

IN THE COURT OF APPEALS OF IOWA

No. 9-592 / 08-1718
Filed October 7, 2009

**MARK TREMEL and BRUCE TREMEL,
Minors, by CITIZENS FIRST NATIONAL
BANK of Storm Lake, Iowa, Their
Conservator,**
Petitioners-Appellants,

vs.

IOWA DEPARTMENT OF REVENUE,
Respondent-Appellee.

Appeal from the Iowa District Court for Harrison County, G.C. Abel, Judge.

Beneficiaries of a life insurance policy not included in the probate estate appeal the district court's ruling holding them responsible for the payment of the Iowa estate tax. **REVERSED.**

Steven J. Roy, Denise M. Mendt, and Bridget C. Shapansky of Nyemaster, Goode, West, Hansell & O'Brien, P.C., Des Moines, for appellants.

Thomas J. Miller, Attorney General, and James D. Miller, Assistant Attorney General, for appellee.

Heard by Sackett, C.J., and Eisenhauer and Doyle, JJ.

EISENHAUER, J.

The Iowa Department of Revenue and the district court determined designated beneficiaries of a life insurance policy not included in the probate estate were responsible for the payment of the Iowa estate tax. We reverse.

I. BACKGROUND FACTS and PROCEEDINGS.

The facts are stipulated and undisputed. Philip Tremel died intestate in September 1998, leaving a surviving spouse, Lynne, and two minor children, Mark and Bruce. Lynne was appointed administrator of Philip's estate and Citizens First National Bank of Storm Lake was appointed conservator for the boys. Lynne disclaimed her interest in the estate and Mark and Bruce became the sole beneficiaries of the estate. At the time of his death Philip owned a life insurance policy on his own life. Lynne filed a separate disclaimer as a beneficiary under the policy and Mark and Bruce, as named contingent beneficiaries, became entitled to \$516,130.15 in life insurance proceeds.

The estate's filings showed \$98,687.92 due for federal estate tax, no inheritance tax due, and \$31,150.79 due for Iowa estate tax. After the payment of administrative expenses, the estate had no assets to pay the federal and Iowa estate taxes. The Iowa estate tax is equal to the federal credit for state death taxes. The estate was insolvent upon its closing. Mark and Bruce received no property from the estate.

On May 6, 2004, the Iowa Department of Revenue (IDOR) assessed the Iowa estate tax against Mark and Bruce and attempted to collect the tax through a levy on the insurance funds Citizens Bank was holding as conservator.

Citizen's Bank entered into an agreement with the IDOR reserving the right to request a refund and, after it received court approval to honor the levy, Citizen's Bank paid \$50,153.05 to the IDOR for Iowa estate tax, interest and penalties. The next month, in June 2005, Citizen's Bank filed timely claims for a refund and the IDOR has no objection to the manner in which the refund claims were made. The IDOR denied the refund claims and Mark and Bruce sought administrative relief.

The only property Mark and Bruce received was the life insurance proceeds. The parties agree these proceeds are not included in or taxable to the estate for inheritance tax purposes. Therefore, the life insurance proceeds are outside of the scope of the provisions of Iowa Code chapter 450, inheritance tax. See *In re Estate of Brown*, 205 N.W.2d 925, 926 (Iowa 1973) (proceeds of life insurance payable to a named beneficiary are exempt from Iowa inheritance tax). The parties also agree the insurance proceeds were included in the taxable estate for federal estate tax and Iowa estate tax purposes, but were not part of the probate estate or assets.

In August 2006, the administrative law judge (ALJ) ruled that because the insurance proceeds were not part of the estate for inheritance tax purposes, the Iowa Code did not authorize the IDOR to collect the estate tax from Mark and Bruce. Subsequently, the ALJ found the IDOR's position was not substantially justified and awarded attorney's fees and costs to Mark and Bruce. The IDOR appealed the decision to its director. The IDOR director reversed the ALJ's decision. The director ruled the IDOR was authorized to collect the estate tax

from the insurance proceeds and reversed the award of attorney's fees and litigation costs. The district court affirmed the director's decision and this appeal followed.

II. SCOPE OF REVIEW.

In this appeal from an administrative agency, our review is for correction of errors at law. *Camacho v. Iowa Dep't of Revenue*, 666 N.W.2d 537, 540 (Iowa 2003).

III. TAXATION.

The resolution of this case involves the interplay of the inheritance tax provisions in Iowa Code chapter 450 and the estate tax provisions in Iowa Code chapter 451 (1997). Mark and Bruce argue the IDOR has no statutory authority to assess and collect the estate tax due from the life insurance proceeds. We strictly construe taxing statutes against the taxing body and liberally in favor of the taxpayer. *Sorg v. Iowa Dep't of Revenue*, 269 N.W.2d 129, 132 (Iowa 1978). "It must appear from the language of the statute the tax assessed was clearly intended." *Id.* For the IDOR's assessment to be upheld there must be a statute creating a lien on property possessed by Mark or Bruce or a statute must impose the requirement to pay the tax on Mark or Bruce. We agree with appellants that there is neither.

A. Personal Representative Obligations.

The filing of an estate tax return is addressed in Iowa Code section 451.5, which provides, "[t]he personal representative of a decedent whose estate may be subject to the [estate] tax . . . shall file . . . the estate tax return." The payment

of Iowa estate taxes is addressed in Iowa Code section 451.6, which provides, “[t]he [estate] tax imposed by this chapter shall be paid by the personal representative.”¹

When, as here, the decedent dies intestate, the term “personal representative” means the administrator of the estate. See Iowa Code § 451.1(8). Lynne, as administrator, is obligated to file the estate tax return and pay the estate tax, but has no personal liability for the taxes. See *In re Meinert’s Estate*, 204 Iowa 355, 358, 213 N.W. 938, 939 (Iowa 1927) (“The tax is not upon the [administrator], or upon his property or upon his right. The tax is not his. His is the duty of deducting or collecting. If he is unable to collect he is not personally liable.”). Clearly Iowa Code sections 451.5 and .6 contain no language obligating Mark or Bruce to either file the estate tax return or pay the estate taxes. Rather, the statute only imposes those duties upon Lynne as the personal representative.

It is undisputed the insurance proceeds are a part of the gross estate for federal and Iowa estate tax purposes. It is also undisputed the proceeds were not part of the probate estate. It is Iowa law that must provide for the payment of Iowa estate tax. Section 451.6 contains no language authorizing the collection of Iowa estate tax from non-probate assets. “[W]e are bound by what the legislature said, not by what it should or might have said.” *Ranniger v. Iowa Dep’t of Revenue*, 746 N.W.2d 267, 270 (Iowa 2008). Under the unambiguous language

¹ Neither section extends the filing or payment obligation to anyone other than the personal representative. Iowa Code §§ 451.5, .6. Because Iowa Admin. Code r. 701-87.3(4) is inconsistent with these statutes, it exceeds the department’s authority. See *Sorg*, 269 N.W.2d at 131.

of section 451.6, Mark and Bruce are not liable for the estate tax because the statute imposes that liability only on the personal representative.

B. Collection of Estate Tax.

Chapter 451 contains no section specifying from which assets the Iowa estate tax may be collected or made subject to a lien. Instead, the Iowa legislature coupled the collection of Iowa's estate tax with the collection provisions of Iowa's inheritance tax. The controlling estate tax provision in effect at the date of Phillip's 1998 death, section 451.12 (1997), provides:

All the provisions of chapter 450 [inheritance tax] with respect to the lien provisions of section 450.7, and the determination, imposition, payment, and collection of the tax imposed under that chapter [inheritance tax] . . . are applicable to this chapter [estate tax], except as they are in conflict with this chapter.

Therefore, we must look to section 450.7 for the applicable lien provisions. Shortly before Philip's death in 1998, the legislature amended the section 450.7 inheritance tax lien provisions, effective July 1, 1997, and added parents and children to the lien *exclusions*. The amended section states:

Section 450.7, subsection 1, unnumbered paragraph 1, Code 1997, is amended to read as follows:

Except for the share of the estate passing to the surviving spouse, and parents . . . children . . . and other lineal descendants, the tax [inheritance] is a charge against and a lien upon the estate subject to tax under this chapter, and all property of the estate or owned by the decedent from the death of the decedent until paid

1997 Iowa Acts ch. 1, § 1 (new language underlined).

Further proof of the applicability of the section 450.7 lien exclusions at the time of Philip's death is found by the legislature's subsequent action amending section 451.12, the section coupling the collection of the estate tax with the

collection of the inheritance tax. As of July 1, 1999, section 451.12 contained additional language making the *exclusions* in the inheritance tax lien provisions *inapplicable* to the estate tax. For clarity, we again quote the entire section:

All the provisions of chapter 450 [inheritance tax] with respect to the lien provisions of section 450.7, and the determination, imposition, payment, and collection of the tax imposed under that chapter [inheritance tax] . . . are applicable to this chapter [estate tax], except as they are in conflict with this chapter. The exceptions to the lien provisions found in section 450.7 do not apply to this chapter [estate tax].

1999 Iowa Acts ch. 151, §§ 49, 89(8) (new language underlined). Therefore, at the time of Philip's death, the exceptions to the lien provisions in section 450.7 applied. Based upon the plain meaning of pre-amendment section 450.12 and post-amendment 450.7, property passing to children of the decedent is exempt from a lien for both inheritance tax and estate tax purposes. This includes the life insurance proceeds at issue here.

Additionally, the collection provisions of chapter 450 provide that insurance proceeds payable to designated beneficiaries are exempt from collection for estate tax due. Liability for inheritance tax is established in section 450.5:

Any person becoming beneficially entitled to any property or interest in property by any method of transfer as specified in this chapter [inheritance tax], and all personal representatives . . . of estates or transfers taxable under this chapter [inheritance tax], are respectively liable for all taxes to be paid by them respectively.

The language of section 450.5, made applicable to estate tax by section 451.12, shows Iowa's inheritance tax is collectable from two groups of assets: (1) the probate assets under the control of the personal representative; and (2)

the non-probate assets subject to the inheritance tax, i.e., “transfers taxable under this chapter [inheritance tax].” It is undisputed that life insurance proceeds payable to named beneficiaries are a non-probate asset and are not subject to inheritance tax. See *Brown*, 205 N.W.2d at 926. The only property Mark and Bruce received was the life insurance proceeds where they were named beneficiaries. Under Iowa law, the insurance proceeds are outside the scope of the inheritance tax provisions in chapter 450. Mark and Bruce have no liability under section 450.5, because they did not receive any property subject to chapter 450.

By operation of section 451.12, these are the same two groups of assets the IDOR may look to for collection of the estate tax. The IDOR admits life insurance proceeds are non-probate assets not subject to inheritance tax. The IDOR cannot ignore the plain language of section 451.12, which controls and limits the assessment and collection of the estate tax.

This result is not changed by the language found in inheritance tax section 450.55, entitled, “Means to collect tax,” which provides:

The provisions . . . pertaining to jeopardy assessments and distress warrants, apply to the unpaid tax . . . imposed *under this chapter*. In addition, the director of revenue and finance may bring . . . suit for the collection of *the tax* . . . against the personal representative or against the person entitled to property subject to *the tax*

Iowa Code § 450.55 (emphasis added).

In context, the first sentence’s reference to “unpaid tax . . . imposed under this chapter” shows the second sentence’s reference to “the tax” is the tax imposed under this chapter, i.e., the inheritance tax. This section does not

expand the class of persons liable for inheritance tax. Rather, as discussed above, liability for inheritance tax is found in section 450.5, entitled “Liability for tax.” Therefore, the clear meaning of the section 450.55 phrase “the personal representative or against the person entitled to property subject to the tax” is those persons who are liable for the inheritance tax as detailed in section 450.5. See *Carlton v. Bd. of Review*, 572 N.W.2d 146, 154 (Iowa 1997) (“It must appear from the language of the statute that the tax assessed against the taxpayer was clearly intended.”).

We conclude there is no statutory language in chapter 451 clearly imposing liability for estate tax on named beneficiaries of life insurance proceeds not part of the probate estate. Therefore, Mark and Bruce are entitled to a refund of the erroneously collected estate tax, penalty, and interest.

IV. LITIGATION COSTS.

Mark and Bruce, as prevailing taxpayers, may be entitled to reasonable litigation costs incurred subsequent to the IDOR’s denial of a refund claim. See Iowa Code §§ 421.60(4)(a), .60(4)(a)(4). A prevailing taxpayer is one who establishes the IDOR’s position was not substantially justified. *Id.* § 421.60(4)(c). We agree with and adopt the ALJ’s analysis in support of an award of litigation costs to Mark and Bruce. The ALJ ruled:

The major problem is the tie to Chapter 450 for the lien and collection process in 451.12. As soon as the Department got referenced back into the inheritance laws, it should have made an analysis as to the nature of the property that it was trying to tax and seize.

Life insurance proceeds made payable to a specific beneficiary—family members—are special property. Since 1973, the case of *In re Estate of Brown*, 205 N.W.2d 925 (Iowa 1973) . . .

made clear that it was not probate property. The court held that . . . the proceeds were exempt from creditors and was passed separate from probate property. In [the IDOR administrative rules], the Department makes it clear that the property is not subject to inheritance tax. The Department wants to close the curtain on this provision. The Department wants to just stay in Chapter 451 and use the federal statutes to say the property is subject to the federal tax, got the federal credit, and, therefore, is subject to a tax lien. The Department put on its blinders and wanted to look no farther.

Tax statutes did not exist in a vacuum. . . . The probate laws of Iowa must be reconciled to the tax laws. The Department completely failed to analyze the nature of the property in relation to existing Iowa law. . . . [L]aw for the exemption of property subject to execution is still in existence today. The various aspects of the probate code must be considered. The Department totally failed to make this analysis. As a result, the Department was not substantially justified in its position.

Therefore, Mark and Bruce, as prevailing taxpayers, are entitled to reasonable litigation costs in the amount of \$14,336.

REVERSED.

Doyle, J., concurs; Sackett, C.J., dissents.

SACKETT, C.J. (dissenting)

I respectfully dissent. I would affirm the district court and the director. I would not award litigation costs. The director and the district court took the state's position. The decision of a three-judge panel of this court drew a dissent. The law is far from clear on this issue. The state's position on this issue was clearly and substantially justified.