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Powers of Appointment and the Kentucky Inheritance Tax— The Department of Revenue's Administration of KRS Section 140.040

BY WILLIAM P. STURM*

INTRODUCTION

Powers of appointment¹ are becoming increasingly popular today² largely because they extend the decedent's control over his property³ and help minimize death taxes.⁴ Most states tax property passing at death under powers of appointment.⁵ States often have a hard time, however, formulating a statutory provision to meet their needs. Those that are on the statute books are often

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¹ A power of appointment is a power or authority conferred by one person called the donor upon another person called the donee to appoint, that is, to select and nominate, the person or persons called the appointees or beneficiaries who are to receive and enjoy an estate or an income therefrom or from a fund after the donee's death or after the termination of an existing right or interest. BLACK'S LAW DICTIONARY 1334 (4th ed. 1951). A donee's power of appointment is said to be "general" if the donee may appoint the property to anyone he chooses or to a limited group which includes himself, his estate, his creditors or the creditors of his estate. If the donee is precluded by the power from appointment to himself, his estate, his creditors, or the creditors of his estate, he holds a "special" power of appointment. Kentucky does not distinguish between general and special powers of appointment in levying inheritance taxes. The federal government does, however, and taxes property subject to a general power twice (once when transferred to the donee and again when transferred from donee to beneficiary), and property subject to a special power once. KENTUCKY LEGISLATIVE RESEARCH COMMISSION, INHERITANCE AND ESTATE TAXATION 14 (1961).

² 3 R. POWELL, REAL PROPERTY ¶ 385, at 337 (1970) [hereinafter cited as POWELL].

³ RESTATEMENT OF PROPERTY, Introductory Note 1808-09 (1940).

⁴ POWELL, *supra* note 2, ¶ 385, at 336-37.

⁵ All states, with the exception of Nevada, have inheritance or estate tax statutes. Of these, only Connecticut, Indiana, Wyoming, New Hampshire, Utah, and Louisiana have no specific provision for the taxation of powers of appointment. Louisiana, a civil law state, does not recognize powers of appointment. 4 CCH INH. EST. & GIFT TAX REP. [State Compilation] ¶ 1540C, at 80, 164-65 (1968).

complex and misunderstood by the average lawyer. The situation in Kentucky is no exception. From the inception of inheritance taxes in 1906⁶ and the first statute specifically relating to powers of appointment in 1924,⁷ there have been conflicts over the constitutionality and interpretation of *Kentucky Revised Statutes* § 140.040 [hereinafter cited as KRS] which have not ceased to this day,⁸ even among legal scholars.⁹ It is submitted that a thorough knowledge of the Department of Revenue's administration of KRS § 140.040 is a prerequisite to further analysis and research in this area of the law. Unfortunately, such information has been previously unavailable in printed form, and much confusion has been caused by legal writers trying to state the Department's interpretation and at the same time formulate their own views. The intent of this article, therefore, is not to criticize or suggest reform of the statute but to provide a straightforward presentation of the Department of Revenue's interpretation and administration of KRS § 140.040.¹⁰ It is hoped that this presentation will be helpful both to lawyers in their everyday practice and to academicians in the further investigation of powers of appointment.

I. STATE TAXATION OF POWERS OF APPOINTMENT GENERALLY

Kentucky levies an inheritance tax and, in a few cases, an estate tax.¹¹ An inheritance tax is imposed on the privilege of

⁶ KY. ACTS ch. 22, art. XIX (1906). In 1936 the act was renumbered § 4281a of CARROLL'S KENTUCKY STATUTES. In 1942, at the time of the general revision, it was redesignated Chapter 140 of the KENTUCKY REVISED STATUTES [hereinafter cited as KRS].

⁷ KY. ACTS ch. 111, § 1(3) (1924), redesignated § 4281a-14 of CARROLL'S KENTUCKY STATUTES in 1936 and § 140.040 of KRS in 1942.

⁸ See Kentucky Bd. of Tax Appeals v. Citizens Fidelity Bank & Trust Co., File Nos. F-198-72, F-205-72 (Ky., filed Sept. 26, 1973).

⁹ For general authority on powers of appointment in Kentucky, see KENTUCKY LEGISLATIVE RESEARCH COMMISSION, INHERITANCE AND ESTATE TAXATION 13-15 (1961); DEP'T OF REVENUE, INHERITANCE AND ESTATE TAXES IN KENTUCKY 36, 42-44 (Special Report No. 6, 1947); Sullivan, *Appellate Court Interpretation of Kentucky Inheritance Tax Statutes*, 35 KY. L.J. 198, 202-04 (1947); Note, *Kentucky Death Taxes—Putting a Price on Inheritance*, 58 KY. L.J. 549, 563-68 (1970). The author is hesitant to cite authorities because articles on Kentucky powers of appointment are often confusing and misleading. The latter note presents the most extensive treatment of powers of appointment but also differs extensively from the Department of Revenue's interpretation and administration of KRS § 140.040.

¹⁰ Although prepared with the full cooperation of the Department of Revenue's Legal Staff and Inheritance Tax Section, this article is not an official publication of the Department.

¹¹ The inheritance tax provisions of KRS § 140.010 *et seq.* apply in the vast majority of cases. Under KRS § 140.065 an estate tax is levied only on estates of \$3,000,000 or more.

receiving inherited property and falls on the beneficiary,¹² although most states require the executor or the administrator of the decedent's estate to collect it.¹³ An estate tax, on the other hand, taxes the privilege of transmitting property at death and is paid by the decedent's estate.¹⁴

Generally it is the *exercise* of the power of appointment by the donee which is the taxable event.¹⁵ For tax valuation purposes, the property subject to the power passing to the donee at the donor's death is composed of two elements, the donee's life estate and the appointee's remainder interest. If the donee has no power to encroach upon the appointive property itself, the value of the donee's life estate gradually decreases as he advances in age with a corresponding increase in the value of the remainder interest. At the donee's death, his life estate will have a zero value and the remainder interest will equal the total value of the appointive property. Although closely tied to a power of appointment, the donee's life estate does not pass pursuant to the exercise of the power and is not taxable as such. The donee's life estate is generally taxed at the donor's death by the donor's state of residence.¹⁶

Great confusion has reigned involving the taxation of powers of appointment. Part of this confusion results from the fact that the common law rule provides that property passing under a power of appointment is deemed to pass directly from the donor to the beneficiary;¹⁷ the donee is only considered to be the instrument the donor uses to carry out his wishes.¹⁸ This is the Kentucky rule as well.¹⁹ The common law rule, however, ignores reality since it is the donee who actually decides who is to finally possess or own the appointive property, and not the donor.²⁰

¹² *Martin v. Storrs*, 126 S.W.2d 445 (Ky. 1939).

¹³ *E.g.*, KRS § 140.220.

¹⁴ *Gearhart's Ex'r v. Howard*, 196 S.W.2d 113 (Ky. 1946).

¹⁵ *Union Bank & Trust Co. v. Bassett*, 253 S.W.2d 632, 639 (Ky. 1952). *But see Allen's Ex'r v. Howard*, 200 S.W.2d 484, 486 (Ky. 1947) where the death of the donor is referred to as the taxable event.

¹⁶ *E.g.*, KRS § 140.040(2).

¹⁷ *Highfield v. Delaware Trust Co.*, 152 A. 124 (Del. 1930); *In re Higgins Estate*, 189 N.W. 752 (Iowa 1922); *POWELL*, *supra* note 2, ¶ 387, at 347-52.

¹⁸ *Bankers Trust Co. v. Variell*, 123 A.2d 874 (Conn. 1956); *RESTATEMENT OF PROPERTY*, Introductory Note 1811 (1940).

¹⁹ *Union Bank & Trust Co. v. Bassett*, 253 S.W.2d 632 (Ky. 1952); *Ream v. Dep't of Revenue*, 236 S.W.2d 462 (Ky. 1951); *Commonwealth v. Fidelity & Columbia Trust Co.*, 146 S.W.2d 3 (Ky. 1940).

²⁰ *Commonwealth v. Fidelity & Columbia Trust Co.*, 146 S.W.2d 3 (Ky. 1940).

When inheritance taxes were first levied, the statutes were often general in nature and did not deal specifically with powers of appointment.²¹ Under such a statute, appointive property was taxed wholly in the donor's, not the donee's, estate because the donee never had title and at common law appointive property is a transfer from the donor.²² Subsequently, states began to clarify and enlarge their inheritance tax statutes, often enacting sections specifically taxing powers of appointment.

Some states originally taxed the exercise of the power of appointment at the *donee's* death.²³ These states changed the common law rule by providing that the appointive property was taxable "as if it belonged absolutely to the donee."²⁴ Those states taxing donees, as Kentucky did before 1936, soon learned that they were losing revenue rightfully considered to be theirs when resident donors gave powers of appointment either to nonresident donees or resident donees who subsequently moved out of the state.²⁵ This was true even though the resident donor had enjoyed all the privileges of residency. On the other hand, states which first levied the tax at the *donor's* death soon discovered that there were many outstanding powers of appointment created by donors dying prior to the effective date of their acts.²⁶ The resident donees were being afforded the same privileges as resident donors and the taxing states felt these donees should bear their fair share of the tax burden. These states, then, had to amend their tax statutes to correct what was considered to be an inequality in the law. It was hard, however, for most states to formulate a clear, concise, and non-discriminatory law which would enable the tax to be collected at the death of all resident donors dying after the effective date of the act and, in all other cases, at the donee's death.²⁷ Once a state decided to change its tax policy

²¹ E.g., KY. ACTS ch. 22, art. XIX (1906); MASS. ACTS ch. 563 (1907).

²² 4 CCH INH. EST. & GIFT TAX REP. [State Compilation] ¶ 1540C, at 80, 164 (1968).

²³ E.g., N.Y. LAWS ch. 284, § 220(6) (1897).

²⁴ POWELL ¶ 392, at 377-78 & n.5; RESTATEMENT OF PROPERTY § 333, at 1880 (1940).

²⁵ Ream v. Dep't of Revenue, 236 S.W.2d 462, 465 (Ky. 1951).

²⁶ E.g., MASS. ACTS ch. 563 (1907).

²⁷ Many states do not try to tax all powers of appointment as Kentucky does, but find it simpler to levy the tax only at the donor's or donee's death. Missouri, New Jersey, and Tennessee, for example, tax appointive property only at the resident donor's death, while Texas, South Dakota, and Washington are examples of states levying the tax at the donee's death.

and shift the incidence of the tax from the donee to the donor, or vice-versa, there was a question of constitutionality. Case law indicates that a state may change its tax policy in this area.²⁸

A bigger problem was that of classification and equal treatment of donors and donees. Here discrimination existed because of hastily and poorly drafted statutes. For this reason, some state statutes, notably that of Massachusetts, were struck down.²⁹ Other states, including Kentucky, found their statutes to be ambiguous or to contain discriminatory omissions which had to be clarified by the state legislatures.³⁰

II. THE HISTORY OF THE POWERS OF APPOINTMENT STATUTE IN KENTUCKY³¹

A. *The 1924 Act*

Kentucky passed its first inheritance tax law in 1906.³² This act, however, had no provision dealing with powers of appointment. The Inheritance Tax Act of 1924³³ was the first to deal with powers of appointment and provided that:

Whenever any person shall exercise a power of appointment derived from any disposition of property, made, whether before or after the passage of this act, such appointment when made shall be deemed a transfer taxable under the provisions of this act in the same manner as though the property to which such appointment relates belonged absolutely to the donee of such power and has been bequeathed or devised by such donee by will; and whenever any person possessing such a power of appointment so derived shall omit or fail to exercise the same within the time provided therefor in whole or in part, a transfer taxable under the provisions of this act shall be deemed to take place to the extent of such omission or failure, in the same manner as though the person thereby

²⁸ *E.g.*, *Whitney v. State Tax Comm'n*, 309 U.S. 530 (1940); *Binney v. Long*, 299 U.S. 280 (1936); *Reeves v. Fidelity & Columbia Trust Co.*, 169 S.W.2d 621 (Ky. 1943).

²⁹ *Mass. Acts ch. 527, § 8* (1909); *Binney v. Long*, 299 U.S. 280 (1936).

³⁰ *E.g.*, *KRS § 140.040*; *Cal. Inh. Tax Act of 1921, § 2(6)* (*as amended 1929*); *N.Y. Laws ch. 710, art. 10(c)* (1930).

³¹ Parts A through C of this section, as edited by the author, were taken from several old Department of Revenue briefs.

³² *Ky. Acts ch. 22, art. XIX* (1906). This act now forms the basis of *KRS § 140.010*.

³³ *Ky. Acts ch. 111, § 3(1)* (1924).

becoming entitled to the possession or enjoyment of the property to which such power related had succeeded thereto by will of the donee of the power failing to exercise such power, taking effect at the time of such omission or failure.

The 1924 Act was first construed in *Commonwealth v. Fidelity & Columbia Trust Co.*³⁴ This case concerned the taxability of certain property transferred pursuant to a power of appointment created in 1896 at the death of the donor, a resident of Kentucky. The donee, also a resident of Kentucky, died in 1936. The Department of Revenue assessed the inheritance tax, at the death of the donee, against that part of the property received by the beneficiaries under the appointment. Since the donor of the power died before the enactment of the statute, there could, of course, be no tax against property passing under his will. In sustaining the Department's assessment, the Court reiterated the common law rule that a donee's exercise of a power of appointment is a disposition of the donor's property. It was pointed out, however, that for purposes of taxation the estate appointed by the donee should be considered as if it were the property of the donee and that if the donee failed to exercise the power, the statute took effect as if the donee owned the property in fee.

B. *The 1936 Act*

In administering the 1924 Act, the Department apparently encountered certain administrative difficulties in collecting the tax. As noted above, under the 1924 Act the tax attached at the death of the donee. Thus, if after the death of the donor, the donee moved out of Kentucky or was a nonresident, certain transfers would escape taxation completely. In an attempt to remedy this situation, the Legislature amended the 1924 Act in 1936³⁵ by adding the following provision:

Provided that in the case of such power of appointment, the transfer shall be deemed to take place, for the purpose of taxation, at the time of the death of the donor and the assessment be made at that time against the life interest of the donee and the remainder against the corpus and collection

³⁴ 146 S.W.2d 3 (Ky. 1940).

³⁵ Ky. Acts ch. 8, § 1(3) (Spec. Sess. 1936).

therefor shall be made pursuant to section eight (8) subsection five (5).

The Court of Appeals considered the 1936 Act in the case of *Reeves v. Fidelity & Columbia Trust Co.*³⁶ The donor of the power of appointment died in 1929. The donee died in 1939 without having exercised the power. At the death of the donee, the Department assessed inheritance tax against the property subject to the power and applied the rate fixed by the 1936 Act. The taxpayers objected to the assessment on the ground that the property should have been taxed under the *proviso* of the 1936 statute and that the lower rates in effect at the time of the donor's death in 1929 should have been applied. The Department contended that the words "created after the effective date of this act" should be interpolated into the *proviso* as follows:

Provided that in the case of such power of appointment [created after the effective date of this act], the transfer shall be deemed to take place, for the purpose of taxation, at the time of the death of the donor and the assessment be made at that time against the life interest of the donee and the remainder against the corpus³⁷

According to the Department, its assessment at the date of the donee's death at 1936 rates was valid since the power had been created before April 24, 1936, the effective date of the Act. In other words, it argued that the *proviso*, which levied the tax at the death of the donor, applied only to powers created after April 24, 1936. With respect to the *proviso* the Court said:

. . . [T]he primary purpose of the *proviso* was to enable the Commission to assess promptly and collect taxes on deferred interest, relieving it of much bookkeeping, necessity of incessantly keeping track of interests of remaindermen, and to collect taxes which might be lost by removals from the jurisdiction, failures to report, etc. The plan, which allows less chance of escape from taxation, seems to be patterned after the New York plan³⁸

The Court found the statute conflicting because the first

³⁶ 169 S.W.2d 621 (Ky. 1943).

³⁷ *Id.* at 622.

³⁸ *Id.*

portion of the section authorized taxation at one time (the death of the donee) and the proviso at a different time (the death of the donor). Applying the rule of construction that, in cases of doubt, revenue statutes should be construed most favorably to the taxpayer, it applied the 1924 rates to the property sought to be taxed. Thus, according to the Court's interpretation of the 1936 statute, in the case of a resident donee dying at any time after the effective date of the 1924 Act, the tax rates applied are those in effect at the time of the death of the donor.

C. *The 1942 Act*

Reeves v. Fidelity & Columbia Trust Company,³⁹ although interpreting the 1936 Act, was actually decided by the Court of Appeals after the 1942 Act had been passed by the Kentucky legislature. The *Reeves* court held the 1936 Act ambiguous and noted that the legislature in 1942 also recognized the confusion when it amended and re-enacted the 1936 Act in such a way to include the same thought as if the words "created after the effective date of this act" had been inserted into the proviso of 1936. The 1942 Act amended the 1936 Act by adding the following:

In the event this provision should operate to provide an exemption for any beneficiary of a donee not authorized by section 4281a-20 of Carroll's Kentucky Statutes, 1936 Edition, then this exemption shall be retrospectively disallowed. It is further provided that the remainder interest passing under the donee's power of appointment, whether exercised or not, shall be added to and made a part of the distributable share of the donee's estate for the purpose of determining the exemption and rates applicable thereto.⁴⁰

In *Allen's Executor v. Howard*,⁴¹ the Court discussed the history of the powers of appointment statute, but concluded that it was not concerned with KRS § 140.040 or its constitutionality, either state or federal. The Court did, however, suggest that the statute only applied to powers of appointment created by wills. This alleged defect was remedied by the 1948 Act.

In *Ream v. Department of Revenue*,⁴² the donor of a power of

³⁹ *Id.* at 624.

⁴⁰ Ky. Acts ch. 204, § 1 (1942).

⁴¹ 200 S.W.2d 484 (Ky. 1947).

⁴² 236 S.W.2d 462 (Ky. 1951).

appointment died a nonresident of Kentucky in 1924. The donee died a Kentucky resident in 1946, having exercised the power in favor of his wife. The Department apparently had never had a case involving a nonresident donor and a resident donee. The Department assessed the tax, using 1946 rates, against the net value of the property passing to the appointee. The taxpayer objected to the assessment on the grounds that it was not the intent of the 1942 Act to levy an inheritance tax upon a transfer of property outside the state under a nonresident testamentary power of appointment and that the statute made the death of the donor the only taxable event. The Court stated that under the decision of the United States Supreme Court in *Graves v. Schmidlapp*⁴³ the state of the donee's residence could tax the exercise of a power of appointment given under the will of a nonresident donor. There remained, however, the question whether the 1942 Act expressly taxed such exercise at the time of the donee's death. Again the Court found the wording of the statute in doubt and resolved that doubt in favor of the taxpayer. It held that the donee's life estate and the 1946 transfer of the remainder interest to the appointee should be taxed at the time of the donor's death in 1924 against the corpus⁴⁴ of the donor's estate. Since Kentucky had no jurisdictional power to tax the life interest of the donee in 1924, the 1924 value of that life interest should be deducted from the 1924 gross estate, and the remainder taxed by Kentucky at the rates prevailing in 1924.⁴⁵

D. *The 1948 Act—Our Present Statute*

In order to clarify the powers of appointment statute and

⁴³ 315 U.S. 657 (1942).

⁴⁴ BLACK'S LAW DICTIONARY 413 (4th ed. 1951) defines "corpus" as "the principal sum or capital as distinguished from the interest or income." Although this definition would apply to "corpus" as used in KRS § 140.040(2), the Department construes "corpus" to refer, not only to the appointive property, but to the entire taxable property in the decedent's estate.

⁴⁵ It appears that certain *Reeves* dicta and the *Ream* decision are incompatible. *Reeves* held that the 1936 Act was ambiguous because the first part of the statute authorized taxation at the death of the donee and the second part (the proviso added in 1936) at the death of the donor. The Court noted that the 1942 Act made the 1936 proviso applicable only to powers of appointment created after 1936. In a situation similar to *Reeves* but decided under the 1942 Act, the Court of Appeals in *Ream* still found KRS § 140.040 ambiguous and proceeded to apply the rates applicable at the death of the donor. This was done in spite of the fact that the power was created long before 1936 and, under the *Reeves* decision, the 1936 proviso (taxing appointive property at the donor's death) did not apply. Therefore, the property should have been taxable at the rates applicable at the donee's death.

to remedy certain defects contained therein, the legislature in 1948⁴⁶ enacted the present language of KRS § 140.040. The 1948 Act corrected the defect noted in the *Ream* case where there was a nonresident donor dying before 1936 and a resident donee dying subsequently. When the controversy began with the death of the donee in 1946, it was obvious that clarification of the law was needed in order to spell out the legislative intent in this area. This was accomplished by the 1948 Act which essentially provided that the tax on the remainder interest be levied at the death of a *resident* donor dying after 1936, and in all other cases (non-resident donor dying before or after 1936 and resident donor dying before 1936), at the death of the resident donee.

In *Allen's Executor* the Court had stated its belief that KRS § 140.040 applied only to wills.⁴⁷ In 1948, the Kentucky General Assembly emphasized that the statute applied to the exercise of a power of appointment not only by will but also by deed, trust agreement, contract, insurance policy, or any other instrument.⁴⁸

Besides clarification of the act, the Kentucky legislature had to solve the following problem. Under the *Ream* decision interpreting the 1942 Act, the transfer of any appointive property

⁴⁶ Ky. Acts ch. 96, § 8 (1948), codified as KRS § 140.040 (1948).

⁴⁷ 200 S.W.2d 484 (Ky. 1947).

⁴⁸ This does not necessarily mean that all appointive property is taxable at the death of the donor. In order to be taxable under KRS § 140.040, it appears necessary that the property be subject to estate or inheritance taxes under KRS chapter 140. Transfers of property are taxable under KRS § 140.010 when made by: (1) will, (2) intestate law, (3) grant or gift made in contemplation of death, or (4) grant or gift made or intended to take effect in possession or enjoyment at or after death. The Court of Appeals further stated in *Martin v. Storrs*, 126 S.W.2d 445, 447 (Ky. 1939), that "an estate tax and an inheritance tax are grounded upon: 1) The passage of title; 2) by reason of death; 3) from the decedent; 4) to the beneficiary or beneficiaries." See also *Gearhart's Ex'r v. Howard*, 196 S.W.2d 113 (Ky. 1946). If the funds are not taxable under KRS § 140.010 at the death of the donor or donee, no tax may be levied merely because a power of appointment is involved. Thus, if a donor creates an irrevocable inter vivos trust, with a power of appointment over the trust, the appointive property should not be taxable at his death. Furthermore, it appears that the donee need not come into immediate possession or enjoyment at the donor's death as long as the donor has divested himself of all incidents of control or ownership. See *Commonwealth v. American Nat'l Bank*, 425 S.W.2d 281 (Ky. 1968). The foregoing analysis can also be applied to property which would ordinarily be tax-exempt, such as insurance proceeds under KRS § 140.020. Countering the Department's argument that life insurance proceeds subject to a power of appointment were liable for inheritance tax at the donor's death, the Court of Appeals in *Kentucky Trust Co. v. Department of Revenue*, 421 S.W.2d 854 (Ky. 1967), stated that a prerequisite to the taxation of property under KRS § 140.040 was that the property itself be subject to tax. Since life insurance proceeds are tax-exempt, no inheritance tax could be levied on these proceeds. The property may be taxable at the donee's death, however. See note 54 *infra* and accompanying text.

to a donee dying after 1936 was held to be a taxable transfer at the time of the donor's death. If a donor creating a power of appointment died before 1906 when there was no Kentucky inheritance tax, the appointive property would have escaped all taxation.⁴⁹ This was remedied by the 1948 statute where the legislature made clear that the tax was to be levied at the death of the resident donee *unless* the resident donor dies after 1936, in which case the tax is levied at the donor's death.

III. THE DEPARTMENT OF REVENUE'S INTERPRETATION AND ADMINISTRATION OF KRS § 140.040

A. KRS § 140.040

The present Kentucky powers of appointment statute, KRS § 140.040, classifies taxpayers (actually the beneficiaries, although KRS § 140.220 requires the tax to be paid by the administrator or executor of the decedent's estate) into what are believed to be two dissimilar classes. Into Class 1 are lumped those estates in which the tax is collectible at the resident donor's death. This *first class* is composed of beneficiaries who are deemed for tax purposes to take at the death of *a resident donor dying after 1936*. This follows the common law rule⁵⁰ but legal gymnastics must be resorted to since KRS § 140.040 purports to tax the *exercise* of the power which occurs at the donee's, not the donor's death.⁵¹ Although KRS § 140.040(1) applies, the basic taxing section is Subsection 2 of the statute.⁵² Class 2 includes those estates in which the tax is collectible only at the resident donee's death because the donor was a nonresident or a resident who

⁴⁹ Estate of Flora M. Woolley, Order No. 390 (Ky. Tax Comm'n, 1944).

⁵⁰ See Ream v. Dep't of Revenue, 236 S.W.2d 462, 465 (Ky. 1951).

⁵¹ In Note, *Kentucky Death Taxes—Putting a Price on Inheritance*, 58 Ky. L.J. 549, 565 (1970), the author contends that KRS § 140.040 creates two taxable events: (1) the *creation* of the power by the donor, and (2) the *exercise*, or *non-exercise*, of the power by the donee. In *theory*, he is wrong; in *actuality*, he is partly right. Realistically, Subsection 2 of KRS § 140.040 does tax the *creation* at death of a power by a resident donor dying after 1936 while Subsection 3 taxes the *exercise* of a power by a donee. It should be noted, however, that some donees are not encompassed by Subsection 3 of KRS § 140.040. If a donor is embraced by Subsection 2, his donee is also included in Subsection 2.

⁵² KRS § 140.040 expressly requires that Subsection 1 be construed with Subsection 2 and 3. Subsection 1 and Subsection 2 at first glance appear to be contradictory. The net effect, however, is that the tax is to be collected at the donor's death from the beneficiaries of any donors falling within Subsection 2. When Subsections 1 and 3 are construed together, it is apparent that the tax is to be collected at the death of the resident donee.

died before the 1936 Act was passed. This *second class* is composed of beneficiaries who take at the death of a resident donee having a power of appointment created by (1) *a nonresident donor dying before 1936*; (2) *a nonresident donor dying after 1936*,⁵³ or (3) *a resident donor dying before 1936*.⁵⁴ Subsection 1 and Subsection 3 form the basis of the tax levied on this class.⁵⁵

B. *Examples of Taxation under KRS § 140.040*

The taxation of powers of appointment is extremely complicated and it may take many years to master the fine points.

⁵³ In a case now pending before the Court of Appeals, Kentucky Bd. of Tax Appeals v. Citizens Fidelity Bank & Trust Co., File Nos. F-198-72, F-205-72 (Ky., filed Sept. 26, 1972) a taxpayer is contending that beneficiaries of nonresident donors dying after 1936 are taxable under Subsection 2 of KRS § 140.040 and not Subsection 3, as the Department of Revenue is arguing. Brief for Appellee at 10-11. The Department asserts that such inclusion would effectively allow beneficiaries of these nonresident donors to escape all taxation on appointive property contrary to KRS § 140.040(5), and that Subsection 2 by its terms can only apply to resident donors. Reply brief for Appellant at 5-8.

⁵⁴ A fourth group would include those beneficiaries of resident donors dying after 1936 on whose estates no tax was collected, *e.g.*, situations where the appointive property was not taxable under KRS § 140.010 at the donor's death or was tax-exempt. See note 48 *supra*.

⁵⁵ As a general rule there may be discrimination based upon classification if that classification is reasonable. See cases cited in MODERN FEDERAL PRACTICE DIGEST, CONSTITUTIONAL LAW § 211(b) (1969, Supp. 1972). Kentucky obviously treats beneficiaries taking appointive property from a resident donor dying after 1936 differently from beneficiaries taking appointive property from other donors.

The Department of Revenue believes this classification is reasonable and constitutionally valid. First, Kentucky provides many benefits to residents of the state, including resident donors. In return, Kentucky taxes the transfer of property by a power of appointment created by resident donors. Before 1936, when the tax was collected at the donee's death, many powers were conveyed to nonresident donees and resident donees who subsequently moved out of Kentucky. As a result, Kentucky lost much tax revenue. The 1936 law alleviated this problem. The present statutory classification is the most practical method of collecting taxes under KRS § 140.040 in order to insure that resident donors and donees give something in return for the benefits Kentucky provides. Second, Massachusetts in *Binney v. Long*, 299 U.S. 280 (1936), and New York in *Whitney v. State Tax Comm'n*, 309 U.S. 530 (1940), had statutes similar to that of Kentucky. Neither statute was held unconstitutional simply because it changed the incidence of the tax to resident donors dying after the act was passed. In fact, the Supreme Court in *Binney* agreed that a state, after adopting a certain taxing policy, was not obligated to hold to that policy *ad infinitum* but could constitutionally change its policy when a justifiable need to do so arose.

Third, the Court of Appeals has studied KRS § 140.040 or its predecessor several times and has always held the powers of appointment statute to be constitutional. *Commonwealth v. Fidelity & Columbia Trust Co.*, 146 S.W.2d 3 (Ky. 1940); *Reeves v. Fidelity & Columbia Trust Co.*, 169 S.W.2d 621 (Ky. 1943); *Ream v. Dep't of Revenue*, 236 S.W.2d 462 (Ky. 1951), quoting *Graves v. Schmidlapp*, 315 U.S. 657 (1942).

Finally, a statutory classification subjecting classes to different treatment is valid if such classification is reasonably related to the purpose of the statute. The purpose of the inheritance tax law is to raise revenue. *Kentucky Tax Comm'n v. Lincoln Bank & Trust Co.*, 245 S.W.2d 950 (Ky. 1952). Obviously, the purpose of this classification is to produce revenue by making the collection of inheritance taxes more certain.

Even the mechanics of levying and calculating the tax are difficult. The following examples illustrate how the Department of Revenue actually taxes an estate when a power of appointment is involved.⁵⁶ Current life expectancy tables⁵⁷ and percentage rates of return⁵⁸ are used. Note that Example 1 corresponds with the first class of beneficiaries, whereas Examples 2 and 3 are both in the second class of beneficiaries. The only difference between Examples 2 and 3 is that the donor in Example 2 was a resident of Kentucky at his death and the donee's life interest was probably taxed then. The donee's life estate in Example 3 could not be taxed in the donor's estate because he was a nonresident.

(1) *Example 1: A resident donor and resident donee both dying after 1936 (see sample forms).*

John Smith died in 1960 with a net estate of \$100,000. He gave \$50,000 to his wife Jane, age 60, for life with power of appointment over the remainder at her death. The residue of the estate was to go to her for life with remainder to his nephew, Jack Smith. At the present time Jane Smith is going to will the appointive property to her husband's nephew, Jack.⁵⁹

In calculating each beneficiary's share of John Smith's estate, the Kentucky Department of Revenue first looks at John's net estate. The widow, Jane Smith, received two interests, a life estate of \$50,000 with a power of appointment over the remainder and a life estate in the residue of John Smith's estate. The amount of each life estate is figured separately and then the two amounts are combined for the purposes of calculating the inheritance tax. The Department first takes her \$50,000 life estate with power of appointment and multiplies this by 4%, the interest rate which

⁵⁶ The objective of the Department of Revenue is to tax the full value of the appointive property once as it passes from donor to donee to appointee. The Department attempts to tax the value of the property at the donee's, rather than the donor's, death because it is usually higher. Since beneficiaries of Class 2 are taxed at the donee's death, there is no problem with this class. As for Class 1 beneficiaries, aggregation of the appointive property with the donee's general estate property results in a higher tax, thus off-setting the generally lower tax at the donor's death.

⁵⁷ See Life Expectancy Tables, 17 Kx. Rev. STAT. 533-35 (1972).

⁵⁸ KRS § 140.100.

⁵⁹ The Department of Revenue, in assessing tax on the appointee's share of the estate, must make an educated guess who the appointee(s) will be. This estimate is usually based on the donee's present intentions and his will. See KRS § 140.110. The fact that the power of appointment is general makes no difference; the Department still taxes the remainder interest on the basis of the probable beneficiary.

KRS § 140.100 provides she should get as a yearly return; the result is multiplied by 11.5162 years, her life expectancy at age 60, which is obtained from KRS actuarial tables: ($\$50,000 \times 4\% \times 11.5162$). The value of her life estate in the appointive property is thus determined to be \$23,032.40. Her life estate in the residue of John's estate is determined in the same way and is the same amount. When these two amounts are added, her total share of John Smith's estate is \$46,064.80. Jane Smith's share then receives an exemption of \$10,000⁶⁰ and the tax rates, as provided by KRS § 140.070, are applied to the remaining \$36,064.80.

Jack Smith, John Smith's nephew, has two interests in John's estate. One interest is a remainder in the appointive property and the other interest is a remainder in the residue. Note that these two interests are *not* aggregated but are separated for the purposes of determining the inheritance tax, because the residue property Jack inherits as a *nephew* of John Smith is taxed at different rates and exemptions than the appointive property he inherits as a *nephew-in-law* (not actually a blood relation) of Jane Smith. Although the appointive property is taxed against the corpus of John Smith's estate, it actually passes under tax law from donee Jane Smith and thus is subject to different rates and exemptions because the degree of relationship is not the same between John and Jack as it is between Jane and Jack.⁶¹ Jack's remainder interest is calculated by subtracting Jane's life estate from the \$50,000 subject to the power of appointment. Jack's interest in the remainder of the appointive property is \$26,967.60 ($\$50,000$ less \$23,032.40). His interest in the residue is derived the same way. Jack receives a \$500 exemption on his remainder interest in the appointive property but he receives a \$1,000 exemption on his remainder interest in the residue. Jack receives a greater exemption on his remainder interest in the residue because his relationship to John is closer than his relationship to Jane. He is deemed to receive the residue from John and the appointive remainder interest from Jane.

Jane Smith died 10 years later at age 70, leaving her entire estate to her nephew-in-law, Jack Smith. The power of appointment property is now worth \$60,000, instead of the original

⁶⁰ KRS § 140.080(1)(a).

⁶¹ See KRS §§ 140.070 and 140.080.

\$50,000, and the balance of her estate is worth \$30,000. To arrive at Jane Smith's net estate, the Department of Revenue subtracts her remaining life estate from her appointive property (\$60,000) and then adds the value of her own estate (\$30,000). The Department calculates her life expectancy at age 70 at 7.9978 years. She could have expected a yearly return of 4% interest. The Department multiplies the value of the appointive property in which Jane Smith had a life estate, $\$60,000 \times 4\% \times 7.9978$ years to arrive at \$19,194.72 which is subtracted from \$60,000. The net value of the appointive remainder interest in which Jane held a life interest is thus \$40,805.28. This amount, added to her other property (\$30,000), brings the total of her net estate to \$70,805.28.

Value of appointive property	\$60,000.00
Less: life interest of Jane Smith at age 70 (\$60,000 x 4% x 7.9978 years)	-19,194.72
Net value of appointive property	\$40,805.28
Add: value of Jane Smith's independent property	+30,000.00
Net estate of Jane Smith	\$70,805.28

There is only one beneficiary, Jack Smith. The inheritance tax due from Jack Smith is calculated first on Jane Smith's net estate, which is an aggregation of her appointive property and her other property. Then the tax on the power of appointment property alone is calculated and this amount is subtracted from the tax on the aggregated net estate. If there had been more than one beneficiary, the calculation would have been the same except that the net estate would have been divided into each beneficiary's share and then the rates and exemptions would have been applied. Each beneficiary's share would still have contained an aggregation of the donee's appointive property and general estate property.

63A200 SAMPLE COMMONWEALTH OF KENTUCKY RESIDENT DONOR
4-67 Department of Revenue DYING AFTER 1936
Frankfort
40601

COMPUTATION OF INHERITANCE TAX

Estate of John Smith	Code No. HR	
Net estate		\$100,000.00
Specific bequest		\$50,000.00
Life insurance payable to beneficiaries		\$.....
Residue		\$ 50,000.00

	Share	Exemption	Balance Taxable	Rate %	Tax \$
Jane Smith 60 widow	\$ 46,064.80	\$10,000.00	\$36,064.80		
50,000.00 for life with Power of Appointment			20,000.00	x 2%	400.00
50,000.00 x 4% x 11.5162 = 23,032.40			10,000.00	x 3%	300.00
life interest in residue			6,064.80	x 4%	242.59
50,000.00 x 4% x 11.5162 = 23,032.40					\$ 942.59
Jack Smith remainder Power of Appointment (\$50,000-\$23,032.40)	26,967.60	500.00	26,467.60		
			10,000.00	x 6%	600.00
			10,000.00	x 8%	800.00
			6,467.60	x 10%	646.76
					<u>\$2,046.76</u>
Jack Smith nephew remainder residue (\$50,000-\$23,032.40)	26,967.60	1,000.00	25,967.60		
			10,000.00	x 4%	400.00
			10,000.00	x 5%	500.00
			5,967.60	x 6%	358.06
					<u>\$1,258.06</u>
TOTAL	100,000.00				<u>\$4,247.41</u>

63A200 SAMPLE COMMONWEALTH OF KENTUCKY RESIDENT DONEE
 4-67 Department of Revenue DYING AFTER 1936
 Frankfort
 40601

COMPUTATION OF INHERITANCE TAX

Estate of Jane Smith Code No. HR

Net estate	\$ 70,805.28
Specific bequests	\$.....
Life insurance payable to beneficiaries	\$.....
Residue	\$ 70,805.28

	Share	Exemption	Balance Taxable	Rate %	Tax \$
Jack Smith net estate 70,805.28	\$70,805.28	\$500.00	\$70,305.28		
			10,000.00	x 6%	600.00
			10,000.00	x 8%	800.00
			10,000.00	x 10%	1,000.00
			15,000.00	x 12%	1,800.00
			15,000.00	x 14%	2,100.00
Power of Appointment property 40,805.28			10,305.28	x 16%	1,648.84
-500.00 exemption		less tax on P. of A. Property			<u>\$7,048.84</u>
					<u>-3,636.63</u>
40,305.28					
10,000.00 x 6% = \$ 600.00					
10,000.00 x 8% = 800.00					
10,000.00 x 10% = 1,000.00					
10,305.28 x 12% = 1,236.63					
					<u>\$3,636.63</u>
TOTAL	\$70,805.28				<u><u>\$3,412.21</u></u>

(2) *Example 2: A resident donor dying before 1936 and a resident donee dying after 1936.*

John Smith, a Kentucky resident, died in 1930, with a net estate valued at \$100,000. In his will he gave his wife Jane, age 30, \$50,000 for life with a power of appointment over the remainder at her death. The residue of the estate, \$50,000, goes to Jane for life with the remainder passing to his nephew, Jack Smith, at her death. Jane plans to will the appointive property to Jack when she dies. Her life estate in the appointive property (using current life expectancy tables and percentage rates of return) is \$38,805.60 and her interest in the residue is another \$38,805.60, both of which are taxed at John's death, as is Jack's remainder interest in the residue, \$11,194.40. Jack's remainder interest in the appointive property is not taxed.

Jane Smith dies in 1970 at age 70. The appointive property is now worth \$60,000 and her independent estate is valued at \$30,000. In arriving at Jane's net estate, the appointive property, \$60,000, is aggregated with the donee's independent property, \$30,000, for a total of \$90,000. Her life estate at age 70 is not subtracted in arriving at her net estate. The Department of Revenue, after calculating the tax on the \$90,000 net estate, does not subtract the tax on the appointive property because the remainder interest in the appointive property was not taxed in the donor's estate. This results in a higher tax than if the appointive property and the other property were separated, a tax calculated on each, and both of these taxes added together.

(3) *Example 3: A nonresident donor dying before or after 1936 and a resident donee dying after 1936.*

John Smith dies a resident of state X in 1930 with a net estate of \$100,000. In his will he gives his wife, Jane, age 30, \$50,000 for life with a power of appointment over the remainder at her death. The residue of the estate, \$50,000, goes to Jane for life with the remainder passing to his nephew, Jack Smith. Jane plans to will the appointive property to Jack at her death. The chances are good that state X taxed Jane's life estate in the appointive property and the residue at John's death along with Jack's remainder interest in the residue. If state X collects inheritance or

estate tax at the death of the donor, it will also tax Jack's remainder interest in the appointive property.

Jane and Jack subsequently become domiciled in Kentucky. Upon Jane's death in 1970 at age 70, the appointive property is worth \$60,000 and her independent estate is valued at \$30,000, all of which she wills to Jack. Her net estate is \$90,000 (\$60,000 + \$30,000). The entire amount is taxed. Her life estate is not subtracted. The tax on the appointive property is not subtracted from the tax on the aggregated estate of \$90,000.⁶²

(4) Summary

Under present law there are four possible combinations of donors and resident donees subject to Kentucky inheritance taxes on either the donor's or donee's death.

1. *A resident donor dying after 1936 and a resident donee of the power also dying after 1936.*

(a) The tax at the donor's death on the appointive property is levied on the life estate of the donee and on the remainder interest which comes out of the corpus of the donor's estate.

(b) At the death of the donee his life estate is deducted in arriving at his net estate. The remainder interest is included in the donee's general estate for rates and exemptions only, and then the tax on the remainder interest in the appointive property is subtracted.

2. *A resident donor dying before 1936 and a resident donee dying after 1936.*

(a) The life estate of the donee in the appointive property is taxed at the donor's death; the remainder interest is not taxed at that time.

(b) Upon the donee's death his life estate is not deducted in determining his net estate. The entire value of the ap-

⁶² The Department has never had a situation where inheritance tax was collected separately on both the donee's life estate and the appointee's remainder interest at the death of the donor and the donee subsequently moves to Kentucky and dies domiciled there. Can the appointive property be taxed again? See KRS §§ 140.040(5) and 140.275. *But see* Ream v. Dep't of Revenue, 236 S.W.2d 462 (Ky. 1951), where Kentucky was allowed to collect inheritance taxes even though the entire value of the donor's estate had been taxed in Connecticut at the donor's death.

pointive property is included in the donee's estate and the tax on the remainder interest in the appointive property is not subtracted.

3. A *nonresident donor* dying *after* 1936 and a *resident donee* also dying *after* 1936.

(a) There is no Kentucky tax at the nonresident donor's death.

(b) Upon the resident donee's death, his life estate is not deducted in determining his net estate. The entire value of the power of appointment property is included in the donee's estate and the tax on the remainder interest in the appointive property is not deducted.

4. A *nonresident donor* dying *before* 1936 and a *resident donee* dying *after* 1936.

(a) There is no Kentucky tax at the nonresident donor's death.

(b) Upon the resident donee's death, his life estate is not deducted in determining his net estate. The entire amount of the appointive property is included in the donee's estate and the tax on the remainder interest in the appointive property is not subsequently subtracted.

C. *Departmental Interpretation of KRS § 140.040 on a line-by-line Basis.*

A discussion of all five sections of KRS § 140.040 and the Department of Revenue's interpretation follows.

§ 140.040(1). Whenever any person shall exercise a power of appointment derived from any disposition of property (whether by will, deed, trust agreement, contract, insurance policy or other instrument) regardless of when made, such appointment shall be deemed a transfer taxable under the provisions of this chapter in the same manner as though the property to which such appointment relates belonged absolutely to the donee of such power and had been bequeathed or devised by such donee by will; and whenever any person possessing such a power of appointment so derived shall omit or fail to exercise the same in whole or in part, within the time provided therefor, a transfer taxable under the provisions of this chapter shall be deemed to take place to the person or

persons receiving such property as a result of such omission or failure to the same extent that such property would have been subject to taxation if it had passed under the will of the donee of such power. The time at which such transfer shall be deemed to take place, for the purpose of taxation, shall be governed by the provisions of subsections (2) to (4) of this section.

This section provides that *all exercises* of powers of appointment are to be taxed as if the property belonged to the donee in fee.⁶³ If a person holding a power of appointment fails to exercise it, the property subject to the power is taxable as though it belonged to the donee and passed under his will. The time when the taxable transfer of the appointive property from the donee to the beneficiary is deemed to take place is to be determined by subsections 2, 3, and possibly subsection 4.

§ 140.040(2). In the case of a power of appointment which passes to the donee thereof at the death of the donor, under any instrument, and if the donor dies on or after April 24, 1936, the transfer shall be deemed to take place, for the purpose of taxation, at the time of the death of the donor and the assessment be made at that time against the life interest of the donee and the remainder against the corpus.

If the donor creating a power of appointment dies on or after April 24, 1936, the taxable transfer takes place at his death. At that time, the donee's life estate is taxed. The remainder interest is taxed out of the corpus. Since only *resident* donors can be taxed in Kentucky at death, the Department of Revenue construes Subsection 2 as applying only to *resident donors dying after April 24, 1936*, the effective date of the Act.⁶⁴ All other donors are taxed under Subsection 3.

§ 140.040(2) (cont.) The value of the property to which the power of appointment relates shall be determined as of the date of the death of the donor and shall be taxed at the rates and be subject to the exemptions in effect at the death of the donor.

⁶³ See note 24 *supra* and accompanying text.

⁶⁴ See note 53 *supra*.

The appointive property is to be valued on the date of the donor's death for inheritance tax purposes and shall be taxed at the tax rates then in effect. The amount of monetary exemption, if any, to which the prospective appointee is entitled shall be the exemption in effect at the donor's death.

§ 140.040(2) (cont.) The determination of the applicable rates and exemptions (in effect at the death of the donor) shall be governed by the relationship of the beneficiary to the donee of the power of appointment.

This section in effect provides that KRS § 140.070 and KRS § 140.080 are to be applied in determining the tax. The governing relationship in determining rates and exemptions is that of the beneficiary to the *donee*, not donor.

§ 140.040(2) (cont.) In the event the payment of the tax at the death of the donor should operate to provide an exemption for any beneficiary of a donee not authorized by KRS § 140.080, then such exemption shall be retrospectively disallowed at the time of the death of the donee.

This sentence was added to KRS § 140.040 in 1942 after the Court of Appeals discovered an ambiguity in the 1936 Act. By it the legislature made clear that after 1936 the tax was to be levied at the donor's death at the rates and exemptions then in effect.⁶⁵

§ 140.040(2) (cont.) It is further provided that the remainder interest passing under the donee's power of appointment, whether exercised or not, shall be added to and made a part of the distributable share of the donee's estate for the

⁶⁵ See footnotes 36-40 *supra* and accompanying text.

This portion of the statute could also apply in situations involving exemptions under the 1936 and 1942 Acts. Under KRS § 140.080, a person inheriting property valued at less than a certain amount was entitled to a specific monetary exemption. No exemption was allowed if the property received was valued greater than a specified sum. For example, a wife got a monetary exemption of \$10,000 if she received under \$30,000. No exemption was granted if the property was worth more than \$40,000. The 1948 Act repealed this provision and granted an exemption regardless of the value of the property received. However, if a donor creating a power of appointment died between 1936 and 1948, the appointee-beneficiary taxed at that time may have been given an exemption on his remainder interest under KRS § 140.080. If the beneficiary subsequently inherits more property than the Department expected and thus would not have been entitled to any exemption under the 1936 or 1942 Acts, the Department will decrease or disallow altogether the exemption at the donee's death.

purpose of determining the exemption and rates applicable thereto.

When a donee dies with a power of appointment created by a resident donor dying after 1936 and the appointive property was taxed in the donor's estate, said appointive property will be aggregated with the donee's general estate property only for the purpose of applying the rates and exemptions. Then the tax on the appointive property alone is calculated and is subtracted from the tax on the aggregated estate to arrive at the amount of tax due.

§ 140.040(3). In all cases other than that described in subsection (2) the transfer shall be deemed to take place, for the purpose of taxation, at the time of the death of the donee.

In all cases where tax is not levied under Subsection 2, *i.e.*, all powers of appointment created by (1) a nonresident donor dying before 1936; (2) a nonresident donor dying after 1936; or (3) a resident donor dying before 1936, the taxable transfer takes place and is taxed at the resident donee's death.⁶⁶

§ 140.040(3) (cont.) In such cases, the value of the property to which the power of appointment relates shall be determined as of the date of the death of the donee and shall be taxed at the rates and be subject to the exemptions in effect at the death of the donee. The determination of the applicable rates and exemptions (in effect at the death of the donee) shall be governed by the relationship of the beneficiary to the donee of the power of appointment.

The tax rates are those in effect at the death of the donee; the amount of monetary exemption is also determined at the donee's death. KRS § 140.070 and KRS § 140.080 are to be applied in determining the amount of the tax.

§ 140.040(4). The provisions of subsection (2) shall not preclude the taxation, at the death of the donee, of any transfer made by means of a power of appointment if such transfer was not in fact reported to or a tax assessed thereon by the Department of Revenue within the period of limitation prescribed by KRS § 140.160. If the transfer by the power of

⁶⁶ See notes 53 and 54 *supra*.

appointment is not so reported or a tax assessed thereon, the period of limitation prescribed in KRS § 140.160 shall not begin to run until the death of the donee of such power.

A beneficiary cannot escape payment of the tax simply by not reporting the exercise of a power of appointment. If a taxable transfer was not reported or no tax was assessed on it by the Department of Revenue, then the 10-year statute of limitations does not begin to run until the donee's death. Therefore, the Department of Revenue can collect taxes under these two circumstances from the donor's estate, if possible. If not, it can collect the tax at the death of the donee and for up to ten years thereafter.

§ 140.040(5). The amendments to this section, adopted by the 1948 General Assembly, shall apply to all powers of appointment whether created before or after the effective date of said amendments. It is the declared intention of the General Assembly to impose a tax upon every transfer of property by means of a power of appointment, regardless of when or how created, and it is the declared intention of the General Assembly that the use of the power of appointment device shall not permit the transfer of property, to which such a power relates, to escape thereby the payment of state inheritance taxes.

The Kentucky General Assembly makes it plain that *all* transfers of property by means of a power of appointment regardless of when or how created, are to be taxed.⁶⁷

CONCLUSION

Powers of appointment are becoming more popular as people increasingly realize that their utilization can greatly minimize Kentucky inheritance taxes. If property is subject to a power of appointment at common law, that property is deemed to pass from the donor to the beneficiary. Kentucky tax law recognizes this

⁶⁷ In *Kentucky Bd. of Tax Appeals v. Citizens Fidelity Bank & Trust Co.*, File Nos. F-198-72 and F-205-72 (Ky., Filed Sept. 26, 1972), now pending before the Court of Appeals, the taxpayer argued that it is significant that the Kentucky legislature omitted the word "where" in Subsection 5 and merely said "when or how created." Brief of Appellee at 13-14. The Department asserted that the most important part of the subsection is the declaration of legislative intent to tax *all* powers of appointment.

rule to the extent that the total value of the property subject to the power is taxed only once as it passes from the donor through the donee to the beneficiary. If the property is not subject to a power of appointment, it will pass under common law, and Kentucky tax law, from the decedent to his heir and will be taxed then as well as when the heir dies. It can be easily seen that unless a power of appointment is used, the property is taxed in each successive estate.

Although the Department usually taxes the entire value of the appointive property in either the donor's or donee's estate, under certain circumstances part of the appointive property may be taxed in both estates. If for some reason only the donee's life estate was taxed at the donor's death, then the beneficiary's remainder interest will be taxed at the donee's death in order to tax the total value of the appointive property. Thus, the Department still taxes the total value of appointive property only once in two estates. The intent of the Department is to levy the tax at the earliest possible time to make collection more certain and to insure that persons receiving services and benefits as residents of Kentucky, whether donor or donee, pay their fair share of the financial burden the state incurs in providing these benefits and services.

KRS § 140.040 has had a colorful history. It has always been upheld constitutionally while often at the same time being termed ambiguous. This has been followed by legislative attempts at clarification. As now in force and administered by the Department of Revenue, however, the statute appears to be constitutional and workable. KRS § 140.040 now classifies taxpayer-beneficiaries into two distinct classes. The class into which a taxpayer-beneficiary is placed depends on (1) whether the donor was a nonresident or resident at death and (2) whether the donor died before or after 1936, the effective date of the act. The first class is composed of taxpayer-beneficiaries in which the tax is actually capable of being collected at the death of the donor. This includes all taxpayer-beneficiaries who take from a *resident donor dying after 1936*. Although appearing contradictory until their legislative and judicial history is understood, Subsections 1 and 2 of KRS § 140.040 form the basis of the tax levied on the first class. The second class is composed of all taxpayer-beneficiaries

not in the first class, which are those estates in which the tax is only collectible at the resident donee's death because (1) the donor was a nonresident at death; (2) the donor was a resident who died before the 1936 Act was passed; or (3) for some other reason no tax could be collected at the resident donor's death. KRS §§ 140.040(1) and (3) form the basis of the tax levied upon this class. Cognizance must also be taken of Subsection 5, which contains the legislative declaration of intent to tax *all* powers of appointment. While this section could conceivably be interpreted to tax appointive property in each decedent's estate, the Department construes it as meaning that appointive property shall be taxed only once in Kentucky. Once the property ceases to be subject to the power, however, it can be taxed again.