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TAXATION-FEDERAL ESTATE AND GIFT TAXATION-POWERS OF APPOINTMENT ACT OF 1951

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TAXATION—FEDERAL ESTATE AND GIFT TAXATION—POWERS OF APPOINTMENT ACT OF 1951—The flexibility and versatility which have made the power of appointment one of the most efficient tools available to an estate planner have made it *nullius in law* for tax purposes. One power may be so broad as to constitute the donee in effect the beneficial owner of the property subject to it. Another may so thoroughly restrict the scope of the donee's authority as to constitute the donee a mere conduit through which the purposes of the donor are effected and persons other than the donee benefited. An intelligent taxing scheme directed at the transmissal of the substantial incidents of ownership must be so drawn as always to tax the devolution from donee to appointee under the former power, while never taxing that under the latter. It is the purpose of this comment to trace the history of Congress' treatment of powers of appointment in the past and to examine the latest legislative pronouncement, the Powers of Appointment Act of 1951.¹

I. History Prior to 1942

The first estate tax act of 1916² made no specific mention of powers of appointment. Although the Treasury³ attempted to bring property passing under the exercise of a general power into the donee's estate under the "shotgun" provisions of section 202(a),⁴ the Supreme Court held such property not included,⁵ on the ground that it was not

* The preliminary research involved in this comment was done by John J. Edman. The comment was later revised by James B. Wilson.—Ed.

¹ P.L. 58, 82d Cong., 1st sess. (1951).

² Revenue Act of 1916, 39 Stat. L. 777.

³ T.D. 2477, April 7, 1917.

⁴ Section 202(a) brought into the decedent's estate all property "to the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate."

⁵ *United States v. Field*, 255 U.S. 257, 41 S.Ct. 256 (1921). See also, *Lederer v. Pearce*, (3d Cir. 1920) 266 F. 497; *Ebersole v. McGrath*, (D.C. Ohio 1920) 271 F. 995, appeal dismissed, (6th Cir. 1921) 272 F. 1022.

"subject to distribution as part of the decedent's estate," as required by that section. In 1918, Congress enacted section 402(e),⁶ the forerunner of the present section 811(f). Section 402(e) brought into the decedent's estate ". . . any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of, or intended to take effect in possession or enjoyment at or after, his death. . . ."⁷ This section, which remained in effect for 24 years, gained its chief distinction as a fairly efficient method for evasion of estate taxation as the property subject to the power passed from generation to generation.⁸

The reason for section 402's inadequacy lay partly in the statute itself and partly in what often appeared to be a militant anti-revenue attitude on the part of the judiciary. Before the property subject to the power could be included in the donee's estate the collector was required to show three things:

(1) That the power was a *general* one. Earlier lower court decisions defined such a power as one which could be exercised in the unfettered discretion of the donee in favor of anyone in the world, including the donee or his estate.⁹ Thus powers to appoint to anyone but X,¹⁰ to anyone but the donee's creditors,¹¹ or only to natural persons and charitable corporations,¹² were treated as non-general and hence non-taxable. So were powers in a trust beneficiary to invade the corpus for his own benefit,¹³ or to appoint only with the assent of a disinterested trustee.¹⁴

⁶ Revenue Act of 1918, §402(e), 40 Stat. L. 1097. The same provision was re-enacted as a §302(f) of the Revenue Act of 1924, 43 Stat. L. 305. It remained under that designation until the Internal Revenue Code was enacted in its present form in 1939. 53 Stat. L. 122.

⁷ It should be pointed out that where the power is reserved rather than donated, so that the donor and donee are the same person, §811(d) will bring the property into the donee's estate, whether or not the power is exercised and whether or not it is general or special. *Porter v. Commissioner*, 288 U.S. 436, 53 S.Ct. 451 (1933); *Commissioner v. Chase National Bank*, (2d Cir. 1936) 82 F. (2d) 157, cert. den. 299 U.S. 552, 57 S.Ct. 15 (1936).

⁸ Leach, "Powers of Appointment," 24 A.B.A.J. 807 (1938); Griswold, "Powers of Appointment and the Federal Estate Tax," 52 HARV. L. REV. 929 (1939).

⁹ This definition was accepted by the Treasury until 1937. *Treas. Reg.* 79, art. 24. The usual definition of a general power, however, includes any powers exercisable in favor of the donee, his estate or his creditors, regardless of how it might otherwise be restricted. 1 SIMES, *FUTURE INTERESTS* §246 (1936); 3 *PROPERTY RESTATEMENT* §320(1) (1940). This definition was adopted in Art. 24 of the 1937 edition of *Treas. Reg.* 80, 2 *FEDERAL REGISTER* 2346, and approved by the Supreme Court in *Morgan v. Commissioner*, 309 U.S. 78, 60 S.Ct. 424 (1940).

¹⁰ *Kendrick v. Commissioner*, 34 B.T.A. 1040 (1936).

¹¹ *Leser v. Burnet*, (4th Cir. 1931) 46 F. (2d) 756.

¹² *Helmholz v. Commissioner*, 28 B.T.A. 165 (1933).

¹³ *Janes v. Reynolds*, (D.C. Minn. 1944) 57 F. Supp. 609.

¹⁴ *Hepburn v. Commissioner*, 37 B.T.A. 459 (1938).

(2) That the power had been *exercised* by the donee. Since unexercised general powers were not taxed,¹⁵ a donee who retained the fullest control over the property during his lifetime but at his death chose to benefit the takers in default by failing to appoint to someone else could avoid the imposition of the estate tax merely by inaction.

(3) That the property had *passed* to the appointees by virtue of the exercise of the power. In *Helvering v. Grinnell*¹⁶ the Supreme Court held that when a donee exercised a power in favor of the takers in default in the same proportions in which they would have taken in the absence of the exercise, nothing "passed" under the power, and hence any such exercise could be made tax free.

Thus the law stood in 1942, when Congress decided to overhaul section 811(f). It was demonstrably inadequate as a fair and efficient levy on the transmission of economic control from dead to living. It was the purpose of the amendments of 1942 to remedy this inadequacy.

II. From 1942 to 1951

The Revenue Act of 1942¹⁷ was eminently effective in correcting the deficiencies of the 1918 act. Its impact on powers of appointment was fivefold:

(1) It swept within its ambit ". . . any property (A) with respect to which the decedent has at the time of his death a power of appointment, or (B) with respect to which he has at any time exercised or released a power of appointment . . ." in a testamentary manner.¹⁸ This conveniently did away with the pre-1942 requirements of "exercise" and "passing."

(2) Release of powers inter vivos was made taxable as a gift to the takers in default.¹⁹

(3) The term "power of appointment" was defined to include "any power to appoint exercisable by the decedent either alone or in

¹⁵ *Helvering v. Safe Deposit & Trust Co. of Baltimore*, 316 U.S. 56, 62 S.Ct. 925 (1942).

¹⁶ 294 U.S. 153, 55 S.Ct. 354 (1935); *Legg's Estate v. Commissioner*, (4th Cir. 1940) 114 F. (2d) 760. Limited by *Rogers v. Commissioner*, 320 U.S. 410, 63 S.Ct. 1446 (1943). There seemed to be some doubt as to whether the taker in default must renounce the appointment. See *Commissioner v. Cardeza's Estate*, (3d Cir. 1949) 173 F. (2d) 19. Cf. *Guaranty Trust Co. v. Johnson*, (2d Cir. 1948) 165 F. (2d) 298; *Kerr v. Commissioner*, 9 T.C. 359 (1947).

¹⁷ 56 Stat. L. 942, 952, §§403(a), 452(a).

¹⁸ Section 811(f)(1).

¹⁹ Section 1000(c).

conjunction with any person . . . ,"²⁰ except for two narrowly defined powers:

(a) A "familial" power, to appoint to or among the spouse, descendants, or spouses of descendants of either the donor or donee, or to appoint to a charity.

(b) A "fiduciary" power, to appoint to or among a "restricted class," which might include others than the family of the donor or donee, provided the donee himself did not have any beneficial interest in the property subject to the power.

(4) Any power, including those falling within the two exempt classes, would be included in the donee's estate if it was exercised in such a manner as to create a second power.²¹ The purpose of this provision was to prevent the use of exempt powers to avoid taxes for more than one generation at a time.²²

(5) The lapse of a power of appointment was considered as a gift from the donee to the takers in default, thus making the donee subject to gift tax.²³

However, criticism of the new act was not long in appearing. Congress in its desire to plug the loopholes of the 1918 act had drawn up a statute which made the use of powers in estate planning a highly risky and unprofitable venture. Moreover, it appeared that the new act did not appreciably increase revenues;²⁴ rather it had the effect of compelling tax conscious testators and donors to dispose of their property in safer and more rigid plans, a result which was unfortunate for the individuals involved and undesirable for the community as a whole.²⁵

One of the major weaknesses of the 1942 act was the unworkability of the so-called "fiduciary" power. It had been the intent of Congress to exempt that class of powers in which a trusted friend or mem-

²⁰ Sections 811(f)(2), 1000(c).

²¹ *Ibid.*

²² Senate Committee Report No. 1631, 77th Cong., 2d sess., p. 232 (1942).

²³ Lapse of powers was not specifically mentioned in the statute, but was considered as an informal type of release by *Treas. Reg.* 105 and 79, 1943 ed., T.D. 5239 and T.D. 5241, March 10, 1943.

²⁴ The purpose of this phase of the federal estate tax appears never to have been to augment revenues directly. See House Committee Report No. 327, 82d Cong., 1st sess., p. 4 (1951); Senate Committee Report No. 382, 82d Cong., 1st sess., p. 3 (1951).

²⁵ Buck, Craven and Shackelford, "Treatment of Powers of Appointment for Estate and Gift Tax Purposes," 34 *VA. L. REV.* 255 (1948); House Committee Report No. 327, 82d Cong., 1st sess., p. 2 (1951); Senate Committee Report No. 382, 82d Cong., 1st sess., p. 2 (1951).

ber of the donor's family is given power to appoint to other members of the family, thus permitting the most efficient and beneficial disposal of the property subject to the power in the light of circumstances existing long after the donor's death.²⁶ The 1942 act made this type of power exempt only if its scope was limited to an undefined "restricted class" of appointees and if the donee himself had no interest, however remote, in the property subject to the power.²⁷ Since members of the testator's or donor's immediate family frequently might have some interest in the property, by way of reversion or otherwise, the only safe way to come within the provisions of the section was to give the power to a stranger, or to restrict the possible class of appointees to those included in the exempt "familial" power.

An alternative to giving a third party the power to determine the devolution of trust property is to give the beneficiary himself the power to invade the corpus. However, the Treasury early ruled that a power of invasion was a taxable power,²⁸ even though limited to the amount necessary to the support and maintenance of the beneficiary. Moreover, the lapse of such a power during the beneficiary's lifetime was considered a gift to the remaindermen, and was taxable as such.²⁹

A further hardship imposed by the 1942 act was caused by the provision that a power of appointment would be included in the donee's estate whether "exercisable alone or with another person." Under this provision the donee of a joint power was somewhat unrealistically considered the sole owner for tax purposes, even though as a practical matter the possibility of its exercise solely in the individual donee's favor might be very remote.³⁰

One of the most objectionable features of the 1942 act was its applicability alike to powers created before and after the date of enact-

²⁶ House Committee Report No. 2333, 77th Cong., 2d sess., p. 161 (1942); Senate Committee Report No. 1631, 77th Cong., 2d sess., p. 233 (1942).

²⁷ See Deputy Commissioner's Telegram, October 26, 1944, CCH FEDERAL ESTATE AND GIFT TAX REPORTER ¶1600.33 (1951). Since a power to alter or amend a trust was considered a power of appointment under the 1942 act, such a power would be taxed even in the hands of a disinterested trustee under the literal terms of the act. However T.D. 5239 and T.D. 5241, March 10, 1943, provided that where the trustee was a "disinterested third party not receiving any beneficial interest" by the transfer of the property, his power would not be taxable. See also, Eisenstein, "Powers of Appointment and Estate Taxes," 52 YALE L.J. 494 at 516 (1943); Looker, "Estate and Gift Taxation of Trustees' Powers to Distribute Principal," 45 COL. L. REV. 52 (1945).

²⁸ T.D. 5239, T.D. 5241, March 10, 1943.

²⁹ *Supra* note 23.

³⁰ That this sort of provision is constitutional seems clear in the light of *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85, 56 S.Ct. 70 (1935), which upheld a similar provision appearing in §811(d).

ment.³¹ Many powers which had been created in reliance on the provisions of the earlier law became by the terms of the new act taxable whether or not exercised. Realizing the injustice of this situation, Congress provided for a short period during which such powers could be released tax free.³² Difficulties in executing such releases and in the reworking of existing estate plans resulted in continued extensions of this period,³³ the latest ending on June 30, 1951.³⁴ It was this "parade of annual extensions" which prompted Congress to enact the Powers of Appointment Act of 1951.

III. *The 1951 Act*

The major purpose of the Powers of Appointment Act of 1951 is, in the words of the House committee,³⁵ to "provide a test of taxability which is simple, clear-cut and easy to apply." In order to eliminate the subtle artificialities of the 1942 act, its provisions have been wiped out of existence, and the present law takes effect as if it had been enacted in 1942.³⁶

A. *Pre-existing Powers.* The present law has drawn a broad distinction between those powers which were in existence at the time of the 1942 act and those which came into existence thereafter. With respect to pre-existing powers, Congress has attempted to restore the law as it was before 1942, with one minor change. Section 811(f)(1) now subjects to taxation only those pre-existing powers which are (1) general and (2) exercised, either by will or inter vivos in such a manner that if the property had been that of the donee it would have been included in his estate under sections 811 (c) or (d).³⁷

³¹ Not all pre-existing powers were subject to the 1942 act. Sections 403(d)(1) and 452(b)(1) exempted from the operation of the act unexercised pre-existing powers to appoint to persons other than the donee, his estate, his creditors, or the creditors of his estate.

³² Section 403(d)(3) and 452 (c). Section 452(c) was not expressly limited to pre-existing powers, but this omission was supplied by T.D. 5241, March 10, 1943.

³³ P.L. 809, 77th Cong., 2d sess. (1942); P.L. 68, 78th Cong., 1st sess. (1943); P.L. 511, 78th Cong., 2d sess. (1944); P.L. 95, 79th Cong., 1st sess. (1945); P.L. 393, 79th Cong., 2d sess. (1946); P.L. 112, 80th Cong., 1st sess. (1947); P.L. 635, 80th Cong., 2d sess. (1948); P.L. 137, 81st Cong., 1st sess. (1949). In 1948 the class of pre-existing powers was broadened to include powers created by wills executed prior to October 21, 1942, when the testator died prior to July 1, 1949. 62 Stat. L. 388.

³⁴ P.L. 578, 81st Cong., 2d sess. (1950).

³⁵ House Committee Report No. 327, 82d Cong., 1st sess., p. 4 (1951); Senate Committee Report No. 382, 82d Cong., 1st sess., p. 3 (1951).

³⁶ Section 2(c).

³⁷ Whether an inter vivos exercise is of the sort which will come within the scope of §§811(c) or (d) depends on the provisions of those sections in force at the time of donee's death. House Committee Report No. 327, 82d Cong., 1st sess., p. 4 (1951); Senate Committee Report No. 382, 82d Cong., 1st sess., p. 4 (1951). Thus an inter vivos

However, the pre-1942 requirement of "passing" has been eliminated, so that if a pre-existing power is exercised in favor of anyone, including the takers in default, it will be included in the donee's estate.³⁸ In this connection it should be remembered that where the donee of a pre-existing power wishes the property to go to the takers in default, he should be explicit in stating his intention not to exercise, thus avoiding a wholly needless tax. If the donee wishes part of the property to go to the takers in default, and part to go to third parties, a partial exercise would be advantageous.

In recognition of the large number of powers which were partially released in reliance on the tax free release privilege accorded to pre-existing powers under the 1942 act, the new act continued the extension acts in force and extended the possible time for partial release until November 1, 1951.³⁹

During the years 1942-1951, many pre-existing powers were partially released in order to trim them down to come within the scope of the exempted powers of the 1942 act. If no such releases had been made, many of such powers would be non-taxable under the present law.⁴⁰ An interesting question may arise under local law as to whether the releases may now be set aside on the ground of mistake.⁴¹ In some states legislatures may be prevailed upon to pass enabling legislation analogous to that enacted after 1942 permitting partial releases.⁴²

exercise by a donee dying after 1950 will not be considered as having been made in contemplation of death if made more than three years before the donee's death, by virtue of §811(1). (Committee's example).

³⁸ For recent decisions as to what constitutes an "exercise" see *Estate of Paul v. Commissioner*, 16 T.C. 743 (1951) (no exercise where the attempted exercise was void under the rule against perpetuities); *Estate of Moran v. Commissioner*, 16 T.C. 814 (1951) (mere renunciation by the appointees does not nullify the exercise).

³⁹ After November 1, 1951, partial releases may be made free of gift tax, but the subsequent exercise of the power will still be treated as the exercise of a general power. House Committee Report No. 327, 82d Cong., 1st sess., p. 4 (1951); Senate Committee Report No. 382, 82d Cong., 1st sess., p. 4 (1951). It should be noted that the complete release of a pre-existing power will no longer be considered an exercise. §§811(f)(1) and 1000(c)(1).

⁴⁰ E.g., a power to appoint to any person in the United States except the donee, his estate, his creditors or the creditors of his estate would have been taxable under the 1942 act and non-taxable under the present law.

⁴¹ This has been done with regard to a family partnership set up in reliance on subsequently changed law. *Stone v. Stone*, 319 Mich. 194, 29 N.W.(2d) 271 (1947). Cf. *Lowry v. Kavanagh*, 322 Mich. 532, 34 N.W.(2d) 60 (1948). See generally, Guterman, "Unravelling Transactions with Frustrated Tax Motives," 4 TAX L. REV. 437 (1949).

⁴² Polisher, "The 1951 Powers of Appointment Act," 56 DICK. L. REV. 3 (1951). State legislation since 1942 dealing with release of powers is collected in PROPERTY RESTATEMENT, 1948 Supp., §335, comment e.

B. *Future Powers*. With respect to powers created after 1942, Congress has adopted the basic philosophy of the 1942 act that mere possession of substantial control over the devolution of property should be the proper basis of taxation. Thus the possession of a general power of appointment created after 1942, or its exercise or release in a testamentary manner, will cause the power to be included in the donee's estate.⁴³ A release of the power inter vivos will be considered a gift to the taker in default.⁴⁴ However, timely renunciation is not considered a release. The second paragraph of section 811(f)(2) is careful to provide that a power of appointment is considered to exist on the date of donee's death, even though its exercise may have been conditioned upon the giving of notice before exercise, or the expiration of a stated period of time before such exercise took effect.

C. *Definition of Taxable Power*.⁴⁵ 1. *Generally*. Probably the most important aspect of the 1951 act from the standpoint of drafting of powers for the future is the definition of a taxable power. In the interest of simplicity, Congress has gone back to the old general—non-general dichotomy of the pre-1942 law. However under the present law a general power has been carefully and explicitly defined.

For the purposes of both pre-existing and future powers, a general power is now defined as one which "is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate."⁴⁶ Since the disjunctive language is used, it seems clear that a power under the terms of which the donee could appoint to *any one* of the four groups would be considered a general power.⁴⁷ Any other reading of the language would open the door to flagrant evasion of the spirit

⁴³ Section 811(f)(2). Here again the question of whether a power has been exercised in a manner contemplated by §§811(c) or (d) will depend on the provisions of those sections in effect at the donee's death. See note 37 supra.

⁴⁴ Section 1000(c)(2).

⁴⁵ Section 811(c)(3) contains a proviso exempting from the effect of that section transfers whereby "possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a power of appointment [as defined in section 811(f)(2)]. . . ." When Congress changed the definition section to §811(f)(3) in the 1951 act it failed to make the corresponding change in the reference of §811(c)(3). If Congress fails to rectify its oversight, the courts will be faced with the necessity of deciding whether §811(c)(3) is to continue to be governed by the pre-1951 §811(f)(2), or whether by judicial legislation the 1951 changes will be read into §811(c)(3).

⁴⁶ This adopts the test of the pre-1942 Treasury Regulations. See note 9 supra.

⁴⁷ However this does not seem to have been the reading given the language by the minority of the House committee. See House Committee Report No. 327, 82d Cong., 1st sess., part 2, p. 5, example 1 (1951).

of the act by such a simple device as a power to appoint to anyone but the donee's creditors.⁴⁸

With this redefinition, the field of nontaxable powers has become conspicuously broadened. In the future, a testator or donor will not be required to tailor his power to the Procrustean standards of the two "exempt" powers of the 1942 act. So long as the donee is not permitted to benefit himself or his creditors, the power may be made as flexible as the needs of the particular estate may require, and still remain nontaxable.⁴⁹

2. *Powers to consume or invade the corpus.* Under the 1942 act, any power given the beneficiary of a trust to invade the corpus was considered a taxable power of appointment.⁵⁰ In order to permit the reasonable use of emergency powers of invasion, the present act provides that any such power "which is limited by an ascertainable standard relating to the health, education, support or maintenance of the decedent shall not be deemed a general power of appointment."⁵¹ In order to take advantage of this provision, care must be taken in the drafting of the power to set up standards which are recognized as judicially ascertainable.⁵²

3. *Joint powers.* Under the 1942 act, powers of appointment were taxable when exercisable by the decedent, "either alone or in conjunction with another person."⁵³ As to pre-existing powers, the present act restores the law prior to 1942 in providing that no power

⁴⁸ For a case holding such a power to be non-general, and hence non-taxable under the pre-1942 law, see *Leser v. Burnet*, (4th Cir. 1931) 46 F. (2d) 756. In this case the power was general in its terms, but under local law a donee could not appoint to his creditors without specific authority from the donor.

⁴⁹ It would not seem necessary that the power be so worded as to exclude explicitly the donee, his estate, his creditors or the creditors of his estate. Thus if the donee is given a power to appoint "to or among the children of A" the fact that a child of A might also be a creditor of the donee should not make the power taxable. Rather any appointment to that child as a creditor, i.e., an appointment whereby the donee's debt is cancelled in return for the appointment, would be considered a fraud on the power, and hence void, or at least voidable. *Sikes v. Sikes*, 163 Ga. 510, 136 S.E. 523 (1927); *Topham v. The Duke of Portland*, 11 H.L.C. 32, 11 Eng. Rep. 1242 (1864); 1 SIMMS, *FUTURE INTERESTS* §290 (1936).

⁵⁰ See note 28 supra.

⁵¹ Sections 811(f)(3)(A) and 1000(c)(3)(A).

⁵² As to what constitutes an "ascertainable standard" see *Henslee v. Union Planters National Bank & Trust Co.*, 335 U.S. 595, 69 S.Ct. 290 (1949); *Merchants National Bank v. Commissioner*, 320 U.S. 256, 64 S.Ct. 108 (1943); *Ithaca Trust Co. v. United States*, 279 U.S. 151, 49 S.Ct. 291 (1929).

⁵³ See notes 20 and 30 supra.

exercisable only in conjunction with another person shall be considered a taxable power.⁵⁴

As to future powers, the criterion of taxability will be the substantiality of the powers held by each joint donee.

a. Where the donee can exercise the power only with the consent of the donor, the power is not considered general. In such a case the property would be included in the estate of the donor under section 811 (d).⁵⁵

b. Where the power is not exercisable by the decedent except in conjunction with another person "having a substantial adverse interest in the property . . . which is adverse to the exercise of the power in favor of the decedent," such power is not considered general. The introduction of the "substantial adverse interest" test, which is new to section 811(f),⁵⁶ avoids the difficulties encountered under the 1942 act, which by its literal terms taxed to the trustee mere veto powers held by a trustee.⁵⁷ On the other hand, it prevents future avoidance of taxability by the device of a power exercisable with the assent of a sympathetic third party.⁵⁸

c. Where the power is joint, and the property could have been appointed to the other donee, but the other donee is a third party having no substantial adverse interest, the power is taxable to the individual donee only to the extent of one-half its value. If there are more than two donees, only a pro rata share will be taxed to the individual donee. Thus, if a general power is given jointly to A, B and C, to be extinguished at the death of the first to die, upon the death of A only one-third of the value of the property would be included in his estate.

⁵⁴ This restores the pre-1942 situation where a power to appoint only with the concurrence of a trustee was held non-general and hence non-taxable. *Hepburn v. Commissioner*, 37 B.T.A. 459 (1938).

⁵⁵ *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85, 56 S.Ct. 70 (1935). House Committee Report No. 327, 82d Cong., 1st sess., p. 5 (1951); Senate Committee Report No. 382, 82d Cong., 1st sess., p. 5 (1951).

⁵⁶ As to what constitutes a substantial adverse interest, see *Estate of Leon N. Gillette v. Commissioner*, 7 T.C. 219 (1946); *Altmaier v. Commissioner*, (6th Cir. 1940) 116 F. (2d) 162; *Mary A. Cushing v. Commissioner*, 38 B.T.A. 948 (1938).

⁵⁷ However, powers held by a "disinterested trustee" were exempted by T.D. 5239 and T.D. 5241, March 10, 1943. See note 27 *supra*.

⁵⁸ Where a power is exercisable only in conjunction with a person who after the donee's death will have a power over the same property exercisable in favor of himself, such other person is deemed to have a substantial adverse interest. Sections 811(f)(3)(C)(ii) and 1000(c)(3)(C)(ii). Thus if a general power is given jointly to A and B with the right of survivorship, upon A's death nothing would be included in his estate, because the power now remains in B's hands to appoint in his own favor. When B dies, the power will be included as part of his gross estate.

The purpose of this provision is to give recognition to the practical fact that *A* during his life could not have made an appointment without the concurrence of *B* and *C*, who normally would demand their share of the property subject to the power.⁵⁹

D. *Exercise by Creation of Another Power.* The State of Delaware has the distinction of being the object of sections 811(f)(4) and 1000(c)(4), which provide that where a future power, either general or non-general, is exercised by creating another power which under local law can be validly exercised so as to postpone the vesting of any interest in the property or suspend the power of alienation for a period ascertainable without regard to the date of the creation of the first power, the exercise of the power will be taxed, to the extent of such exercise.⁶⁰ The purpose of this section is to bar the possibility of perpetual avoidance of estate taxes by the creation of a series of non-general powers. In all jurisdictions but Delaware this possibility would be foreclosed by the application of the rule against perpetuities, which counts the time of suspension of vesting or suspension of power of alienation from the date of the creation of a special power.⁶¹ In Delaware, however, a statute provides that the creation of a special power will not suspend the vesting of any interest,⁶² so that in the absence of a provision such as this in the estate tax law a series of non-general powers *ad infinitum* would be possible.⁶³

E. *Lapse of Powers.* As to future powers, the provision of the 1942 act that a lapse of a power would be considered a release of such power is continued.⁶⁴ Therefore a lapse of a general power will be considered a gift to the takers in default and will be taxable as such. Since the gift to the takers in default is a future interest, no exclusion from value will be allowed under section 1003(b)(3).

⁵⁹ It has been suggested that upon the extinguishment or lapse of the power upon the death of one of the joint donees, the surviving donees may be considered to have made a taxable gift under §1000(c)(5) to the takers in default. Craven, "The Powers of Appointment Act of 1951," 65 HARV. L. REV. 55 at 74 (1951).

⁶⁰ A non-general power may thus become taxable if it is exercised so as to create another power, if during the lives covered by the two powers the period of the rule against perpetuities or analogous statutory rule has not been running.

⁶¹ SIMES, FUTURE INTERESTS §537 (1936).

⁶² Del. Rev. Code, c. 117, §48 (1935).

⁶³ Although this possibility has intrigued some writers, no cases have been reported in which this was attempted. Bettner, "The Rule Against Perpetuities as Applied to Powers of Appointment," 27 VA. L. REV. 149 at 164 (1940); Leach, "Powers of Appointment," 24 A.B.A.J. 807 (1938); Leach, "Perpetuities in a Nutshell," 51 HARV. L. REV. 638 (1938).

⁶⁴ Sections 811(f)(5) and 1000(c)(5).

However, a very important exception has been added by the new act. The lapse of a power to the extent of \$5,000 or 5% of the corpus of the trust, whichever sum is the larger, per year will not be considered a release.⁶⁵ Thus a life tenant will now be allowed a substantial emergency power to invade the corpus without the necessity of having to pay a tax upon failure to exercise the power. A testator or donor of a \$200,000 trust may give the life tenant the power to invade the corpus to the extent of \$10,000 per annum, so long as the power is non-cumulative. If he wishes to give the donee the right to draw down \$15,000 per annum, the lapse of such right will be considered a taxable release only to the extent of \$5,000. One of the principal advantages of this provision is that there is no requirement that the power be limited by any judicially ascertainable standards relating to health, education, support or maintenance, thus simplifying the drafting of the power and giving the donee full and complete discretion over the disposition of the funds subject to the power. If the testator or donor desires, he may give the beneficiary a limited power to invade the corpus and give the trustee a further power of invasion for the health, education, support or maintenance of the beneficiary, thus achieving the maximum of protection against unforeseen contingencies.

F. *Retroactivity.* Section 2(c) of the 1951 act provides that, "The amendments made by this section shall be effective as if made by section 403 of the Revenue Act of 1942 on the date of its enactment. . . ." But Congress is silent as to whether this means that suits for refunds of taxes paid under the 1942 act are no longer barred by the three year period of limitations⁶⁶ or the doctrine of *res judicata*.⁶⁷ There is no relief provision analogous to that of the Technical Changes Act of 1949,⁶⁸ permitting the reopening of cases otherwise closed. If an intent that such relief provision be incorporated into the 1951 act cannot be read into the language of section 2(c),⁶⁹ legislative relief from this situation would seem to be in order.

⁶⁵ *Ibid.*

⁶⁶ Sections 910 and 1027(b)(1).

⁶⁷ See generally, Griswold, "Res Judicata in Federal Tax Cases," 46 *YALE L.J.* 1320 (1937). It seems usually to have been assumed by the courts that once tax liability for one tax period has been adjudicated, subsequent change of law will not be grounds *per se* for relitigation of the issues as to that period. The bulk of litigation centers on the question whether the judgment is *res judicata* as to subsequent periods. Cases are collected in 150 *A.L.R.* 5 (1944).

⁶⁸ Section 7(c), 63 *Stat. L.* 896. See also, §407(d) of the Revenue Act of 1942, 56 *STAT. L.* 949.

⁶⁹ The Supreme Court has indicated a willingness in proper cases to read in remedial provisions from other acts *in pari materia*. *Keifer & Keifer v. Reconstruction Finance Corp.*,

Conclusion

The 1951 act has brought welcome relief from the rigors of the 1942 amendments. It gives recognition to the needs of flexible and efficient estate planning, which can frequently be satisfied only through the wise use of powers of appointment.

As to pre-existing powers, making the tax contingent on the exercise of a power may ignore the economic reality of the donee's position as the holder of a power to direct the devolution of property whether or not exercised;⁷⁰ but in fairness to the creators and holders of these powers the pre-1942 law has been revived.

As to future powers, the present act properly retains as the touchstone of taxability the possession of substantial elements of economic control. It may be questioned whether the line between general and non-general powers has been accurately drawn, since a donee with a power to appoint to anyone in the world but himself, his estate, his creditors or the creditors of his estate is still the chief beneficiary of the power, and, it is submitted, should be taxed as such.⁷¹ Limited emergency powers of invasion of corpus are no longer taxed; and joint powers in the future will be taxed more realistically on the basis of the actual economic positions of the joint donees. With this assist from Congress, powers of appointment should play a larger and more useful part in the efficient planning of estates.

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306 U.S. 381, 59 S.Ct. 516 (1939). This process would be materially aided by the language of the House committee: "The amendments made by the bill will take effect as if they had originally been contained in the 1942 act at the time of its enactment. *Thus they will apply to the estates of all decedents dying after October 21, 1942.*" House Committee Report No. 327, 82d Cong., 1st sess., p. 7 (1951) (Italics supplied).

⁷⁰ The anomaly of taxing only the exercise of the pre-existing power is not substantially altered by the elimination of the "passing" requirement. Now whether a tax will be levied may depend merely on the accident of express or implied exercise in favor of takers in default rather than achievement of the same result through non-exercise.

⁷¹ The House minority report suggested that the class of non-taxable powers be limited to include "any power to appoint within a restricted class not including the holder of the power, his estate or his creditors." House Committee Report No. 327, 82d Cong., 1st sess., part 2, p. 5 (1951).