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APPELLATE COURT INTERPRETATION OF KENTUCKY INHERITANCE TAX STATUTES*

RODMAN SULLIVAN**

The purpose of this article is to consider briefly the interpretation by the courts of the various inheritance tax statutes.

The amount of litigation over enforcement of the collection of the inheritance tax has been comparatively small, if the number of cases decided by the Court of Appeals be any measure. The rates have never been unreasonably high, the exemptions until 1936 have been quite liberal, and ample time after the death of the decedent has been allowed for payment. It may be that these facts partly explain the lack of legal wrangling, as it might be cheaper or less troublesome to pay than to contest disputed points in the courts; but such a conclusion is mostly a guess and not readily susceptible of proof. In fact, it might easily be argued that the various statutes regarding inheritance taxation have not always been as simple, clear, and comprehensive as they might have been, thereby encouraging or necessitating resort to judicial interpretation. Again, it may be that the tax was evaded, or at least avoided, by many in its earlier history and that when such practices became increasingly difficult under the administration of the Tax Commission the laws had been amended in the direction of clarity and comprehensiveness, so that there was little room to mistake the intent of the legislature.

The original inheritance tax as enacted in 1906 was very short, being in fact but the barest outline and omitting points which would be considered essential in any modern inheritance tax statute.

As was to be expected, the question of the constitutionality of the law soon came up for the courts to decide; but the courts held in its favor.¹ "An inheritance tax is not a tax on the prop-

* The Kentucky Department of Revenue is publishing simultaneously a larger study of inheritance taxation of which this material is a part.

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¹United States v. Perkins, 163 U.S. 624; Com. v. Cumberland Telephone Company, 146 Ky. 142, 142 S.W. 392 (1912); Booth v. Com., 130 Ky. 88, 113 S.W. 61 (1908).

erty inherited but is an excise duty on the right to inherit.”²

That section of the law levying a tax on personal property of nonresident decedents who owned no real property in the state was later tested in the courts but was held to be valid in the case of *DeWitt v. Commonwealth*.³ However, no provisions were made for compelling payment of the tax until 1914. The case just referred to also held that the law was not rendered inoperative by reason of this failure to provide such a remedy and that, if a nonresident died before the passage of the 1914 statute, which did provide such a remedy and a tribunal to enforce valuation of the property and collection of the tax, the state could proceed to value the property and collect the tax at any time before distribution of the estate, even though it resulted in giving the act a retroactive effect.⁴ This retroactive effect was not carried so far, however, as to apply to a conveyance made prior to the passage of the 1906 law whereby property was granted reserving a life estate which did not end until after 1906.⁵

The 1916 act contained a paragraph which provided that:

“Property of any amount bequeathed or transferred to any municipal corporation within this state for public purposes, to institutions of purely public charity, to institutions of education not used or employed for gain by any person or corporation and the income of which is devoted solely to the cause of education, to public libraries, or to any person or persons, society, corporation, institution or association in trust for any of the purposes above mentioned, shall be exempt from such tax.”⁶

The provision just quoted was soon before the courts for interpretation. A church was held to be a purely public charity within the meaning of the act and was therefore exempted from inheritance taxation.⁷ Nonresident religious and educational institutions not operated for gain were also held to be exempt under the meaning of this act.⁸

² *Bosworth v. Batterton*, 159 Ky. 771, 169 S.W. 506 (1914).

³ 187 Ky. 437, 212 S.W. 437 (1920).

⁴ *Loc. cit.*

⁵ *Com. v. McCauley's Ex'r.*, 166 Ky. 450, 179 S.W. 411 (1915).

⁶ *Kentucky Acts*, 1916, chap. xxvi, p. 296.

⁷ *Sage's Ex'rs. v. Com.*, 196 Ky. 257, 244 S.W. 779 (1922).

⁸ *Bingham's Adm'r. v. Com.*, 196 Ky. 318, 244 S.W. 781 (1922).

The courts were asked to determine whether the 1924 act placed cousins in Class B with nieces, nephews, aunts, uncles, etc., or in Class C with strangers-in-blood. Though cousins are not specifically mentioned, the inclusion of some kin by marriage might indicate that it was the intent of the legislature to include all reasonably close blood relations, but in the case of *Commonwealth v. Thompson's Administrator*⁹ it was held that cousins were in Class C.

The "contemplation of death" clause was taken before the courts in 1930. In the case of *State Tax Commission v. Robinson's Ex'r.*,¹⁰ it was held that, "In so far as this subsection provided an irrebuttable presumption in that a gift made within three years of death shall be deemed one made in contemplation of death, it is unconstitutional."

A second case interpreting this clause was decided in 1940. The decedent gave, during a period from one to seven months before his death, gifts in the form of bonds to an amount of \$30,000 to his wife and daughters. The latter contended that these gifts were not made in contemplation of death as the donor was enjoying normal health, and furthermore, that they did not constitute a material part of the estate. (The estate was valued for taxation purposes at \$649,000.) They also stated that for many years prior to his death it was customary for the decedent to make gifts to his wife and daughters. It is obvious that the distributor could have disposed of his entire estate within a few years if he had continued to make gifts at that rate. The high court ruled that, although the decedent might not have thought of his death as imminent, the gifts were motivated by the thought of death and were therefore taxable.¹¹

The reasoning in this case appears to have established the line of thought which the court will follow as it was quoted with approval in a subsequent case to be mentioned below.

"Gifts made in contemplation of death within the meaning of the Inheritance Tax Act are gifts motivated by the thought of death. This does not mean that the donor must believe that death is imminent. The purpose of inserting in inheritance tax laws provisions for taxing gifts made in contemplation of death is to prevent evasion of the tax by transfers which are merely

⁹ 225 Ky. 75, 7 S.W. 2d 848 (1928).

¹⁰ 234 Ky. 415, 28 S.W. 2d 491 (1930).

¹¹ *Chase's Ex'r. v. Com.*, 284 Ky. 471, 145 S.W. 58 (1940).

substitutes for testamentary dispositions, and the determination of the nature of the gifts turns on the motive of the donor. The value of the gift, age of the donor, and condition of his health are some of the circumstances to be considered in determining the question of motive."

In the next case involving this principle the donees did not deny that a material part of the estate had been given since the gifts amounted to about two-thirds of its value, but based their claim of exemption on the fact that the donor, who was past 83 when he made the gifts, was actuated by the desire to see the donees in present enjoyment of the property and established with a separate competency. The court held that these motives are not necessarily inconsistent with the transfer of the property in contemplation of death.¹² The Commonwealth's hand in this case was strengthened by the fact the donor had been ill for twelve of the fifteen months next preceding the gifts and had undergone two operations.

Certain Tax Commission orders have also dealt with the subject of contemplation of death. These orders have the force and effect of law unless they are overruled upon appeal to the courts. In one case¹³ farms in the possession of sons since 1915 were willed to them in 1935 and deeded to them in 1941. The donor died in 1943 at age 86. The third farm had been in the possession of a son for 11 years. They were held to be gifts not made in contemplation of death, but gifts of cash made in 1942 were so held.

Credits without adequate consideration on a note entered prior to knowledge of the decedent of the serious state of his health were held not to have been made in contemplation of death though death occurred within 11 months of the credit entry.¹⁴

Property owned by joint tenants with right of survivorship was held to be taxable to the extent of the interest of the tenant who died, by the decision in *DuBois' Administrator v. Shannon*.¹⁵ Some of the difficulties involved in taxing property claimed to be jointly owned are illustrated by a case where the administratrix claimed to be a partner of the decedent holding

¹² *Sellinger's Admr., et al. v. Reeves, et al.*, 292 Ky. 114, 166 S.W. 54 (1942).

¹³ Dawson Estate, Order No. 392, April 11, 1944.

¹⁴ Stephenson Estate, Order No. 373, Nov. 18, 1943.

¹⁵ 275 Ky. 516, 122 S.W. 2d 251 (1938).

one-half interest in certain property.¹⁶ The commission determined as a matter of fact that there was no partnership interest.

The practice of valuing the estate and distributable shares as of the date of death of the distributor was upheld in *Cochran's Executor and Trustee v. Commonwealth*.¹⁷ However, in another case, the Court, while reiterating this principle, further held that past and future valuations may be looked to as potent evidence bearing on and pointing to the valuation on the required date.¹⁸ This was an unusual case as the plaintiff maintained that the value of real and personal property was drastically reduced by the bank moratorium, making ordinary values meaningless as of the date of decedent's death, because virtually all buying and selling were estopped by inability to obtain means of payment. The court would not accept such a narrow view of the phrase "at the time of death."

The five-year limitation against the right of action of the Commonwealth to collect an inheritance tax has been held not to begin until eighteen months or more after the death of the decedent in the case of *Ritcher v. Commonwealth*,¹⁹ and *Commonwealth, By, Etc. v. Paynter*.²⁰ Acceptance by the Revenue Department of a payment of inheritance tax by the personal representative of the estate prior to the assessment of the tax by the department is tentative only and does not prevent an increase of the tax based upon increased valuations as a result of investigation of the property. Furthermore in the absence of a showing of a bona fide dispute and a compromise intentionally entered into, a check marked "in full payment" of a tax does not prevent the recovery by the Commonwealth of the correct amount of the tax due.²¹

In many respects the most upsetting decision of the Court of Appeals was the overthrow of the method of taxation in cases of power of appointment. Under the 1924 law the Department of Revenue taxed such bequests at the rates and valuations in effect at the death of the donee according to the relationship of the beneficiaries to the donee. It continued to do so under the

¹⁶ Howe Estate, Order No. 248, July 6, 1942.

¹⁷ 241 Ky. 656, 44 S.W. 2d 603 (1932).

¹⁸ Com. v. Wood's Ex'x., 297 Ky. 583, 180 S.W. 2d 312 (1944).

¹⁹ 180 Ky. 4, 201 S.W. 456 (1918).

²⁰ 222 Ky. 766, 2 S.W. 2d 664 (1927).

²¹ Com., et al. v. Wood, 289 Ky. 649, 159 S.W. 2d 403 (1942).

1936 act. This method was upheld by the Court of Appeals in 1940 in sustaining the constitutionality of the statutory section²² for the reason that it cannot be determined until the donee's death to whom the property will go. "It is the settled rule in Kentucky that when the donee of a power exercises the appointment, he is disposing of the property of the donor". ". . . the beneficiary had no right to the possession and enjoyment of the estate until the donee's death, and thus a new right came into existence and it is this which the statute has taxed". But the proviso attached to the section on appointment as reenacted in 1942 called for taxation as of the date of death of the donor and was held by the court to take precedence over the remainder of the section.²³ The donor died in 1929, the donee in 1939. In accordance with this decision the Department of Revenue made the valuations as of the death of the donee (1936 Act), levied the rates of the 1924 act, which were in effect at the death of the donor, in accordance with relationship to the donor. The full effect of this decision was felt in the order²⁴ of the tax commission in a 1944 case involving the exercise of a power of appointment made prior to the enactment of the earliest inheritance tax (1906). No taxes were held to be due though the appointment was exercised in 1943.

A border-line case was that of a will giving to his wife all of a man's estate with full power to sell but expressing a desire that the property undisposed of by her go to the children. This will was held to give a life estate to the wife with remainder to the children instead of a fee simple interest to her.²⁵

In a recent case²⁶ the court held that possession and enjoyment of property did not take effect at or after death and that the decedent derived no income from the property where he had deeded farms to his children several years prior to his death but had retained the right to approve sales of the property and investments of the proceeds, to settle controversies between his children regarding the leasing of the property, and had further

²² Commonwealth, et al. v. Fidelity and Columbia Trust Company, et al., 285 Ky. 1, 146 S. W. 2d 3 (1940).

²³ Reeves v. Fidelity and Columbia Trust Company, 293 Ky. 544, 169 S.W. 2d 621 (1943) (1942 as modified 1943).

²⁴ Number 390.

²⁵ Berner, et al. v. Luckett, 299 Ky. 744, 186 S.W. 2d 907 (1945).

²⁶ Commonwealth, et al. v. Nelson P. Van Meter, Jr. Ex'r., et al., 301 Ky. 132, 190 S.W. 2d 668 (1946).

provided for the payment of quarterly sums equal to the rental value to himself and wife during their lives. It was also held that the circuit court where the property was situated had jurisdiction to quiet title to property when an inheritance tax lien existed.

The Department of Revenue had included the value of the property in the gross estate and contended that by reason of the control retained and the income paid to the decedent he had not actually parted with his property and that true possession and enjoyment did not come to the children of the decedent until his death. It further contended that, the Kentucky law being modeled after the New York law, decisions under the New York law should be followed rather than federal estate tax decisions even though an amendment to the Kentucky law was similar to the federal statute.

The problem of estates in trust came before the Court of Appeals again in the case of *W. B. Allen's Executor v. Howard*.²⁷ Here the property had passed under power of appointment created by the donor under irrevocable trusts which were executed during the lifetime of the donor in 1924 and 1935. The donor died in 1941. The Court held that the trusts were unaffected by the death of the testator and that the remainder interests thereby created did not fall within the purview of section 140.010, Kentucky Revised Statutes.

One of the most elusive legal points to be decided by the Court was that involved in the valuation of an estate which included an interest-bearing note payable to the decedent by his insolvent son, who was one of the beneficiaries. The beneficial share was more than sufficient to reimburse the estate for principal and interest of the note. The Court held that the note and accrued interest must be included in the distributable estate of the decedent and were subject to the transfer tax.²⁸

²⁷ Decided Oct 4, 1946.

²⁸ *Gearhart's Ex'r. and Ex'x. v. Howard*, 302 Ky. 709, 196 S.W. 2d 113 (1946).