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The Nontaxation of Nontestamentary Acts: Will *Byrum* Survive the Tax Reform Act of 1976?

*John T. Gaubatz**

The author is of the view that notwithstanding the amendment to section 2036 of the Internal Revenue Code included by Congress in the Tax Reform Act of 1976, the Supreme Court's decision in United States v. Byrum remains viable. By directing attention toward the result reached by the Court, the author discerns a disinclination on the part of the Court to include transferred property in the decedent's gross estate unless the transfer was, upon an objective analysis, intended to take effect at death. Support for such a posture is drawn from the authority cited by the Court, the historical development of section 2036, and the judiciary's treatment of similar cases.

IN LIGHT OF THE AMENDMENT to section 2036 of the Internal Revenue Code included by Congress in the Tax Reform Act of 1976,¹ further

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1. Pub. L. No. 94-455, § 2009(a), 90 Stat. 1893 (codified at 26 U.S.C.A. § 2036(a) (Supp. 1977)).

Prior to the amendment, section 2036(a) provided:

The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from the property, or

discussion of the Supreme Court's decision in *United States v. Byrum*² might seem unwarranted.³ However, the language of the amendment is not only ambiguous,⁴ but also sufficiently narrow that skillful counsel may well be able to avoid it.⁵ There remains, therefore, considerable room for judicial interpretation of the applicability of section 2036 to transactions resembling those in *Byrum*. The reasoning of that decision will undoubtedly be influential in this interpretative process. Further analysis of *Byrum* is also warranted by the fact that it illustrates the attitude of the Supreme Court toward the estate tax. Indeed, the author is of the view that in the furor

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2009(a) of the Tax Reform Act of 1976 amended this provision by appending the following sentence: "For purposes of paragraph (1), the retention of voting rights in retained stock shall be considered to be a retention of the enjoyment of such stock."

2. 408 U.S. 125 (1972).

3. *Byrum* generated no fewer than thirty-five articles, notes, and comments prior to the 1976 Act, most of them critical. Aslanides, *Supreme Court Rules on Grantors Retaining Certain Rights over Property Transferred to Trust*, 51 TAXES 157 (1973); Clark, *Supreme Court Says Grantor May Return Voting Control of Stock Placed in Trust*, 37 J. TAX. 138 (1972); Covey, *The Byrum Case and Closely Held Stock: An Analysis*, 3 TAX ADVISOR 644 (1972); Friedman, *Establishing Trusts With Controlled Corporation Stock: Tax Problems*, 24 S. CAL. TAX INST. 409 (1972); Horvitz, *Retention of Control: The Implication of the Byrum Case*, 32 N.Y.U. INST. FED. TAX. 235 (1974); Moore, *Byrum Revisited*, 27 S. CAL. TAX INST. 439 (1975); Newman & Kalter, *Transfers of Corporate Securities by Persons in Control of Corporate Policy*, 111 TRUSTS & EST. 118 (1972); Newman & Kalter, *Transfers of Corporate Securities by Persons in Control of Corporate Policy: Byrum Revisited*, 111 TRUSTS & EST. 710 (1972); Soled, *Estate Tax Consequence of Inter Vivos Transfers of Stock in a Closely-Held Corporation*, 31 MD. L. REV. 191 (1971); Spurgeon, *Transfer of Stock in Closely Held Corporations to Inter Vivos Trusts*, 22 TUL. TAX INST. 434 (1973); Comment, *Application of Section 2036 to Inter Vivos Transfers of Stock in Closely-Held Corporations*, 22 BUFFALO L. REV. 459 (1973); Note, *Judicial Limitation of Section 2036: The Byrum Doctrine*, 61 GEO. L.J. 1087 (1973); Comment, *United States v. Byrum: The Troubled Application of I.R.C. § 2036*, 46 TEMP. L.Q. 498 (1973); Comment, *Section 2036 of the Federal Estate Tax and Inter Vivos Transfers in Trust of Stock of Close Corporations*, 9 WILLAMETTE L.J. 328 (1973); 14 B.C. INDUS. & COM. L. REV. 1091 (1973); 53 B.U.L. REV. 173 (1973); 50 DEN. L.J. 227 (1973); 58 IOWA L. REV. 354 (1972); 12 J. FAM. L. 293 (1973); 33 LA. L. REV. 464 (1973); 19 LOY. L. REV. 485 (1973); 3 MEM. ST. U.L. REV. 402 (1973); 24 MERCER L. REV. 957 (1973); 38 MO. L. REV. 299 (1973); 51 N.C.L. REV. 325 (1972); 48 NOTRE DAME LAW. 474 (1972); 26 SW. L.J. 934 (1972); 50 TEX. L. REV. 1435 (1972); 46 TUL. L. REV. 1038 (1972); 41 U. CIN. L. REV. 950 (1972); 26 U. MIAMI L. REV. 652 (1972); 1972 UTAH L. REV. 586; 8 VAL. L. REV. 156 (1973); 30 WASH. & LEE L. REV. 97 (1973); 14 WM. & MARY L. REV. 226 (1972).

4. The reference to "retained stock" is certainly peculiar. That it is a clerical error is suggested by H.R. CONF. REP. NO. 94-1515, 94th Cong., 2d Sess. 623, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 1222, 1365, wherein it appears that the conferees intended to adopt the "transferred stock" terminology which appeared in H.R. 14844, 94th Cong., 2d Sess. (1976), even though that bill was not the one enacted.

5. Even assuming the amendment applies to "transferred" stock, it does not address the issue raised by Rev. Rul. 67-54, 1967-1 C.B. 269, where two classes of stock are used to divorce control from economic value. Since the amendment covers only voting rights which are retained with respect to transferred stock, it fails to resolve the question of whether nonvoting shares which are transferred should be included in the decedent's gross estate where he retained control by means of voting shares. The author is of the view that the result in *Byrum* signifies an authorization of this type of arrangement. See text accompanying notes 113-14 *infra*.

over the reasoning of the Court in *Byrum*, the real significance of the case has been lost. The principal significance of the decision is not found in its technical reasoning but in its result—a result which evidences a bias against including in the decedent's gross estate property which is the subject of a transaction lacking in substance the underlying characteristic of "testamentariness"—the *ratio legis* of section 2036.⁶

The facts of *Byrum* are well known to estate planners. Byrum, the controlling shareholder in three closely held corporations, transferred a portion of his stock holdings in each corporation to an irrevocable trust for the benefit of his children. An independent corporation was appointed trustee, but Byrum retained the right to vote the shares, to veto their sale or transfer, to veto any investment or reinvestment, and to remove the trustee and appoint another corporation as successor. Byrum remained active in the three corporations following the transfer, apparently drawing a salary. Almost no dividends were paid during his life, however. Thus, the stock generated only a minimal amount of income for the trust.

Following Byrum's death, the Commissioner of Internal Revenue included the stock transferred into the trust in the decedent's gross estate on the grounds that the strings retained by the settlor constituted retained interests or rights within the meaning of section 2036 of the Internal Revenue Code. Having paid the additional tax assessed, the estate sued for a refund and prevailed in both the district court⁷ and the Court of Appeals for the Sixth Circuit.⁸ The Supreme Court affirmed.

It was the Commissioner's position throughout the litigation that the power inherent in the rights retained by Byrum—to vote and veto sale or transfer of the stock—enabled him to elect the three corporations' boards of directors and thereby control not only the corporations' business affairs, including his own employment and salary, but also their dividend policies. The power to elect the boards of directors, the Commissioner argued, was a retained right to enjoy the stock includable in the gross estate under section 2036(a)(1), while the power to control dividend policies was a right to designate the persons who could enjoy the income from the stock includable pursuant to section 2036(a)(2). The Court, however, rejected both of these contentions. The right to designate the beneficiaries of the income was said not to exist because Byrum's power to elect directors was not equivalent to a retained right and because their actions were limited by fiduciary obligations imposed by corporate law. Enjoyment of the stock itself was not present for the reason that "enjoyment" as used in the estate tax provisions contemplated retention of a "substantial present economic benefit" and because

6. See notes 15-63 *infra* and accompanying text.

7. *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970).

8. *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971).

"control" was not a benefit transferred with the stock—the trust never owned as much as fifty percent of the outstanding shares.

Comment regarding *Byrum* has been varied. A few have praised the decision as an important concession to the small businessman⁹ or as a craftsmanlike use of judicial precedent.¹⁰ Most, however, have been critical. The most frequently raised objection is that the decision ignores the power of a controlling shareholder to materially affect the salary levels of employees and the declaration of dividends.¹¹ Adherents to this position find preposterous the Court's assertion that state corporation law and Internal Revenue Service supervision serve as an effective check upon such powers. Others find in the Court's use of precedent a retreat to veneration of form over substance.¹² Congress rendered the ultimate objection to *Byrum* by amending section 2036(a)(1) to include transferred stock in the gross estate where the voting rights to the stock are retained by the transferor.¹³

While the commentators' criticisms may be meritorious in the abstract and the congressional response justifiable disagreement as to whether or not retention of the particular "strings"¹⁴ exhibited the requisite testamentariness, *Byrum* remains a viable decision. If one cuts through the Court's discussion of whether retained voting rights constitute a retained "right to designate" under section 2036(a)(2) or a retained interest under section 2036(a)(1), there emerges the almost irresistible conclusion that the Court did not perceive the mere retention of voting control in a closely held corporation as indicating, upon an objective analysis, any particular desire to either retain income to which the donor would not otherwise be entitled or to control the flow of income to the holders of the beneficial interest in that stock, and that in

9. Cf. Newman & Kalter, *Transfers of Corporate Securities by Persons in Control of Corporate Policy*, 111 TRUSTS & EST. 118 (1972) (reasoning of the majority opinion sound); 30 WASH. & LEE L. REV. 97 (1973) (narrow construction given both 2036(a)(1) and 2036(a)(2) does not constitute riskless mechanism for estate tax avoidance).

10. Cf. Comment, *The Application of Section 2036 to Inter Vivos Transfers of Stock in Closely-Held Corporations*, 22 BUFFALO L. REV. 459 (1973) (Court's analysis of section 2036(a)(2) implicitly adopts the methodology of *Jennings v. Smith*, 161 F.2d 74 (2d Cir. 1947), *State St. Trust Co. v. United States*, 263 F.2d 635 (1st Cir. 1959), and *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970)); 41 U. CIN. L. REV. 950 (1972) (language and interpretations of sections 2036(a)(1) and 2036(a)(2) support the Court's conclusions).

11. 19 LOY. L. REV. 485 (1973).

12. 46 TUL. L. REV. 1038 (1972); 1972 UTAH L. REV. 586.

The Court relied heavily upon the decision in *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929), in reaching its decision in *Byrum*. See text accompanying notes 20–25, 73–75 *infra*. Objections to its use center primarily upon its date. Indeed, in 1929, the language now used in section 2036(a) had not yet made its appearance in the Code. See notes 26–45 *infra* and accompanying text.

13. See note 1 *supra*.

14. "Strings" is used intentionally in order to avoid the definitional problem arising from the fact that a voting right may be a retained power over income but not a right to control income.

reality, the retention of such control is more likely to be the result of business considerations. In other words, the decision recognizes that owners of closely held businesses should not be forced to put their jobs on the line in order to distribute by way of *inter vivos* gift the major asset of their estate—their stock.¹⁵

Admittedly, there is little language in the opinion expressly supporting such a hypothesis. Nevertheless the authority cited by the Court hints at the conclusion suggested. The historical development of section 2036 offers stronger support, as does the judiciary's handling of similar cases. Moreover, the narrowness of the corrective amendment passed by Congress suggests that the general approach of the Court may actually conform to current congressional will.

I. READING INTENT BACK INTO THE CODE

The Supreme Court has often said that sections of the Internal Revenue Code such as section 2036 were designed to include in the gross estate property which is the subject of transactions basically testamentary in nature.¹⁶ In the past, this concept has been used principally as support for decisions dealing with transfers not clearly covered by the Code. It is, however, capable of being a double-edged sword. Indeed, if testamentariness can comprehend the taxation of transfers without a formal retention of "powers" because in substance "rights" are in fact retained, then it should also comprehend the exclusion of transfers subject to retained "powers" which are not sufficiently "testamentary" in substance to be called retained "rights."¹⁷

That the foregoing represents the view of the Court in *Byrum* is suggested by its otherwise inexplicable reliance upon the 1929 decision in *Reinecke v. Northern Trust Co.*¹⁸ decided under statutory language designed to tax transfers "intended to take effect . . . at . . . death."¹⁹ Such reliance can only suggest that the Court considers that statutory concept to be a viable part of section 2036. The history of section 2036 and its companion provisions supports the accuracy of this general proposition. While it reflects occasional congressional displeasure with particular Supreme Court decisions, that history does not indicate that Congress meant "intent" to disappear as a criterion for determining whether the subject of a transfer should be included in the decedent's gross estate. Indeed, it suggests that

15. See *Mathey v. United States*, 491 F.2d 481, 489 (3d Cir. 1974) (dissenting opinion).

16. E.g., *United States v. Grace*, 395 U.S. 316, 320 (1969); *Commissioner v. Estate of Church*, 335 U.S. 632, 643 (1949); *Helvering v. Hallock*, 309 U.S. 106, 112 (1940).

17. Sections 2036(a)(1) and 2036(a)(2) speak to "rights," not "powers." See note 1 *supra*.

18. 278 U.S. 339 (1929).

19. Revenue Act of 1921, ch. 136, § 402(c), 42 Stat. 278.

the language of section 2036 was actually developed in order to help clarify this criterion, not to change it.

A. *The Significance of Reinecke v. Northern Trust Co.*

In responding to the Commissioner's argument that the rights retained by Byrum constituted a right to designate the persons who would enjoy the income from the property within the meaning of section 2036(a)(2), the Court in *Byrum* invoked *Reinecke v. Northern Trust Co.*²⁰ as authority for the proposition that the retention of broad managerial powers by a transferor of property is not necessarily sufficient to require inclusion of the property in the decedent's gross estate. The Court then noted that perhaps hundreds of draftsmen of *inter vivos* trusts had relied on this holding, and that although Byrum had not made himself trustee as was true of the settlor in *Northern Trust*, the powers retained by him were essentially the same.²¹ Thus, it recognized that to hold for the Commissioner could result in an unwarranted "serious adverse impact."²²

As both the dissent in *Byrum*²³ and many commentators²⁴ note, by relying upon *Northern Trust* the Court attached little significance to congressional amendments that had been enacted between the dates of the two cases in an effort to reach transfers subject to retained rights or interests. Even the majority in *Byrum* recognized this weakness.²⁵ It is this very weakness, however, which forces one to suspect that there is more to *Byrum* than appears on its surface. The Court did not have to reach back for precedent; the case could easily have been treated as a new problem under a new statute. Yet in the eyes of the Court the problem in *Byrum* was governed by the same principles as was *Northern Trust*. Since those principles could only result from the then operative statutory provision, the Court's citation of *Northern Trust* suggests that the requirements of that statute, including its "intent" component, continue to have some viability under current law.

B. *The History of Section 2036*

Critics of the *Byrum* opinion have suggested that any powers retained by a decedent which might be used for his own personal gain or to control the

20. 278 U.S. 339 (1929).

21. The powers reserved by the settlor in *Northern Trust* were (a) to supervise reinvestment of the trust funds; (b) to require the trustee to execute proxies running to the settlor's nominee; (c) to vote the shares of stock held by the trustee; (d) to control all leases executed by the trustee; (e) to appoint successor trustees; and (f) to modify the trust with the consent of the beneficiary or beneficiaries of the trusts.

22. 408 U.S. at 134.

23. *Id.* at 164.

24. See note 12 *supra*.

25. 408 U.S. at 133-34.

income payable under a trust should result in the inclusion of the transferred property in his gross estate under section 2036. This absolutist approach, however, denies the history of that section. Indeed, the pre-*Byrum* history of section 2036 suggests that retained powers should cause transferred property to be included in the gross estate only where the decedent lacked the intent to presently transfer its possession or enjoyment.

The history of section 2036 begins with the estate tax imposed by Congress in 1916.²⁶ That tax applied to probate property,²⁷ jointly held property,²⁸ and prior transfers "with respect to which the decedent had created a trust, in contemplation of, or *intended to take effect in possession or enjoyment at or after his death.*"²⁹ In *Helvering v. Hallock*³⁰ the Supreme Court later observed with respect to the 1926 draft of the statute³¹ that the emphasized language was intended to tax "not merely those interests which are deemed to pass at death according to refined technicalities of the law of property[, but] also . . . *inter vivos* transfers that are too much akin to testamentary dispositions not to be subjected to the same excise."³²

Notwithstanding general agreement with this fundamental purpose, the uncertainty created by its simple language fostered repeated challenges thereto, which, when coupled with Supreme Court hostility to the estate tax, slowly forced congressional action to provide specifically for taxation of a variety of testamentary transfers. Insurance was expressly included in the gross estate in 1918,³³ as were dower and curtesy interests³⁴ and property passing pursuant to the exercise of general powers of appointment.³⁵ Real estate, an asset often not subject to claims,³⁶ and therefore not part of the probate estate, was included by the redraft of 1926.³⁷ Also included by the

26. Revenue Act of 1916, ch. 463, §§ 200-12, 39 Stat. 777-80.

27. *Id.* § 202(a), 39 Stat. 777.

28. *Id.* § 202(c), 39 Stat. 778.

29. *Id.* § 202(b), 39 Stat. 777-78 (emphasis added).

30. 309 U.S. 106 (1940).

31. Revenue Act of 1926, ch. 27, § 302(c), 44 Stat. 70.

32. 309 U.S. at 112.

33. Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1098. The Ways and Means Committee Report notes that insurance was being used as a means of avoiding the 1916 Act. H.R. REP. NO. 767, 65th Cong., 2d Sess. 22 (1918).

34. Revenue Act of 1918, ch. 18, § 402(b), 40 Stat. 1097. The Ways and Means Committee Report indicates congressional surprise at the suggestion that such interests were not covered as "interests" under the 1916 Act. H.R. REP. NO. 767, 65th Cong., 2d Sess. 21 (1918).

35. Revenue Act of 1918, ch. 18, § 402(e), 40 Stat. 1097.

36. *Cf.* T. ATKINSON, WILLS § 123, at 670-71 (2d ed. 1953) (statutes do not ordinarily authorize the sale of land in order to pay the decedent's debts unless there is a deficiency of personalty).

37. Revenue Act of 1926, ch. 27, § 302(a), 44 Stat. 70. The change was worked by deleting the "subject to" language so that the emphasis of the statute became taxing the "interest . . . of the decedent [in property] at the time of his death."

1926 Act was property transferred subject to a power, held at death, to "alter, amend, or revoke" the transfer.³⁸

In 1926, the "intended to take effect in possession or enjoyment at or after . . . death" language was found in section 302(c).³⁹ This language became the subject of considerable controversy as a result of *May v. Heiner*⁴⁰ and a series of related cases.⁴¹ In *May*, the Court held that the grantor's reservation of a contingent life estate did not indicate that the remainder was "intended to take effect . . . at . . . his death." In the related cases, the Court expanded this holding so that even where the decedent reserved an outright life estate, the transfer was considered absolute, and therefore not embraced by the operative language. These results, rejecting as they did not only the common understanding of the phrase,⁴² but also the Treasury's long standing regulations,⁴³ were so shocking that within a day of the decisions in the *May*-related cases the Joint Resolution of March 3, 1931, was adopted by Congress and signed by the President.⁴⁴ This resolution amended section 302(c) by adding to the "intended to take effect . . . at . . . death" language, the phrase

including a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property or (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom.⁴⁵

Notably, the Joint Resolution of March 3, 1931, did not remove "intent" from the revenue laws, for it was still present in section 302(c). It merely added specific language defining one of the types of transfers to be included under that general language. "Intent" remained as the basic criterion of includability.

Because the Joint Resolution of March 3, 1931, forms the substance of section 2036(a) of the Internal Revenue Code of 1954, its subsequent history

38. *Id.* § 302(d), 44 Stat. 71. The Ways and Means Committee Report indicates a belief that with the fall of this retained power "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." H.R. REP. NO. 179, 68th Cong., 1st Sess. 46 (1932).

39. Revenue Act of 1926, ch. 27, § 302(c), 44 Stat. 70.

40. 281 U.S. 238 (1930).

41. *Burnet v. Northern Trust Co.*, 283 U.S. 782 (1931) (per curiam); *Morsman v. Burnet*, 283 U.S. 783 (1931) (per curiam); *McCormick v. Burnet*, 283 U.S. 784 (1931) (per curiam).

42. The consensus on this point is perhaps best illustrated by the fact that the Third Circuit Court of Appeals affirmed the district court's decision in *May* in a one sentence per curiam opinion. 32 F.2d 1017 (3d Cir. 1929), *aff'g per curiam*, 25 F.2d 1004 (W.D. Pa. 1928).

43. Treas. Reg. 37, art. 24, T.D. 2910, TREAS. DEC. INT. REV. 771 (1919).

44. Pub. Res. No. 131, ch. 454, 46 Stat. 1516-17 (1931).

45. *Id.*

is of extreme importance. In *Hassett v. Welch*,⁴⁶ the Court held the effect of the resolution to be prospective only, not applying to transfers made before its enactment by decedents who died thereafter. This led to a renewal of questions concerning the applicability of the *May* decision, which were resolved when the Court overruled the decision in *Commissioner v. Estate of Church*.⁴⁷ The Court recognized that the sole purpose behind the resolution was to reverse the Court's interpretation of the "intended to take effect . . . at . . . death" clause in *May*.

It is strongly urged that we continue to regard *May v. Heiner* as controlling and leave its final repudiation to Congress. Little effort is made to defend the *May v. Heiner* interpretation of "possession or enjoyment" on the ground that it truly reflects the congressional purpose, nor do we think it possible to attribute such a purpose to Congress. There is no persuasive argument, if any at all, that trusts reserving life estates with remainders over at grantors' deaths are not satisfactory and effective substitutes for wills.⁴⁸

This was nothing more than recognition of the obvious. The letter from the Secretary of the Treasury which precipitated the resolution made specific reference to *May* and its companion decisions, and deplored the results.⁴⁹ Moreover, the speed with which Congress reacted clearly reflected a desire to overcome an immediate problem. And although no congressional report accompanied the resolution, congressional intent was later expressed when clarifying language was added by the Revenue Act of 1932.⁵⁰

The purpose of this amendment to section 302(c) of the Revenue Act of 1926 is to clarify in certain respects the amendments made to that section by the joint resolution of March 3, 1931, which were adopted to render taxable a transfer under which the decedent reserved the income for his life. The joint resolution was designed to avoid the effect of decisions of the Supreme Court hold-

46. 303 U.S. 303 (1938).

47. 335 U.S. 632 (1949). *Church* was itself made inapplicable to transfers prior to March 4, 1931, in the case of decedents dying prior to January 1, 1950, by the Technical Changes Act, ch. 720, § 7(b), 63 Stat. 895-96, (1949), amending Int. Rev. Code of 1939, ch. 1, § 811(c), 53 Stat. 121. Although the decision accurately reflected the substantive purpose of the Joint Resolution of March 3, 1931, Congress felt that it was unfair in its retroactive application.

48. 335 U.S. at 646.

49. 74 CONC. REC. 7198-99 (1931).

50. Ch. 209, § 803(a), 47 Stat. 279-80 (1932). Inserted into section 302(c) of the Revenue Act of 1926, as amended by the Joint Resolution of March 3, 1931, were these phrases: "or for any period not ascertainable without reference to [the decedent's] death;" "or for any period which does not in fact end before his death;" "the right to the income;" and "either alone or in conjunction with any person."

ing such a transfer not taxable if irrevocable and not made in contemplation of death.⁵¹

Aside from the clarifying language added by the Revenue Act of 1932, section 302(c) as modified by the Joint Resolution was codified with minor changes as section 811(c) of the Internal Revenue Code of 1939.⁵² The legislative history discloses no intent to change the coverage of the provision. Both the House Ways and Means Committee and Senate Finance Committee Reports which accompanied the legislation speak strictly in terms of consolidation and codification of the then existing laws.⁵³

In 1949, the Technical Changes Act gave the language added by the Joint Resolution in 1931 its own section, 811(c)(1)(B), and moved the "intended to take effect . . . at . . . death" language to section 811(c)(1)(C).⁵⁴ However, the Conference Report to the Technical Changes Act indicates no intention to alter the coverage of the section: "Paragraph (1) [811(c)(1)] merely states the existing general rule . . ." ⁵⁵ Thus, to the extent that section 811(c)(1)(B) contained an implied limitation from the precedents decided under the "intended to take effect . . . at . . . death" language, that limitation apparently remained.

When Congress enacted section 2036 of the Internal Revenue Code of 1954 it deleted the "intended to take effect . . . at . . . death" language of section 811(c)(1)(C) while retaining section 811(c)(1)(B) virtually without change. The argument can therefore be made that Congress meant for "intent" to disappear as a criterion for determining whether transferred property should be included or excluded from the gross estate. However, it is once again difficult to find such a purpose in the legislative history. The Senate Finance Committee Report on the 1954 Code not only indicates that no substantive changes were intended by the adoption of section 2036,⁵⁶ but

51. H.R. REP. NO. 708, 72d Cong., 1st Sess. 46 (1932).

52. Ch. 1, § 811(c), 53 Stat. 121 (1939).

53. H.R. REP. NO. 6, 76th Cong., 1st Sess. 1 (1939); S. REP. NO. 20, 76th Cong., 1st Sess. 1 (1939).

54. Ch. 720, § 7(a), 63 Stat. 894-95. Amended section 811(c) thus read:

(1) GENERAL RULE.— To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or

(C) intended to take effect in possession or enjoyment at or after his death.

55. CONF. REP. NO. 1412, 81st Cong., 1st Sess. 10, reprinted in [1949] U.S. CODE CONG. & AD. NEWS 2183, 2189.

56. "This section [2036] except for clerical changes, corresponds to section 811(c)(1)(B) of the 1939 Code, as amended. No substantive change has been made." S. REP. NO. 1622, 83d Cong.,

also that Congress considered the "intent" language of section 811(c)(1)(C) to be embodied in the consolidation of that section with sections 811(c)(2) and 811(c)(3) worked by Code section 2037.⁵⁷

In order to appreciate fully the significance of section 2037 it is necessary to take note of the Supreme Court's decision in *Estate of Spiegel v. Commissioner*.⁵⁸ Two of the sections of the 1939 Code consolidated by section 2037—811(c)(2) and 811(c)(3)—were added in 1949 by the Technical Changes Act in order to correct the absolutist approach taken by the Court therein. In *Spiegel*, the Court held that a transfer pursuant to which the decedent failed to give away a reversion contingent upon his having to survive both his children and grandchildren was covered by 811(c)(1)(C). In support of this decision the Court cited, as it had in *Commissioner v. Estate of Church*,⁵⁹ its decision in *Helvering v. Hallock*,⁶⁰ stating: "After such a transfer has been made, the settlor must be left with no present legal title in the property, no possible reversionary interest in that title, and no right to possess or to enjoy the property then or thereafter."⁶¹ Section 811(c)(2) responded to the Court's conclusion in *Spiegel* by limiting section 811(c)(1)(C)'s coverage of reversionary interests to those with a value in excess of five percent of the value of the property.⁶² By this action Congress rejected a rigid approach to the inclusionary reach of the "intended to take effect . . . at . . . death" language just as firmly as it had rejected *May's* rigid approach to exclusion in the Joint Resolution of March 3, 1931. In other words, just as Congress established by its resolution in 1931 that property concepts were not to be used as an absolute standard for exclusion from coverage, so it established by the 1949 Act that those same concepts were not to be used as an absolute standard for inclusion. Rather, transferred property was to be included only where the reservation of a reversionary interest illustrated testamentary intent by virtue of its size.

2d Sess. 469, reprinted in [1954] U.S. CODE CONG. & AD. NEWS 4621, 5113. Therefore, to the extent that the language in section 811(c)(1)(B) carried with it an implied limitation from the "intended to take effect . . . at . . . death" language formerly associated therewith, that limitation carried over into section 2036. See text accompanying note 55 *supra*.

57. "This section [2037] is a combination and revision of existing law found in sections 811(c)(1)(C), 811(c)(2), and 811(c)(3) of the 1939 Code. This section corresponds to provisions of existing law insofar as they relate to transfers of property made prior to October 8, 1949." S. REP. NO. 1622, 83d Cong., 2d Sess. 469, reprinted in [1954] U.S. CODE CONG. & AD. NEWS 4621, 5113.

58. 335 U.S. 701 (1949).

59. 335 U.S. 632 (1949).

60. 309 U.S. 106 (1940).

61. 335 U.S. at 705.

62. Ch. 720, § 7(a), 63 Stat. 894-95 (1949). Coverage of section 811(c)(2) was limited to transfers made prior to October 8, 1949. Coverage of transfers made after October 7, 1949, was governed by section 811(c)(3). It was restricted to those transfers which required the grantee to survive the grantor—a condition expressed by the Court in *Spiegel*.

With this history as background, the consolidation worked by section 2037 in 1954 no longer appears as an attempt to rid the Code of an "intent" criterion. As a result of the Technical Changes Act, nonincome reversions were essentially all that was left to be covered by the "intended to take effect . . . at . . . death" language in section 811(c)(1)(C). Reversionary interests in income created prior to October 8, 1949, were expressly excluded from section 811(c)(1)(C) by section 811(c)(2) while reserved life estates were implicitly excluded because of the express inclusion called for by section 811(c)(1)(B). Thus, combination of 811(c)(1)(C), 811(c)(2), and 811(c)(3) into a single "reverter" section was logical.

The foregoing discussion makes it clear that the goal of section 2036 remains much the same as that of the original section 302(c) as amended in response to *May* and as transmuted through section 811(c)—to tax those transfers of property "intended to take effect . . . at . . . death" that are in the form of life estates. In substance, it does little more than illustrate the type of transfers which are taxable simply because, in the words of the Court in *Hallock*, they are "too much akin to testamentary dispositions not to be subjected to the same excise."⁶³

This practical reading of section 2036 is reinforced by section 2038. Section 2038 requires inclusion of property in the gross estate where its possession and enjoyment are subject to change through the exercise of a retained "power (in whatever capacity exercisable) . . . to alter, amend, revoke, or terminate" the transfer. Section 2036, on the other hand, speaks only in terms of "rights"—an assumedly narrower standard of coverage—and lacks the parenthetical modifier found in section 2038. The familiar principle of statutory interpretation, *expressio unius est exclusio alterius*, would therefore suggest that Congress did not intend section 2036 to cover rights retained in certain capacities.⁶⁴

Section 2038 suggests a practical reading of section 2036 in other ways. By its terms, section 2038 will tax those transfers subject only to the transferor's power to modify. Where one retains only this power, he retains power without clear economic gain. Taxation must therefore be premised upon the testamentary intent exhibited.⁶⁵ The fact that Congress chose to tax only those interests in the transferred property which are subject to the

63. 309 U.S. at 112.

64. This does not mean that by mere change in capacity one can avoid the application of section 2036. Such a result would be troubling, to say the least. One can, however, draw from the lack of capacity language the absence of an intent to make 2036 a section covering absolutely all retained powers or even rights. *Byrum* reflects such a less than absolute approach, and therefore seems consistent with congressional intent. *But see* Treas. Reg. § 20.2036-1(b)(3) (1958).

65. The question is obviously quite different from that of determining whether a transaction is "testamentary" under the Statute of Wills. *See* T. ATKINSON, *supra* note 36, at §§ 38-49. There, the question is one of legal form—clearly not the question here.

proscribed powers under section 2038 also indicates that its purpose was to cover only those powers which made the transfer of property subject thereto indicative of testamentary intent. Thus, section 2038 does indeed reinforce the proposition of the Court in *Hallock* that the thrust of the estate tax provisions is to tax only those transactions which are basically testamentary in nature.

II. RETAINED POWERS AS NONTESTAMENTARY ACTS⁶⁶

In addition to helping expose testamentary intent as the root criterion for taxation under section 2036, *Byrum* underscores the fact that when viewed in light of objective circumstances many powers retained by donors of property have as their most likely genesis a purpose which is nontestamentary. That Congress seems also to have recognized this fact may be inferred from the narrow manner in which it responded to the decision. Instead of attacking the right versus power distinction raised by the Court in its analysis of section 2036(a)(2), Congress reversed the decision by providing that for the purposes of section 2036(a)(1) "the retention of voting rights in [transferred] stock shall be considered to be a retention of the enjoyment of such stock."⁶⁷ While it was unnecessary for Congress to go further than this in order to reverse *Byrum*, its failure to close the potential gap in the coverage of section 2036(a)(2) created by the right-power distinction⁶⁸ suggests that it (and perhaps the Internal Revenue Service as well) does not perceive the decision as being out of line with the purposes of that section.

In its analysis of the applicability of section 2036(a)(2), the Court in *Byrum* recognized that just as a trustee's activities are limited by the fiduciary duties imposed by trust law, so too are the activities of a majority shareholder and board of directors limited by the fiduciary obligations imposed by state corporation law. It did so in order to help support an analogy between the facts presented and those in several cases wherein it was held that broad management powers held by a donor-trustee will not cause the transferred property to be included in the decedent's gross estate.⁶⁹ This controlling shareholder to donor-trustee analogy is not unreasonable, although some have disagreed with it.⁷⁰ In each situation the decedent's retention of powers does not normally suggest a testamentary purpose: control-

66. The phrase is mine, borrowed from a similar doctrine in the law of decedents' estates. See generally T. ATKINSON, *supra* note 36, at § 81.

67. Tax Reform Act of 1976, Pub. L. No. 94-455 § 2009(a), 90 Stat. 1893 (codified at 26 U.S.C.A. § 2036(a) (Supp. 1977)).

68. See notes 94-107 *infra* and accompanying text.

69. 408 U.S. at 133-34, 141-43.

70. See, e.g., 19 LOY. L. REV. 485 (1973).

ling shareholders of family businesses may wish to continue in control in order to achieve an employment-related goal or to preserve their status in the family rather than to effect a wealth transfer;⁷¹ donors, often the most logical trustees, need a broad range of powers in order to operate their trusts efficiently.⁷²

A. Retention of Powers by Donor-Trustees

Citation by the Court in *Byrum*⁷³ of *Reinecke v. Northern Trust Co.*⁷⁴ suggests that the Court still does not perceive the retention of "management" powers which may be used to "designate the persons who shall possess or enjoy the property or the income therefrom"⁷⁵ as ipso facto establishing a testamentary intention. This is understandable. A donor-trustee may desire management control over transferred property in order to benefit all of the trust's beneficiaries rather than to harm one or more of them. Indeed, such would be the normal case for retaining such powers. Their presence in the hands of a donor-trustee is therefore at worst neutral evidence of testamentary intent.

The same can be said of retained "administrative" powers.⁷⁶ These powers can easily be used by a donor-trustee to enhance income at the expense of principal or principal at the expense of income.⁷⁷ Yet in the leading case of *Old Colony Trust Co. v. United States*⁷⁸ the First Circuit Court of Appeals held that no cumulation of purely administrative powers violated the constraints of section 2036. The court found "it difficult to see how a power can be subject to control by the probate court, and exercisable only in what the trustee fairly concludes is in the interests of the trust and its beneficiaries as a whole, and at the same time be an ownership power."⁷⁹

Any realist must admit that if a trustee desires to maximize the interest of one beneficiary to the detriment of another the significant latitude permitted him in exercising his administrative powers will enable him to do so. The realist will also recognize that family members are unlikely to enforce the equitable duties constraining a donor-trustee—particularly where further

71. See notes 81–87 *infra* and accompanying text; Horvitz, *Retention of Control: The Implication of the Byrum Case*, 32 N.Y.U. INST. FED. TAX. 235, 242, 244–45 (1974) (buy-a-job theory for taxation under section 2036(a)(1), see note 85 *infra*).

72. See text accompanying notes 73–79 *infra*.

73. 408 U.S. at 133–34, 146–47.

74. 278 U.S. 339 (1929).

75. I.R.C. § 2036(a)(2).

76. Examples of such powers are those which permit the trustee to determine whether trust receipts shall be allocated to principal or income and to make investments not normally allowed other trustees.

77. *State St. Trust Co. v. United States*, 263 F.2d 635, 639 (1st Cir. 1959).

78. 423 F.2d 601 (1st Cir. 1970).

79. *Id.* at 603.

assets remain to be distributed. Because of the clear possibility for abuse, *Old Colony* and cases like it suggest that courts do not feel that the average donor-trustee will exercise retained powers so as to harm one or more of the trust's beneficiaries. Rather, the perception seems to be that such powers are retained in order to help the donor-trustee maximize the profitability and security of the trust and are, in general, neutral with respect to their intended effect on beneficiaries. If such perceptions are true, the donor does not, practically speaking, retain a right to designate who shall receive possession, enjoyment, or income since he does not reserve the powers with the purpose of varying the interests of the beneficiaries. The retention of powers in and of itself should therefore not be a sufficient reason for including the transferred property in the donor-trustee's gross estate; it is, in effect, a nontestamentary act.

B. Byrum

If testamentary intent is to be ascertained, as suggested in *Commissioner v. Estate of Church*,⁸⁰ by inquiring into whether or not a particular power would, in the normal case, be retained in order to be exercised against the interest of a beneficiary, it is important to recognize that there were significant reasons for the powers Byrum retained which stemmed from sources other than antibeneficiary intent. For example, because the trustee to which Byrum transferred his stock was a third party, there arose a possibility for significant outside influence in what were basically family businesses.⁸¹ In such a situation the natural reaction of the "owner" is to try to protect them. The easiest manner in which to do this is that which was used by Byrum—prohibit sale of the shares and retain the voting rights.

If the prohibition on retention of powers is perceived as being directed against the trustee, the property should not be included in the gross estate under section 2036(a)(2). This section is directed only against those rights which affect beneficial interests—possession, enjoyment, or income.⁸² Be-

80. 335 U.S. 632, 641 (1949). The Court in *Church* cited with approval *Reish v. Commonwealth*, 106 Pa. 521 (1884), for its holding that "the test of 'intended' was not a subjective one, that the question was not what the parties intended to do, but what the transaction actually effected as to title, possession and enjoyment." 335 U.S. at 638. This interpretation reflects the "objective factual" test preferred by Surrey & Aronson, *Inter Vivos Transfers and the Federal Estate Tax*, 32 COLUM. L. REV. 1332, 1337-40 (1932).

81. While there were other "outside" shareholders prior to the transfer into trust, Byrum owned a vast majority of shares in each of the companies. See 408 U.S. at 130 n.2.

82. Coverage of section 302(c) of the Revenue Act of 1926, ch. 27, 44 Stat. 70, one of section 2036's many predecessors, was early recognized as applying to a "shifting of the economic benefits." Surrey & Aronson, *supra* note 80, at 1344. Byrum notes the same thrust through its endorsement of the interpretation given the word "enjoyment" in *Commissioner v. Estate of Holmes*, 326 U.S. 480, 486 (1946), that is, power over a "substantial present economic benefit." 408 U.S. at 145.

cause the trustee is entitled to none of these, powers that are designed to restrain him should not violate the section. In terms of "intent:" if the powers were retained with antitrust intent, they were not retained with testamentary motives and therefore do not indicate that the transfer of the beneficial interest was "intended to take effect . . . at . . . death."

It is true that the powers retained by Byrum could have been used to the detriment of the income beneficiaries. The fact that it would have been possible for him to grant the voting and veto powers to one or more of them seems to support the conclusion that the retained powers were intended to be so used. On the other hand, it must be recognized that closely held stock has value not only as an item of economic wealth but also as a formal prerequisite to the control of a business. Indeed, there are several good business reasons for the key man in a closely held corporation to have the voting rights to its stock. Two of the most obvious are to enable him to influence corporate expansion through accumulation of earnings and to give him the ability to retain needed personnel by increasing their salaries.⁸³ Without the capacity to make these types of decisions the entrepreneur is unlikely to be successful in running his business.⁸⁴ This suggests that in the normal case the retention of voting power over stock in a closely held corporation which is transferred in trust by a key figure in the company's operations may be motivated at least as much by business reasons as it is by a purpose to control the flow of economic benefits to the beneficiaries. It is, in other words, as much an indication of a nontestamentary purpose as it is of a testamentary one.⁸⁵

The family head's natural inclination to protect his position as such also suggests a nontestamentary purpose in retaining control over transferred stock. Indeed, had Byrum given the voting rights to his children he would have effectively reversed the normal operation of the family; his position, his duties, and his salary would all have been subject to their control.⁸⁶ It is

83. See 408 U.S. at 139-42.

84. Indeed, the security of continued business control may be one of the primary reasons for issuing nonvoting stock as a means of raising capital. E. DONALDSON & J. PFAHL, *CORPORATE FINANCE* 732 (3d ed. 1969).

85. One commentator refers to retention of voting control as the "buy-a-job" power. Horvitz, *supra* note 71, at 235, 242, 244-45 (1974). Under this view retention of voting control enables the holder to "enjoy" the stock under section 2036(a)(1) because he is able to insure his employment and the salary which goes with it. The Court in *Byrum* rejected this argument, and rightly so, for a "buy-a-job" motive is but another phrasing of the reason for not holding the transaction testamentary. Nevertheless, the amendment to section 2036(a)(1) included by Congress in the Tax Reform Act of 1976 appears to accept the theory that the ability to "buy-a-job" is sufficient to justify taxation.

86. The trust assets included a 48% ownership interest in one corporation and a 46% interest in another. Byrum retained only 35 and 42% interests respectively. 408 U.S. at 130 n.2. The beneficiaries would thus have been in a fairly dominant position.

unlikely that a parent would want to be subject to such control by his children. It is therefore entirely possible to perceive the retention of control by Byrum as being motivated by a desire to retain parental supremacy rather than to retain the right to designate the persons who were to enjoy the economic benefits of the stock. If this perception is true it cannot be argued that section 2036(a)(2) is applicable. Preserving parental status is not the sort of intent against which the section is directed.⁸⁷

C. *The Family Home Cases*

The *Byrum* result is also consistent with the manner in which the courts have applied section 2036(a)(1) to the decedent who remained in possession of a home that he transferred to his spouse or children. In these cases the principal question is generally whether or not the transfer was made pursuant to an implied agreement whereby the decedent retained a right to possess or enjoy the property. Such an inference is an easy one to draw. Nevertheless, courts have been wary of applying section 2036(a)(1), and in fact, have consistently refused to find the requisite agreement where the transfer has been from one spouse to another.⁸⁸ On the other hand, it now appears likely that an agreement giving the donor a right to possess and enjoy the property will be implied where the donor and donee are parent and child.⁸⁹

The reasons for the distinction between spousal and parental transfers are not readily discernable. In both instances the parties assume that the donor will continue to occupy the premises after the transfer and in both instances the donor does in fact continue to do so. It is submitted that the cases can only be understood by comparing the transfers to those in the ordinary course of an ordinary family's life.

The nature of marriage is such that common use of individually owned assets is expected. As a result, gifts made within the context of a normal marriage presuppose that the donor will retain a continued benefit. Because the transfer of the family home is no different in this respect, the testamentary intent necessary for taxation cannot be implied. In the parent-child context, however, retention of title until transfer of possession would appear to be the norm. Indeed, it is unusual for a parent to transfer his or her house

87. The distinction being made here between a retention of family property and a retention of family status may make a reference to Roman law appropriate. See generally H. MAINE, *ANCIENT LAW* 172-84 (3d ed. 1873).

88. E.g., *Union Planters Nat'l Bank v. United States*, 361 F.2d 662 (6th Cir. 1966); *Estate of Binkley v. United States*, 358 F.2d 639 (3d Cir. 1966); *Allen D. Gutchess*, 46 T.C. 554 (1966), *acquiesced in*, 1967-1 C.B. 2.

89. E.g., *Guynn v. United States*, 437 F.2d 1148 (4th Cir. 1971); *Estate of Emil Linderme*, Sr., 52 T.C. 305 (1969); Rev. Rul. 70-155, 1970-1 C.B. 189.

before the need for it ceases. Earlier transfer with continued possession thus raises the inference that the transfer is in fact subject to a right to possess.

That the distinguishing factor between the spousal and parental transfer cases is the regularity of the transaction within the context of a normal family structure is confirmed by the decision in *Diehl v. United States*.⁹⁰ In *Diehl*, the court found that a transfer by an aged father to his son after the latter and his wife had sold their own home and moved in so as to be able to take care of him was not made pursuant to an implied agreement giving the father a right to stay, notwithstanding any assumption the parties may have had, and thus held that section 2036(a)(1) did not apply. Because a parental transfer was involved, one would have expected the Commissioner to have won this case. However, the transfer in *Diehl* was made to a party who at the time of the transfer was making the home his permanent residence. Thus, continued occupation of the home by the father was as consistent with an absolute gift of his entire interest as it was with a retained life estate, and because either was possible, no presumption of an agreement justifying inclusion of the property in the gross estate could be made. In other words, the regularity of the transaction when compared with an objective view of the circumstances indicated that the transfer was a nontestamentary act.

III. LOOKING AHEAD

Presuming *Byrum* does in fact endorse testamentariness as the standard to be applied in evaluating transfers arguably within the scope of section 2036, the case suggests results for a variety of situations with which the courts are presently struggling.

A. *The Family Home Cases*

The most obvious effect of reading *Byrum* as embracing a testamentariness test would be affirmation of the manner in which the family home cases are presently being resolved. Because continued residence by a donor-spouse is consistent with an absolute transfer of a house within the marriage context, it should not, on that basis alone, be included in the donor's estate. Similarly, where both the donor and donee reside in the house prior to the transfer, continued occupancy should not result in inclusion—even where the donor-donee relationship is one of parent and child.⁹¹

On the other hand, an express agreement between spouses for continued residence until sale of the house or dissolution of the marriage by death or otherwise would seem to violate section 2036(a)(1) even though such an

90. 68-1 U.S. Tax Cas. (CCH) ¶ 12,506 (W.D. Tenn. 1967).

91. Of course, if the child were a minor, one might find sufficient irregularity to raise the issue of testamentary intent based upon the control which a parent exercises over his child.

agreement would be but a restatement of expected behavior, because the very existence of the agreement indicates a posture of negotiation—a posture contrary to the normal marriage relation.⁹² Certainly, if the agreement for continued occupancy extends beyond sale of the house or divorce, section 2036(a)(1) should cause the house to be included in the donor's gross estate because it would clearly exceed the normal expectations as to ownership by the donee.⁹³

B. Implied Rights

Although *Byrum* may protect some implied agreements (such as the family home cases) from automatically running afoul of section 2036, there seems no reason to assume that it will protect all of them. At best, the case dictates a presumption against inclusion if the acts are as consistent with a nontestamentary purpose as with a testamentary one. Nowhere in *Byrum* is it suggested that a retained "power" cannot constitute a retained "right" covered by 2036 where that power is in fact used to the detriment of a donee.⁹⁴ Indeed, since post-retention use may provide the best evidence of intent at the time of the transfer, such cases should reach results opposite that in *Byrum*.⁹⁵

An example of such a case is *Estate of Hilton W. Goodwyn*.⁹⁶ There, notwithstanding a "friendly trustee" who consistently followed the requests of the donor in exercising his discretionary powers, the Tax Court held that *Byrum* prohibited including the transferred property in the decedent's gross estate. Such a reading of *Byrum* seems unwarranted. Nothing in the language of section 2036 requires an express reservation of rights, and since

92. In the normal case it is arguable that there is no retention as required by the statute, but merely a permitted use. On the other hand, where the parties enter into an agreement the fact of retention is clear.

93. Indeed, there is little question that continued possession would be adverse to that of the purchaser, in the case of a sale, and to the former spouse, in the case of divorce.

94. It is noteworthy that although only minimal dividends were paid during *Byrum's* tenure there was no proof that this was inconsistent with prior company policy or otherwise the result of an effort by *Byrum* to control the flow of dividends to the trust.

95. Cf. *Lazarus v. Commissioner*, 513 F.2d 824 (9th Cir. 1975) (transfer of stock into trust in exchange for annuity deemed a transfer with a reserved life estate in income rather than a sale); *Estate of William duPont, Jr.*, 63 T.C. 746 (1975) (conveyance of bulk of residential and recreational estate to wholly owned corporation and transfer of its shares to irrevocable trust not a bona fide arm's length transaction divesting the grantor of possession or enjoyment where he leased back the property for less than adequate consideration for a period of ten years with an option to renew), noted in 28 U. FLA. L. REV. 258 (1976); *Mark Bixby*, 58 T.C. 757 (1972) (trust interposed in transaction between buyer and seller deemed a sham transaction); *Estate of Pamela D. Holland*, 47 B.T.A. 807 (1942), modified 1 T.C. 564 (1943) (stock transferred during life of decedent accompanied by immediate retransfer as "security" included in decedent's gross estate). See also 30 WASH. & LEE L. REV. 97 (1973).

96. 32 T.C.M. (CCH) 740 (1973).

early in the section's history the regulations have clearly stated that it applies to rights either "express or implied."⁹⁷ The clear intent of this regulation is to prohibit avoidance of section 2036 by means of a paper transaction whereby property that is the subject of a seemingly outright transfer remains subject to the donor's life estate or control. In such cases the inability to obtain evidence of an express agreement ought not stand in the way of taxation.⁹⁸

This conclusion is supported by several persuasive pre-*Byrum* decisions. In *Estate of McNichol v. Commissioner*,⁹⁹ for example, a parent-grantor reserved for his life the rents from transferred property pursuant to oral agreements with the children-grantees. The estate argued that the retained income interest was not a "right" because the statute of frauds could preclude judicial enforcement of the agreements from which it arose, and that even if it were a right, it was not includable because it was not retained "under" the transfer to the children. The Third Circuit Court of Appeals noted, however, that the "right to income" clause of section 811(c)(1)(B) of the 1939 Code, the predecessor to section 2036, was not intended by Congress to circumscribe the "possession or enjoyment" clause, but was instead meant to broaden its sweep by making clear its coverage of those cases where a decedent who was not receiving income was in fact entitled to do so.¹⁰⁰ In so doing it rejected the notion that "possession or enjoyment" contemplated an enforceable claim against the transferee. And with respect to the taxpayer's technical argument that a retained life interest must be "under" the original transfer the court simply stated that "[t]his [was] too constricted an interpretation to place on the statute. The statute means only that the life interest must be retained in connection with or as an incident to the transfer."¹⁰¹

A similar and more recent case of like import is *Estate of McCabe v. United States*.¹⁰² There, the decedent had transferred stock to a trust for his wife with a remainder to his children. On several occasions following the creation of the trust and until the decedent's death, he prepared requests for distributions of corpus which were readily signed by his wife who admitted that she could not recall ever having seen the trust agreement or having its terms explained to her. Most of the withdrawn funds were deposited by the trustee in the decedent's checking account, and in one instance were used to pay off his personal note. Not surprisingly, the court found that this "pre-

97. Treas. Reg. § 20.2036-1(a)(ii) (1958) (last sentence).

98. This is especially true where the creation of the evidence is within the control of the decedent.

99. 265 F.2d 667 (3d Cir. 1959).

100. *Id.* at 670-71.

101. *Id.* at 670.

102. 475 F.2d 1142 (Ct. Cl. 1973).

tended transfer to a wife, with the retention of a life estate by the husband so apparent from the facts as here, is the archetypal situation reached by subdivision (1) of § 2036(a)."¹⁰³

The *McCabe* situation is nearly identical to that in *Goodwyn*. In both instances a party occupying what should have been an independent or adverse position was willing to do as the decedent requested. The result reached in *McCabe*, recognizing as it does the realities of the situation, seems certainly to be preferred. Actually, this result may be mandated by the decision in *United States v. Estate of Grace*¹⁰⁴ wherein the Supreme Court recognized the concept of implied rights in reaching the conclusion that reciprocal trusts must be included in the gross estate under section 811(c)(1)(B) of the 1939 Code.¹⁰⁵ The Court observed that "[t]he general purpose of the statute was to include in a decedent's gross estate transfers that are essentially testamentary—*i.e.*, transfers which leave the transferor a significant interest in or control over the property transferred during his lifetime,"¹⁰⁶ and concluded not only that the reciprocal trust doctrine should be recognized, but also that a finding of reciprocity did not depend "upon a finding that each trust was created as a *quid pro quo* for the other."¹⁰⁷ This analysis seems to recognize that which the Tax Court in *Goodwyn* believed to be precluded by *Byrum*—the demonstration of an implied retention of right. Yet nowhere in *Byrum* is *Grace* invalidated. Indeed, the *Byrum* decision went no further than to find that the powers there retained were insufficient to show the retention of such a right. In clearer cases one would expect to reach different results. This being true, *McCabe* and *McNichol* should have controlled the decision in *Goodwyn*.

C. Term Trusts

Section 2036 extends to transfers subject to retained rights or interests which last "for [a] period which does not in fact end before [the decedent's] death." This language appears to be without exception. However, the history of section 2036 suggests that the quoted language was intended only to cover those cases in which a term was used as a substitute for a retention for life. Indeed, the Senate Finance Committee Report explaining the addition of the specific language in 1932 stated:

The insertion of the words "or for any period which does not in fact end before his death" . . . is to reach, for example, a transfer

103. *Id.* at 1148.

104. 395 U.S. 316 (1969).

105. Int. Rev. Code of 1939, ch. 1, § 811(c)(1)(B), 63 Stat. 894-95 (now I.R.C. § 2036(a)).

106. 395 U.S. at 320.

107. *Id.* at 324.

where decedent, 70 years old, reserves the income for an extended term of years and dies during the term, or where he is to have the income from and after the death of another person until his own death, and such other person predeceases him.¹⁰⁸

Moreover, when Congress passed the 1954 Code, it stated in the Senate Finance Committee Report that section 2036 represented section 811(c)(1)(B) of the 1939 Code except for clerical changes.¹⁰⁹ The regulations under that section had limited its coverage to interests "for a period as would evidence [the decedent's] intention that it should extend at least for the duration of his life."¹¹⁰ Arguably, therefore, Congress endorsed the then current regulations as accurately defining the scope of section 2036.¹¹¹

The foregoing suggests that a strong argument can be made that short term trusts created by young donors were never contemplated as being within the coverage of section 2036. *Byrum* adds support to this conclusion through its recognition of the more basic proposition—that section 2036 is meant to cover only those transfers that are "intended to take effect . . . at . . . death." Short term trusts created by young donors would seem not to be so intended on any objective standard, and should therefore be excluded from its coverage.¹¹²

D. *The Family Business*

Since *Byrum* dealt specifically with control of a closely held business, it would appear to have its most significant impact in that area. While retention of voting rights has been precluded by the amendment to section 2036,¹¹³ *Byrum* appears to authorize the type of transaction disapproved of in Revenue Ruling 67-54¹¹⁴ whereby the owner retains control of his business by retaining the company's voting stock while transferring to others

108. S. REP. NO. 665, 72d Cong., 1st Sess. 50 (1932).

109. S. REP. NO. 1622, 83d Cong., 2d Sess. 469, reprinted in [1954] U.S. CODE CONG. & AD. NEWS 4621, 5113.

110. Treas. Reg. 81, § 81.18(a)(1) (1939).

111. See *Helvering v. Winmill*, 305 U.S. 79, 83 (1938).

112. The current regulations do not address the problem, and so far the cases seem to have avoided directly confronting the issue. See, e.g., *Bayliss v. United States*, 326 F.2d 458 (4th Cir. 1964); *Estate of Edson Bradley*, 9 T.C. 145 (1947). *Shukert v. Allen*, 300 F. 754 (D. Neb. 1924), *aff'd*, 6 F.2d 551 (8th Cir. 1925), *rev'd*, 273 U.S. 545 (1927), provides an illustration of the classic case for inclusion. There, a trust for a term of thirty years was established by a gentleman with a life expectancy of only sixteen or seventeen years. See also Treas. Reg. § 20.2037-1(e) Ex. 5 (1958).

113. See notes 1, 4-5 *supra*.

114. 1967-1 C.B. 269. In rejecting the rationale of this ruling *Byrum* is in accord with *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. (CCH) ¶ 12,524 (N.D. Ill. 1968) (power to vote stock of family corporation as trustee and as individual and to manage the trust, including the power to sell and invest the trust property for the best interests of the beneficiaries, deemed not to constitute a retained interest in or right to govern the beneficiaries' enjoyment of the property and thus

nonvoting shares representing the economic incidents of ownership. Such a plan can be justified on the basis of management retention motives and would thus seem permissible under *Byrum*. Furthermore, because voting rights are not retained with respect to the transferred stock, such an arrangement may even survive the amendment to section 2036 included in the Tax Reform Act of 1976.

Of greater difficulty is a case such as *Estate of Charles Gilman*,¹¹⁵ where corporate control rested in six shares of voting common and the bulk of the equity in nonvoting preferred stock, where it was the *voting* shares which were transferred into trust, and where the decedent-donor was one of three trustees with express power to vote the shares. Since the only value of the common shares was contained in their ability to control the business, retention of that control by the donor, even as trustee, would appear to be a retention of the only possible "enjoyment" of the shares, even without reference to the 1976 amendment. As a result, the transaction should not have been excluded from the coverage of section 2036 on the basis of *Byrum*.¹¹⁶ Indeed, withholding control of an asset whose only value is control is far different from retaining for control assets whose major value is found in corporate equity as was true in *Byrum*. In the former case the retention is directed primarily against the value purportedly transferred while in the latter it is not. That one may more easily discern a testamentary purpose in the former instance is clear.

Finally, one can contrast *Gilman* with a case such as *Estate of Harry H. Beckwith*.¹¹⁷ There, the decedent retained voting power by means of making himself trustee of the trust to which he transferred his shares. This power, coupled with proxies regularly given him by other shareholders, gave him control over the corporation. Since the power was held only as trustee or as the result of transfers of others, the decedent's estate would properly not include the value of the trust shares under *Byrum*. Even with respect to shares that he had transferred, voting power held as a trustee illustrates only a desire to perform normal trustee activities and cannot, by itself, be taken as an indication of a reservation counter to the interests of the beneficiaries.

excluded from the decedent's gross estate), and *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970) (voting rights of closely held corporation's stock held as trustee and as proxy not sufficient to require inclusion in the gross estate under section 2036 because no express or implied agreement could be inferred which would restrict the trustees' freedom either in voting or disposing of the stock), *acquiesced in*, 1971-2 C.B. 1, *noted in* 1971 WASH. U.L.Q. 681. Newman & Kalter, *Transfers of Corporate Securities by Persons in Control of Corporate Policy*, 111 TRUSTS & EST. 118 (1972).

115. 65 T.C. 296 (1975), *aff'd*, 547 F.2d 32 (2d Cir. 1976). For a discussion of the effect of *Gilman*, see Pressment, *Effect of Tax Court's Gilman Decision on Estate Planning For the Close Corporation*, 44 J. TAX. 160 (1976).

116. For a contrary view, see 41 U. CIN. L. REV. 950 (1972).

117. 55 T.C. 242 (1970), *acquiesced in*, 1971-2 C.B. 1. See note 114 *supra*.

With the amendment to section 2036, the question in *Beckwith* may be somewhat closer, although the result should be similar. Technically, the transfer of stock to a trust carries with it voting rights, so that the rights are not "retained" in a classic sense. Even assuming that such a transfer would be held to comprehend a "retention,"¹¹⁸ there still is a question whether voting rights held by a trustee as legal owner of the stock would be held to constitute a "right to vote" the stock under the amendment. Voting rights form a part of the ownership interest in stock. Unless they are severed from other ownership rights, it is difficult analytically to say that the trustee has a right to vote the stock rather than mere ownership of it. As a result, *Beckwith* may well not illustrate a forbidden transaction under either *Byrum* or the amendment to section 2036.

IV. CONCLUSION

Despite the amendment to section 2036 included by Congress in the Tax Reform Act of 1976, *Byrum* remains a significant decision. In addition to helping expose the fundamental inquiry under section 2036—whether or not the transaction in question was, upon an objective analysis of the circumstances, "intended to take effect . . . at . . . death"—the result reached by the Court recognizes that the concept of "testamentariness" can easily be a double-edged sword. Whether the judicial realism of these basic principles will survive the Tax Reform Act of 1976 and decisions which rely heavily upon the Court's technical reasoning such as *Goodwyn* and *Gilman* is a question which only time can answer.

118. See *United States v. O'Malley*, 383 U.S. 627 (1966).