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TAXATION - INHERITANCE AND ESTATE TAXES - POWERS OF APPOINTMENT

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TAXATION — INHERITANCE AND ESTATE TAXES — POWERS OF APPOINTMENT — From time immemorial, problems arising from the creation and exercise of powers of appointment have proven enigmatic to the judiciary. These problems are not decadent but still possess an abundance of vitality. The increased complexity of statutes imposing death taxes has tended to foment litigation. These two fertile sources of intricate problems, in combination, have borne the apprehended fruits. The taxation of powers of appointment has created problems of infinite variety, harassing alike the attorney, the judge and the legislator. The questions involved are not simply of academic or theoretical importance. Under our modern death tax statutes the questions are of primary practical significance, due to the fact that, while the power of appointment is a useful and ingenious dispositive device, it may also be employed as an effective camouflage for a tax avoidance scheme.

I.

The questions involved in the taxation of powers of appointment usually arise in a situation where *F*, the father, by his will, leaves a life estate in certain property to his son, *S*, and, in addition, a power to ap-

point the remainder of the property upon his death. The power of appointment given to *S* may be a power to appoint only among particular persons or classes, in such proportions as *S* shall desire. On the other hand, *S* may be given a power to appoint to whomever he desires. In addition, *F* may choose to specify persons who will take in default of the exercise of the power.

Statutes imposing death taxes are of two types: (1) an inheritance tax statute, which is theoretically a tax imposed upon the privilege of receiving property upon the death of the benefactor; (2) an estate tax statute, which is theoretically a tax upon the privilege of transmitting property upon death. Consequently, upon the death of the donor of the power, under an inheritance tax statute, it seems clear that the transfer of a life estate to the donee would be presently taxable. And under an estate tax statute, it seems equally clear that the whole fee would be included in the gross estate of the donor. The imposition of death taxes upon the death of the donee entails a more difficult problem.

In the absence of express language in the statute taxing powers of appointment, the common-law theory of powers prevails and the appointee is deemed to derive his interest in the property from the donor, rather than from the donee, of the power.[1] Following this theory, the exercise of the power by the donee, under an inheritance tax statute, would simply serve to vest the remainder, which would then be taxable as a transfer from the donor of the power. Under an estate tax statute, the value of the interest passing upon the exercise of the power would not be included in the gross estate of the donee.[2]

However, at an early date the state legislatures began to enact statutes containing provisions expressly taxing powers of appointment. Following the New York statute of 1897,[3] many states imposed transfer taxes upon appointments in the same manner as though the property

[1] "An estate created by the execution of a power takes effect in the same manner as if it had been created by the deed which raised the power. The party who takes under the execution of the power, takes under the authority, and under the grantor of the power, whether it applies to real or personal property, in like manner as if the power, and the instrument executing the power, had been incorporated in one instrument." 4 KENT, COMMENTARIES, 14th ed., 337 (1896); ROBINSON, SAVING TAXES IN DRAFTING WILLS AND TRUSTS, 2d ed., 40 (1933); PINKERTON and MILLSAPS, INHERITANCE AND ESTATE TAXES 131 (1926). See also Simes, "The Devolution of Title to Appointed Property," 22 ILL. L. REV. 480 (1928).

[2] United States v. Field, 255 U. S. 257, 41 S. Ct. 256 (1921).

[3] "Whenever any person or corporation shall exercise a power of appointment derived from any disposition of property made either 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 had been bequeathed or devised by such donee by will. . . ." N. Y. Laws (1897), c. 284, § 220(5).

belonged absolutely to the donee of the power. These statutes do not distinguish between special and general powers. Under these provisions, the value of the remainder would be taxed as though it were a transfer from the donee. But Congress, under section 302(f) of the Revenue Act of 1926 (substantially reenacted by the later acts),[4] required only that property "passing" by the exercise of a "general" power of appointment be included in the gross estate of the donee.[5] The construction of this provision in the federal estate tax law has led to tax avoidance through the use of special powers of appointment, both genuine and simulated.[6] New York, in 1930, changed its death tax system from one of an inheritance tax to that of an estate tax. The power provision in the New York estate tax law was copied from that of section 302(f).[7] But to preclude tax avoidance through the use of special powers, New York in 1932 amended its estate tax law.[8] Recently, this provision,

[4] "To the extent of any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of, or intended to take effect in possession or enjoyment at or after, his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. . . ." Revenue Act of 1926, § 302(f), 44 Stat. L. 71. This provision has been substantially reenacted by the later acts and the Internal Revenue Code. 53 Stat. L. 122 (1939), 26 U. S. C. (Supp. 1939), § 811(f).

[5] Attention is here called to one exceptional situation where property passing by special power is taxed. Where the donor of a special power of appointment is also the donee, the transfer upon the death of the donee may be taxed in his estate as a transfer to take effect in possession or enjoyment at or after death under § 302(c), or as a transfer with the reservation of a power to alter, amend or revoke under § 302(d) of the Revenue Act of 1926. In Internal Revenue Commissioner v. Chase Nat. Bank, (C. C. A. 2d, 1936) 82 F. (2d) 157, cert. denied, Chase Nat. Bank v. Commr., 299 U. S. 552, 57 S. Ct. 15 (1936), the court held that such a transfer came within the purview of § 302(d).

[6] The Treasury Department has defined a general power: "Ordinarily a general power is one to appoint to any person or persons in the discretion of the donee of the power, or, however limited as to the persons or objects in whose favor the appointment may be made, is exercisable in favor of the donee, his estate, or his creditors." TREAS. REG. 80, 1937 ed., art. 24, p. 62. This interpretation of "general power" opens a wide avenue for tax evasion, although there are limits, even under this construction. See Whitlock-Rose v. McCaughn, (C. C. A. 3d, 1927) 21 F. (2d) 164. For a recent construction of the terminology, see Morgan v. Commissioner of Internal Revenue, 309 U. S. 78, 60 S. Ct. 424 (1940), where the Supreme Court held that federal law, and not state law, is to govern the determination of what constitutes a general power.

[7] N. Y. Laws (1930), c. 710, art. 10-C, § 249-r, par. 7.

[8] N. Y. Laws (1932), c. 320, § 249-r, par. 7(a), where it is provided: "To the extent of any property passing under a power of appointment exercised by the decedent (a) by will, or (b) by deed executed in contemplation of, or intended to take effect in possession or enjoyment at or after, his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth, exclusive of property the value of which is required to be included in the gross estate pursuant to paragraph numbered seven of this section, and provided that the transfer of such property is not

which requires under certain circumstances the inclusion in the gross estate of property passing under a special power, was upheld by the New York Court of Appeals and by the United States Supreme Court.[9] This result is in line with the apparent tendency of the Supreme Court to disregard technical property concepts in taxation problems.[10]

The evolution of statutes taxing powers of appointment has also raised questions as to whether a tax may be imposed in the estate of the donee when the appointee, who is also the taker in default, takes the same interest that he would have taken had the power not been exercised. The New York courts have consistently maintained the position that, in such instance, the interest is, in reality, derived from the donor of the power and is not taxable in the estate of the donee. This result is predicated upon the right of the appointee to elect to take under the will of the donor or by intestacy, but it has been extended, under a theory of presumed election, to any case where the interest of the recipient as appointee is the same as that as taker in default.[11] This extension seems justifiable, since otherwise the result would be made to depend upon mere form and would penalize a failure to renounce. The same conclusion has been reached under section 302(f) of the federal estate tax upon the theory that such property is not property "passing" by the exercise of a general power of appointment.[12] The result seems the same whether the tax is imposed under an estate or an inheritance tax law. In a recent New York case, the court held that the property was not taxable in the estate of the donee although the ap-

or was not subject to a death tax in the estate of the grantor of such power but would have been so taxable except for a statute providing that the tax on the transfer of such property should be imposed in the estate of the grantee of such power in the event of the exercise thereof."

[9] In re Vanderbilt's Estate, 281 N. Y. 297, 22 N. E. (2d) 379 (1939), affd. Whitney v. State Tax Comm. of N. Y., 309 U. S. 530, 60 S. Ct. 635 (1940). In the latter case, counsel contended that, although special powers might be taxed under an inheritance tax law, to tax such powers under an estate tax law would be to include in the gross estate property which was not owned by the donee of the power.

[10] In Helvering v. Hallock, 309 U. S. 106 at 118, 60 S. Ct. 444 (1939), Justice Frankfurter said: "The importation of these distinctions and controversies from the law of property into the administration of the estate tax precludes a fair and workable tax system. . . . Distinctions which originated under a feudal economy when land dominated social relations are peculiarly irrelevant in the application of tax measures now so largely directed toward intangible wealth."

[11] In re Lansing's Estate, 182 N. Y. 238, 74 N. E. 882 (1905). In this case, there was no renunciation. The appointees merely contested the tax. To the same effect is In re Slosson's Estate, 216 N. Y. 79, 110 N. E. 166 (1915).

[12] Helvering v. Grinnell, 294 U. S. 153, 55 S. Ct. 354 (1935), noted in 45 YALE L. J. 172 (1935). See also the discussion of the case in Griswold, "Power of Appointment and the Federal Estate Tax," 52 HARV. L. REV. 929 at 933 (1939).

pointee, as taker in default, would have been required to share with another taker in default, who was not an appointee.[13]

The New York statute of 1897 contained a provision taxing the non-exercise, as well as the exercise, of a power of appointment.[14] The court then held this provision to be unconstitutional,[15] and the legislature repealed the provision in 1911. However, this declaration of unconstitutionality was unnecessary to the case before the court, and one may well speculate as to the precise implications of the decision.[16] Despite this decision, other states, which had copied the New York provision either before or after it was held unconstitutional, have held that a state may constitutionally tax the non-exercise of a power.[17] This result has been approved by the United States Supreme Court.[18]

[13] In re Duryea's Estate, 277 N. Y. 310 at 318, 14 N. E. (2d) 369 (1938), where Hubbs, J., stated: "It is well established that where an appointee takes the same share that would have passed to that person under the will of the donor of the power, even in the absence of an expressed intent in the will of the donor, the share is to be taxed as passing under the will of the donor and in such case no tax can be imposed in the estate of the donee of the power, and if there was no tax applicable to the estate of the donor there would be no tax upon the property transferred to the appointee." To the same effect is James C. Webster, Exr., 38 B. T. A. 273 (1938). See also Estate of Mary Adele Morris, 38 B. T. A. 408 (1938). The last two cases are noted in 52 HARV. L. REV. 531 (1939).

[14] ". . . and whenever any person or corporation 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 omissions or failure, in the same manner as though the persons or corporations thereby becoming entitled to the possession or enjoyment of the property to which such power related had succeeded thereto by a will of the donee of the power failing to exercise such power, taking effect at the time of such omission or failure." N. Y. Laws (1897), c. 284, § 220(5). For a compilation of other state statutes taxing the non-exercise of powers, see PINKERTON and MILLSAPS, INHERITANCE AND ESTATE TAXES 136 (1926).

[15] In re Lansing's Estate, 182 N. Y. 238 at 247, 74 N. E. 882 (1905), where Vann, J., said: "We pass without serious discussion that part of the statute which provides, in substance, that the failure or omission to exercise a power of appointment subjects the property to a transfer tax in the same manner as if the donee of the power had owned the property and had devised it by will. . . . Where there is no transfer there is no tax and a transfer made before the passage of the act relating to taxable transfers is not affected by it, because . . . such an act imposes no direct tax and is unconstitutional since it diminishes the value of vested estates, impairs the obligation of contracts and takes private property for public use without compensation."

[16] In this case, the donee had exercised the power. In addition, the statements of the court seem to indicate that the decision was only intended to apply to the non-exercise of powers created prior to the enactment of the statute imposing a death tax.

[17] Minot v. Treasurer & Receiver General, 207 Mass. 588, 93 N. E. 973 (1911); Montague v. State, 163 Wis. 58, 157 N. W. 508 (1916); State v. Brooks, 181 Minn. 262, 232 N. W. 331 (1930); Manning v. Board of Tax Commrs., 46 R. I. 400, 127 A. 865 (1925).

[18] Saltonstall v. Saltonstall, 276 U. S. 260, 48 S. Ct. 225 (1928).

However, section 302(f) of the Revenue Act of 1926 taxes only general powers which are exercised. It seems reasonable to assume that by failing to exercise a power, as well as by exercising a power, the donee does affect the course of succession, whether the power be general or special in nature. By the non-exercise of the power, the donee, in reality, exercises the power in favor of the takers in default. On this hypothesis, it would seem that the taxation of the non-exercise of a power might be justified under either an inheritance or an estate tax system.

It must constantly be kept in mind that, while upon the death of the donor a transfer of a life estate to the donee ensues, there is also a transfer of a remainder interest. The inheritance tax statutes generally contain provisions for the taxation of remainder interests, whether vested or contingent. Under most of these statutes, a contingent remainder is taxed at the death of the donor at either the highest or lowest rate possible, and generally there is a provision for adjustment upon the actual vesting of the interest.[19] The question then arises as to whether this transfer may also be taxed under the power provision of the statute. In Minnesota, it has been held that a tax may be imposed under both provisions of the statute.[20] But in Wisconsin, the court concluded that the power section is to control, and only the transfer from the donee may be taxed.[21] Taxing under both provisions of the statute does seem to result in unnecessary double taxation. This is particularly true in those states which tax the non-exercise of the power. Some states impose a transfer tax upon contingent remainders only upon the vesting of the interest.[22] Here it would seem that the taxation should be limited to that under the powers provision by construing the statute in the alternative. This problem would not seem to arise under an estate tax, since the theory is that it is a tax upon the transmission, rather than upon the reception, of property at death.

2.

When the donee is endowed with a general power of appointment, there is a clear basis for the imposition of a death tax in his estate. Whether we conclude that property passing under a power of appointment, either special or general, emanates from the donor or from the donee would seem to depend upon the result which is to be desired.

[19] 1 Minn. Stat. (Mason, 1927), § 2294; Wis. Stat. (1937), §§ 72.15 (6) and (8); ROBINSON, SAVING TAXES IN DRAFTING WILLS AND TRUSTS, 2d ed., 7-39 (1933).

[20] In re Robinson's Estate, 192 Minn. 39, 255 N. W. 486 (1934).

[21] Will of Morgan, 227 Wis. 288, 277 N. W. 650, 278 N. W. 859 (1938), noted in 37 MICH. L. REV. 154 (1938). Although double taxation actually resulted in this case, it was due to the error of the representatives of the two estates.

[22] For a compilation of statutes, see PINKERTON and MILLSAPS, INHERITANCE AND ESTATE TAXES 90 (1926).

Either conclusion could be substantiated by legal theory. Consequently, the taxation of powers of appointment resolves itself into a question of fundamental policy. There is a distinct conflict of interest and policy involved. First, there is the policy involved in effectuating the purpose of the death tax statutes to produce revenue.[23] Next, there is the policy involved in the perpetuation of the power of appointment as a distributive device.[24] The tendency of the present Supreme Court is to disregard technical property concepts in order to further the policy of the taxing statutes. This tendency would seem to indicate that future legislative panaceas for the preclusion of death tax avoidance through the employment of powers of appointment will receive judicial sanction.[25] Whether the increased revenues resulting from taxation of special powers is a more important consideration than the tax-free use of a handy dispositive device is a question Congress will have to answer to its own satisfaction.

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[23] Griswold, "Powers of Appointment and the Federal Estate Tax," 52 HARV. L. REV. 929 (1939). Professor Griswold believes that the federal estate tax law should include the taxation of special powers of appointment. He seems to feel that, under the present statute, the special power, in general, is an instrumentality of tax evasion.

[24] Leach, "Powers of Appointment and the Federal Estate Tax—A Dissent," 52 HARV. L. REV. 961 (1939). Professor Leach believes that the inclusion of special powers within § 302(f) would emasculate an ingenious and useful dispositive device. He advocates the broadened interpretation of "general power," under the statute as it now stands, to encompass the pseudo-special powers, employed solely as a tax avoidance scheme.

[25] The jurisdiction to tax powers of appointment is beyond the scope of this comment. For a recent discussion of such problem, see comment in 53 HARV. L. REV. 1013 (1940).