

XVII. Taxation*

During this survey period¹ there were significant interpretations of the Indiana inheritance tax statutes.² *In re Estate of Cassner*³ dealt with the meaning of the term "proceeds" under the Indiana inheritance tax statute, which exempts from inheritance tax all proceeds of life insurance payable to other than the decedent's estate.⁴ Cassner died the owner of four separate life insurance policies payable to his wife Mary. In addition to the face amount of the policies, Mary was entitled to accumulated dividends, post-mortem dividends, and termination dividends.⁵

An interesting but unanswered question grew out of the complex facts of this case. In sequence, the issues arose in this way: Partnership #1 owned the dominant and servient tracts, and mortgaged the dominant tract upon which an apartment house was built. The dominant tract was then sold to Partnership #2, and Partnership #1 became a general partner in it. Later Partnerships #1 and #2 executed the mortgage in question to the original mortgagee which apparently reaffirmed the original mortgage and for the first time granted to the mortgagee an easement on the servient tract. After this corrective mortgage was executed and recorded, Partnership #1 sold the servient tract to the plaintiff who claimed that he was not bound by the easement burdening the tract he purchased. The court held that the easement granted to the mortgagee was valid, but it was not clearly determined that the easement ran in favor of Partnership #2, the owner of the dominant estate.

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¹One other tax case decided during this survey year is worthy of notice. In *Griffin v. Boonville Sav. Ass'n*, 325 N.E.2d 494 (Ind. Ct. App. 1975), the First District Court of Appeals held that the plaintiff was not required to tender the redemption price of real property before a tax deed was issued to the purchaser at the sale as a condition precedent to challenging the legality of the entire original assessment and subsequent tax sale.

²IND. CODE §§ 6-4-1-1 *et seq.* (Burns 1972). Two amendments to the Indiana Code relating to inheritance tax matters should also be noted. These amendments altered the inheritance tax exemption and rate computation scheme. *Id.* §§ 6-4-1-2, -3 (Burns Supp. 1975), *amending id.* §§ 6-4-1-2, -3 (Burns 1972). Also, the legislature replaced the widow's allowance and support provisions for surviving children with a flat \$8,500 exemption for the surviving spouse, which passes free of Indiana inheritance tax. *Id.* § 29-1-4-1 (Burns Supp. 1975).

³325 N.E.2d 487 (Ind. Ct. App. 1975).

⁴IND. CODE § 6-4-1-1 (Burns 1972). The provision reads in pertinent part:

Proceeds of life insurance policies on the life of a decedent payable in such a manner as to be subject to claims against his estate and to distribution as a part thereof shall be hereunder held to be a part of the estate, but payable either directly or in trust for the use of any person or persons other than the estate so that it does not become a part thereof or subject to such claims, said proceeds shall not be taxed.

⁵325 N.E.2d at 488.

The State argued that the term proceeds includes the face value amount only and excludes all dividends because life insurance policies are a risk-shifting investment mechanism and dividends are not directly related to the risk.⁶ The executor of the estate maintained that such dividends had never been taxed under Indiana inheritance tax law and that exclusion of these dividends from proceeds would be contrary to existing federal tax laws.⁷ The Marion County Probate Court held that the beneficiary was entitled to receive these dividends as proceeds of life insurance free of Indiana inheritance tax.

On appeal by the State, Judge Buchanan, writing for the Second District Court of Appeals, stated that the intent of the legislature was to exclude all proceeds of life insurance policies from Indiana inheritance tax.⁸ He found that there was no basis for the narrow construction of the term proceeds offered by the State. Furthermore, following the State's interpretation would entail a departure from forty years of accepted interpretations of the Indiana inheritance tax statutes⁹ and from federal laws that include these dividends in proceeds of life insurance.¹⁰ Thus the court reaffirmed many years of accepted practice.

In *In re Estate of Osland*,¹¹ insurance proceeds were made payable to co-trustees of an *inter vivos* trust, and the trustees were authorized to use the proceeds to satisfy certain claims against the estate.¹² The State maintained that the discretionary powers

⁶*Id.* at 490. The State relied on the following cases: *Cahen Trust v. United States*, 292 F.2d 33 (7th Cir. 1961) (which indicated in dicta that the insurer was bound to pay the face value of the policy on the death of the insured); *In re Hamilton's Estate*, 113 Colo. 141, 154 P.2d 1008 (1945) (in which the Colorado Supreme Court construed a similar but not identical inheritance tax statute as excluding accumulated disability payments from proceeds of life insurance). The *Cassner* court distinguished both cases and did not consider the State's argument based on insurance law principles applicable because the concern in this particular instance was primarily with tax law. 325 N.E.2d at 490-91.

⁷325 N.E.2d at 288-89. See note 10 *infra*.

⁸325 N.E.2d at 490.

⁹*Id.* at 493. The court believed legislative action a more appropriate vehicle for change where the public's long reliance on established interpretations predisposes a court to accept those interpretations absent a compelling reason otherwise.

¹⁰*Id.* at 492, citing INT. REV. CODE OF 1954, § 2042. This section exempts from the beneficiary's income those lump-sum proceeds from life insurance policies and includes in the decedent's gross estate the amounts receivable by the executor and all other beneficiaries under life insurance policies on the life of the decedent.

¹¹328 N.E.2d 448 (Ind. Ct. App. 1975).

¹²*Id.* at 499. The trust indenture provided that the trustees had the discretion to pay the expenses of Osland's last illness, the funeral expenses, and

of the trust indenture made the transfer taxable.¹³ The estate pointed out that the proceeds were not distributable as a part of the decedent's estate nor subject to claims against the estate even though the proceeds could be used under the discretionary powers of the trustees to pay specified claims. Therefore, the proceeds were not subject to inheritance tax. The Boone County Superior Court agreed with the arguments presented by the estate and entered judgment excluding the proceeds from the inheritance tax.

The First District Court of Appeals clarified the two-fold test provided by the inheritance tax statute.¹⁴ In order to include proceeds in a decedent's estate for inheritance tax purposes, "the proceeds must be payable in such a manner so as to: (1) be subject to claims against the decedent's estate AND (2) be subject to distribution as part of the decedent's estate."¹⁵ Osland had transferred the ownership of the policies to the trustees and designated them as beneficiaries. The right to the proceeds had vested in the trustees and could not be subject to distribution as part of Osland's estate. Since the second requirement of the statute was not fulfilled, the proceeds could not be taxed under the Indiana inheritance tax law.¹⁶ The court found it unnecessary to decide whether or not the proceeds were subject to claims against the estate, but it is reasonable to conclude they were not.

*State Department of Revenue, Inheritance Tax Division v. Estate of Powell*¹⁷ dealt with the definition of life insurance for Indiana inheritance tax purposes. Powell had participated in his employer's pension plan, which required the trustees of the plan to purchase life insurance policies on the lives of the participants. The trustees were the beneficiaries and sole owners of the policies.¹⁸ Although the pension plan was primarily to provide retirement income, a participant had to designate to whom death bene-

any taxes chargeable to the estate. The principle source of funds for the trust were Osland's life insurance proceeds.

¹³IND. CODE § 6-4-1-1 (Burns 1972). This provision is set out at note 4 *supra*.

¹⁴328 N.E.2d at 449. This two-part requirement of IND. CODE § 6-4-1-1 (Burns 1972) was previously recognized by an opinion of the Attorney General. [1961] OPS. ATT'Y GEN. IND. No. 60, at 385.

¹⁵328 N.E.2d at 450, *construing* IND. CODE § 6-4-1-1 (Burns 1972) (emphasis supplied by the court).

¹⁶328 N.E.2d at 450.

¹⁷333 N.E.2d 92 (Ind. Ct. App. 1975).

¹⁸*Id.* at 94. The pension plan gave the trustees the right to sell or assign the policies, surrender them for cash, and change the beneficiaries. The pension plan and the life insurance policies limited the life insurance company's obligation to payment of the proceeds. The insurer was not required to oversee any distribution or application of the monies paid to the trustees.

fits would pass under the plan. There were two different provisions for payment to the beneficiary under the plan. If the participant died before retirement, the designated beneficiary would receive an immediate lump-sum payment; but, if the participant died after retirement, the designated beneficiary would receive at most 120 reduced payments.¹⁹ Powell designated his wife as his beneficiary, and upon his death, the trustees paid the same amount to Powell's widow as they received from the life insurance policies covering his life. The trial court held that these funds were life insurance proceeds payable to a designated beneficiary and thus were exempt from the Indiana inheritance tax.²⁰

On appeal to the First District Court of Appeals, the State argued that because the money was paid from the general pension fund and not specifically from the proceeds of the insurance policies, the money constituted death benefits and not life insurance proceeds. The State further pointed out that the purpose of the pension plan was post-employment benefits, and the same funds that were claimed as insurance proceeds under state law were exempted as an annuity on the federal estate tax return.²¹

In rejecting the State's argument, the court of appeals was careful to note that the employer's pension plan contemplated a special benefit by the purchase of these life insurance policies. The court held that as long as a third party employer's pension plan involves the essential elements of risk for the parties, it can operate as a conduit for life insurance proceeds; and the employee's beneficiary, although paid from the fund established and maintained by the employer, will not be subject to Indiana inheritance tax on the proceeds.²² The provisions of this particular plan that required the trustees to pay the same amount received to the employee's named beneficiary clearly supported the court's finding that the monies paid to Powell's widow from the pension fund were life insurance proceeds.

This past year's litigation indicates that the Inheritance Tax Division of the State Department of Revenue narrowly interprets the scope of the statutory exemptions and exclusions from the

¹⁹333 N.E.2d at 102.

²⁰IND. CODE § 6-4-1-1 (Burns 1972). This provision is set out at note 4 *supra*.

²¹Powell had the power under the pension plan to change the beneficiary at his death. This incident of ownership would make the insurance proceeds taxable to his estate under federal law. INT. REV. CODE OF 1954, § 2042. The State argued that since the funds were from an exempted annuity under section 2039(c) of the Internal Revenue Code, the funds could not be held insurance proceeds under state law—to hold otherwise would allow taxpayers to change the nature of their income to satisfy different taxing authorities.

²²333 N.E.2d at 104.

Indiana inheritance tax. In rejecting the State's interpretations, the court of appeals preserved the expectations of the practicing bar and public—expectations that followed from years of accepted interpretations—and disavowed the piecemeal alteration of the statutory inheritance tax scheme.

XVIII. Torts

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A. Tort v. Contract

In *Strong v. Commercial Carpet Co.*,¹ the Third District Court of Appeals, in an analysis premised upon the modern rules of pleading,² held that a plaintiff who brings an action predicated on both breach of contract and negligence is not required to elect his remedy and is entitled to seek recovery on both theories. The court prefaced its holding with a helpful discussion of when a claim will be actionable in both tort and contract. Following the traditional distinction between misfeasance and nonfeasance,³ the court stated that the total nonperformance of a promise is actionable only as a breach of contract, while the misperformance of a promise is actionable in tort as well as contract.⁴ Although the line between misfeasance and nonfeasance is often difficult to draw,⁵ the court concluded that the distinction provides a valid means of determining when a breach of contract can be characterized as a tort. While an action in tort generally is preferable because of the availability of greater damages,⁶ *Strong* should be

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¹322 N.E.2d 387 (Ind. Ct. App. 1975).

²The court relied exclusively on IND. R. TR. P. 8 (E) (2), which permits a plaintiff to seek relief on alternate theories of recovery.

³Dean Prosser concludes "that there will be liability in tort for misperformance of a contract whenever there would be liability for gratuitous performance without the contract . . ." W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 92, at 617 (4th ed. 1971) [hereinafter cited as PROSSER]. A leading case in this area is *Flint & Walling Mfg. Co. v. Beckett*, 167 Ind. 491, 79 N.E. 503 (1906).

⁴322 N.E.2d at 390.

⁵See PROSSER § 92, at 618.

⁶Contract damages are limited by the well-known rule of *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854), that only those damages that were in the contemplation of the parties can be recovered. See generally 5 A.