



OFFICE OF THE ATTORNEY GENERAL OF TEXAS
AUSTIN

0-4142
GERALD C. MANN
ATTORNEY GENERAL

Honorable George H. Sheppard
Comptroller of Public Accounts
Austin, Texas

Dear Sir:

Opinion No. 0-4142

Re: Whether the insurance policies forming the res of the trust in the A. Schwartz Estate are subject to payment of inheritance tax.

We are in receipt of your letter of May 4, 1942, in which you request the opinion of this department as to the taxability of the above mentioned trust funds.

The facts as appear from your letter and the enclosed copy of the trust instrument are as follows: In 1933 A. Schwartz created an irrevocable trust in favor of named beneficiaries who were his three children. The grantor assigned insurance policies with a maturity value of \$150,000.00 to the trustees having the policies made irrevocably payable to them and reserving no control over them or their cash surrender value. The trustees assumed no obligation to pay policy premiums and are only obligated for the safe keeping of the policies and distribution of the proceeds on or after the death of the grantor. On death of the grantor the trustees are given authority to collect the proceeds of the policies and in their discretion either pay the corpus of the trust over to the beneficiaries or invest under expressed provisions of the trust for a definite period of years, distributing annually the income to each of the beneficiaries. During this period the trustees are given authority at any time to withdraw and distribute any part of the corpus of the trust as they may consider to be to the best interest of the beneficiaries. Article XIII of the trust instrument provides for the following contingency:

"In the event any of the beneficiaries hereinafter named die before coming into possession of the entire principal and corpus of his or her trust estate, the same and the income therefrom, shall be thereafter held, distributed, paid, delivered and transferred as hereinabove provided, as follows:

Honorable George H. Sheppard, Page 2

"(a) In the event of the death of any of the beneficiaries, unmarried or not having child or children surviving him, if married, then his share in the trust estate shall go to the surviving beneficiary or beneficiaries, share and share alike if either or both of the other beneficiaries survive. If there are no surviving beneficiaries and no surviving child or children of the beneficiaries, then the trust estate shall pass according to the last will and testament of the last surviving beneficiary, or according to the laws of descent and distribution if he dies without will.

"(b) In the event said deceased beneficiaries shall have been married and leave a child or children surviving him, then instead of the deceased beneficiaries' share being administered for the benefit of the other beneficiaries, it shall be administered and belong to the surviving child or children, share and share alike."

As to the taxability of this trust the following questions have been submitted:

"(1) Are the proceeds of the insurance policies placed in trust, less the statutory exemption, taxable under the Texas Inheritance Tax law?

"(2) If it be shown that the beneficiaries under the trust paid the premiums on the insurance policies after same were placed in trust, what effect would this have upon the taxability of the proceeds collected thereunder?

"(3) Would the beneficiaries be entitled to an exemption on the insurance policies equal to the cash surrender value of said policies at the time said policies were transferred to the trust?"

Article 7117, Revised Civil Statutes, as amended in 1939 provides:

Honorable George H. Sheppard, Page 3

"All property within the jurisdiction of this State. . . including the proceeds of life insurance . . . to the extent of the excess over Forty Thousand Dollars (\$40,000) of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life . . . which shall pass absolutely or in trust by will or by the laws of descent or distribution of this or any other State, or by deed, grant, sale or gift made or intended to take effect in possession or enjoyment after the death of the grantor or donor, shall, upon passing to or for the use of any person, corporation or association, be subject to a tax. . ."

Let us consider the nature of the interests of the beneficiaries under the insurance trust created by Mr. A. Schwartz in 1935. Prior to the death of the settlor in 1941, the beneficiaries each had a one third interest in the ultimate proceeds of the insurance policies placed in trust, subject, however, to complete defeasance until the distribution of the proceeds by the trustees after the death of the settlor. If any one of the beneficiaries died during the life of the settlor without issue, his interest was defeated. During this period the beneficiaries had no right to the proceeds or enjoyment of the property in the insurance policies. It is not until the distribution of the proceeds of the policies by the trustees in accordance with the terms of the trust, after the death of the settlor, that the interests of the beneficiaries become indefeasibly vested. Certainly the grant to the beneficiaries could not "take effect in possession or enjoyment" until "after the death of the grantor."

It is clear, that upon the creation of this insurance trust in 1935, the settlor divested himself of all interest in and control over the insurance policies and their proceeds. The proceeds of insurance policies were made subject to the payment of inheritance taxes in Texas for the first time by the 1939 amendment to Article 7117, H. B. No. 990, Section 1, Acts 1939, 45th Legislature, quoted in part above. If the incidence of the Texas inheritance tax were upon the transfer of property by the decedent as is the case of the federal estate tax, no tax could be levied in this instance--for to do so would give

a retroactive effect to the 1939 amendment, since the transfer of all the decedent's interest took place upon the creation of the trust in 1935. *Lewellyn v. Frick* (1925) 268 U. S. 238, 59 L. Ed. 934, 45 S. Ct. 487; *Bingham v. U. S.*, 296 U. S. 211; *Industrial Trust Co. v U. S.*, 296 U. S. 220; *Helvering v. Helmholtz*, 296 U. S. 93. Such is not, however, the nature of the Texas inheritance tax. It does not tax the transfer of property by the decedent, but rather the privilege of the beneficiary to receive the property. This distinction between the Federal estate tax and the Texas inheritance tax was clearly enunciated by Judge Blair for the Austin Court of Civil Appeals in *Betha v. Sheppard* (1940), 143 S. W. (2d) 997 (writ of error refused) at page 1002:

"We do not regard as necessary a lengthy discussion of the distinction recognized by the authorities between the federal estate tax and the inheritance or succession tax levied by the various states. Suffice it to say that the federal estate tax is imposed upon the right of grantor or transferor to transfer property, and that the inheritance or succession tax by the State is imposed upon the right to receive or succeed to the possession or enjoyment of property. Nor is it necessary to discuss the conflict of authorities with respect to the distinction as to these two forms of taxes. Under the Federal Estate Tax Law, the primary question to determine is when the decedent or grantor parted with all property rights, Under our State Inheritance or Succession Tax Statute, the primary question is whether the transfer was made or intended to take effect in possession or enjoyment after the death of grantor or settlor, particularly in cases of transfer of property in trust. It is not a question of when the beneficial interest is created, but the tax is imposed upon the right to receive in possession or enjoyment after the death of grantor or settlor. In consequence, a grantor or settlor may create an irrevocable trust during his lifetime, still if he postpones the right of possession or enjoyment of the beneficiary until after grantor's death, the property or any interest therein is subject to the

inheritance or succession tax at or after his death. Under our statute, where either 'possession' or 'enjoyment' is made contingent upon the death of grantor or settlor of all or any part of the trust estate, such transfer is taxable."

The above quotation, discussing as it does, the general principles of the application of the Texas Inheritance Tax Law to inter vivos trusts whereby the settlor postpones until after his death, the beneficiary's possession and enjoyment, seems to compel the conclusion that the insurance trust in the instant case is taxable, since here, not merely the coming into possession and enjoyment by the three beneficiaries, but also the indefeasible vesting of their respective interests cannot take place until after the death of the settlor. The opinion in the Bethea case applies with even greater particularity to the instant case; in fact, sounds almost descriptive of it, when it discusses the provisions of the trust there involved, at page 1001:

"That is, we construe the instrument as conclusively showing the intention of grantor or settlor to withhold the full or complete possession or enjoyment of the trust estate, except the annuity payable to appellant primarily out of the revenues, from appellant until after the death of grantor, or until eight years after her death. The trust instrument expressly provides that the 'remainder' of the estate 'shall not be distributed' during the lifetime of grantor, and not 'until the expiration of eight years after her death'. The transfer or right of possession or enjoyment of the remainder of the trust estate was made contingent upon appellant's surviving the grantor, which necessarily fixed appellant's right at or after the death of grantor. . . Thus the trust instrument expressly provided that the death of the grantor must in all events occur before the remainder of the estate can take effect in possession or enjoyment in appellant, the beneficiary. And thus the trust instrument

Honorable George H. Schppard, Page 8

by its own terms brings the instant case squarely within the statute, which does not impose the tax on the transfer of the property, nor on the passing of the property from the grantor, nor on the right to become beneficially interested in the property, but imposes the tax upon the passing of the property or interest therein when 'made or intended to take effect in possession or enjoyment after the death of the grantor'. In other words, the thing burdened with the tax is the right to receive or the right of succession as distinguished from the right of transfer. State v. Hogg, 123 Tex. 568, 70 S. W. (2d) 699, 72 S. W. 2nd 693."

Applying the above construction of the Texas Inheritance Tax Law to the instant case, it follows that the taxable event, (i.e. the accrual of the respective beneficiaries' rights to receive the proceeds) takes place after the death of the settlor, which occurred in 1941, and therefore no retroactive effect is given to the 1939 amendment in applying it in this case.

As said by Mr. Justice Stone, speaking of a state inheritance tax such as ours, in *Saltontall v. Saltontall* (1925), 275 U. S. 260, 48 S. Ct. 225, 72 L. Ed. 565:

"So long as the privilege of succession has not been fully exercised it may be reached by the tax. See *Cahen v. Brewster*, 203 U. S. 543; *Orr v. Gilman*, 183 U. S. 278; *Chanler v. Kelsey*, 205 U. S. 456; *Moffitt v. Kelly*, 218 U. S. 400; *Nichel v. Cole*, 256 U. S. 222."

In *Cahen v. Brewster*, cited above, the United States Supreme Court sustained a Louisiana inheritance tax levied upon the estate of a decedent who died prior to the passage of the taxing act, but before distribution of the property. Mr. Justice McKenna, in that opinion, declared, at page 551:

"There is nothing in those cases which restrains the power of the State as to the time of the imposition of the tax. It may select the moment of death, or it may exercise its power during any of the time it holds the property from the legatee. 'It is not', we said in

Honorable George H. Sheppard, Page 7

the Perkins case, 'until it has yielded its contribution to the State that it becomes the property of the legatee.'

Bogert in his work on "Trusts and Trustees", Vol. 2, Sec. 281, makes the following statement as to the taxability of trusts created prior to the passage of the tax law, in which the beneficiaries' interests are subject to defeasance until after the death of the settlor:

"But, if such remainder, though technically vested were subject to defeasance at the time the tax statute came into effect, the weight of state authority sustains the validity of the tax, whether the remainder were defeasible by failure of the remainderman to survive the death of the life tenant or the settlor."

In *Helvering v. Hallock* (1940), 309 U. S. 106, 60 S. Ct. 444, 84 L. Ed. 604, 125 A. L. R. 1368, the United States Supreme Court held that an irrevocable inter vivos trust was subject to the federal estate tax upon the death of the settlor, where his death extinguished a possibility of reverter in him--as constituting a transfer "intended to take effect in possession or enjoyment at or after his death." If the extinguishment of a possibility of reverter at the settlor's death constitutes a "taxable event under the federal estate tax, which looks to the transfer from the decedent as the incidence of the tax--certainly the extinguishment of a possibility of defeasance of the beneficiaries' interests under a trust, would constitute a taxable event under the Texas inheritance tax, which looks to the receipt of property by the beneficiary as the incidence of the tax.

The Supreme Court of Connecticut in discussing the incidence of the inheritance tax of that State in *Topping v. McLaughlin* (1939) 6 Atl. (2d) 343, declared:

"It applies to transfers wherein the death of the settlor is a factor in the devolution of the use or enjoyment of the property. It is intended to reach a shifting of the enjoyment of property--economic benefits or economic interests therein--which bears a distinct and necessary relation to the death of the settlor."

Honorable George H. Sheppard, Page 8

And as said in *Re Hollander's Estate*, 123 N. J. Eq. 52, 195 A. 805, 808, quoted with approval in *Bethea v. Sheppard*, 143 N. W. (2d) 997, 1002:

"The test of taxability is not the time of the complete divesting of the transferor's interest or ownership; it is the time of the complete succession by the transferee. Where there is a transfer of a specific interest in property and the succession of the transferee does not become, and under the terms of the transfer is not to become complete until a time at or after the death of the transferor, that transfer is taxable. 'The distinction . . . rests on . . . whether the donee is deprived of an interest of some kind . . . until the donor's death.'"

Under the authorities and for the reasons hereinabove discussed, in answer to your first question, it is our opinion that the proceeds of the life insurance policies placed in trust by Mr. A. Schwartz in excess of \$40,000.00 are subject to the inheritance tax imposed by Article 7117, N. C. S., as amended in 1939.

Your second question, relating to the effect upon the taxability of the proceeds of the policies, if it be shown that the beneficiaries paid the premiums since the creation of the trust in 1935, is substantially the same as that involved in *Hansen v. Blackmon*, recently decided by the El Paso Court of Civil Appeals in which application for writ of error is now pending before the Texas Supreme Court. Until the Supreme Court passes on this question, we do not consider it proper for us to attempt to answer it.

For the reasons discussed above, it is our opinion that your third question should be answered in the negative; i.e. that the beneficiaries are not entitled to an exemption on the insurance policies equal to the cash surrender value of said policies at the time said policies were transferred to the trust. Since the transfer of the policies to the beneficiaries, distinguished from the trustees, under the terms of the trust, does not become complete

Honorable George H. Sheppard, Page 9

until after Mr. A. Schwartz's death, the surrender value of the policies as of the date of the creation of the trust can have no significance for inheritance tax purposes.

Yours very truly

ATTORNEY GENERAL OF TEXAS

By *Joseph E. Jackson*
Joseph E. Jackson

By *Walter R. Koch*
Walter R. Koch
Assistant

WRK:LM

APPROVED AUG 31, 1942

Gerald C. Mann

ATTORNEY GENERAL OF TEXAS

