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Inheritance Taxes - The Present Situation in Colorado

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Inheritance Taxes—The Present Situation in Colorado

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THERE are many well informed people of divergent points of view who believe that the whole system of death duties should be abolished as economically unsound. In the State of Colorado there is a considerable party urging the repeal of our own inheritance tax, and the making of a covenant with the world, in the form of a constitutional amendment, that such a tax law will not be reenacted. The majority of this group are so aligned upon the theory that Colorado would gain a peculiar benefit by adding to its charm of climate a guarantee of freedom from death duties—that these advantages, sufficiently advertised, would bring to our State accumulations of capital and development of resources more than off-setting any direct loss of revenue which might result from repeal of the inheritance tax. In other words they would have us follow the experiment of which Florida's program is the most spectacular example.

However, so long as the "80% credit" clause of the 1926 Federal Estate Tax Act remains in force no such temptation can be dangled before foreign capitalists, because if we do not collect the tax the Federal Government will. Indeed, the 80% clause was written into the Federal statute solely for the purpose of preventing any successful emulation of Florida, and of penalizing that state for its enterprise in this direction.

The life of this provision is uncertain. Congressional opinion is divided, and the constitutionality of the scheme is already the subject of direct attack in the United States Supreme Court by the State of Florida. It would seem, however, that whatever merits adhere to the abolitionists' argument on general principles, their proposal must remain moot while the existing Federal legislation stands. It is necessary, moreover, to also take into consideration the undisputed fact that tax experts and economists throughout the country are in general agreement that death duties in some form constitutes a legitimate source of revenue, made specially attractive by the ease and economy of collection. While the present development of this form of taxation in America dates back only to the experiments of the State of New York in 1886, it has, nevertheless, been quite thoroughly tried out by the Federal Government and by practically every State in the Union.

The Importance of the Tax

We have, therefore, to deal with a form of revenue legislation which is well seasoned, perhaps generally accepted as sound, and the opposition to which has been for the moment checked by the attitude of Congress. If, therefore, we are at this time to examine the system critically, our attention should be directed primarily to the form and detail of the system rather than to the question of its existence. We may profitably consider whether we in Colorado have adopted the most satisfactory form of death duties; whether in its operation our system is fair and reasonable; whether our rates are equitable and such as to bring the greatest lasting benefits to our state.

First, then, what is the amount of the tax, and what is its relation to other revenue? The following table, for which I am indebted to Mr. George W. Loomis of the Denver Real Estate Exchange, sets forth the situation as prevailing under the now existing statute of 1921.

YEAR	Net Inheritance Tax Collected	Total State Tax By Mill Levy	Mill Levy	Percentage Inheritance Tax of General Tax
1921	473,127	6,890,445	4.35	6.86
1922	485,338	6,947,729	4.48	7.00
1923	678,577	6,080,798	3.93	11.16
1924	839,009	5,699,851	3.70	14.72
1925	887,488	5,700,710	3.70	15.57

The collection for the year 1926 will also approximate $900,000, and it is probable that in the near future the average annual revenue from this source will reach $1,000,000, or, a little less than one-sixth of the revenue raised by the state's mill levy for general purposes. In other words, if the inheritance tax were to be entirely abolished, the state's general levy would have to be increased by 60 cents per thousand dollars of assessed valuation. Applying these figures to the aggregate general taxes as paid by property owners in Denver we find that if the inheritance tax were to be wholly omitted, the levy in Denver would have to be increased from approximately $31 per thousand dollars of assessed valuation to $31.60 per thousand dollars, an advance of slightly less than 1/50th. For practical purposes we may, therefore, treat the inheritance taxes as equal to about 1/50th of the burden of our general taxes, an important, but minor, factor.

Second, what of the comparative level of the rates in Colorado and in other states? Three states (Alabama, Florida and Nevada) have no inheritance tax. Georgia has only a simple statute taking advantage of the "80% credit" clause in the Federal estate tax act. The other 44 impose death duties in some form. Mr. W. N. Trant of Haskins and Sells has recently prepared, for the Denver Chamber of Commerce, a table of such comparisons. It will be understood by those familiar with the subject that the possible combinations of factors (size of estate, number of beneficiaries and their degree of relationship, amount of exemptions, etc.) in succession taxes (as distinguished from estate taxes) are so numerous that a comprehensive comparison of succession tax statutes is wholly impracticable. Mr. Trant's calculations, intended as an illustration, were based upon estates ranging from $50,000 to $10,000,000 in value, all passing to the widow as the sole beneficiary. His table follows:

Amount of the Estate	Colo. tax under present statute with retroactive scale	Colo. tax under existing rates changed to progressive scale	Average of 43 American States	Federal Act 1926
$ 50,000.00	$ 600.00	$ 600.00	$ 610.12	
100,000.00	2,400.00	2,100.00	1,917.44	
200,000.00	9,000.00	6,600.00	5,457.44	$ 1,500.00
500,000.00	28,800.00	24,100.00	18,588.14	12,500.00
1,000,000.00	68,600.00	59,100.00	45,380.47	41,000.00
2,000,000.00	138,600.00	129,100.00	104,326.28	124,500.00
5,000,000.00	348,600.00	339,100.00	311,232.68	489,500.00
10,000,000.00	698,600.00	689,100.00	646,312.91	1,334,500.00

It will be seen that while the Colorado rates, as now applied approximate the American average in the lowest ($50,000) bracket, they are in all other brackets up to $5,000,000 substantially higher than the average of other American state, and in all brackets up to, and somewhat in excess of, $2,000,000 substantially higher than the Federal estate tax; also, that in estates approximating $100,000 the excess is fully 25%, in other brackets up to $1,000,000 fully 50%, and at $2,000,000 fully 30%.

It appears from these calculations that we could effect a downward revision of our rates without seriously affecting our general taxes, and that such revision could be carried to the extent of at least 30% (on estates valued at well upwards of $2,000,000) without bringing the level of our rates below the American average or below the amount required to take full advantage of the Federal credit. It is, therefore, not difficult to understand the point of view of those who now urge that it is unwise for Colorado to impose upon that capital which we invite to participate in the development of our resources an inheritance tax higher than the American average.

There are, of course, several methods by which the rates might be lowered; for example: by direct reduction; by change to the progressive block method of calculation (see Mr. Trant's third column); or, by a change from the succession tax form of statute which we now have to the more simple form known as the estate tax. These two latter alternatives will be discussed below in other connections.

Objectionable Features

There are, however, several other objections to our present statute which are more serious than the level of rates. These are frequently referred to as "nuisance features", and there is throughout the bar and associations of business and professional men a strong sentiment in favor of their elimination. Eight or nine such objections are most commonly considered as follows:

1. The retroactive progressive method of determining the rate, by which the rate imposed on the highest bracket is applied to the entire estate. This plan is used in no other state excepting Maine, where the maximum tax on near relatives is only 2%. It is inequitable and unscientific in that there is no logical reason why a difference of $1 in valuation should result in an additional tax of 1% on the whole estate. It is out of line with approved practice as exemplified in the succession taxes of 42 other states, the Federal estate tax and the income taxes. In practice it results in placing a premium on efforts of representatives of the estate or the government to bring about a fictitious appraisal.

2. Denial of exemption to life estates. So far as I am advised this characteristic appears in no other death duty statute in this country. The result is that if a husband leaves his wife an estate of $20,000 to dispose of as she pleases, she pays no tax, but if he safeguards her and the children by giving her a life estate with remainder over to their descendants (whether by legal or equitable means), the whole of the life estate is subject to tax. The value of the life estate depends on the expectancy of the widow. For example: If she is 56 years old her life estate is valued at approximately one-half the value of the property composing the same. The same principle, of course, applies to the portions of other members of the family. A recently retired inheritance tax commissioner advises me that there is more objection to this provision, particularly from lawyers outside of Denver, than to any other feature of the statute.

3. Repetition of the tax on the same property without an interval of exemption (by reason of successive deaths in the line of descent, devise or bequest). It is a common practice to extend immunity from taxation for a period of from two to five years to property upon which death duties have once been paid (for example: Federal statute, 5 years; Mississippi, 2 years; California, 5 years as to Class 1). Our statute grants no such immunity, and it is not unusual for an estate to be taxed two or three times before the administration of the first decedent's estate can be completed.

4. Mutiple taxation. This scheme of taxing such of the intangibles of non-resident decedents as are within the sovereign jurisdiction of the state is the outstanding evil which has brought down upon the whole death duties system torrents of wrath and criticism, and is largely responsible for the nation's wide demand for reform. Recently the Supreme Court of the United States has placed a decided check upon the avarice of the states in this direction (Rhode Island Hospital Trust Company vs. Doughton, 46 Sup. Ct. 256; Frick vs. Pennsylvania, 268 U. S. 473), and there has been a decided wave of reform legislation. Georgia, Rhode Island, Tennessee, Vermont and New Jersey have entirely exempted intangibles of non-residents; for practical purposes Nebraska, Delaware, Maryland, Louisiana, Wyoming (as to corporate securities), New Hampshire (as to certain corporate securities and as to bank balances), and other states are in the same class. Four jurisdictions have no inheritance tax, and New York, Massachusetts, Pennsylvania, Connecticut and New Mexico (as to corporate securities) grant such exemptions reciprocally. This reciprocal offer, however, has no application to Colorado estates, because Colorado does not grant similar privileges to the citizens of the last mentioned states; consequently, until we abolish the duties on non-residents' intangibles, either completely or reciprocally, the estates of our citizens must continue to pay tribute on the stocks and other intangibles controlled by New York, Massachusetts, Pennsylvania and Connecticut. Fortunately, the complete abolition of this extremely unpopular phase of the tax can be now accomplished in Colorado with practically no revenue disturbance. The day was when perhaps 10% of our total inheritance tax collections was derived from non-residents' intangibles—particularly the stock of the Wells-Fargo Express Company and the Denver and Rio Grande Western Railroad Company, the first of which is no longer in business and the latter reorganized as a Delaware corporation. Now, Mr. Eaton, Deputy Inheritance Tax Commissioner, informs me that the collections have dwindled to practically nothing—perhaps three or four per cent.

5. Tax on foreign charities. It seems to me that a strange relic of barbarism that many American states in adopting inheritance taxes should have placed the highest possible tax rate on gifts for religious, educational, or other charitable purposes if there was any possibility of the money being used outside of the taxing state. Modernly, there is a tendency to reform, but Colorado and some 18 other states still grant exemptions to charities only when the funds are to be used entirely within the state. If a resident of this state makes a testamentary gift to foreign missions, or to a church, college, or other institution, located outside of this state, or located in this state with a field of operations wider than our own boundaries, Colorado will first carve out an inheritance tax at the maximum rate. Six states, Connecticut, Iowa, Rhode Island, New York,

Massachusetts and Ohio, have now expressly extended complete or practically complete exemption to all charitable gifts, regardless of the place of use. Seven other states appear to make no distinction between foreign and domestic charities. Possibly charitable gifts should bear a small tax, but to penalize them with a maximum rate because they are not to be used exclusively in Colorado seems hardly consistent with modern spirit, and causes great resentment.

6. Widows' allowances and commissions. Prior to 1921 our statute permitted a widow to receive her $2,000 widow's allowance without impairment by inheritance taxes. Similarly, if she were the executor or administrator of her husband's estate the fees to which she would be entitled were deductible as expenses. In the 1921 revision the rates were radically increased, and there was inserted in Section 23 a phrase which extended the tax to the widow's (and orphan's) allowance and her executor's fees.

7. The *conclusive presumption* that gifts made within one year of death are in contemplation of death and taxable. For example: If a husband aged 25 gives his wife a home and is killed by accident the following day, the statute makes the gift taxable as a part of his estate upon the conclusive presumption that he contemplated death. In addition our statute contains a test of intention as follows:

> "The words 'contemplation of death' as used in this Act shall be taken to include that expectancy of death which actuates the mind of a person on the execution of his will" (Sec. 2c).

Consequently, if a young man makes a will and at or about the same time transfers his home to his wife, the gift is taxable, although he may have been in perfect health and thereafter lives fifty years, that is, if the statute means what it says. I believe no attempt has ever been made to enforce this latter provision. Prior to the Revenue act of 1926, the Federal policy has been to treat the question of contemplation of death as a matter of fact to be proven like any other circumstance, and such is the practice in most of the states, and the recommendation of the National Committee on Inheritance Taxation. The Supreme Court of the United States has recently held void a statute attempting to establish a six year conclusive presumption (Schlesinger vs. Wisconsin, 70 L. Ed. 301).

8. Absence of power to correct errors and make refunds. Our 1921 statute makes no provision for payments under protest or for the recovery of payments erroneously made. The Compiled Laws of 1921, however, show (Sec. 7513) a section of the act of 1907 providing for refunds, the usefulness of which is at least doubtful by reason of the fact that it seems to require a condition precedent to refund the signature of the County Treasurer who in 1907 was a receiving officer but is no longer so. I understand, however, that in small cases our Inheritance Tax Department has been making refunds under this old statute. A new provision is needed.

There are other sections in our statute which merit attention because unworkable or of doubtful value, but space will not permit of a complete analysis. For example: in section 3 appears the following:

> "and the tax * * * shall be immediately (at death) due and payable * * * except, however, in cases where the property is transferred by deed, grant, or gift made in contemplation of death, in which event the tax thereon shall be due and payable *at the time of such transfer.*"

This practically constitutes a gift tax,

the accrual of which will seldom, if ever, be conceded or determined until the subsequent death of the donor, perhaps decades later. So far as I know the clause has never been invoked, but it seems to contain germs of a first class law suit and ought to be eliminated.

Succession Tax or Estate Tax

We come finally to consider the form of the tax. There are two principal forms of death duties, viz, succession taxes and estate taxes. Most of the states, including Colorado, have used the former—perhaps because they began by levies limited to collateral relatives, for which purpose the succession tax is best fitted. Under it calculation of the tax is complicated, accurate forecasting of the tax burden on a given estate is impracticable, uniformity with the practice of other states or the Federal government unobtainable and adjustment to a given revenue requirement impossible.

The estate tax, which is a levy on the estate as a whole rather than upon the portions of the several heirs, legatees, or devisees, is best typified by the Federal practice, but it is also in use in Georgia and Mississippi, and to some extent in New York, Utah, Rhode Island, Virginia and Massachusetts. It is simple to calculate, the probable burden upon a given estate easy to estimate, it is adjustable to revenue demands, and readily capable of comparison with similar revenue measures of other jurisdictions. This is of particular importance for the moment by reason of the 80% credit now allowed under Federal statute, to meet which our succession tax cannot be adjusted, but as to which an estate tax could be brought into perfect alignment so that on large estates Colorado might receive precisely the amount of tax which would otherwise go to the Federal Government, and thereby receive substantial revenue without otherwise adding to the burdens of the estate.

The estate tax has the emphatic recommendation of the National Committee on Inheritance Taxation (originated under the sponsorship of President Coolidge, the governors of the several states, and the National Tax Association, for the purpose of eliminating the apparent evils in the existing death duties system), and the Chamber of Commerce of the United States. While the succession tax is specially adapted to placing a heavier burden upon remote relatives than upon immediate dependents, the estate tax can also be made to embody the same principles by adjustment of the exemptions. The estate tax like the succession tax is an excise duty—not a property tax—and inequality of exemptions would therefore, probably be constitutional.

New Statute Desirable

While the need for substantial changes in our existing system of inheritance taxation seems obvious, it should also be emphatically stated that the administrative machinery of our statute (as embodied in Sections 6 to 30) has given general satisfaction and is sound. Under it the system has been efficiently and economically administered by a succession of able and well qualified commissioners and deputies. This machinery is adaptable either to a revised succession tax or to an estate tax.

It is believed, however, that the desired comprehensive revision of the earlier sections, and the incidental adjustments of the administrative machinery, could be best accomplished by the passage of a complete act rather than by a series of amendments. If this be true, it is desirable that a new statute should be adopted, retaining in substance the present administrative section coupled with new tax-

ing section along the lines of either the succession tax or the estate tax, which new act should repeal the existing act with an appropriate saving clause as to pending cases.

If committees representing the City and State Bar Associations and the Chamber of Commerce should undertake to sponsor such revision, as seems worthy of serious consideration, they will find three sources from which to draw invaluable aid. First, Attorney General Boatright, Mr. Andrew Wood, the present inheritance tax commissioner, and his deputies. Second, The recently retired commissioner—for example, Mr. Hetherington, Mr. Ault and Mr. Blackman, several of whom have publicly expressed sympathy with the general recommendations here made. Third, A comprehensive report by the National Committee, and particularly the model laws, drafts of which are now being completed by that committee.

General Boatright is this month attending the annual meeting of the National Tax Association at Philadelphia. Mr. Wood was present at last year's meeting at New Orleans when the report of the National Committee on Inheritance Taxation was received. Mr. Hetherington took part in the important debates at St. Louis two years ago. Mr. Ault, in an address before the Law Club at the time of his retirement from office, called attention to the desirability of several of the changes above recommended. Senator Toll, Chairman of the Legislative Committee of the Colorado Bar Association, and Senator Fairfield of the Denver Bar Association were active in seeking similar legislation two years ago. We are fortunate, therefore, in having well informed public officials ready to cooperate actively in such program as may seem for the best interests of the state.

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GEORGE A. CARLSON

GEORGE A. CARLSON, former Governor of Colorado and a member of this Association, passed away during the past month.

President James A. Marsh appointed a Committee composed of Cass E. Herrington, Benjamin Griffith and A. X. Erickson to extend the sympathy of this Association to the widow and to attend the funeral as representatives of this Association.

C. A. MURRAY

CHARLES A. MURRAY, a veteran member of The Denver Bar and long a member of this Association passed away during the past month.

President James A. Marsh appointed a Committee composed of John F. Rotruck, Robert Collier and Omar E. Garwood to attend the funeral as representatives of this Association.

The Rule of Reason

"Why should courts be less reasonable than reasonable men?"—Denison, J., in 78 Colo. 144.

We'll bite, Judge; why should they?

—Contributed

A Prophesy Come True

Albert Vogl sends the Record the following Biblical quotation which is cited as having a bearing upon a certain cause celebre:

"And though they hide themselves in the top of Carmel, I will search and take them out thence; and though they be hid from my sight in the bottom of the sea, thence will I command the serpent, and he shall bite them:"

—Amos 9, 3.