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Taxation

TAXATION

Estate and Inheritance Taxes

THE effect of inheritance and estate taxes is more far reaching than a mere exactment of revenue. The desirability of the limitation that such taxes place upon the pyramiding of wealth from one generation to another, with its social and economic consequences, is a matter over which legislatures have differed. At one time, men of means found it profitable to take their movables and die in states that had no inheritance tax laws. In 1926, the Federal Government enacted an estate tax law, designed to remedy the lack of uniformity between the states by inducing them to pass uniform inheritance tax laws. This 1926 Revenue Act required that an estate tax (basic tax) be paid the United States with the provision that if a decedent's estate paid a similar tax to a state, credit for such payment might be taken up to 80% of the amount due the United States.[1]

In the 1932 Revenue Act[2] Federal estate taxes were increased over the basic tax of the 1926 act. These provisions of the Revenue Act of 1932 were designed primarily as a revenue measure. This additional tax did not give the taxpayer the privilege of deducting any similar taxes paid to the states; all revenue therefrom went to the United States. A detailed discussion of this additional tax is outside the scope of this article.

The basic provisions of the Texas inheritance tax laws are found in Chapter 5, Title 122, of the Revised Civil Statutes, and were enacted in 1923.[3] The exemptions allowed vary with the degree of kinship of the decedent to his beneficiaries—in general, the closer the kinship the greater the exemption. In some instances the Texas tax would not be as great as the 80% deduction allowed

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[1] 44 Stat. 70 (1926).

[2] 47 Stat. 243 (1932).

[3] Tex. Rev. Civ. Stat. Ann. (Vernon's, 1925) Articles 7117-7144.

by the Federal statute (basic tax). To remedy this and gain full benefit of the Federal statute, Texas in 1933 enacted what is popularly called a "take up" statute.[4] In substance this act provides that if the amount due Texas under its regular inheritance tax laws is found to be less than 80% of the amount due the Federal Government an amount sufficient to exhaust 80% is automatically assessed.

THE PROBLEM OF APPORTIONMENT AND THE TEXAS "TAKE UP" STATUTE

Until 1942, parties interested in a decedent's estate were indifferent toward the "take up" statute in that it did not increase the tax burden but merely channelled the full 80% to Texas and the minimum 20% to the Federal Government. Prior to 1942 when either spouse died only one-half of the community property was included in decedent's gross estate for both federal and state tax purposes. In 1942 the federal acts were amended. These amendments,[5] as construed and upheld by the United States Supreme Court in the case of *Fernandez v. Wiener*,[6] subjected all the community property to the federal estate tax upon the death of either spouse, except that part which could be shown to be economically attributable to the survivor, up to one-half of the entire community. In 1948 the 1942 amendments were repealed,[7] effective January 1, 1948 as to estate taxes, and April 2, 1948 as to gift taxes. Such repeal was not retroactive except to a limited extent in the case of estate taxes. So between 1942 and the effective dates of the 1948 amendments, in almost every instance where the

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[4] *Id.*, art. 7144a.

[5] 44 STAT. 71 (1926), 26 U. S. C. § 811 (e) (2) (1946 ed.) as amended by 56 STAT. 798 (1942), 26 U. S. C. § 402 (1946 ed.).

[6] 326 U. S. 340 (1945). This case holds that an estate tax being an excise on the privilege of transmitting property at death, and not a tax on the property itself, may be measured by the entire community property on the death of either spouse because of the resulting enlargement of interest in the survivor.

[7] 62 STAT. 116 (1948). After the effective date of the 1948 amendments only one half of the community property will be included in a decedent's estate.

husband died first, the Federal Government included the entire community property in his gross estate.[8] In so far as the Texas inheritance tax was concerned, theoretically at least, only the decedent's half was to be included in his gross estate. But since the federal tax attached to the entire community property, the "take up" statute in effect made the Texas tax attach to all.

Therefore, in many cases where one-half of a decedent's gross estate was less than $100,000 it might not be subject to the general tax laws of Texas. Whereas, according to federal law the decedent's gross estate (because of inclusion of the survivor's interest in the community property) would be more than $100,000 and therefore subject to the federal basic tax. The Texas "take up" statute would then come into operation and make payable to Texas an amount sufficient to absorb the 80% deduction allowed by the federal statute. The problem immediately arose as to whether the "take up" amount payable to Texas because of the Federal Government's inclusion of the survivor's community property interest in decedent's gross estate should be apportioned between the survivor and decedent or all charged against the decedent's interest. This is still believed to be an open question.

There also exists the problem of apportionment as to that amount payable to the Federal Government because of the inclusion of the survivor's interest in community property in decedent's gross estate.[9] This was also an open question until the Texas Legislature in 1947 enacted article 3683a[10] providing for apportion-

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[8] For the period 1942-1947 inclusive, the commissioner as a matter of practice, included only one-half of the community in the decedent's estate when it was the wife who died first, where no part of the community property was economically attributable to the wife.

[9] Whether or not apportionment will be allowed is purely a state matter. The United States has a lien on the whole estate for the federal tax.

[10] TEX. REV. CIV. STAT. ANN. (Vernon's, 1925) art. 3683a. "Whenever a Federal Estate Tax is collected under Section 811 (e) (2) of the United States Internal Revenue Code, or any corresponding section hereafter enacted by the Congress of the United States, and such tax is measured in part by the value of the surviving spouse's interest in community property owned by the decedent, and such surviving spouse at the decedent's death, the executors, administrators, or personal representatives of the decedent, unless the decedent directs otherwise in his or her will, shall be entitled to recover from

ment. The federal repeal of the 1942 amendments puts an end to including the survivor's interest in community property in a decedent's gross estate and removes the apportionment problem except for the period between 1942 and the effective date of the Texas apportionment statute of 1947.[11] For the period between the effective date of the Texas apportionment statute and the effective date of the 1948 federal amendments, the Texas statute will control as to amounts payable to the Federal Government.

In connection with the problem of apportionment, a 1947 opinion of the Texas Attorney General,[12] is of interest. The pertinent facts before the Attorney General were:

Mr. X died in 1943, leaving a community estate in Texas. The Federal Government pursuant to the 1926 Revenue Act and the 1942 amendments included in Mr. X's gross estate not only his half of the community but also the half of his survivor, Mrs. X. Texas, in assessing its inheritance tax, included in Mr. X's gross estate only his half of the community property. However, the "take up" statute came into operation and assessed an additional amount sufficient to absorb 80% of the full amount of the federal tax. Mrs. X died in 1945, approximately two years after the death of Mr. X.

The following question was presented: is the one-half community property of Mrs. X subject to the Texas inheritance tax or is it to be deducted from her gross estate because of Article 7125?[13] The pertinent provisions of Article 7125 are:

> "The only deductions permissible under this law are . . . an amount equal to the value of any property forming a part of the gross estate

the surviving spouse such portion of the total federal estate tax paid under said Sect. 811 (e) (2) as the net value of the survivor's interest in the community estate included in the decedent's estate in the computation of the federal estate tax bears to the net taxable estate."

[11] It is the opinion of the writer that the 1947 Texas apportionment statute is not retroactive. Therefore the right of apportionment as to amounts payable to the federal government where a decedent's death occurred between January 1, 1942, and the effective date of said apportionment statute is still an open question.

[12] Attorney General Opinion N. V-402, Oct. 8, 1947.

[13] TEX. REV. CIV. STAT. ANN. (Vernon's, 1925) Art. 7125.

> . . . received from any person who dies within 5 years prior to the death of the decedent, this reduction, however to be only in the amount of the value of the property upon which an inheritance tax was actually paid and shall not include any legal exemptions. . . ."

The Attorney General concluded that the one-half community property of Mrs. X was not to be deducted and was subject to the Texas tax. The opinion reasons that the half community property of Mrs. X was never a part of Mr. X's gross estate as far as Texas law was concerned and had not previously been legally subjected to the state inheritance tax, notwithstanding that when Mr. X died, the Texas "take up" statute was invoked to consume the 80% of the amount assessed by the Federal Government on the entire community property.

From this reasoning it would be logical to infer that for the period 1942 until the effective date of the 1948 federal amendments, apportionment will not be allowed of the amount payable to Texas and attributable to the survivor's interest in the community property and the "take up" statute; the entire tax burden will fall on the decedent's interest in the estate.

In *Simco v. Shirk*[14] the Supreme Court of Texas held that other states cannot through their taxing policies defeat the power of Texas to levy a tax sufficient to absorb the full 80% of the basic tax levied by the Federal Government upon property located in Texas, notwithstanding Section 8 of the "take up" statute.[15]

The facts of the case are as follows: A taxpayer living in state A died in state A. His gross estate was located in state A, state B and Texas. All was taxed by the Federal Government under the provisions of the 1926 Revenue Act. States A and B levied taxes to consume not only 80% of the federal tax attributable to property located in states A and B but also to consume 75% of the federal tax attributable to property located in Texas. The property located in Texas is exempt by the regular state inheritance tax law.

The question for decision was whether Texas under the "take

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[14] 200 S. W. (2d) 704 (Tex. Civ. App. 1947).

[15] TEX. REV. CIV. STAT. ANN. (Vernon's, 1925) Art. 7144a, § 8.

up" statute could assess an inheritance tax in an amount sufficient to absorb 80% of that amount levied by the Federal Government and attributable to property located in Texas? Or should Texas be limited to 5%, the amount of the allowable unused by states A and B?

The Texas Supreme Court reversing the Court of Civil Appeals,[11] held that the entire 80% was taxable and not merely the 5%.

Sections 4 and 5 of Article 7144a make provision for assessment of the full 80% by Texas on estates located in or partly outside of Texas and not taxable by the regular inheritance tax laws of Texas.

Section 8 of Article 7144a which was relied upon by the taxpayer as the basis for his contention that he should be given credit by Texas for the 75% paid to states A and B and that only the unused 5% was taxable by Texas, refers to sections 1-7 inclusive of Article 7144a which states in part:

> ". . . this Chapter shall aways be construed so as not to increase the total amount of taxes payable to the State and Federal Government combined upon the estates of decedents, the only purpose of said additional tax being to take full advantage of the 80% credit allowed by the Federal Revenue Act of 1926. . . ."

The court construed the word "State" in the above section to mean Texas only. By this, any amounts paid to other states are excluded in considering whether the Texas tax violates Section 8 by increasing the total amount of taxes payable to the State and Federal Government combined upon the estates of decedents.

If states A and B choose to charge rates that exhaust more than 80% of the amount of the federal tax assessed against property located in states A and B, it is no concern of Texas. However, such payment to A and B cannot be used as an offset to the right of Texas to a full payment of 80% of the amount of the federal tax attributable to property located in Texas.

FRANCHISE TAX—NO PAR STOCK

Par value stock of a corporation is included at its par value, whether paid in or not, in computing the Texas franchise tax.

As to no par stock, a different rule obtains. Involving this problem is the 1947 case of *Sterling Oil and Refining Corp. v. Isbell, et al.*[16] The corporation was organized in 1933 with a capital stock of $100 divided into 10 shares of a par value of $10 each. In the same year the charter was amended changing the capital structure to 80 shares at a par value of $1.25 each, the total legal capital remaining at $100. In 1934 the board of directors, in securing a charter amendment to authorize an issue of 80,000 shares of no par value stock, filed a sworn statement that the value of the 80 shares is $1,033,181.25. At a time when the 80 shares of par stock had an appraised or represented value of $1,033,181.25 as against a book value of $100.00, the corporation issued 40,000 of its no par stock to its share holders in exchange for their 80 shares of par stock.

The question in the case was whether $100 or $1,033,181.25 was the amount subject to the franchise tax.

Art 7084 provides:

> "For the purpose of computing the tax of corporations issuing no par stock, such stock shall be taken and considered as being of the value actually received at the time of issue thereof. . . ."[17]

After considering the above article the court held that the $1,033,181.25 represented value of the 80 shares and that that amount and not the $100 book value was the value actually received at the time of the issue of the 40,000 shares of no par stock, and, therefore, was the amount to be included in computing the franchise tax.

After this case, the State auditor requested an opinion from the Attorney General as to whether the amount actually paid in for shares of capital stock of non-par corporations is the amount

[16] 202 S. W. (2d) 300 (Tex. Civ. App. 1947).
[17] TEX. REV. CIV. STAT. ANN. (Vernon's, 1925) Art. 7084.

of capital stock on which the franchise tax should be based or whether the amount should be based on the entire amount authorized after ascertaining the value of the unissued stock.

In Opinion No. V-341 dated August 14, 1947 the Attorney General replied:

> "In computing the franchise tax due by corporations whose capital stock has no nominal or par value, only the amount that has actually been paid in, which does not always represent the total number of shares authorized by the charter, is used as the amount of capital stock for such tax purposes and no tax is assessed on that portion of the authorized capital stock that has not been paid in. . . ."[18]

The *Sterling* case was cited by the Attorney General in support of his opinion. In that case, after 40,000 shares of non-par stock had been exchanged for 80 shares of outstanding par stock, most of the remaining 40,000 shares were sold to the public at $25 per share. The corporation paid a franchise tax on the number thus sold and not on the unissued shares. This action was upheld by the court.

FORECLOSURE OF TAX LIENS AND THE PERIOD FOR REDEMPTION; THE LAW BEFORE AND AFTER JUNE 23, 1947

In 1947 Texas law as to when the redemption period begins in the case of a judgment foreclosure and tax sale was changed by an amendment to Article 7345b Section 12,[19] effective June 23, 1947.

This amendment has been construed by the Attorney General as follows:

> "In tax suits not reduced to judgment prior to June 23, 1947, the effective date of the amendment to Sect. 12 . . . the redemption period

[18] Attorney General Opinion No. V-341, Aug. 14, 1947.

[19] TEX. REV. CIV. STAT. ANN. (Vernon's, 1925) Art. 7345b as amended: "In all suits heretofore or hereafter filed to collect delinquent taxes against property, judgment in said suit shall provide for the issuance of writ of possession within 20 days after the period of redemption shall have expired to the purchaser at foreclosure sale . . .; but whenever land is sold under judgment in such suit for taxes, the owner of such property, or anyone having an interest therein, . . . may, within 2 years from the date of the filing for record of the purchaser's deed and not thereafter, have the right to redeem . . . ."

> begins from the date of the recording of the purchaser's deed. In tax suits reduced to judgment prior to June 23, 1947, the effective date of the amendment, the redemption period runs from the date of sale."[20]

Garcia v. Aycock,[21] construes the statute of limitations on the right of redemption, as it existed prior to June 23, 1947. In this case land was sold November 3, 1942, to the county after a judicial foreclosure of a tax lien. The sheriff's deed to the county was not filed until three years later. Article 7345b Section 12[22] provided for the privilege of redemption within two years of the date of sale. The delinquent taxpayer contended that his right of redemption could not be limited to two years from the date of sale because Article 8 Section 13 of the Texas Constitution allows two years from the date of recording of the deed.

The court rejected this contention pointing out that the constitutional provision applies only to summary proceedings and does not effect the limitation on the period of redemption as imposed by statute which applies to a sale pursuant to a foreclosure proceeding in court. Therefore the date of the sale and not the date of the filing of the sheriff's deed starts the two-year period of limitation. By this test the taxpayer was barred from redemption by limitations.

C. S.

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[20] Attorney General Opinion No. V-362, Aug. 27, 1947.

[21] 203 S. W. (2d) 982 (Tex. Civ. App. 1947).

[22] TEX. REV. CIV. STAT. ANN. (Vernon's, 1925) Art. 7345b, § 12.