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FEDERAL GROSS ESTATE TAX—CONSTITUTIONALITY—REVOCABLE TRANSFERS BY WAY OF TRUST—Five recent decisions of the United States Supreme Court,[1] together with a decision of the United States Court of Appeals for the Third Circuit,[2] have considerably changed some

[1] Helvering v. City Bank Farmers Trust Co., 296 U. S. 85, 56 S. Ct. 70 (1935); Helvering v. Helmholz, 296 U. S. 93, 56 S. Ct. 68 (1935); White v. Poor, 296 U. S. 98, 56 S. Ct. 66 (1935); Helvering v. St. Louis Union Trust Co., 296 U. S. 39, 56 S. Ct. 74 (1935); Becker v. St. Louis Union Trust Co., 296 U. S. 48, 56 S. Ct. 78 (1935).

[2] Pennsylvania Co. v. Commissioner, (C. C. A. 3rd, 1935) 79 F. (2d) 295, certiorari denied 296 U. S. 651, 56 S. Ct. 310 (1935).

of the currently accepted theories regarding the taxability under the Federal Estate Tax of transfers reserving various degrees of control to donors, both with respect to what may be considered to be a sufficient reserved control and what the constitutional limits on the taxing power may be. Some perplexing questions have been settled by these decisions while others quite as vexing seem to have been raised and left for future determination.

I.

Problems arising out of variations in the degree of control reserved by the settlors of trusts have long been a source of litigation under the act. By virtue of *Reinecke v. Northern Trust Co.*,[3] it was established that a trust completely revocable at the will of the settlor, though created prior to the enactment of the Estate Tax law, was nevertheless taxable as a transfer "taking effect in possession or enjoyment at or after death" under section 402(c) of the 1921 Revenue Act[4] when the settlor died subsequently.[5] But, in the same case, the Court held that the tax was not applicable to trusts in which a power to revoke was reserved to be exercised with the consent of some, but not all, of the beneficiaries, because the requirement of a consenting adverse interest practically divested the settlor of effective control.[6] Certain language used in the opinion in this case[7] led to the belief that a reserved power to revoke which expressly stated that it could not be exercised for the benefit of the settlor himself would be a complete transfer not taxable under section 402(c).[8]

[3] 278 U. S. 339, 49 S. Ct. 123 (1929).

[4] 42 Stat. L. 278 (1921); which provided that in calculating the tax there should be included in the gross estate all property, tangible and intangible,

> "To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death (whether such transfer or trust is made or created before or after the passage of this Act). . . . "

[5] The decision with respect to the "two trusts" involved in that case was based on the theory that the transfers remained incomplete until the death of the settlor, at which time a tax act then in existence applied.

[6] The reference is to the "five trusts" considered in that case.

[7] Reinecke v. Northern Trust Co., 278 U. S. 339, 49 S. Ct. 123 (1929). In denying taxability as to the "five trusts" because the power to revoke was to be exercised by the settlor only with the consent of one adverse in interest, the Court said (278 U. S. 346):

> "The shifting of the economic interest in the trust property which was the subject of the tax was thus complete as soon as the trust was made. His power to recall the property and of control over it for his own benefit then ceased and as the trusts were not made in contemplation of death, the reserved powers do not serve to distinguish them from any other gift inter vivos not subject to the tax."

[8] Rottschaefer, "Taxation of Transfers Intended to Take Effect in Possession or Enjoyment at Grantor's Death," 14 MINN. L. REV. 613 at 632 (1930).

In 1924, the act was amended by adding section 302(d) which, for the first time, expressly imposed the tax upon transfers in trust or otherwise in which powers to revoke were reserved.[9] Although the loophole was seemingly closed by this new enactment, the circuit courts of appeals held that an attempt to tax such "completed" transfers would be unconstitutional and that, therefore, section 302(d) was inapplicable, the test of taxability being the power reserved in the grantor to recall for himself the beneficial enjoyment of the property transferred.[10] Whatever doubts may have existed as a result of the language in the *Reinecke* case and the circuit court decisions referred to, they were effectively dispelled by the Supreme Court in *Porter v. Commissioner*,[11] which held taxable any transfer, whether made before or after the enactment of section 302(d), in which the settlor reserved a power to revoke the trust except in favor of himself. The Court rejected the notion that the power to recall was the test of taxability, but rather pointed out that the settlor's death in such case terminated his control and ended any possibility of change by him, thereby giving a permanence to the beneficiary's interest which it had theretofore lacked. This possibility of modification during the lifetime of the donor was deemed sufficient to render the property taxable at the death of the settlor.[12]

As has been stated, the trusts which were held to be not taxable in the *Reinecke* case involved reserved powers of revocation to be exercised in conjunction with a beneficiary. The literal wording of section 302(d) [13] of the act included such transfers, providing for taxability "where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power . . . in conjunction with any person, to alter, amend, or revoke. . . . " However, the general opinion among the authorities as well as the trend of the cases relevant seemed to indicate that transfers should not be regarded as subject to the tax if the power of revocation could be exercised only with the consent of an adverse interest.[14] Those who entertained this idea felt that

[9] 43 Stat. L. 304 (1924) provided: "The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated . . .

"(d) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke. . . . "

[10] Brady v. Ham, (C. C. A. 1st, 1930) 45 F. (2d) 454; White v. Erskine, (C. C. A. 1st, 1931) 47 F. (2d) 1014.

[11] 288 U. S. 436, 53 S. Ct. 451 (1933).

[12] Surrey and Aronson, "Inter Vivos Transfers and the Federal Estate Tax," 32 COL. L. REV. 1322 (1932).

[13] 43 Stat. L. 304 (1924). See note 9, supra.

[14] Lit v. Commissioner, 28 B. T. A. 853 (1933), affd. (C. C. A. 3rd, 1934) 72

"any person" should be construed to mean "any person not having a substantial interest."[15] This belief was not without adequate foundation, since the statement of the Committee on Ways and Means of the House[16] showed that the intention was to incorporate in the Estate Tax Act a section analogous to section 219(g) of the Income Tax Law,[17] which taxed to the settlor the income from trusts as to which he had reserved a power of revocation to be exercised in conjunction with "any person *not a beneficiary of the trust.*" To this was added the influence of the language used by the Court in the *Reinecke* case, treating such a transfer as practically absolute. This was not an unreasonable basis for doubting the constitutionality of an attempt to reach the transaction under the Estate Tax Act.[18]

Somewhat of a surprise, then, was the recent decision of the Supreme Court in *Helvering v. City Bank Farmers Trust Co.*[19] There the settlor created a trust in 1930, after the enactment of section 302(d), retaining the income for life and reserving a power to revoke to be exercised in conjunction with a beneficiary and the trustee. This was held to be taxable under section 302(d). The Court, relying on the complete clarity of the language used in the act, refused to construe "in conjunction with any person" to mean "in conjunction with any person not a beneficiary." For that reason it also refused to be guided by the comment of the Committee on Ways and Means of the House.[20]

More significant than its decision on the facts is the treatment accorded to the question of constitutionality. Prior to this decision, *Schlesinger v. Wisconsin*[21] seemed effectively to bar as unconstitu-

F. (2d) 551; Lowndes, "A Day in the Supreme Court with the Federal Estate Tax," 22 VA. L. REV. 261 (1936).

[15] Leaphart, "The Use of the Trust to Escape Federal Income and Estate Taxes," 15 CORN. L. Q. 587 at 593 (1930); Sutter and Owen, "Federal Taxation of Settlors of Trusts," 33 MICH. L. REV. 1169 at 1186-1189 (1935); 30 ILL. L. REV. 361 at 365 (1935).

[16] H. Rep. 179, 68th Cong., 1st sess., p. 28 (1924): "Even though the decedent has made the transfers specified in this subdivision, he has retained substantial control over the disposition of the property, through the power to change the enjoyment thereof. Such property interests should therefore fairly be taxed as part of the decedent's estate, particularly since, by virtue of his death, the substantial interest which he had has been wiped out, and to the same extent the property interest of the legal title holder, his transferee, has been increased. This provision is in accord with the principle of 219(g) of the bill which taxes to the grantor the income of a revocable trust."

[17] 43 Stat. L. 277 (1924), amended by 48 Stat. L. 729 (1934), 26 U. S. C., § 166 (1934) to read "any person not having a substantial adverse interest."

[18] See note 15, supra.

[19] 296 U. S. 85, 56 S. Ct. 70 (1935).

[20] See note 16, supra.

[21] 270 U. S. 230, 46 S. Ct. 260 (1926).

tional any attempt to include completed transfers within the tax act on the theory that their inclusion was necessary to prevent tax avoidance. There, in holding unconstitutional a Wisconsin statute raising a conclusive presumption that all gifts made within six years of death were in contemplation of death, Justice McReynolds said:[22]

> "The presumption and consequent taxation are defended upon the theory that exercising judgment and discretion, the legislature found them necessary in order to prevent evasion of inheritance taxes. That is to say, 'A' may be required to submit to an enactment forbidden by the Constitution if this seems necessary in order to enable the State to readily collect lawful charges against 'B.' Rights guaranteed by the Federal Constitution are not to be so lightly treated; they are superior to this supposed necessity. . . . A classification for purposes of taxation must rest on some reasonable distinction. A forbidden tax cannot be enforced in order to facilitate the one properly laid."[23]

A new approach[24] to testing the validity of a tax measure under the due process clause of the Fifth Amendment is announced by the Court in *Helvering v. City Bank Farmers Trust Co.*[25] In the majority opinion, four justices concurring, Justice Roberts states:

> "Congress may adopt a measure reasonably calculated to prevent avoidance of a tax. The test of validity in respect to due process of law is whether the means adopted is appropriate to the end. A legislative declaration that a status of the taxpayer's creation shall, in the application of the tax, be deemed the equivalent of another status falling normally within the scope of the taxing power, if reasonably requisite to prevent evasion, does not take property without due process."[26]

It is to be noted that the Court does not say that every "completed" transaction may be treated as a subject for taxation, but only those that are *reasonably* necessary to be reached in order to prevent tax avoidance. The standard of necessity qualified by reasonableness is not clear of application, but, even with this limitation, a test which looks to the purpose of the measure is bound to be more inclusive than one which has its limitations grounded in theories of property and more or less tech-

[22] Schlesinger v. Wisconsin, 270 U. S. 230 at 240, 46 S. Ct. 260 (1926).

[23] See also, Hoeper v. Tax Comm. of Wisconsin, 284 U. S. 206, 52 S. Ct. 120 (1931), and Heiner v. Donnan, 285 U. S. 312, 52 S. Ct. 358 (1932).

[24] See 36 COL. L. REV. 333 (1936) and 49 HARV. L. REV. 492 (1936).

[25] 296 U. S. 85, 56 S. Ct. 70 (1935).

[26] 296 U. S. 85, 56 S. Ct. 70 (1935).

nical considerations of completeness or incompleteness of the transfer or "vesting" at the time it is effected.

The test of *Helvering v. City Bank Farmers Trust Co.* is an adoption of that urged by Justice Holmes in his dissenting opinion in *Schlesinger v. Wisconsin:* [27]

> "Of course many gifts will be hit by the tax that were made with no contemplation of death. But the law allows a penumbra to be embraced that goes beyond the outline of its object in order that the object may be secured. A typical instance is the prohibition of the sale of unintoxicating malt liquors in order to make effective a prohibition of the sale of beer. The power 'is not to be denied simply because some innocent articles or transactions may be found within the proscribed class.'" [28]

Assuming that a gift with respect to which the settlor reserves a power to revoke in conjunction with a beneficiary may constitutionally be taxed prospectively, there remains open the question of the retroactive taxation of such a transfer. Since transactions of this type were, before the enactment of section 302(d), considered to be "complete" [29] and inasmuch as there were no prior analogous sections taxing such transfers which could be said to have served as a warning to those setting up similar trusts,[30] it would seem that any attempt at retroactive application would be unconstitutional.[31]

[27] 270 U. S. 230 at 241, 46 S. Ct. 260 (1926).

[28] Citing: Purity Extract & Tonic Co. v. Lynch, 226 U. S. 192, 33 S. Ct. 44 (1912); Hebe Co. v. Shaw, 248 U. S. 297, 39 S. Ct. 125 (1919); Pierce Oil Corp. v. Hope, 248 U. S. 498, 39 S. Ct. 172 (1919). See also the dissenting opinion in Heiner v. Donnan, 285 U. S. 312, 52 S. Ct. 358 (1932), and the majority opinion in Burnet v. Wells, 289 U. S. 670, 53 S. Ct. 761 (1933).

[29] Reinecke v. Northern Trust Co., 278 U. S. 339, 49 S. Ct. 123 (1929).

[30] Section 302(d) first appeared in 1924; 43 Stat. L. 304 (1924).

[31] Milliken v. United States, 283 U. S. 15, 51 S. Ct. 324 (1931); Nichols v. Coolidge, 274 U. S. 531, 47 S. Ct. 710 (1927). It is to be noted, however, that Porter v. Commissioner, 288 U. S. 436, 53 S. Ct. 451 (1933), permitted retroactive application of section 302(d) so as to reach trusts with respect to which the settlor had reserved a power to revoke not exercisable in favor of himself. The Court was able to reach this result by reconstruing the language it had used in the Reinecke case so as to reject the power of recall as the test of taxability. See notes 11 and 12, supra.

But, to allow retroactive application of section 302(d) to reach transfers as to which the settlor reserved a power to revoke to be exercised in conjunction with a beneficiary would be to disregard what the Court regarded as the essence of the Reinecke decision when it decided Porter v. Commissioner as it did.

That retroactive application is hardly probable is shown by the Court's emphasis on the fact that it was prospectively applying the tax in Helvering v. City Bank Farmers Trust Co., 296 U. S. 85, 56 S. Ct. 70 (1935). This is borne out by the dictum in White v. Poor, 296 U. S. 98, 56 S. Ct. 66 (1935), and Helvering v. Helmholz, 296 U. S. 93, 56 S. Ct. 68 (1935).

2.

Bearing a close relationship to the reserved power to alter, amend, or revoke to be exercised in conjunction with any other person, are the situations in *Helvering v. Helmholz* [32] and *White v. Poor* [33] which were decided by the Supreme Court on the same day [34] as *Helvering v. City Bank Farmers Trust Co.*[35]

In the first of the cases referred to, the settlor created a trust in 1918 reserving a life interest in income with remainders over. Provision was made for termination of the trust by a written declaration to that effect, executed by all of the beneficiaries and delivered to the trustees. The government argued that this was equivalent to a power to revoke, to be exercised by the settlor with others, because the settlor was a beneficiary and she, with the other beneficiaries, could have executed the writing requisite to terminate the trust. Chief Justice Hughes and Justice Roberts joined with the dissenting justices of *Helvering v. City Bank Farmers Trust Co.* to reject the government's contention. As a matter of construction, it was held that the power to terminate in this manner was not intended to be included within the definition of section 302(d). Justice Roberts, speaking for the majority, said: [36]

> "This argument overlooks the essential difference between a power to revoke, alter or amend, and a condition which the law imposes. The general rule is that all parties in interest may terminate the trust. The clause in question added nothing to the rights which the law conferred. Congress cannot tax as a transfer intended to take effect in possession or enjoyment at the death of the settlor a trust created in a state whose law permits all beneficiaries to terminate the trust."

The Court went on to say that, even if section 302(d) was intended to reach such a transfer, its retroactive application to reach this transfer not taxable when made would be violative of the Fifth Amendment. The three remaining justices concurred in the opinion on this point only.[37]

A similar result was reached in *White v. Poor*.[38] There the settlor

[32] 296 U. S. 93, 56 S. Ct. 68 (1935).

[33] 296 U. S. 98, 56 S. Ct. 66 (1935).

[34] November 11, 1935.

[35] 296 U. S. 85, 56 S. Ct. 70 (1935).

[36] 296 U. S. 93 at 97, 56 S. Ct. 68 (1935). And see 45 YALE L. J. 684 at 687 (1936) where the argument is made that this is sensible because the donor has divested himself as completely as possible and the donees have always had the privilege of making a gift back.

[37] Justices Brandeis, Stone, and Cardozo.

[38] 296 U. S. 98, 56 S. Ct. 66 (1935).

in 1919 created a trust naming herself, her son, and a third person as trustees. Vacancies amongst the trustees were to be filled by the remaining trustees with the consent of the beneficiaries. The settlor reserved no power of revocation to herself, but provided for termination by the trustees. The settlor resigned as trustee, but was later reappointed and continued to act in that capacity until her death in January, 1931.

Once more the government contended that the trustees' power to terminate fell within the definition of section 302(d) as a reserved power to alter, amend, or revoke in conjunction with any other person. The Court again rejected the argument for taxability and said that, technically, this did not constitute such a power as was contemplated by section 302 (d), evidently because the action by the settlor was not to be in that capacity, but in her position as one of the trustees. The decision, however, seems to proceed on the somewhat narrower ground that since the settlor was a trustee at the time of her death by *appointment* rather than by virtue of her own instrument, she acquired whatever power she might have had as a result of the appointment, so that it was not a reserved power within the intendment of section 302(d).[39]

Aside from the fact that the tax was prospective in *Helvering v. City Bank Farmers Trust Co.*[40] and retroactive in *White v. Poor*,[41] there is some difficulty in reconciling the cases, for, if a power to be exercised in conjunction with a beneficiary is held taxable under section 302(d), despite the adverse interest of the beneficiary, it would seem that a power given to the trustees to terminate should likewise render the transfer taxable if the settlor is one of the trustees. If the Court in *White v. Poor*[42] means that the settlor can name himself as trustee and reserve a power to terminate to be exercised in conjunction with other trustees without making the transfer taxable, it opens up a method of reserving a power to terminate in conjunction with a person who has no substantial adverse interest—a simple method of avoiding *Helvering v. City Bank Farmers Trust Co.*,[43] which held taxable a transfer with respect to which the settlor had reserved a power to revoke to be exercised in conjunction with a beneficiary. This would make taxability depend upon whether the settlor reserved a power to revoke in his capacity as *settlor* or as *trustee*, the transfer being taxable in the former instance despite the fact that the consent of the beneficiary

[39] The Court points out that even if included within the definition of section 302(d), any attempt to reach the transfer retroactively would violate the Fifth Amendment.

[40] 296 U. S. 85, 56 S. Ct. 70 (1935).

[41] 296 U. S. 98, 56 S. Ct. 66 (1935).

[42] 296 U. S. 98, 56 S. Ct. 66 (1935).

[43] 296 U. S. 85, 56 S. Ct. 70 (1935).

who holds an adverse interest is necessary and not taxable in the latter although the trustee whose consent is necessary to the exercise of the power would have far less reason for opposition than a beneficiary who stands to have his rights cut off by the action of the settlor. If the decision is meant to be limited to a case in which the settlor becomes a trustee by subsequent appointment rather than by virtue of the creating instrument, this would place no great obstacle in the path of tax avoidance, for it would be comparatively simple to so arrange matters as to have a vacancy amongst the trustees occur by resignation and follow this appointment of the settlor to fill the vacancy. The decisions can be reconciled if *White v. Poor* [44] can be taken to mean that the court will investigate the bona fides whenever the settlor appears as trustee and perhaps in that case the Court did find that the subsequent appointment of the settlor to fill the vacancy was not in accordance with any pre-arranged plan, yet the language used by the Court seems to indicate that the decision might not have been otherwise even if the settlor had merely become a trustee by virtue of the creating instrument or through appointment to a vacancy occurring in accordance with plans previously made.[45]

Although life incomes were reserved by the settlors in both *Helvering v. Helmholz* [46] and *White v. Poor*,[47] no consideration is given by the Court to the applicability of the tax based on this factor under section 302(c) as amended by the Joint Resolution of 1931.[48] Indeed, it is likely that this basis was not even urged by the Government in view of the fact that the trusts, having been created prior to March 3, 1931, and both settlors having died prior to June 6, 1932, were transfers which the federal authorities have not attempted to reach under section 302(c).[49]

By virtue of the decision in *Third National Bank & Trust Co. of Springfield v. White* [50] that a tenancy by the entireties set up by the

[44] 296 U. S. 98, 56 S. Ct. 66 (1935).

[45] See 45 YALE L. J. 684 at 687 (1936).

[46] 296 U. S. 93, 56 S. Ct. 68 (1935).

[47] 296 U. S. 98, 56 S. Ct. 66 (1935).

[48] J. Res., Pub. No. 131, 71st Cong., 2d sess. (March 3, 1931).

[49] Treas. Reg. 80, Art. 18(b) (1934). Taxability of transfers with respect to which the settlor reserved a life interest but no power of revocation was denied under section 302(c) by May v. Heiner, 281 U. S. 238, 50 S. Ct. 286 (1930); Burnet v. Northern Trust Company, 283 U. S. 782, 51 S. Ct. 342 (1931); McCormick v. Burnet, 283 U. S. 784, 51 S. Ct. 343 (1931); Morsman v. Burnet, 283 U. S. 783, 51 S. Ct. 343 (1931).

Congress lost no time in amending section 302(c) so as to expressly cover these cases: J. Res., Pub. No. 131, 71st Cong., 2d Sess. (March 3, 1931). It is with respect to this amendment that the question of retroactivity arises. See BOGERT, TRUSTS AND TRUSTEES, § 272 (1935).

[50] 287 U. S. 577, 53 S. Ct. 290 (1932), affg. per curiam (C. C. A. 1st, 1932)

deceased tenant could be taxed retroactively, it would appear that an irrevocable trust in which the settlor reserved a life interest would be accorded similar treatment. In its broad outlines, a tenancy by the entireties resembles such a trust, for it is irrevocable, the tenant enjoys a life interest, and death is the event which causes the full shift of economic benefits to another free from the fettering rights of enjoyment by the decedent.

Prior to the decision in *Third National Bank & Trust Co. of Springfield v. White,*[51] the test which determined whether the tax might be applied retroactively was the presence of a power retained by the settlor to divest other interests.[52] That this power could not be exercised so as to recall the entire gift to himself did not bar retroactive taxation.[53] Where the trust was irrevocable, it was held impossible to tax retroactively.[54]

With regard to retroactivity, Justice Roberts said by way of dictum in *Helvering v. Helmholz:* [55]

> "Another and more serious objection to the application of Section 302(d) in the present instance is its retroactive operation. The transfer was complete at the time of the creation of the trust. There remained no interest in the grantor. She reserved no power in herself alone to revoke, to alter or to amend. Under the Revenue Act then in force the transfer was not taxable as intended to take effect in possession or in enjoyment at her death.[56] If Section 302(d) of the Act of 1926 could fairly be considered as intended to apply in the instant case its operation would violate the Fifth Amendment." [57]

If Justice Roberts used this language with the fact in mind that the settlor had reserved a life interest, it would be a strong indication that the Court did not regard the passing at death of economic benefits alone sufficient to render the transaction so incomplete as to permit taxation under an act not in force at the time of its creation. This would be reversion to the fullest implications of the language of *Nich-*

58 F. (2d) 1085, affg. per curiam (D. C. Mass. 1930) 45 F. (2d) 911. See 46 HARV. L. REV. 718 (1933); 1 GEO. WASH. L. REV. 258 (1933).

[51] See previous notes and also Morrison, "Some Recent Decisions on the Law of Taxation," 22 CAL. L. REV. 277 at 300 (1934).

[52] Reinecke v. Northern Trust Co., 278 U. S. 339; 45 S. Ct. 123 (1929); Stimson, "When Revocable Trusts are Subject to an Inheritance Tax;" 25 MICH. L. REV. 839 (1927).

[53] Porter v. Commissioner, 288 U. S. 436, 53 S. Ct. 451 (1933).

[54] Nichols v. Coolidge, 274 U. S. 531, 47 S. Ct. 710 (1927).

[55] 296 U. S. 93 at 97, 56 S. Ct. 68 (1935).

[56] Citing Reinecke v. Northern Trust Co., 278 U. S. 339, 49 S. Ct. 123 (1929).

[57] Citing Nichols v. Coolidge, 274 U. S. 531, 47 S. Ct. 710 (1927).

ols v. Coolidge[58] and a limitation on the per curiam decision of the Court in *Third National Bank & Trust Co. of Springfield v. White.*[59] It has been suggested that such is the trend of the dictum.[60]

On the other hand, if Justice Roberts did not have in mind the reserved life estate, which is the more likely assumption,[61] his language to the effect that no interest had been reserved would mean only that the power retained by the settlor, even if considered to be within the definition of section 302(d) as a power to "alter, amend, or repeal," was not a reserved "interest" at the time the trust was created and therefore the transfer could not be reached retroactively under section 302(d). The opinion would draw the line between types of reserved powers with respect to retroactive taxation; it would not seek to distinguish between reserved powers of revocation and reserved life interests by treating the latter as if no interest were reserved. If this be sound, the dictum has no bearing upon the question of retroactive application of 302(c) as amended to a situation in which the settlor has reserved a life estate.

3.

In *Helvering v. St. Louis Union Trust Co.*[62] and *Becker v. St. Louis Union Trust Co.*,[63] the Court considered the applicability of section 302(c) to a gift in trust to a life tenant with remainders over, with the added condition that the trust should terminate and the corpus revert to the settlor if the life tenant should predecease him. The Court

[58] 274 U. S. 531, 47 S. Ct. 710 (1927). The Court said (274 U. S. 542): "And we must conclude that § 402(c) of the statute here under consideration, insofar as it requires that there shall be included in the gross estate the value of property transferred by a decedent prior to its passage merely because the conveyance was intended to take effect in possession or enjoyment at or after his death, is arbitrary, capricious and amounts to confiscation. Whether or how far the challenged provision is valid in respect of transfers made subsequent to the enactment, we need not now consider."

It is to be noted that in this case the life interest reserved by the settlor had been released to the beneficiaries before his death so that the estate was for practical purposes vested in the beneficiaries. However, the decision of the Court goes on the assumption that this interest was outstanding at death, for otherwise the case could have been disposed of as not falling within the meaning of section 302(c). See Morrison, "Some Recent Decisions on the Law of Taxation," 22 CAL. L. REV. 277 at 298 (1934); 22 ILL. L. REV. 437 at 439 (1927); Kroeger, "Inheritance Taxation of Transfers not Taking Place at Death," 15 ST. LOUIS L. REV. 113 at 123 (1930).

[59] 287 U. S. 577, 53 S. Ct. 290 (1932), affg. per curiam (C. C. A. 1st, 1932) 58 F. (2d) 1085, affg. per curiam (D. C. Mass. 1930) 45 F. (2d) 911.

[60] Lowndes, "A Day in the Supreme Court with the Federal Estate Tax," 22 VA. L. REV. 261 (1936).

[61] See note 49, supra.

[62] 296 U. S. 39, 56 S. Ct. 74 (1935).

[63] 296 U. S. 48, 56 S. Ct. 78 (1935).

held that since the beneficiaries had vested interests, nothing passed to them as a result of the settlor predeceasing the life tenant inasmuch as this merely extinguished the possibility that the corpus might revert to the settlor.

In *Klein v. United States*,[64] the Court by unanimous decision held taxable as part of the decedent's estate land which he had conveyed to his wife for life with remainder in fee to her if she survive him. Thus, taxability today seems to depend upon whether vesting of the remainder is contingent upon survivorship of the beneficiary, or whether it is vested subject to being divested by the beneficiary predeceasing the settlor.

Justice Sutherland, speaking for the majority in *Helvering v. St. Louis Union Trust Co.*, said:[65]

> "But here the grantor parted with the title and all beneficial interest in the property, retaining no right with respect to it which would pass to anyone as a result of his death. Unlike the *Klein* case, where death was the generating *source of title*,[66] here, as the court below said, the trust instrument and not the death was the generating source. The death did not transmit the possibility, but destroyed it."

The Court, by making the shift of title the event which gives rise to the tax, places a premium on the technicalities of conveyancing, since it is a simple matter to achieve the result desired by a donor and yet to avoid the tax by the mere choice of phraseology which has no effect on the settlor's plan.[67]

The theory adopted by the Court is unfortunate, not only because it points the way to a technical method of tax avoidance by attempting to draw a line between cases in both of which the final disposition of the property depends upon whether the settlor or the life tenant dies first,[68] but also because it is not consistent with decisions holding taxable those transfers with respect to which the *settlor* has reserved a power to divest a vested remainder. In these decisions the accepted theory is that the termination of this power by death is an accretion to the interest of the remainderman which passes by virtue of the death of the settlor.[69]

More in accord with the spirit of constitutional interpretation

[64] 283 U. S. 231, 51 S. Ct. 398 (1931).

[65] 296 U. S. 39 at 45, 56 S. Ct. 74 (1935).

[66] Italics ours.

[67] 49 HARV. L. REV. 661 (1936).

[68] 49 HARV. L. REV. 661 at 662 (1936).

[69] Reinecke v. Northern Trust Co., 278 U. S. 339, 49 S. Ct. 123 (1929); Porter v. Commissioner, 288 U. S. 436, 53 S. Ct. 451 (1933). And see 45 YALE L. J. 684 at 690 (1936).

adopted in *Helvering v. City Bank Farmers Trust Co.*[70] and with the language used by Justice Sutherland in the *Klein* case[71] is the opinion of Justice Stone speaking for the minority[72] in *Helvering v. St. Louis Union Trust Co.*:[73]

> "It seems plain that the gift here was not complete until decedent's death. He wished to keep the property for himself in case he survived his daughter. He kept his hold upon it by reserving from his gift an interest, terminable only at his death, by which full ownership would be restored to him if he survived his daughter. . . . Having in mind the purpose of the statute and the breadth of its language it would seem to be of no consequence what particular conveyancers' device—what particular string—the decedent selected to hold in suspense the ultimate disposition of his property until the moment of his death. In determining whether a taxable transfer becomes complete only at death we look to substance, not to form. . . . However we label the device it is but a means by which the gift is rendered incomplete until the donor's death. The extent to which it is incomplete marks the extent of the 'interest' passing at death, which the statute taxes."

The view adopted by the Court with respect to an irrevocable trust as to which the settlor reserved an interest to revert to him in the event of the prior decease of the beneficiary, lends support to the decision of the Circuit Court of Appeals for the Third Circuit in *Pennsylvania Co. v. Commissioner*.[74] There the Court held that an insurance policy in which the beneficiary's interest was irrevocably vested,[75] was not taxable as part of the decedent's estate under section 302(g) of the act. The decision is based upon the fact that the consent of the beneficiary was necessary in order to make it possible for the insured to surrender the policy, obtain loans thereon, or to change the benefici-

[70] 296 U. S. 85, 56 S. Ct. 70 (1935). See notes 25 and 26, supra.

[71] 283 U. S. 231 at 234, 51 S. Ct. 398 (1931): "Nothing is to be gained by multiplying words in respect of the various niceties of the art of conveyancing or the law of contingent and vested remainders. It is perfectly plain that the death of the grantor was the indispensable and intended event which brought the larger estate into being for the grantee and effected its transmission from the dead to the living, thus satisfying the terms of the taxing act and justifying the tax imposed. . . ."

[72] Chief Justice Hughes, together with Justices Brandeis and Cardozo, joined in the dissent.

[73] 296 U. S. 39 at 47, 56 S. Ct. 74 (1936).

[74] (C. C. A. 3rd, 1935) 79 F. (2d) 295, certiorari denied 296 U. S. 651, 56 S. Ct. 310 (1935).

[75] The general rule is that the insured must expressly reserve the right to change the beneficiary, otherwise he can make no subsequent change. See Condon v. New York Life Insurance Co., 183 Iowa 658, 166 N. W. 452 (1918); Garner v. Germania Life Ins. Co., 110 N. Y. 266, 18 N. E. 130 (1888).

ary.[76] Although the Court makes nothing of the point, under Pennsylvania law if the beneficiary predeceases the insured, the latter has the right to name a new beneficiary.[77] The analogy between this situation and the one presented by *Becker v. St. Louis Union Trust Co.*[78] and *Helvering v. St. Louis Union Trust Co.*[79] with respect to trusts makes practically inescapable the conclusion that the Supreme Court will ultimately approve the position taken by the circuit court. This conclusion is especially to be anticipated in view of the fact that the Court has adopted revocability as the test of taxability of insurance policies, just as it has done in the case of trusts.[80] If an interest which is to revert to the settlor in the event of the prior decease of the beneficiary is not sufficient to make a trust taxable as part of the settlor's estate, *a fortiori* the same result should follow with respect to insurance policies where a like possibility exists. Even more apparent is the non-taxability of an insurance policy in those states which hold that no interest reverts to the insured upon the prior decease of the beneficiary, but rather that this right of the beneficiary devolves in the same manner as his other property at his death.[81]

These decisions have clarified the application of the Federal Estate Tax in a number of situations where doubt was formerly felt and have indicated the tests which will be applied in ascertaining the constitutionality of attempts to reach certain transactions prospectively or retroactively.

1. The reservation by the settlor of a power to alter, amend, or revoke his bounty to be exercised in conjunction with another constitutes a taxable transfer at the settlor's death and it does not matter that the

[76] If the insured has not reserved the right to change the beneficiary, he cannot surrender the policy or borrow on it without the consent of the beneficiary unless there is express stipulation to the contrary in the policy. 7 COOLEY, BRIEFS ON INSURANCE, 2d ed., 6399 (1928).

[77] Smith v. Metropolitan Life Ins. Co., 222 Pa. 226, 71 A. 11 (1908). The majority rule, however, permits the rights under the policy to devolve to the estate of a beneficiary who has an irrevocable vested interest. 2 COUCH, INSURANCE, § 338 (1929); 7 COOLEY, BRIEFS ON INSURANCE, 2d ed., 6479 (1928); 9 COL. L. REV. 183 (1909). For the effect of express reservations of reverter, see 7 COOLEY, BRIEFS ON INSURANCE, 2d ed., 6482 (1928).

[78] 296 U. S. 48, 56 S. Ct. 78 (1935).

[79] 296 U. S. 39, 56 S. Ct. 74 (1935).

[80] Chase National Bank v. United States, 278 U. S. 327, 49 S. Ct. 126 (1929). For a criticism of this case, see Davis, "Taxation of Beneficiaries' Interest in Life Insurance Policies," 10 BOST. UNIV. L. REV. 138 (1930).

[81] See note 72, supra. That a death tax imposed on the proceeds of a policy unconditionally payable to a third person would be a tax on property possessed by the beneficiary and so unconstitutional, is urged by VANCE, INSURANCE, 2d ed., § 159 (1930).

power is to be exercised in conjunction with a person having an adverse interest, such as a beneficiary.[82]

2. Provision for termination by all of the beneficiaries, though the settlor be one of these, does not constitute a power to alter, amend, or revoke within the meaning of section 302(d), at least where the local law permits termination of a trust by all of the interested parties.[83]

3. Provision for termination by the trustees, the settlor being a trustee, does not constitute a power to alter, amend, or revoke within the meaning of section 302(d), at least if the settlor is trustee not by virtue of the creating instrument, but due to a bona fide appointment to fill a vacancy.[84]

4. Provision for reverter of the corpus in the event that the beneficiary predeceases the settlor or donor does not render this taxable at the latter's death, for it is considered not to fall within the definition of section 302(c) as a transfer intended to take effect in possession or enjoyment at or after death.[85]

5. Insurance policies in which the rights of the beneficiaries are irrevocably vested so that the insured at his own option can neither deal with them for his own benefit nor change the beneficiaries are not taxable.[86]

6. A liberal attitude is displayed by the Court in permitting Congress prospectively to reach completed transactions if necessary to prevent tax avoidance.[87] But a stricter attitude is shown when dealing with the problem of retroactivity, and from the dicta [88] of these cases it appears that property concepts as to completeness of transfers will determine the constitutionality of attempts to reach them.

C. F. H.

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[82] Helvering v. City Bank Farmers Trust Co., 296 U. S. 85, 56 S. Ct. 70 (1935).

[83] Helvering v. Helmholz, 296 U. S. 93, 56 S. Ct. 68 (1935).

[84] White v. Poor, 296 U. S. 98, 56 S. Ct. 66 (1935).

[85] Becker v. St. Louis Union Trust Co., 296 U. S. 48, 56 S. Ct. 78 (1935); Helvering v. St. Louis Union Trust Co., 296 U. S. 39, 56 S. Ct. 74 (1935).

[86] Pennsylvania Company v. Commissioner, (C. C. A. 3rd, 1935) 79 F. (2d) 295, certiorari denied 296 U. S. 651, 56 S. Ct. 310 (1935).

[87] Helvering v. City Bank Farmers Trust Co., 296 U. S. 85, 56 S. Ct. 70 (1935).

[88] White v. Poor, 296 U. S. 98, 56 S. Ct. 66 (1935); Helvering v. Helmholz, 296 U. S. 93, 56 S. Ct. 68 (1935).