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REVENUE:
Application of Inheritance and Transfer Tax Law to Deferred Compensation Paid to Designated Beneficiaries

William J. Boys
Director
Department of Personnel
Springfield, Illinois 62706

Dear Mr. Boys:

I have your letter wherein you inquire whether sums paid to a beneficiary designated pursuant to section 5.11 of the Illinois State Employees Deferred Compensation Plan, are subject to taxation under section 1 of the Inheritance and Transfer Tax Law (Ill. Rev. Stat. 1978 Supp., ch. 120, par. 375). You also inquire whether, if such sums are taxable, the State must hold them until a written consent for their release is obtained from my office. For the reasons hereinafter stated, it is my opinion that deferred compensation payable to a named beneficiary on the death of a participant, is subject to taxation under section 1 of the aforementioned Act. It is also my opinion that a written consent must be obtained pursuant to section 9 of the Act (Ill. Rev. Stat. 1977, ch. 120, par. 383) before payment of the deferred compensation may be made to a designated beneficiary.

The Illinois State Employees Deferred Compensation Plan, like similar plans in use for a number of years in the private sector, exists as a vehicle for the transfer of income from peak earning years to retirement years for the purpose of reducing Federal income tax liability. This office, in the exercise of its administrative responsibilities under section 11 of the Inheritance and Transfer Tax Law (Ill. Rev. Stat. 1977, ch. 120, par. 385), has consistently determined that private deferred compensation plan benefits are subject to the inheritance tax, and I find no distinguishing factor in the recently implemented State plan which would lead me to reach a different conclusion with regard to compensation deferred under that plan.

Section 1 of the Inheritance and Transfer Tax Law provides in pertinent part as follows:

> "A tax is imposed upon the transfer of any property, real, personal, or mixed, or of any interest therein or income therefrom, in trust or otherwise, to persons, institutions or corporations, not hereinafter exempted, in the following cases:
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> * * *

> 3. When the transfer is of property made by a resident, or by a non-resident when such non-resident's property is within this State, or having a taxable situs in this State and not subject to inheritance, succession or estate tax in the state of the decedent's residence, by deed, grant, bargain, sale or gift, made in contemplation of the death of the grantor, vendor or donor, or intended to take effect in possession or enjoyment at or after such death, * * *.
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> * * * "

The transfer of deferred compensation funds to a designated beneficiary is a gift intended to take effect in possession or enjoyment at or after the death of the participant. As such, it is clearly a transfer within the ambit of the above provision and therefore, is subject to the inheritance tax.

The factual situation in People v. Schallerer (1957), 12 Ill. 2d 240, a landmark case in the area of inheritance taxation, is analogous to the one at hand. In Schallerer, the court dealt with a purchased refund annuity contract under which the purchaser named a beneficiary to receive the balance of the stipulated annuity amount not paid out by the date of annuitant's death. The primary question before the court was whether the transfer to the designated beneficiary constituted a transfer of property under item 3 of section 1 of the Inheritance and Transfer Tax Law.

In concluding that the transfer in question constituted a transfer of property for purposes of section 1, the court stated at pages 243-244:

> " * * *
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> A refund annuity, such as we have in the instant situation, is a contract whereby the annuitant protects himself, during his life, by making an investment to assure annual payments to himself during his life. If he dies prematurely, his beneficiaries receive the undistributed portion of the investment. [Citations.] The monies refunded to the beneficiaries in each of these refund annuity situations are only that undistributed portion of the decedent's original investment or deposit plus accruals, monies belonging to decedent during his lifetime and not acquired by virtue of the occurrence of a stated risk.
>
> This court has determined that a transfer intended to take effect in possession or enjoyment at or after death is a disposition in which the donor retains the economic interest or enjoyment of the property during his life. [Citation.] Upon the designation of beneficiaries in these refund annuity contracts a transfer occurred. [Citations.] The transfer did not then vest in possession or enjoyment. Only upon the death of the decedent purchaser of or investor in the refund annuity, did the interest of the beneficiary ripen into possession or enjoyment. It was a transfer or passing of a <u>contingent</u> interest in the annuity investment in which the decedent retained control of or an interest in the property transferred in one or more respects. It is therefore clear that in refund annuities which are here in question we find (1) a transfer of property, (2) by grant or gift, (3) intended to take effect in possession or enjoyment at or after the death of the grantor or donor. Thus these refund annuities clearly fit within the specified limits and requirements of section 1 of the Illinois Inheritance Tax Act and are taxable transfers. * * *
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> * * * "

Although deferred compensation funds remain part of the general assets of the State and although a participant's right to receive payment under the terms of the plan is no greater than the right of any unsecured general creditor of the State of Illinois, the disposition of the deferred compensation is fundamentally at the election of the participant. (Illinois State Employees Deferred Compensation Plan, § 5.2.) A participant may request that the deferred compensation be invested in one of four funds; he may select the mode of distribution of the funds upon termination, retirement or death; and he may, in certain extenuating circumstances, draw on the funds prior to termination or retirement. (Illinois State Employees Deferred Compensation Plan, §§ 5.3 through 5.4, 5.6 through 5.9.) Furthermore, a participant's designation of a beneficiary is subject to change. (Illinois State Employees Deferred Compensation Plan, § 5.11.) Therefore, there is no basis for a conclusion that deferred compensation funds are not subject to the inheritance tax.

Section 9 of the Inheritance and Transfer Tax Law provides in pertinent part as follows:

> "No safe deposit company, trust company, corporation, bank, trustee or other institution, person or persons having possession or control of, or title to, as trustee, custodian or otherwise, securities, deposits, or other assets belonging to, standing in the name of, or being

> held for the benefit or use of a decedent who was a resident or non-resident, or belonging to, standing in the names of, or being held for the benefit or use of such a decedent and one or more persons jointly, * * * shall deliver, transfer or consent to the delivery or transfer of the same * * * unless an inventory of the securities, deposits or other assets is sent to the State Treasurer and Attorney General prior to such delivery, transfer or consent to the delivery or transfer; nor shall any such safe deposit company, trust company, corporation, bank, trustee or other institution, person or persons deliver, transfer or consent to the delivery or transfer of any securities, deposits or other assets belonging to or standing in the name of a decedent, or belonging to, or standing in the names or for the benefit of a decedent and one or more persons jointly, * * * without retaining a sufficient portion or amount thereof to pay any tax or interest which may thereafter be assessed on account of the delivery, transfer or consent to the delivery or transfer of such securities, deposits or other assets, * * * unless the State Treasurer and Attorney General consent thereto in writing.
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> * * * "

The intent of section 9 is obviously to ensure that the assets subject to the tax imposed by section 1 will not be transferred without the knowledge and consent of the appropriate State officials, and to ensure that sufficient assets will remain for the satisfaction of inheritance tax liability.

Although section 9 does not specifically mention assets which may be held by the State, a conclusion that assets held by the State are not subject to the provision would clearly run counter to its intent and thwart its purpose. Furthermore, section 9 is made applicable to all "persons", a term which may be applied to bodies politic and corporate as well as individuals (Ill. Rev. Stat. 1977, ch. 131, par. 1.05). It is therefore my conclusion that deferred compensation may not be transferred to designated beneficiaries until such time as the appropriate consent for such transfer is presented.

Very truly yours,

A T T O R N E Y G E N E R A L