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This thoroughly documented article explores caselaw determinations of estate and inheritance tax consequences which attach to employee death benefits. Mr. Parks contrasts federal and state tax treatments to indicate the variety of rationales by which courts determine the character of decedent's property interests, including powers of appointment, in death benefits, which is a key to taxation. The author concludes with notes on two recently changed Colorado inheritance tax laws.

THE author's attention was first drawn to the subject matter of this article by a decision of the Colorado Supreme Court[1] in which the court upheld the applicability of the inheritance tax statute to the greater part of certain death benefits under an employee benefit plan. This decision prompted an examination of the whole area of death benefits under employee benefit plans.

This study revealed, first, a significant difference between state and federal taxation of death benefits, and secondly, a great diversity in statutory and case treatment of the problem by various state jurisdictions. The variety of these differences and some of the underlying general principles that can be discerned are the subject matter of this article.

I. Federal Taxation of Death Benefits

The Federal Government has encountered some difficulty in attempting to impose its estate tax on certain employee benefits. Successful taxation of such benefits by the Federal Government requires that a measure of ownership be imputable to the employee. The federal courts have held that such ownership is not evident, for example, in those plans in which the employee does not have the power to make a transfer to take effect at death. In such a case the benefits are not taxable in his estate.[2]

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1 People v. Bejarano, 145 Colo. 304, 358 P.2d 866 (1961).

2 *E.g.,* Commissioner v. Twogood, 194 F.2d 627 (2d Cir. 1952); Herrick v. United States, 108 F. Supp. 20 (E.D.N.Y. 1952); C. LOWNDES & R. KRAMER, *Federal Estate and Gift Taxes* § 10.3 (2d ed. 1962); Note, *Estate Taxation of Survivor Annuities,* 6 STAN. L. REV. 473 (1954). With a number of important exceptions, the estate tax is based on property in which the decedent had an interest at death. INT. REV. CODE of 1954, § 2033.

Federal authorities have had some success in reaching employee death benefits, without establishing ownership, by the taxation of a *power of appointment* relating to the disposition of the death benefits. A power of appointment is any power, whatever the language used to create it, which permits the donee of the power to designate, within any prescribed limitations, who shall receive the subject matter of the power and the shares in which that subject matter shall be received.[3] The Illinois Supreme Court has defined this power as follows:

> A power of appointment is not an absolute right or property, nor is it an estate, for it has none of the elements of an estate. The donor does not vest in the donee of the power title to the property, but simply vests in the donee power to appoint the one to take the title. The appointee under the power takes title from the donor and not from the donee of the power.[4]

As power of appointment is applied to employee death benefit cases, the donee would typically be the employee, the donor would be the employer or the fund itself, and the appointee would be the recipient of the death benefits.

Federal taxation of a power of appointment has been successful only where the power is unrestricted, thus amounting to a *general* power of appointment.[5] If there is a restriction on the right to name a beneficiary, *i.e.*, a *special* power, the exercise or lapse is nontaxable.[6] Since many employee benefit plans impose some restriction on the right to name the recipient of death benefits, only infrequently will the power meet the statutory definition of a general power. Moreover, since 1954, the federal estate tax law, while taxing commercial annuities to the extent that they are attributable to the decedent's contribution, has exempted benefits paid under qualifying employee benefit plans (and they generally are designed to qualify) except to the extent such benefits are attributable to the direct contributions of the employee.[7]

II. STATE TAXATION OF DEATH BENEFITS

The rationale of state inheritance taxation of employee death benefits is considerably more complex when compared to the tax practices of the federal jurisdiction. Although state courts recognize

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[3] RESTATEMENT OF PROPERTY § 318 (1936); *see* 72 C.J.S. *Powers* §§ 1, 5, 31 (1951); 41 AM. JUR. *Powers* § 2 (1942). *See* COLO. REV. STAT. ANN. § 107-1-2 (Supp. 1967) for a statutory definition which closely followed the Restatement but which was enacted too late to affect the recent Colorado decisions cited notes 51, 52 *infra*.

[4] People v. Kaiser, 306 Ill. 313, 137 N.E. 826 (1923).

[5] Wolf v. Commissioner, 29 T.C. 441 (1957), *rev'd on other grounds*, 264 F.2d 82 (3d Cir. 1958). The exercise or release of only a general power is a taxable event. INT. REV. CODE of 1954, § 2041.

[6] Hanner v. Glenn, 111 F. Supp. 52 (W.D. Ky. 1953).

[7] INT. REV. CODE of 1954, § 2039.

the principle of ownership as a basis for taxation and some even adhere closely to the federal rationale on what constitutes ownership, most state jurisdictions have had less difficulty than the federal courts in discovering ownership of benefits in the deceased employee. Nevertheless, the principle of ownership is of fundamental importance to state decisions, and it is mainly the standard of measure that is different.

The concept of ownership can be an overriding consideration even in jurisdictions which adopt other theories of taxation. Where ownership can be readily established, the question can be settled on that basis and with fairly uniform results. But where ownership is not ascertainable, resolution of the tax question requires additional and more complex inquiry and the results are less uniform. For example, state inheritance tax laws almost uniformly levy a tax on gifts or grants intended to take effect in possession or enjoyment at or after death and in which the transferor reserves or purchases a life income or interest. Since in such cases the decedent has retained an indisputably large measure of ownership in the benefits purchased, as is the case in a commercial annuity with a "refund" feature, there have been only a few instances of litigation over the effect of the statutes.[8] On the other hand, when the annuity or other benefit is purchased not by the decedent but by someone else (as for example, an employer) and the decedent does not make a transfer or conveyance of something in which he has a vested interest, there is not the obvious imputation of ownership that could settle the matter. If in such a case the decedent can be shown to have retained the power to name a beneficiary, then he can be held to possess a sufficient power over the *res* so that the court will look to another basis for taxation in order to reach what is considered an equitable result. Because of the uncertainties involved, however, decisions in these closer cases are often in conflict.

A major difference between federal and state practice on the taxation of powers of appointment is that states do not uniformly tax such powers, and if they do at all, they generally make no distinction between general and special powers. Statutes may provide specifically for taxation in either the estate of the donor or the estate of the donee, depending upon the particular jurisdiction.

The state laws also do not provide the sweeping exemption of employee death benefits that the federal law contains. Thus, some

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[8] People v. Schallerer, 12 Ill. 2d 240, 145 N.E.2d 585 (1957); Gregg v. Commissioner, 315 Mass. 704, 54 N.E.2d 169 (1944); Garos v. State Tax Comm'n, 99 N.H. 319, 109 A.2d 844 (1954); Annot., 73 A.L.R.2d 157, 187 (1960) (dealing with employee death benefits). *See also* Sager & Weinburg, *State Taxation of Employee Benefits*, 31 FORDHAM L. REV. 414 (1963); Brink, *Minnesota Inheritance Tax*, 43 MINN. L. REV. 443, 472 (1959).

state courts tax employer benefit plans by the same rules applicable to commercial annuities. Furthermore, unlike the federal rule, the state courts make no distinction over whether the employer finances all of the benefits (noncontributory plans) or only shares in the financing (contributory plans). Nor does a prohibition against assigning rights or withdrawing from the fund — the usual spendthrift provisions in such plans — make any difference. The basic reasoning of the courts is that the contributions by the employer are made in consideration of the services of the employee. The general effect for inheritance tax purposes (not to be confused with the income tax consequences) is the same as if the employee had received the amount of the employer's contributions and had purchased his own benefits.

There is also a basic difference between an *estate* tax and an *inheritance* tax. This detracts from the applicability of federal estate tax cases to the interpretation of inheritance tax laws. An estate tax is a tax on the right to *transmit* property interests at death or in a transaction akin to a transfer at death.[9] An inheritance tax is a tax on the right to *receive* the same property in a similar transfer.[10]

This essential difference in the point of tax application causes many disparate results in the field of death taxation where transfers are intended to take effect at or after death. To illustrate: Under an estate tax law, if the decedent has made a completed gratuitous *transfer* of some property in which he retains no economic interest or reversion and retains no right of future control, death does not give rise to a tax since nothing is left to pass from him on his demise. This is true even though the income is accumulated during the donor's life or for a period after his death, and the principal and accumulations cannot be delivered to the beneficiary at any earlier time. Under inheritance tax laws, since attention is focused on what the beneficiary *receives* at the death of the donor by reason of the previous transfer by him, and since the beneficiary receives nothing until the death of the donor, the property is included in the decedent's gross estate.[11] The same distinction is carried over into the specific area of employee death benefits by most state courts, which look not to what the employee *transmits* to the beneficiary but to what the beneficiary *receives* by reason of the action of the employee.

In summary, the taxing rationale applied by various state courts may be reduced to the following essential principles: (1) imputation of a retained ownership to the employee; (2) taxing of powers of appointment — general and special; (3) similar treatment of em-

[9] 1 J. MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION § 1.02 (1959).
[10] People v. Bemis, 68 Colo. 48, 189 P. 32 (1920).
[11] Annot., 6 A.L.R.2d 223, 232 (1949).

ployee benefit plans and commercial annuities; (4) emphasis on inheritance taxation, *i.e.*, on the *receiving* as opposed to the *transmitting* aspects of the disposition.

III. Outline of Employee Benefit Plans

One source of difficulty in treatment of employee benefit taxation by state courts is the great diversity of the plans that have been devised. The following broad categories of benefit plans have been dealt with by the courts:

> (1) A noncontributory profit-sharing trust funded entirely by the employer which provides benefits for the surviving employee to begin at a designated time, but which also transfers either to persons named by the employee or to the employee's estate those residual benefits not received by a deceased employee.[12]
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> (2) A contributory profit-sharing and thrift plan under which the employee designates a beneficiary to receive the fund if the employee fails to survive the distribution date.[13]
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> (3) A noncontributory trusteed pension plan under which the employee has the right to designate who will receive post mortem benefits.[14]
>
> (4) A noncontributory pension plan, funded with life insurance policies, in which the employee designates a beneficiary to receive a survivor's annuity in consideration of a reduced annuity to the employee, and the employee has received some benefits before death.[15]
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> (5) A noncontributory annuity purchased by the employer under which the employee has the right to name a beneficiary to receive benefits after his death.[16]
>
> (6) A contributory pension plan under which the employee's estate or his beneficiary will receive the total

[12] Gould v. Johnson, 156 Me. 446, 166 A.2d 481 (1960); Estate of Brackett, 342 Mich. 195, 69 N.W.2d 164 (1955); Estate of Daniel, 159 Ohio St. 109, 111 N.E.2d 252 (1953).

[13] People v. Egbert, 436 P.2d 116 (Colo. 1968); People v. Bejarano, 145 Colo. 304, 358 P.2d 866 (1961); Estate of Dorsey, 366 Pa. 557, 79 A.2d 259 (1951).

[14] Estate of Patterson, 21 Ohio Op. 2d 55, 184 N.E.2d 562 (P. Ct. 1962); Estate of Stone, 10 Wis. 2d 467, 103 N.W.2d 663 (1960).

[15] *In re* Harbord's Estate, 132 N.Y.S.2d 647 (Sur. Ct. 1954).

[16] Borchard v. Connelly, 140 Conn. 491, 101 A.2d 497 (1953); Estate of Patterson, 21 Ohio Op. 2d 55, 184 N.E.2d 562 (P. Ct. 1962); Estate of DeVenuto, 35 Pa. D. & C.2d 352 (Orphans' Ct. 1964); Estate of Burke, 85 Pa. D. & C. 56 (Orphans' Ct. 1953); Estate of Enbody, 85 Pa. D. & C. 49 (Orphans' Ct. 1953).

of his contributions, plus interest, if he dies before retirement.[17]

(7) A pension plan under which the employee elects to take a smaller pension in consideration of an annuity to his surviving beneficiary.[18]

(8) A noncontributory plan which has no funding of any kind.[19]

(9) A deferred, assignable compensation plan for payments of a fixed amount each year for a number of years after retirement, the employee naming his spouse as beneficiary but retaining the right to change the beneficiary at any time, and employee dies before receiving any payments.[20]

(10) A variety of modifications and combinations of the foregoing benefit plans.[21]

IV. STATE COURT DECISIONS: BENEFITS HELD TAXABLE

A review of some of the state decisions should serve to illustrate how these courts construe the various employee benefit plans. For purposes of organization, those cases are first discussed which find, for one reason or another, that benefit plans are taxable in the estate of the employee. Next, those decisions are discussed which hold for nontaxability.

An interesting early case, *Estate of Dorsey*,[22] deals with a profit-sharing trust to which employer and employee jointly contributed. At the discretion of the trustees, death benefits were payable to the beneficiary in cash or as an annuity, but the employer retained no reversion. In view of the vested nature of the surviving employee's right to receive the fund on retirement and his absolute right to

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[17] Estate of Richartz, 45 Cal. 2d 292, 288 P.2d 857 (1955); Estate of Simpson, 43 Cal. 2d 594, 275 P.2d 467 (1954); Cruthers v. Neeld, 14 N.J. 496, 103 A.2d 153 (1954); Estate of Shade, 38 Ohio Op. 2d 357, 224 N.E.2d 401 (P. Ct. 1966); Estate of Chadwick, 167 Ohio St. 373, 149 N.E.2d 5 (1958); Estate of Burke, 85 Pa. D. & C. 56 (Orphans' Ct. 1953); Estate of Clark, 10 Utah 2d 427, 354 P.2d 112 (1960) (court characterizing statute as imposing an estate tax).

[18] People v. Hollingsworth, 436 P.2d 114 (Colo. 1968); Estate of Endemann, 307 N.Y. 100, 120 N.E.2d 514 (1954); Estate of Stone, 10 Wis. 2d 467, 103 N.W.2d 663 (1960); Estate of Sweet, 270 Wis. 256, 70 N.W.2d 645 (1955).

[19] Dolak v. Sullivan, 145 Conn. 497, 144 A.2d 312 (1958); Estate of Dolbeer, 117 Ohio App. 517, 193 N.E.2d 174 (1962); Fitzpatrick v. State Tax Comm'n, 15 Utah 2d 29, 386 P.2d 896 (1963); Estate of Stevens, 266 Wis. 331, 63 N.W.2d 732 (1954).

[20] Estate of Dolbeer, 117 Ohio App. 517, 193 N.E.2d 174 (1962); Estate of Cameron, 15 Pa. D. & C.2d 557 (Orphans' Ct. 1958).

[21] Estate of Richartz, 45 Cal. 2d 292, 288 P.2d 857 (1955); People v. Egbert, 436 P.2d 116 (Colo. 1968); Borchard v. Connelly, 140 Conn. 491, 101 A.2d 497 (1953); Cruthers v. Neeld, 14 N.J. 496, 103 A.2d 153 (1954); Estate of Endemann, 307 N.Y. 100, 120 N.E.2d 514 (1954).

[22] 366 Pa. 557, 79 A.2d 259 (1951).

name a beneficiary or to permit his share in the fund to pass to his estate, the court found that the employee possessed sufficient attributes of ownership so that the fund was taxable in his estate. The portions of the fund attributable to the employee's own contributions and to those of his employer were both subject to the tax.

Later cases attempted to interpose defenses against the levy of the inheritance tax. One such defense raised the contention that the decedent owned none of the after-death benefits since, during his lifetime, he could not have reduced them to his own possession, nor did he have possession in such degree as to effect their transfer.

The defense raised in the *Dorsey* case suggested that all the decedent had was a power of appointment over property which he did not own. Under the statute then applicable,[23] a power of appointment was not taxable in the donee's estate but only in the estate of the donor of the power, and taxation of the donor was limited to cases in which a decedent had created the power — not a corporate employer. Under this type of statute, if the death benefit was nevertheless to be taxed in the employee's (donee's) estate, the taxing authorities had to rely on some theory other than power of appointment, *e.g.*, they had to show some measure of ownership in the decedent. The specific rationale used in *Dorsey* was to argue that the decedent had the requisite ownership even of the employer's contributed share of the fund in that the employee possessed the power to transfer it, effective at death. Indeed, as pointed out by the court, a power of appointment never can exist if the so-called "donee" is the owner of the property.

In a Maine case,[24] decided under a statute[25] similar to the one in *Dorsey,* it was urged that the decedent had merely a power of appointment over the death benefits and hence no tax could be imposed. The argument was rejected, and it was held that the decedent had sufficient ownership of the benefits to have made a transfer.

In contrast to the foregoing, many of the later cases have been decided in states which have statutory provisions for taxing the exercise or lapse of powers of appointment in the estate of the donee. To impose the tax under such statutes, there seems to be no real necessity of proving ownership or its substantial equivalence. The fact of ownership can become relatively unimportant by first asserting the decedent's ownership and then asserting, in the alternative, that if the decedent did not transfer property which he did own, he exercised or allowed to lapse a power of appointment over property which he did not own.

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[23] PA. STAT. ANN. tit. 72, § 2301(d) (1961).

[24] Gould v. Johnson, 156 Me. 446, 166 A.2d 481 (1960).

[25] ME. REV. STAT. ANN. tit. 36, § 3461(1) (B) (1964).

Surprisingly, however, the device of arguing in the alternative does not seem to have been widely adopted in states where the power of appointment theory is clearly available to taxing authorities. Instead, the cases have been decided for the most part either on the theory of ownership or of third party beneficiary. Under the latter theory, the contract is construed to be one for which the employee's services constitute the consideration, and since payment is to be made at or after death, there is a gift to take effect at death.

Similar results have been reached in cases involving contributory retirement annuities,[26] noncontributory annuities,[27] pension plans,[28] and profit-sharing funds.[29] In each case, death benefits were included in decedent's gross estate on the theory of ownership evidenced by some measure of authority the employee had to name a beneficiary, or to otherwise influence the passage of the death benefits to his estate.

The essentials of ownership have been found even in cases where an employer has retained substantial control of an employee fund. For example, benefits have been included in the gross estate, as a transfer to take effect at death, even though in an unfunded plan an employer could discontinue or modify benefits at any time, and benefits would not be paid to an employee who left the company for any reason other than death or retirement. It has been held that such a contract is between employer and employee for the benefit of a third person, effective at death, and the consideration is the employee's services. The uncertainties in the plan affect the value, not the ownership, of benefits.[30] Even where a commercial annuity is purchased by the employer in the name of the employee but with refund to the employee's beneficiary in the nature of a death benefit, the death benefit is taxable in the annuitant's estate.[31]

The fact that there are general statutes exempting the pensions of public employees from "taxation" usually will not prevent their being subject to inheritance taxation, since there is a tendency to construe strictly such exemption statutes as referring to ad valorem taxation.[32]

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[26] Cruthers v. Neeld, 14 N.J. 496, 103 A.2d 153 (1954); Estate of Clark, 10 Utah 2d 427, 354 P.2d 112 (1960).

[27] Borchard v. Connelly, 140 Conn. 491, 101 A.2d 497 (1953).

[28] Estate of Daniel, 159 Ohio St. 109, 111 N.E.2d 252 (1953).

[29] Estate of Brackett, 342 Mich. 195, 69 N.W.2d 164 (1955).

[30] Dolak v. Sullivan, 145 Conn. 497, 144 A.2d 312 (1958).

[31] People v. Schallerer, 12 Ill. 2d 240, 145 N.E.2d 585 (1957); Gregg v. Commissioner, 315 Mass. 704, 54 N.E.2d 169 (1944); *see* Borchard v. Connelly, 140 Conn. 491, 101 A.2d 497 (1953).

[32] Estate of Simpson, 43 Cal. 2d 594, 275 P.2d 467 (1954); Estate of Endemann, 307 N.Y. 100, 120 N.E.2d 514 (1954).

In a number of cases an attempt has been made to defend against taxation of death benefits in the gross estate by asserting that the statutory exclusion of insurance proceeds was applicable to such benefits. The courts have uniformly found that the risk element associated with insurance is not present in such arrangements, and they have rejected that argument.[33]

Without discussing in further detail the remaining cases that hold employee benefits to be taxable, it will suffice to summarize the decisions as follows: (1) The employee had a sufficiently vested interest or ownership in the death benefits; (2) The naming of beneficiaries to receive benefits could be considered as a transfer of property interests; or (3) The employee's acceptance of less than full benefit was the consideration for the benefits payable to his beneficiaries after death.[34]

Another principle which is evident in this line of cases is that the death benefits attributable to an employee's own contributions are taxable in the employee's estate the same way as they would be in a commercial annuity. In this connection, even death benefits attributable to the employer are usually taxable to the estate on the theory that the employee's services furnish the consideration for a third party agreement by the employer to provide the death benefits. The only provisos are that the benefits be vested with reasonable certainty, or be assignable, and that the employee has reasonable freedom of choice to name a beneficiary.

V. STATE COURT DECISIONS: BENEFITS HELD NONTAXABLE

A number of courts have declined on a variety of grounds to include employee death benefits in the gross estate. For example, in three Pennsylvania decisions it was concluded that the employee did not possess the required ownership of benefits since he would have had to live to receive them. In one of these cases, the pension plan was such that benefits of an employee who did not name a recipient

[33] Estate of Richartz, 45 Cal. 2d 292, 288 P.2d 857 (1955); Borchard v. Connelly, 140 Conn. 491, 101 A.2d 497 (1953); Garos v. State Tax Comm'n, 99 N.H. 319, 109 A.2d 844 (1954); Cruthers v. Neeld, 14 N.J. 496, 103 A.2d 153 (1954); Estate of Rhodes, 197 Misc. 232, 94 N.Y.S.2d 406 (Sur. Ct. 1949); Estate of Chadwick, 167 Ohio St. 373, 149 N.E.2d 5 (1958); Estate of Clark, 10 Utah 2d 427, 354 P.2d 112 (1954).

[34] Estate of Richartz, 45 Cal. 2d 292, 288 P.2d 857 (1955); Estate of Simpson, 43 Cal. 2d 594, 275 P.2d 467 (1954); Dolak v. Sullivan, 145 Conn. 497, 144 A.2d 312 (1958); Borchard v. Connelly, 140 Conn. 491, 101 A.2d 497 (1953); Gould v. Johnson, 156 Me. 446, 166 A.2d 481 (1960); Estate of Brackett, 342 Mich. 195, 69 N.W.2d 164 (1955); Garos v. State Tax Comm'n, 99 N.H. 319, 109 A.2d 844 (1954); Cruthers v. Neeld, 14 N.J. 496, 103 A.2d 153 (1954); Estate of Endemann, 307 N.Y. 100, 120 N.E.2d 514 (1954); *In re* Harbord's Estate, 132 N.Y.S.2d 647 (Sur. Ct. 1954); Estate of Patterson, 21 Ohio Op. 2d 55, 184 N.E.2d 562 (P. Ct. 1962); Estate of Chadwick, 167 Ohio St. 373, 149 N.E.2d 5 (1958); Estate of Daniel, 159 Ohio St. 109, 111 N.E.2d 252 (1953); Estate of Dorsey, 366 Pa. 557, 79 A.2d 259 (1951); Estate of Cameron, 15 Pa. D. & C.2d 557 (Orphans' Ct. 1958); Estate of Stone, 10 Wis. 2d 467, 103 N.W.2d 663 (1960).

would go to his heirs and not to his estate. If there were a failure to take the property, it would revert to the fund for the benefit of the other participants. The right to divest the heirs and name others was held to be a mere power of appointment, and since Pennsylvania did not tax the exercise or lapse of such power, there was no tax.[35]

A companion case concerned two plans, one contributory and the other noncontributory. In the first, the death benefits arose from the employee's contributions and were held to be taxable because of the ownership evidenced by the employee's right to withdraw his contributions at any time. In the other, the benefits were attributable to the employer's contributions, and the employee had no right of withdrawal. These benefits were held nontaxable since the employee lacked the attributes of ownership in the portion of the fund from which they were payable. The latter part of the case was distinguished from the *Dorsey* decision, where the employee had the right at all times to withdraw his interest in the fund, including the employer's paid-in share.[36]

The third of the Pennsylvania cases concerned a noncontributory plan in which the employer reserved the right of termination at any time. Since the employee could not assign his interest, the court held that he did not own the installments payable after his death and had only a nontaxable power of appointment.[37]

In an Ohio lower court case, a corporation's board of directors authorized a contract to make payments to the wife of an employee over a specified period, but the board reserved the right to discontinue the payments if it found that the employee had engaged in conduct which it considered detrimental to the interest of the company. The court held that the employee never had any interest in the payments to his wife, and hence there was no transfer by him.[38] A somewhat similar Utah case involved an employment contract whereby payments were made for a specified period with the provision that if the employee died in service, his wife would receive the payments during the balance of the period of the contract. The court held the payments to be income to the widow and not taxable in the gross estate.[39]

An inheritance tax law which provides that death benefits under an employee benefit plan are not to be included in the gross estate unless the employee has the right to possess, enjoy, assign, or anticipate the payments, has been construed quite literally by the Penn-

[35] Estate of Enbody, 85 Pa. D. & C. 49 (Orphans' Ct. 1953).

[36] Estate of Burke, 85 Pa. D. & C. 56 (Orphans' Ct. 1953).

[37] Estate of DeVenuto, 35 Pa. D. & C.2d 352 (Orphans' Ct. 1964).

[38] Estate of Dolbeer, 117 Ohio App. 517, 193 N.E.2d 174 (1962).

[39] Fitzpatrick v. State Tax Comm'n, 15 Utah 2d 29, 386 P.2d 896 (1963).

sylvania courts. An employee was receiving benefits and had named a beneficiary to take after his death, but it was held that he had none of the described rights in the post mortem payment.[40]

A Wisconsin court has held, in at least two cases, that where the decedent has no real choice as to the persons who receive death benefits, they are not taxable in his gross estate. In *Estate of Sweet*,[41] the decedent had been a federal civil servant and, under the federal law then in effect, his widow was entitled to certain benefits which were beyond his control. The benefits to the widow were declared to result not from the decedent's designation but rather from that of the Federal Government. However, a strong dissent was entered asserting that the benefits flowed from a third party agreement, the consideration for which was the decedent's services.

Despite a contrary holding in an intervening case to the effect that benefits are taxable where a decedent has the power to elect a joint and survivorship annuity with his wife,[42] the Wisconsin court has held that where such a plan itself selected the beneficiary, without the employee having any control over who should receive the benefits, the amounts are not taxable.[43]

It should be noted that although the decedents in the Wisconsin cases escaped taxation, a statute[44] was in force which taxed the exercise or lapse of powers of appointment. The statute, however, expressly exempted powers under which the donee was not permitted to appoint himself and could appoint only to the immediate family group of the donee. For this reason invocation of this statute would have been futile. In any event, where the employer selects the beneficiary, the employee has no power of appointment.

Additional state cases holding employee benefits nontaxable may be cited which depend upon variations of the rationale already discussed.[45] A fundamental principle of these cases is a broad reliance on nonownership or lack of control in the employee with variations dependent upon particular state statutes.

Of some relevance to the state decisions in this area are rulings relating to the federal estate tax. Specifically, the Internal Revenue Service has ruled that because the Social Security Act[46] does not permit a decedent to select the recipient of benefit payments, a lump

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[40] Estate of Huston, 423 Pa. 620, 225 A.2d 243 (1967).

[41] 270 Wis. 256, 70 N.W.2d 645 (1955).

[42] Estate of Stone, 10 Wis. 2d 467, 103 N.W.2d 663 (1960).

[43] Estate of King, 28 Wis. 2d 431, 137 N.W.2d 122 (1965).

[44] WIS. STAT. ANN. § 72.01(5) (1957).

[45] Estate of Shade, 38 Ohio Op. 2d 357, 224 N.E.2d 401 (P. Ct. 1966); Estate of Stevens, 266 Wis. 331, 63 N.W.2d 732 (1954); O'Daniel v. District of Columbia, CCH INH. EST. & GIFT TAX REP. ¶ 19,473 (1963). *See generally* Note, *Taxation — Retirement Plans — Election Under Joint and Survivor Option*, 1961 WIS. L. REV. 153.

[46] 42 U.S.C. § 402 (1964).

sum payment to a spouse, as well as survivor's annuity payments under the Act and workman's compensation death benefits payable to persons prescribed in the Act, are not taxable in the decedent's estate. Also covered by these rulings are benefits under the Railroad Retirement Act.[47] The principle thus developed for the estate tax should be equally applicable to an inheritance tax.[48]

VI. TREATMENT OF EMPLOYEES' BENEFITS IN COLORADO

The Colorado Supreme Court has ruled on the inheritance taxation of employee benefits on at least three occasions. The first of these involved a case where the employer had established a savings or thrift plan under which both employer and employee had made contributions. The major issue was whether in Colorado— a non-community property state — the entire amount of benefits attributable to the employee's contributions made while he was employed in community property states should be subject to tax or whether the tax should be based upon only one-half of the amount of the benefits. It was held that to the extent that benefits to the employee's widow flowed from earnings in the community property states, her interest in the benefits vested at the time the contributions were made and hence were not subject to tax in the estate of the employee.[49] However, the employer's contributions were not vested in her and hence the benefits flowing from them were subject to the tax. No dispute existed as to the taxability of the benefits accrued during employment in common law jurisdictions, since the employee retained such control as to constitute essential ownership — if no beneficiary were named, the benefits would flow to his estate. In making its award, the court held that all the benefits flowing from the employee's contributions while in common law states and one-half of the contributions made while in community property states, along with all of his employer's contributions, were includible in the employee's taxable estate.

Two recent Colorado cases have adopted the Wisconsin viewpoint that where the decedent's power to designate a beneficiary is severely circumscribed or nonexistent, death benefits are not taxable.[50] In the first, *People v. Hollingsworth*,[51] the decedent was a federal civil servant, as was the decedent in the *Sweet* case. Following the

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[47] 45 U.S.C. § 228(e) (1964).

[48] Rev. Rul. 60-70, 1960-1 CUM. BULL. 372; Rev. Rul. 56-637, 1956-2 CUM. BULL. 600; Rev. Rul. 55-87, 1955-1 CUM. BULL. 112; E.T. 18, 1940-2 CUM. BULL. 285.

[49] People v. Bejarano, 145 Colo. 304, 358 P.2d 866 (1961).

[50] Estate of King, 28 Wis. 2d 431, 137 N.W.2d 122 (1965); Estate of Sweet, 270 Wis. 256, 70 N.W.2d 645 (1955).

[51] 436 P.2d 114 (Colo. 1968).

Sweet rationale, the Colorado Supreme Court held that the benefits payable to decedent's widow did not constitute property until the worker's death but were only a right or status and hence not transferable by decedent. Therefore, the death benefits were not included in decedent's gross estate.

In the second case, *People v. Egbert*,[52] decedent had purchased group life insurance which was convertible at death into a certificate for a lump sum benefit to his widow as named beneficiary. The plan was subject to change by the employer at any time, and the beneficiary's rights depended on the plan as it stood at the decedent's death. The class of beneficiaries which could be designated included only persons who were dependent on the decedent for support, and it was not possible to dispose of the benefits by will or to name his estate to receive them. The court held that the decedent did not own, control, or possess the property from which the widow's benefits flowed and, accordingly, could not make a gift of them to take effect at death. The court noted that the state did not attempt to classify the death benefits as insurance since, in that case, the insurance exemption would have applied.

The foregoing cases were largely decided on the lack of ownership in the employee. In neither case was a contention made that the employee possessed a power of appointment over the property so as to make the question of title immaterial. Yet it seems that plausible arguments could have been advanced for taxability of the benefits based upon a theory of power of appointment.

It will be recalled that in Pennsylvania and Maine, states in which the exercise of powers of appointment did not result in taxation in the estate of the donee of the power, it was unsuccessfully urged that the decedent's designation of a beneficiary of death benefits was not a transfer but merely the exercise of a power.[53] Since he had title, however, he was deemed to have more than a mere power of appointment.

A Colorado inheritance tax law,[54] patterned from a New York statute,[55] was in effect at the time of the deaths of the decedents in the *Hollingsworth* and *Egbert* cases. This law provided for the taxation of the exercise or the omission or failure of exercise of a power of appointment as though the donee of the power had owned the subject matter of the power and had transferred it by his will to

[52] 436 P.2d 116 (Colo. 1968).

[53] Gould v. Johnson, 156 Me. 446, 166 A.2d 481 (1960); Estate of Dorsey, 366 Pa. 557, 79 A.2d 259 (1951); Estate of DeVenuto, 35 Pa. D. & C.2d 352 (Orphans' Ct. 1964); Estate of Enbody, 85 Pa. D. & C. 49 (Orphans' Ct. 1953).

[54] COLO. REV. STAT. ANN. § 138-3-12 (1963). The statute has subsequently been amended, effective June 17, 1967.

[55] Cons. Laws N.Y., Ch. 60, Art. 10 § 220(6) (1913).

persons succeeding to the property. In a case decided under New York law, a decedent had exercised a power to appoint certain real property by deed. It was held that on his death the transfer was constitutionally subject to inheritance tax, as though he had transferred it by a will which became effective on the date of the deed.[56] Since this decision antedated Colorado's adoption of the provisions of the New York law, the New York decision probably is controlling in Colorado.[57]

In the *Hollingsworth* case, the decedent, a federal civil servant, was permitted by the Government Organization and Employees statute [58] to elect a reduced pension for himself so as to provide a survivor's annuity for his wife. The annuity became effective when the pensioner died. The benefits under this arrangement arose only by virtue of the election of a reduced pension and the creation of the survivor's annuity in the spouse. While the pensioner was held by the court not to have owned the property from which the survivor's annuity was derived, it seems clear that his act of election and designation was the effective agency which channelled property he did not own to the survivor—the exercise of a power of appointment.

In the *Egbert* case, the employer had a plan by which a group annuity life insurance benefit was convertible at death into a lump sum payment to a beneficiary named by the employee. The plan permitted the employee to name as beneficiary only persons who were dependents of the employee. The case does not state what would have happened to the benefits in the absence of a designation, but it is clear that without a designation the beneficiary would have received nothing. The court held that the employee did not own the property from which the benefits flowed since the benefits could not be disposed of by his will or made payable to his estate. The court found that the benefits passed directly from the employer to the beneficiary widow. The effective agency which channelled the benefits to her was the employee's designation — an exercise of a power of appointment over property which the decedent did not own.

VII. EFFECT OF 1967 AMENDMENT TO INSURANCE PROVISIONS OF COLORADO INHERITANCE TAX LAW

Before leaving the subject of Colorado inheritance taxation of employee death benefits, consideration should be given to a 1967

[56] Estate of Wendel, 223 N.Y. 433, 119 N.E. 879 (1918). *See* 28 AM. JUR. *Inheritance, Estate, and Gift Taxes* §§ 211, 212 (1959).

[57] Cruse v. Stayput Clamp & Coupling Co., 113 Colo. 254, 156 P.2d 397 (1945); People v. Linn, 357 Ill. 220, 191 N.E. 450 (1934), holding that when Illinois adopted from New York the equivalent of our COLO. REV. STAT. ANN. § 138-3-12 (1963), it adopted New York prior construction. *See* 50 AM. JUR. *Statutes* §§ 458-62 (1944).

[58] 5 U.S.C. § 2258 (1964).

amendment to the Colorado inheritance tax statute which may sweep into gross estates some, but probably not many, employee death benefits. Until 1967, life insurance proceeds (annuity contracts being expressly excluded from its definition) payable to, or in trust for, named or described beneficiaries were included in the gross estate, but were subject to a $75,000 exclusion if the decedent possessed any of the incidents of ownership at death, a provision which was noted in the *Egbert* case.[59] Effective March 31, 1967, this provision was modified to include in the proceeds entitled to the benefit of the exclusion "any annuity contract or pension benefits."[60]

The statute requires that the decedent possess, at death, "any of the incidents of ownership." Historically, this phrase seems to have been applied only to life insurance, and it comprehends many powers of dominion over the policy which fall short of, but are akin to, absolute ownership. It includes such rights as that to change the beneficiary, to surrender the policy for its cash value, to cancel the policy, to assign it, to pledge it, or to borrow from the insuror. Except for the right to change the beneficiary, none of the customary incidents of ownership is likely to have any application to the ordinary commercial annuity or to pension benefits because such rights usually are denied by the express terms of the contract under which such arrangements come into being. The unlimited right to change the beneficiary of an insurance policy, regardless of how acquired, becomes significant for death tax purposes because, under the provisions of the standard policy, if no beneficiary is effectively named, the proceeds will be payable to the insured's estate,[61] so that if the holder of the power is also the insured, this right enables him to divert the proceeds from his estate, and if he is not the insured, he can channel the proceeds to himself or to his estate.[62] Such a power is practically the equivalent of ownership. A number of the cases on employee death benefits which have been previously discussed make it clear that, without regard to the propriety of applying the term "incidents of ownership" to it, the power of the holder to pass the proceeds to himself or his estate, or to prevent such passage by naming a beneficiary to receive them, constitutes "ownership" and causes the benefits to be included in the gross estate for tax purposes. Thus, whether the decedent "owned" the death benefits or had "incidents of ownership" with respect to them, if he can channel the proceeds

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59 436 P.2d 116 (Colo. 1968).

60 COLO. REV. STAT. ANN. § 138-3-9 (Supp. 1967).

61 2A J. APPLEMAN & J. APPLEMAN, INSURANCE LAW AND PRACTICE § 1122 (1966).

62 2 J. MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION § 17.13 (1959); C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES § 13.7 (2d ed. 1962).

to himself or his estate or from himself or his estate, they will be part of his gross estate for inheritance tax purposes. Accordingly, the amendment should have very little practical effect on the inheritance taxation of death benefits in Colorado, but, of course, the exact effect will depend on the details of the plan and the extent of the rights conferred upon the employee.

A question of construction inevitably will arise under the amendment to the exclusionary provision. The amendment refers only to "pension benefits." Does this language remove from the operation of the amendment death benefits under the variety of employee plans heretofore described which are payable to him in a lump sum or are payable to him in installments under other than strictly pension plans? It may be argued that the conjunction of annuities with pension benefits implies that the amendment is intended to apply only to such survivorship benefits as are payable under purely pension plans after the death of an employee who was receiving benefits in installments. However, the addition of the word "benefits" strongly suggests that the legislature did not intend to confine the subject matter of the amendment only to installment pension plans. And, the Colorado Supreme Court has construed the word "pension" broadly so as to include, for example, the funeral expenses of the pensioner.[63] Therefore, it would appear that the words "pension benefits" *should* be construed to include death benefits under *any* plan, whether or not the employee is to receive benefits in installments, which is designed to assist the employee in funding his retirement needs.

CONCLUSION

In both of the recent Colorado cases, even conceding the lack of ownership in the employee, the application of the power of appointment provision would have taxed the death benefits in the same way as if the decedent had actually owned the property and had passed it by will, to become effective on the date of the designation.

The argument that a decedent has such a power of appointment over death benefits will not be available in future Colorado cases, except in an extremely limited way, because the Colorado statute was amended effective June 17, 1967. Taxation of powers in the estate of the donee now requires that they must be created by decedents, that is, by will or by decedent's *inter vivos* transfer.[64] In those

[63] Redmon v. Davis, 115 Colo. 415, 174 P.2d 945 (1946). The case also states that a grant of assistance to one, merely because he has reached a certain age, is a pension. *See* 31A WORDS & PHRASES 548 *et seq.* (1957), for examples of conflicting definitions of the word "pension."

[64] COLO. REV. STAT. ANN. § 138-3-12 (Supp. 1967).

jurisdictions which retain provisions similar to the prior Colorado law, invocation of such provisions should result in taxation of death benefits in many cases in which "ownership" is subject to question.[65]

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[65] CCH INH. EST. & GIFT TAX REP. ¶ 12,030 (1963) has an excellent synoptic table of principal features of death tax statutes of the states, including the tax treatment of powers of appointment. It also has an editorial discussion of powers of appointment in the *Treatise* section at § 1540 *et seq.*, and a detailed editorial discussion of the tax treatment of powers of appointment in each state section under the same number (with appropriate reference to the statute itself). It appears that a majority of states have statutes taxing powers similar to that in Colorado prior to 1967 (which, in turn, was the adoption of an early New York statute, since repealed).