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***Medford v. Lynch*: North Carolina's Shift to the Minority Rule Regarding Inheritance Taxation and Will Compromise Agreements**

In *Medford v. Lynch*¹ the North Carolina Court of Appeals recognized the North Carolina General Assembly's decision to impose inheritance taxes in accordance with the transfers under a compromise agreement when such an agreement is incorporated into a consent judgment in a caveat proceeding.² The majority view—previously followed by North Carolina—imposes inheritance taxes in accordance with the will provisions.³ *Medford* was the first opportunity for a North Carolina appellate court to interpret North Carolina General Statutes section 105-2(1)⁴ since its amendment in 1974⁵ to provide that inheritance taxes shall be imposed upon a transfer “when the transfer is made pursuant to a final judgment entered in a proceeding to caveat a will.”⁶ The *Medford* court found that a consent judgment qualified as a final judgment⁷ and therefore held that inheritance taxes should be imposed in accordance with the transfers under a compromise agreement when the agreement is incorporated into a consent judgment.⁸ This Note will explain the majority and minority views on imposing inheritance taxes; analyze the *Medford* decision under section 105-2(1); review the history of inheritance taxes in North Carolina concerning will compromise agreements; discuss the policy arguments behind both the minority and majority

1. 67 N.C. App. 543, 313 S.E.2d 593 (1984).

2. *Id.* at 546, 313 S.E.2d at 595. This places North Carolina in the minority of states. See 42 AM. JUR. 2D *Inheritance, Estate, And Gift Taxes* § 76 (1969) (discussing the majority and minority views on effect of compromise of will contest). A “caveat proceeding” is a proceeding undertaken in the proper courts to prevent (temporarily or provisionally) the proving of a will” BLACK’S LAW DICTIONARY 202 (5th ed. 1979).

3. See *Pulliam v. Thrash*, 245 N.C. 636, 639-40, 97 S.E.2d 253, 256 (1957) (citing Annot., 36 A.L.R. 2D 917 (1954)). See generally 42 AM. JUR. 2D, *supra* note 2, §§ 71, 76 (1969) (discussing the majority and minority views on taxation effect of compromise of will contest). The majority view also holds that transfers should be taxed according to intestate succession, rather than according to a compromise agreement, when decedent died intestate. *Id.* § 71. All further references in this Note to the majority tax according to the will view also apply to taxation according to intestacy.

4. The section reads:

A tax shall be and is hereby imposed upon the transfer of any property, real or personal, or of any interest therein or income therefrom, in trust or otherwise, to persons or corporations, in the following cases:

(1) When the transfer is by will or by the intestate laws of this State from any person dying seized or possessed of the property while a resident of the State, or when the transfer is made pursuant to a final judgment entered in a proceeding to caveat a will executed by any person dying seized of the property while a resident of this State.

N.C. GEN. STAT. § 105-2 (1979 & Supp. 1984).

5. Act of April 1, 1974, ch. 1287, 1973 N.C. Sess. Laws 557 (codified at N.C. GEN. STAT. § 105-2(1) (1979 & Supp. 1984)).

6. N.C. GEN. STAT. § 105-2(1) (1979 & Supp. 1984). The section quoted was added by a 1974 amendment cited at note 5.

7. *Medford*, 67 N.C. App. at 545-46, 313 S.E.2d at 594-95.

8. *Id.* at 546, 313 S.E.2d at 595. The language of § 105-2(1) implies that a compromise agreement which is not incorporated into a final consent judgment will not qualify for taxation according to the compromise, but must be taxed according to the transfers specified by the will or by intestacy.

views; and briefly explain why the minority view, adopted by North Carolina, is the better view.

Two views exist regarding the correct method of taxing transfers from an estate when the will or intestate distribution has been contested and a compromise agreement between the heirs or devisees and the contestants has been consummated.⁹ The majority view holds that the tax should be imposed on transfers as provided in the will even though the compromise agreement may provide for a different distribution.¹⁰ Under this view a devisee would pay inheritance taxes on his total bequest under the will, even though he may not receive the entire bequest because of the compromise agreement. A contestant not named in the will would not pay any tax on the property he receives.¹¹ The minority view holds that the inheritance tax should be imposed on transfers made in accordance with the compromise agreement, thereby taxing a devisee, heir, or contestant only on the property he actually receives.¹² Because of these two views, the difference in inheritance taxes paid by each party to a will contest can vary substantially.¹³

In *Medford* plaintiff Bobby Lee Medford was executor and sole beneficiary of the estate of Mary Clemens under a 1978 will.¹⁴ After Medford probated this will, Robert McLendon instituted a caveat proceeding to probate a 1977 will, supposedly executed by Clemens, that made McLendon a devisee.¹⁵ Patrick Span and Claudia Span Johns, representing all of Clemens' heirs at law, intervened in the caveat proceeding.¹⁶ During the trial all parties executed a compromise agreement which provided that the 1978 will would be probated, but that the estate would be distributed in accordance with the terms of the agreement.¹⁷ The jury determined that the 1978 will was Clemens' last will and testament, and the trial court entered a consent judgment to that effect. The court ordered that the estate be distributed in accordance with the terms of the compromise agreement.¹⁸

As executor of the Clemens estate, Medford filed a North Carolina Inheri-

9. See generally 42 AM. JUR. 2D, *supra* note 2, § 76 (discussing both the majority and minority views on effect of compromise of will contest).

10. *Id.*

11. See, e.g., *Cochran's Ex'r & Trustee v. Commonwealth*, 241 Ky. 656, 661, 44 S.W.2d 603, 605 (1931).

12. *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 80, 172 N.W. 902, 903-04 (1919); 42 AM. JUR. 2D, *supra* note 2, § 76.

13. An heir or devisee would have to pay inheritance tax on his total bequest under the majority view; he would only pay inheritance tax on the part of the bequest he actually received under the minority view. Also, tax rates and exemption amounts for beneficiaries vary according to the closeness in kinship of the beneficiary and the decedent. See N.C. GEN. STAT. §§ 105-4, -5 (1979 & Supp. 1984). The majority, taxation according to the will view, can deny the advantages of such provisions to a contestant-beneficiary under a compromise agreement if he is closer in kin to the decedent than was the devisee.

14. *Medford*, 67 N.C. App. at 543, 313 S.E.2d at 593.

15. *Id.*

16. *Id.*

17. *Id.* The compromise agreement provided for a distribution as follows: fifty percent to Medford, twenty-eight percent to McLendon, and eleven percent each to Span and Johns. *Id.*

18. *Id.* at 543-44, 313 S.E.2d at 593.

tance Tax Return, computing the tax due based on the transfers under the consent judgment.¹⁹ Defendant Department of Revenue ignored the consent order, computing the estate's inheritance tax liability in accordance with the terms of the will and assessing Medford \$4,845.92 in additional taxes, penalties, and interest.²⁰ Medford paid the assessment, was denied a refund, and sued to recover the amount paid.²¹ In the resulting nonjury trial, the presiding judge ruled in favor of the Department of Revenue and concluded, as a matter of law, that Medford was required by section 105-2(1) to determine the inheritance tax in accordance with the terms of the will.²²

A unanimous court of appeals reversed, ruling that section 105-2(1) required Medford to compute the inheritance tax in accordance with the compromise agreement distributions contained in the consent judgment.²³ The Department of Revenue had contended that the 1957 case of *Pulliam v. Thrash*²⁴ was controlling.²⁵ In *Pulliam* the North Carolina Supreme Court had held that "the succession tax is computable in accordance with the terms of the will, unaffected by the compromise agreement" which had been incorporated into a consent judgment.²⁶ The *Medford* court, however, noted that *Pulliam* was decided prior to the amendment of section 105-2(1),²⁷ which added that a transfer is to be taxed "when the transfer is made pursuant to a final judgment entered in a proceeding to caveat a will."²⁸ The court found that the legislature, through this amendment, intended to change the *Pulliam* result and held that section 105-2(1) as amended clearly required that the inheritance tax be computed on transfers in accordance with the final judgment in a caveat proceeding.²⁹

The Department of Revenue also argued that the consent judgment was only a contract between the parties and did not constitute a "final judgment" as intended by section 105-2(1).³⁰ The court disagreed,³¹ noting that the North Carolina Supreme Court had held that:

Once the court adopts the agreement of the parties and sets it forth as a judgment of the court . . . the contractual character of the agreement is subsumed into the court ordered judgment. At that point the court and the parties are no longer dealing with a mere contract

19. *Id.* at 544, 313 S.E.2d at 594.

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. 245 N.C. 636, 97 S.E.2d 253 (1957).

25. *Medford*, 67 N.C. App. at 545, 313 S.E.2d at 594.

26. *Pulliam*, 245 N.C. at 639, 97 S.E.2d at 256 (quoting Annot., 36 A.L.R. 2D 918 (1954)). "Succession tax" is merely a synonym for inheritance tax.

27. *Medford*, 67 N.C. App. at 545, 313 S.E.2d at 594.

28. N.C. GEN. STAT. § 105-2(1) (1979 & Supp. 1984).

29. *Medford*, 67 N.C. App. at 545, 313 S.E.2d at 594.

30. *Id.*

31. *Id.*

between the parties.³²

Therefore, the court held "that a consent judgment entered in a caveat proceeding is, absent any evidence of collusion, a final judgment for purposes of section 105-2(1)."³³ Accordingly, the court correctly held that the inheritance tax should have been computed according to the compromise agreement transfers instead of according to the will provisions.³⁴

Until 1937 North Carolina followed the majority rule of computing inheritance taxes according to the distributions made under the will or by intestate succession.³⁵ The inheritance tax statute was then amended to provide expressly that when an estate was distributed in accordance with a compromise agreement, inheritance taxes should be computed according to that agreement.³⁶ This change, however, did not last long. In 1941 the legislature again amended the inheritance tax statute, deleting the provision dealing with compromise agreements and realigning North Carolina with the majority view of taxation according to the will.³⁷ When the statute was amended to its present form in 1974, North Carolina rejoined the minority view of taxation according to the compromise agreement.³⁸

Although the North Carolina statute governing inheritance taxes has shifted between the majority and minority views, all pre-*Medford* cases concerning inheritance taxation in North Carolina were decided under the statute when it reflected the majority view. These cases, therefore, supported taxation according to the will.³⁹

32. *Id.* at 545-46, 313 S.E.2d at 594-95 (quoting *Henderson v. Henderson*, 307 N.C. 401, 407-08, 298 S.E.2d 345, 350 (1983)).

33. *Id.* at 546, 313 S.E.2d at 595.

34. *Id.*

35. *See, e.g.*, Act of May 9, 1935, ch. 371, § 1, 1935 N.C. Sess. Laws 429, 429; Act of March 10, 1925, ch. 101, § 6, 1925 N.C. Sess. Laws 116, 119; Act of March 9, 1915, ch. 285, § 6, 1915 N.C. Sess. Laws 355, 357; Act of March 15, 1901, ch. 9, § 12, 1901 N.C. Sess. Laws 116, 123. Until 1939 North Carolina's revenue act had to be renewed every two years. The statutes cited are examples of the inheritance tax statute during this period.

36. Act of March 13, 1937, ch. 127, 1937 N.C. Sess. Laws 170. This change reflected the minority view. *See supra* notes 9-13 and accompanying text.

37. Act of Feb. 28, 1941, ch. 50, 1941 N.C. Sess. Laws 66.

38. Act of Apr. 11, 1974, ch. 1287, 1973 N.C. Sess. Laws 557 (codified at N.C. GEN. STAT. § 105-2(1) (1979 & Supp. 1984)).

39. *See, e.g.*, *Pulliam v. Thrash*, 245 N.C. 636, 97 S.E.2d 253 (1957); *Bailey v. McLain*, 215 N.C. 150, 1 S.E.2d 372 (1939); *Greene v. Lynch*, 51 N.C. App. 665, 277 S.E.2d 454 (1981); *In re McCoy*, 39 N.C. App. 52, 249 S.E.2d 473 (1978), *disc. rev. denied*, 296 N.C. 585, 254 S.E.2d 36 (1979). In *McCoy*, which was decided four years after § 105-2(1) was amended, the court had to apply the statute as it appeared in 1973, the year of the decedent's death. Its holding therefore follows the majority view.

Pulliam was the first case in which the North Carolina Supreme Court explicitly recognized the majority view. The *Pulliam* court held that an executor must compute inheritance taxes according to the distributions in the will, basing its decision on the 1957 version of § 105-2(1). *Pulliam*, 245 N.C. at 639, 97 S.E.2d at 255-56. Section 105-2 did not then include a provision regarding caveat proceedings or compromise agreements. The court stated that:

Our statutes impose inheritance taxes upon transfers of property by will, by intestate laws or in contemplation of death. . . . No provision [in section 105-2] is made for the assessment of inheritance taxes on a different basis, because, pursuant to a contract made by the devisees after testator's death, the ultimate disposition differs in whole or in part from that prescribed by the will.

North Carolina's recognition of the majority view, however, was expressly rejected in *Medford*.⁴⁰ The *Medford* court found that the North Carolina legislature, through its 1974 amendment of section 105-2(1), had adopted the minority view—taxation according to the compromise agreement.⁴¹ The court of appeals' interpretation of this statute is consistent with the statutory language and, therefore, is correct.

The power to levy an inheritance tax and to specify how the tax should be computed is entirely within the province of the general assembly.⁴² The North Carolina General Assembly, by amending section 105-2(1) in 1974, has provided that North Carolina should follow the minority rule and tax transfers according to their distribution in a compromise agreement if the agreement is incorporated into a final judgment in a caveat proceeding.⁴³ Although it is clear that the legislature has amended section 105-2(1) to adopt the minority rule, the reasons for the legislature's reversal are unclear. Because no legislative history exists in North Carolina to identify the supporting arguments behind the amendment, an examination of the public policies supporting both the majority and minority views clarifies the North Carolina General Assembly's change in position.⁴⁴

Four major rationales support the majority, taxation according to the will view. First, some jurisdictions reason that the transfer to be taxed occurs on the date of the decedent's death, and the tax is fixed as of that time.⁴⁵ Any subse-

Id.

40. *Medford*, 67 N.C. App. at 546, 313 S.E.2d at 595.

41. *Id.* at 545, 313 S.E.2d at 594.

42. See *In re Morris' Estate*, 138 N.C. 259, 262-63, 50 S.E. 682, 683 (1905). The *Morris* court stated that:

[T]he right to take property by devise or descent is not one of the natural rights of man, but is the creature of the law The authority which confers such rights may impose conditions upon them, or take them away entirely. Accordingly, it is held that the states may tax the privilege, grant exemptions, discriminate between relatives and between these and strangers, and are not precluded from the exercise of this power by constitutional provisions requiring uniformity and equality of taxation. Neither is it necessary to the validity of the tax that the state Constitution should contain a specific delegation of power authorizing the Legislature to impose such taxation. The power of the Legislature over the subject of taxation is absolute unless restricted by the Constitution of the state or nation.

Id.

43. *Medford*, 67 N.C. App. at 545, 313 S.E.2d at 594.

44. Although each state's statute governing inheritance taxes is different, the public policy reasoning behind these statutes, examined in existing case law, should be applicable and persuasive irrespective of the differences in the statutes' wording. Also, whether the majority or minority view will benefit the state or the taxpayer depends upon the facts peculiar to each situation; neither view consistently benefits one party more than the other.

The federal government's taxation on transfers at death is an estate tax based on a decedent's total estate, not an inheritance tax upon particular inheritances. Therefore, the federal government's attitude towards the majority and minority view will not be examined in detail. The vast majority of cases dealing with the federal estate tax and compromise agreements deal with charity-legatees who agree to pay a portion of the bequest to decedent's heirs at law in return for the heir's withdrawal of a will contest suit. The general rule in these cases favors the minority view and taxes the amount received by the heirs, while the charity's share is nontaxable. *Annot.*, 36 A.L.R. 2d 917, 920-21 (1954). Two earlier cases, however, did involve a federal inheritance tax and taxed the distributions made in accordance with the compromise agreements. See *Page v. Rives*, 18 F. Cas. 990 (C.C.W.D. Va. 1877) (No. 10,666); *McCoy v. Gill*, 156 F. 985 (C.C.D. Mass. 1907).

45. See *MacKenzie v. Wright*, 31 Ariz. 272, 252 P. 521 (1927); *People v. Upson*, 338 Ill. 145, 170 N.E. 276 (1930); *Indiana Dept. of State Revenue, Inheritance Tax Div. v. Kitchin*, 119 Ind.

quent compromise agreement is merely a contract by which an heir or devisee assigns a part of his interest in the decedent's estate to the contestant.⁴⁶ Second, since the will is an essential link in the chain of title⁴⁷ and transfers in the will take effect at the testator's death, seisin immediately vests in the devisee upon testator's death. If the taxable transfer was made pursuant to a later compromise agreement, the seisin would not be vested in anyone from the time of testator's death until the compromise agreement became effective, violating the doctrine that someone must always possess the seisin.⁴⁸

The third rationale supporting the taxation according to the will view is that it, unlike the minority view, offers no opportunity for tax avoidance.⁴⁹ The minority view would allow a contestant and an heir or devisee to arrange collusively the property distribution so as to take advantage of favorable tax rates and exemptions.⁵⁰ This manipulation of taxes would, according to the majority position, wrongfully deprive the state of inheritance taxes.⁵¹

A fourth rationale in favor of the majority view is that statutory provisions allowing taxation according to the compromise agreement are unnecessary because the same result can be reached between the compromising parties by apportioning the total inheritance tax to be paid in the compromise agreement.⁵² The parties can specify in a tax apportionment clause that each will pay a certain percentage of the tax due, or apportion the taxes consistently with the property each receives from the estate.⁵³ Thus, the majority view can provide an equitable allocation of taxes according to the property actually received by a beneficiary while still complying with the doctrinal requirement that inheritance taxes

App. 422, 86 N.E.2d 96 (1949) (en banc); *Cochran's Ex'r and Trustee v. Commonwealth*, 241 Ky. 656, 44 S.W.2d 603 (1931); *Baxter v. Stevens*, 209 Mass. 459, 95 N.E. 854 (1911); *In re Cook's Estate*, 187 N.Y. 253, 79 N.E. 991 (1907).

46. *Indiana Dept. of State Revenue, Inheritance Tax Div. v. Kitchin*, 119 Ind. App. 422, 424, 86 N.E.2d 96, 97 (1949) (en banc); *Cochran's Ex'r and Trustee v. Commonwealth*, 241 Ky. 656, 659, 44 S.W.2d 603, 604 (1931).

47. *Borish v. Zink*, 2 N.J. Super. 42, 44, 64 A.2d 461, 461 (1949).

48. This argument concerning seisin seems less significant today because of the reduced emphasis on seisin in modern property law.

49. See Note, *A Survey of Statutory Changes in North Carolina in 1941*, 19 N.C.L. REV. 435, 527 (1941).

50. See *People v. Union Trust Co.*, 255 Ill. 168, 99 N.E. 377 (1912); *Hart v. Mercantile Trust Co.*, 180 Md. 218, 23 A.2d 682 (1942); *In re Gartside's Estate*, 357 Mo. 181, 207 S.W.2d 273 (1947); *In re Kierstead's Estate*, 122 Neb. 694, 241 N.W. 274 (1932); *In re Pepper's Estate*, 159 Pa. 508, 28 A. 353 (1894). Many states following the minority view, however, require that the compromise agreement be entered into in good faith and for purposes other than tax avoidance. These states guard against tax avoidance compromises through the use of fraud statutes and by requiring that compromise agreements be incorporated into a court judgment or decree, thereby providing judicial review of the agreement. See *Hart v. Mercantile Trust Co.*, 180 Md. 218, 222, 23 A.2d 682, 684 (1942); *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 80-81, 172 N.W. 902, 904 (1919); *In re Estate of Kierstead*, 122 Neb. 694, 703, 241 N.W. 274, 278 (1932).

51. *Hart v. Mercantile Trust Co.*, 180 Md. 218, 222, 23 A.2d 682, 684 (1932).

52. See *Brown v. McLoughlin*, 287 Mass. 15, 190 N.E. 795 (1934); *Pulliam v. Thrash*, 245 N.C. 636, 97 S.E.2d 253 (1957).

53. *Cohn v. Cohn*, 20 Cal. 2d 65, 68, 123 P.2d 833, 835 (1942); *Pulliam v. Thrash*, 245 N.C. 636, 640, 97 S.E.2d 253, 256 (1957); *In re Estate of Rendsland*, 92 Wash. 2d 185, 190, 594 P.2d 1346, 1349 (1979). See generally Annot., 70 A.L.R. 3d 691, 717 (1954) (discussing tax apportionment provisions in will compromise agreements).

tax transfers at decedent's death.⁵⁴

The minority, taxation according to the compromise agreement view also possesses significant public policy support. Five rationales have been advanced in support of the minority view. First, taxation according to the compromise provides a more equitable tax allocation.⁵⁵ Under the minority view, only the property actually received by a beneficiary under the compromise agreement is taxed.⁵⁶ If a compromise agreement significantly alters the transfers mentioned in a will, basing the inheritance tax due on the will provisions would impose an inequitable tax burden on the devisees.⁵⁷

Second, taxation according to the compromise agreement more closely follows the legislative intent implicit in inheritance taxes—to tax the transfer of the decedent's property.⁵⁸ Inheritance taxes do not tax a decedent's estate, but rather tax the receipt of property from that estate.⁵⁹ A third rationale supporting the minority view is based on the relationship between a testator and the contestant of his will.⁶⁰ To have standing to contest, a party must have an interest that would be adversely affected by probate of the contested will.⁶¹ Thus, an interested party could include heirs at law and beneficiaries under a prior will.⁶² Because of this interest requirement many courts have held that any property transferred to a contestant as a result of a compromise agreement should be treated as having passed under the laws concerning descent and distribution to an heir of the same relationship as the contestant was to the testator and taxed accordingly.⁶³ This result seemingly would create a part-will part-intestacy dis-

54. Under the majority view, however, the tax would be assessed against the beneficiaries under the will. See *In re Cook's Estate*, 187 N.Y. 253, 259-60, 79 N.E. 991, 993 (1907). Therefore, the majority view would ignore any favorable tax rates or exemptions a contestant close in kin to the decedent might possess that the minority view would allow. See *infra* note 63 and accompanying text.

55. See *In re Estate of Thorson*, 150 Minn. 464, 185 N.W. 508 (1921); *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 172 N.W. 902 (1919); *In re Estate of Gartside*, 357 Mo. 181, 207 S.W.2d 273 (1947); *In re Estate of Kierstead*, 122 Neb. 694, 241 N.W. 274 (1932); *In re Pepper's Estate*, 159 Pa. 508, 28 A. 353 (1894).

56. See *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 80, 172 N.W. 902, 903 (1919).

57. See *In re Estate of Gartside*, 357 Mo. 181, 185, 207 S.W.2d 273, 275 (1947); *Pepper's Estate*, 159 Pa. 508, 510, 28 A. 353, 353 (1894).

58. See *Hart v. Mercantile Trust Co.*, 180 Md. 218, 23 A.2d 682 (1942); *In re Estate of Thorson*, 150 Minn. 464, 185 N.W. 508 (1921); *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 172 N.W. 902 (1919); *In re Estate of Gartside*, 357 Mo. 181, 207 S.W.2d 273 (1947).

59. *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 80, 172 N.W. 902, 903 (1919); *In re Morris' Estate*, 138 N.C. 259, 262, 50 S.E. 682, 683 (1905). Although transfers from an estate theoretically are taxed as of the time of decedent's death and compromise agreements are entered into after a decedent's death, the legislative intent of inheritance tax law overrides this discrepancy and demands that the tax be computed on the property as it actually is distributed to the beneficiaries. See *State ex rel. Hilton*, 143 Minn. at 80, 172 N.W. at 903.

60. See *People ex rel. Attorney Gen. v. Rice*, 40 Colo. 508, 91 P. 33 (1907); *Taylor v. State*, 40 Ga. App. 295, 149 S.E. 321 (1929); *Hart v. Mercantile Trust Co.*, 180 Md. 218, 23 A.2d 682 (1942); *In re Estate of Gartside*, 357 Mo. 181, 207 S.W.2d 273 (1947); *In re Estate of Kierstead*, 122 Neb. 694, 241 N.W. 274 (1932); *In re Hastings' Estate*, 183 Misc. 517, 49 N.Y.S.2d 524 (1944).

61. *In re Will of Calhoun*, 47 N.C. App. 472, 267 S.E.2d 385, *disc. rev. denied*, 301 N.C. 90, 273 S.E.2d 311 (1980).

62. *In re Estate of Gartside*, 357 Mo. 181, 184, 207 S.W.2d 273, 275 (1947); *In re Will of Belvin*, 261 N.C. 275, 276, 134 S.E.2d 225, 226 (1964).

63. *Taylor v. State*, 40 Ga. App. 295, 295, 149 S.E. 321, 321 (1929); *Hart v. Mercantile Trust Co.*, 180 Md. 218, 222, 23 A.2d 682, 684 (1942); *In re Estate of Gartside*, 357 Mo. 181, 184, 207

tribution and would allow the transfers to be taxed according to the compromise agreement while still meeting the doctrinal requirement that transfers be taxed at the testator's death.⁶⁴ The theory of partial renunciation also supports the minority view.⁶⁵ Under this theory, when a beneficiary renounces a bequest or legacy he is not taxed on the attempted transfer; the property passes through intestacy and is taxed to the receiving heirs.⁶⁶ Likewise, a devisee under a will should not be taxed on his whole bequest if, as a result of a compromise agreement, he does not receive the whole bequest; the amount passing under the compromise agreement should be treated as a partial renunciation by the devisee and should be taxed to the recipients as if it were passing through intestacy.⁶⁷

The fourth public policy rationale in favor of the minority view is that taxation according to the compromise agreement encourages the settlement of will-contest litigation.⁶⁸ Because under the minority view a devisee or legatee must pay inheritance taxes only on the amount received and not on the total bequest or intestate share, a devisee or legatee should be more willing to compromise and settle a will-contest suit.⁶⁹

The fifth rationale favoring the minority view deals with the requirement, imposed by several states, that the compromise agreement be incorporated into a court decree or judgment for the minority rule to apply.⁷⁰ The possibility of an invalid will may create uncertainty as to who is entitled to property passing through a testator's estate.⁷¹ Therefore, the logical result in will-contest suits would be to hold that no actual transfer of the estate assets occurs until a court

S.W.2d 273, 275 (1947). Treating the transfers under a compromise agreement as having passed under the laws of descent and distribution would also meet the majority view's requirement that the transfer to be taxed occur at the decedent's death.

64. See *supra* notes 45-46 and accompanying text.

65. See *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 81-82, 172 N.W. 902, 904 (1919); *In re Estate of Kierstead*, 122 Neb. 694, 704, 241 N.W. 274, 278 (1932).

66. *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 81-82, 172 N.W. 902, 904 (1919); *In re Estate of Kierstead*, 122 Neb. 694, 704, 241 N.W. 274, 278 (1932).

67. *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 81-82, 172 N.W. 902, 904 (1919); *In re Estate of Kierstead*, 122 Neb. 694, 704, 241 N.W. 274, 278 (1932). Of course, under partial renunciation the property renounced would pass through intestacy to the heirs at law as a class, not to a specific "heir" as it would under a compromise agreement.

68. See *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 81, 172 N.W. 902, 904 (1919); *In re Estate of Kierstead*, 122 Neb. 694, 704, 241 N.W. 274, 278 (1932); Note, *Taxation—Effect of North Carolina Inheritance Tax on a Will Compromise Agreement*, 36 N.C.L. REV. 236, 238 (1958). A danger exists, however, that by encouraging settlements the minority view may also encourage a devisee and contestant to avoid inheritance taxes by apportioning the property in such a manner as to maximize the effect of favorable tax rates and exemptions available to parties close in kin to decedent. See *supra* notes 49-51 and accompanying text. By encouraging settlements, the minority view also may tempt a devisee and contestant to withhold evidence concerning the invalidity of a will in order to facilitate an agreement between themselves, possibly excluding rightful heirs. See *Bailey v. McLain*, 215 N.C. 150, 158-59, 1 S.E.2d 372, 377 (1939) (Clarkson, J., dissenting). Both of these dangers, however, can be minimized by requiring that the compromise agreement be incorporated into a judgment, thus subjecting it to judicial review. See *infra* notes 70-75 and accompanying text.

69. *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 81, 172 N.W. 902, 904 (1919).

70. See *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 172 N.W. 902 (1919); *In re Estate of Kierstead*, 122 Neb. 694, 241 N.W. 274 (1932); *Medford v. Lynch*, 67 N.C. App. 543, 313 S.E.2d 593 (1984).

71. *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 80, 172 N.W. 902, 903-04 (1919).

enters a final decree or judgment providing for a valid distribution.⁷² Any such decree or judgment would be treated as having occurred at decedent's death and would be binding on all, unless a compromise agreement had been entered into collusively.⁷³ The requirement that a compromise agreement be incorporated into a final decree or judgment provides the court an opportunity to evaluate whether the agreement was made collusively or solely to avoid taxes, rather than to settle a bona fide controversy.⁷⁴ Therefore, to require incorporation of a compromise agreement into a judgment or decree refutes criticism that the minority view allows taxation of transfers made after the decedent's death and encourages tax avoidance.⁷⁵

The minority view is the better of the two approaches. By taxing a beneficiary only on property he actually receives, the minority view provides a more equitable result.⁷⁶ Under this view, a devisee would not suffer any disproportionate inheritance tax hardship when he surrenders a portion of his bequest to a will contestant in a compromise agreement. The majority view would force the devisee to pay the inheritance tax on his total bequest under the will.

The minority view fulfills the legislative intent underlying inheritance taxes—to tax the beneficiary of a transfer of estate property only on the amount he actually receives.⁷⁷ Since the North Carolina Supreme Court has held that “[a] law imposing an inheritance tax is to be liberally construed to effectuate the intention of the Legislature,”⁷⁸ this result should be of primary importance. Therefore, the *Medford* court was correct in its interpretation of section 105-2(1) and its recognition of the minority view in North Carolina. The minority view also best implements the testator's intent. A testator would not wish for an intended devisee to pay inheritance taxes on property the devisee did not receive while an intentionally omitted contestant to the will pays no taxes on property received pursuant to a compromise agreement.

The criticisms of the minority view are unfounded. The principle criticism is that the minority rule does not comply with the theoretical requirement that

72. *Id.* The court in *State ex rel. Hilton v. Probate Court*, 143 Minn. 77, 80, 172 N.W. 902, 903-04 (1919) stated:

Where a decedent has attempted to transfer his estate by a purported will, there is frequently an uncertainty as to the persons who eventually will participate in the estate, and the amount or value of the portion to be received; and there is also a possibility that the transfer may after all be in virtue of the intestate law, and not through the will. The will may turn out not properly executed, or invalid because of lack of testamentary capacity or the exertion of undue influence. Therefore, in case of a contest between the beneficiaries named in the will, or where the instrument is attacked by one claiming under the intestate law, the practical proposition is that there is no actual transfer of any portion of the estate until the final decree of distribution is made, or until a court of competent jurisdiction construes or determines the issue between the claimants. The decree so finally entered relates back, and, of course, makes the transfer effectual as of the date of death.

73. *Id.*

74. *Id.*; Appellant's Brief at 7, *Medford*.

75. For a discussion of the majority view's criticism of these points, see *supra* notes 45-46 and 49-51 and accompanying text.

76. See *supra* notes 55-57 and accompanying text.

77. See *supra* notes 58-59 and accompanying text.

78. *Watkins v. Shaw*, 234 N.C. 96, 98, 65 S.E.2d 881, 883 (1951).

inheritance taxes be levied on transfers at the time of testator's death.⁷⁹ The minority view, however, counters this criticism by implying that the property the contestant received passes under the statutes of descent and distribution and relates back to the date of the testator's death under the compromise agreement.⁸⁰ This construction is supported by the close relationship that usually exists between the contestant and the testator.⁸¹ Therefore, the minority view satisfies the requirement that transfers be taxed at the date of testator's death.

By interpreting section 105-2(1) to tax inheritances according to the distributions in a compromise agreement when that agreement is incorporated into a final judgment in a caveat proceeding, the *Medford* court has given judicial recognition to the minority view of taxation according to the compromise agreement in North Carolina. This decision provides North Carolina with an equitable inheritance tax law that best effectuates both the legislative intent of the inheritance tax statute and the decedent's intent.

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79. See *supra* notes 45-46 and accompanying text.

80. See *supra* notes 60-67 and accompanying text.

81. See cases cited *supra* note 60.