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TAXATION-FEDERAL ESTATE TAX-REVERSIONARY INTERESTS UNDER THE RULE OF THE HALLOCK CASE-VALUATION

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TAXATION—FEDERAL ESTATE TAX—REVERSIONARY INTERESTS UNDER THE RULE OF THE HALLOCK CASE—VALUATION—In 1929 the decedent established a trust, reserving a life estate in the income. On the termination of this life estate, the income was payable in equal amounts to the decedent's daughters. If either daughter died, that part of the corpus supporting the share of income of the deceased daughter was to go to her descendants; if none, then to the other daughter or her descendants. If both of the daughters died without issue, the corpus was to be paid to such persons as decedent appointed by will; if no appointment was made, the corpus was to go to certain charities. Decedent exercised her power of appointment at the time she executed her will in 1930. Both daughters survived the decedent, and both had issue. An estate tax was levied on the entire property of the trust. The executors paid the tax, and filed a refund claim on the theory that the values of the life estates in the daughters and the remainders in their issue should not have been included in the trust assets as part of the taxable estate. *Held*, the entire corpus of the inter vivos trust was subject to the estate tax since the settlor by means of the reserved power of appointment had retained a reversionary interest in the same. *Fidelity-Philadelphia Trust Co. v. Rothensies*, 324 U.S. 108, 65 S.Ct. 508 (1945).[1]

[1] A companion case to the one noted is Commissioner v. Field, 324 U.S. 113, 65 S.Ct. 511 (1945). The Court applied the same reasoning as in the principal case in holding that the entire corpus was taxable.

In view of the uncertain theories concerning the application of section 302 (c)[2] of the Revenue Act of 1926, a writer is inviting disaster by concluding that any of the controversies arising therefrom have been settled by the instant decision.[3] The principal case does, however, give courts, the Treasury Department and writers a more concrete guidance than could be found in the implications of cases not directly involving the issue of valuation of reversionary interests includible in gross estates under section 302 (c).[4] In the present case the Court observes: "It is fruitless to speculate on the probabilities of the property being distributed under the contingent power of appointment. Indeed, such speculation is irrelevant to the measurement of estate tax liabilities." [5] Some of the lower courts attempt to solve the valuation problem by looking at the degree of remoteness of the reversion, or by ascertaining the certainty of the "possibility of reverter" to the grantor.[6] This approach to the problem is discarded by the Supreme Court's statement that "no more should the measure of the tax depend upon conjectures as to the propinquity or certainty of the decedent's reversionary interests." [7] While such an approach seems more equitable for the taxpayer,[8] it is not surprising that it was rejected. The difficulty of obtaining a rational evaluation of contingent interests is obviously tremendous; moreover, the revenue necessary to meet governmental obligations is at the highest peak in history, and the "remoteness" test would deprive the treasury of an important source of funds.[9] the string theory is adopted by the Court; under this test "It is enough if he retains some contingent interest in the prop-

[2] Now § 811 (c) of the Internal Revenue Code.

[3] The Supreme Court limited certiorari to the issue of evaluation of reversionary interests in trusts covered by § 302 (c). The perplexing question as to what transfers are includible under the section is left unanswered. Thus a "no-man's-land" continues to exist between the line drawn by May v. Heiner, 281 U.S. 238, 50 S.Ct. 286 (1930), and that established by Helvering v. Hallock, 309 U.S. 106, 60 S.Ct. 444 (1940). See MONTGOMERY, FEDERAL TAXES ON ESTATES, TRUSTS AND GIFTS 387-392 (1944-45).

[4] Everett, "Valuation of a 'Possibility of Reverter' under the Hallock Case," 18 TAXES 611 (1940). 1 PAUL, FEDERAL ESTATE AND GIFT TAX, 1st ed., § 7.24 (1940); in § 7.25 Mr. Paul suggests that Treasury Decision 5008, 1940, in excluding vested life estates from the gross estate, may be an unnecessary concession to taxpayers. It appears that the view suggested by Kauper, "Federal Estate and Gift Taxation: A Review," 40 MICH. L. REV. 856 at 865 (1942), more nearly approaches that adopted by the Court in the principal case. See also MONTGOMERY, FEDERAL TAXES ON ESTATES, TRUSTS AND GIFTS 396-399 (1944-45).

[5] The principal case at 111.

[6] Hughes, 44 B.T.A. 1196 (1941). Allen, 3 T.C. 844 (1944). MONTGOMERY, FEDERAL TAXES ON ESTATES, TRUSTS AND GIFTS 394 (1944-45).

[7] Principal case at 111-112. It should be noted that the Court is not disagreeing with the decision in Commissioner v. Kellogg, (C.C.A. 3d, 1941) 119 F. (2d) 54; there the theory of remoteness was applied in determining whether the transfer was includible under the estate tax. The Court rejects, in the principal case, the theory of remoteness as a method of evaluation of transfers found includible under the tax.

[8] Everett, "Valuation of a 'Possibility of Reverter' under the Hallock Case," 18 TAXES 611 (1940). Therein Mr. Everett asserts that deducting only vested interests still places too high a value on the contingent interest retained by the decedent.

[9] 1 PAUL, FEDERAL ESTATE AND GIFT TAX, 1st ed., § 7.30 (1940).

erty until his death or thereafter, delaying until then the ripening of full dominion over the property by the beneficiaries." [10] Thus the value of the property attached to the string is swept into the corpus of the trust for tax purposes. It does not follow however that the Supreme Court adopts the view expounded by the government in *Central National Bank of Cleveland v. United States*,[11] where it was argued that vested interests, even to the extent of outstanding life estates, should be included in the trust corpus. The most ardent tax collector can find no string attached to such interests. The Court is not concerned with "interests or intervening estates not affected by the decedent's death." [12] The Court herein demonstrates anew its adherence to the mode of thought displayed in *Helvering v. Hallock* by discarding conventional concepts of property law in favor of a system of evaluation that makes tax avoidance an even more difficult feat.[13] This broad interpretation of the Estate Tax may be viewed as evidence of the Court's tendency "to reach all inter vivos transfers that may serve as substitutes for testamentary dispositions." [14] Thus, where transfers are held to be ones to take effect in possession or enjoyment at or after death, under section 302 (c), pursuant to the rule of the *Hallock* case, the principal case appears to have definitely settled the controversy as to the proper method of evaluation.

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[10] The principal case at 112. Mr. Justice Stone based his dissent in Helvering v. St. Louis Trust Co., 296 U.S. 39, 56 S.Ct. 74 (1935), on the string theory. In overruling the St. Louis Trust cases, the Court in Helvering v. Hallock, 309 U.S. 106, 60 S.Ct. 444 (1940), again relied on the string theory. For a criticism of the string theory see Nelson, "Reverters in Estate Taxation," 23 TAXES 98 at 102 (1945).

[11] This view the court rejected; (Ct. Cl. 1941) 41 F. Supp. 239. It is interesting to note that the government took this stand while § 81.17, REGULATIONS 105 (1945), expressly excepted such interests. It appears that the confusion reigning in this field is not confined to courts, writers, and taxpayers.

[12] The principal case at 112.

[13] It becomes apparent then that the principal case cannot be considered as a limitation on May v. Heiner, 281 U.S. 238, 50 S.Ct. 286 (1930). See note 3, supra.

[14] Kauper, "Federal Estate and Gift Taxation: A Review," 40 MICH. L. REV. 856 at 864 (1942). See 1 PAUL, FEDERAL ESTATE AND GIFT TAX, 1st ed., § 7.05 (1940).