based upon jurisdiction over the individual. The fact that he died a resident of Illinois is sufficient to subject his entire estate to the Illinois inheritance tax with the sole exception of real estate and tangible personal property actually located in foreign states.

Estates of decedents who were not residents of Illinois are also subject to the Illinois inheritance tax to the extent that their property is subject to the jurisdiction of this state. Real estate and tangible personal property located in the state are subject to tax and also stock of Illinois corporations and other intangible property having a situs in this state, even though the owner was a resident of a foreign state and probate proceedings are had in that state.

It might be well to say at this point that probate and the right to impose an inheritance tax are two separate things. For example, at the death of a joint tenant one-half of the value of the property is subject to inheritance tax, although there is no probate of such property. A tax is imposed upon the full value of gifts made in contemplation of death or to take effect in possession or enjoyment at or after death. In such cases the property passes directly to the donee or to the trustee for the benefit of the donee and no probate proceedings are involved. Yet such transfers are so closely related to the death of the owner of the property that the state has a right to impose an inheritance tax even though the property passes independent of probate proceedings.

Following this thought a little further, it might be well to emphasize the principle that a transfer will be held subject to inheritance tax if the enjoyment of this beneficial interest by the donee commences on or after the death of the donor. This rule was well illustrated in a recent decision of the supreme court of this state. The case involved the question whether the inheritance tax

should be imposed upon property transferred to a trustee about five years prior to her death by Nettie Fowler McCormick, the widow of Cyrus McCormick, founder of the International Harvester Company. Mrs. McCormick created this trust, but reserved certain powers to direct how the income should be paid over and distributed during her lifetime. If her private income was below \$250,000 a year she had the right to direct the trustee to pay her up to that amount out of the income of the trust. She further reserved the right to direct the trustee to pay over the income to such charitable institutions as she might direct during her lifetime. At her death the income from the trust was to be paid to her three children. The children contended that their interests became vested in them by virtue of the trust agreement executed five years prior to their mother's death and that they did not take as a result of their mother's death. The court, however, held that there was a transfer to take effect in enjoyment at the mother's death, because of her powers over the income of the trust during her lifetime and the fact that if the children died prior to her death the trust property was to be transferred back to her.

We should remember, therefore, that the inheritance tax law not only affects transactions that result from the death of an individual, but it also may affect instruments executed many years prior to death. If the inheritance tax law were not broad enough to cover these situations then the door would be left open to evasion of the tax by wealthy persons who would create trusts reserving complete powers over the property until death and yet escaping the inheritance tax. Naturally the law will not tolerate such a situation and if a beneficiary has no right of enjoyment in property until the death of the donor, whether the property is transferred by deed,

contract, will or intestate law, an inheritance tax is due and payable.

A further important principle to be kept in mind in considering the subject of inheritance taxation is the fact that the tax in this state is a succession tax as distinguished from an estate tax. An estate tax is one that is levied upon the aggregate estate left by a deceased person and the rates are applied to the total value of the estate as a unit. A succession tax, however, is a tax that is applied to the various legacies or distributive shares as separate units. In other words, the amount of inheritance tax due to the state in a given case depends upon the way in which the estate is distributed. Each legacy or share must bear its proportionate part of the tax.

If an individual should die leaving a will which gave legacies of a thousand dollars each to three friends and distributed the balance of the estate equally between a wife and child, there would be five different units or shares to which the tax would be applied. A tax would be payable on each thousand dollar legacy and would be deducted by the executor before the legacies were paid over to the legatees. Each share of the residuary estate would bear its tax and these amounts, too, would be deducted by the executor before paying over such share. It is important to remember that the tax is imposed upon the net shares in the residuary estate. That is to say, the statute allows certain deductions such as debts due and owing at the death of the decedent, administration expenses, the Federal Estate Tax and property taxes for which the decedent was liable during his lifetime. These items are of course payable out of the general estate and so reduce the actual shares which the residuary legatees receive. Consequently the statute does not attempt to tax those amounts which the residuary legatees never receive. The deductions are allowed before the tax is computed on their shares.

As stated above, the executor or administrator deducts the tax from the various shares before making distribution to the legatees or distributees. The statute makes him personally liable for not paying the tax due on any property which passes through his hands. Consequently an executor or administrator must be very careful to reserve sufficient funds to pay the inheritance taxes that are assessed.

The inheritance tax law provides, among other things, that "It shall be the duty of the attorney general to exercise general supervision over the assessment and collection of the inheritance tax provided in this act." In Cook County this duty is performed through the inheritance tax attorney who has direct charge of matters relating to the administration of the inheritance tax law. The assessment of the tax is actually made in proceedings before the county judge. The attorney general represents the state in these proceedings and the executor, by his attorney, represents the estate. Appeal from the assessment by the county judge may be had to the county court and further appeal may be had from the county court direct to the supreme court of the state.

The inheritance tax is probably one of the most equitable forms of taxation, particularly in view of the fact that fairly liberal exemptions are allowed. For example, in Illinois a surviving spouse or child is allowed a \$20,000 exemption from the share which it takes. Furthermore, charitable, religious and educational corporations in the state receive bequests entirely free from the inheritance tax. In general, therefore, the payment of inheritance taxes imposes no particular burden upon the recipient and the popularity of inheritance taxation is amply attested by the fact that a tax similar to the one imposed by the state of Illinois is now in force in forty-four of the other states of this country.