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THE IMPACT OF THE LAW OF POWERS UPON OUR INTERNAL REVENUE LAWS

Montgomery B. Angell *

AN interesting difference in view has arisen recently in the halls of the Harvard Law School on the use of powers of appointment under the federal estate tax act. One view is that the chief efficacy today of the power of appointment lies in its capacity for use in tax evasion, which should be corrected.[1] The other view is that there is a salutary tendency toward using sensible and flexible powers of appointment, which should be encouraged in meeting changing and difficult family situations, but which would be checked were the former view accepted.[2] Thus we find here the age-old clash between the benefits of an established and salutary device for controlling human affairs, and the asserted dangers arising out of a possible abuse. As shedding light upon the controversy, it may not be inappropriate to consider some of the problems underlying the taxation of property subject to a power of appointment.

The impact of the law of powers[3] upon our internal revenue statutes cannot be fully appreciated without a realization of the historical character and development of powers, for the conflicting theories which have been recently advanced and the solution of the problems confronting us will be clear only in so far as we have before us certain fundamental conceptions.

A power is the capacity to change legal rights in respect of property. Whatever may be the character of the holder's interest, it is in

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[1] Griswold, "Powers of Appointment and the Federal Estate Tax," 52 HARV. L. REV. 929 (1939).

[2] Leach, "Powers of Appointment and the Federal Estate Tax—a Dissent," 52 HARV. L. REV. 961 (1939).

[3] The powers of appointment here considered are quite distinct from and should not be confused with a simple power of attorney to convey property or take any action in the name of and for the benefit of another.

essence an authority over property. At the common law the holder of a power of appointment was not regarded in any sense as the owner of the property and he did not have an estate in the property, until the power was exercised and the property subject to the power came into possession.[4] For our purposes, the exact character of the right is of no consequence. Whatever it is, the holder of a power unquestionably is in a position where he may exercise control over the disposition of property, but only at the time and in the manner designated in the particular power in question.[5]

The subject of powers has given rise to much judicial controversy and considerable confusion.

> "The law of powers, as all who have attempted to master it, will readily admit, is probably the most intricate labyrinth in all our jurisprudence. . . . We encounter this darkness at the very threshold of our inquiries, as the division or classification of powers . . . seems industriously framed to confound all intelligence of their meaning and utility."

[4] Powers were known before the Statute of Uses, but they were mere directions to the trustee of the legal estate made to convey the estate, or, as Sugden says, "in truth they were future uses to be designated by the person to whom the power was given; these as they arose equity compelled the trustee to observe. . . ." SUGDEN, POWERS, 8th ed., 17 (1861).

After the Statute of Uses, powers still remained "as mere rights of designation which bound the conscience of the trustee, and the estates to be created by force of them were still clearly *future or contingent uses*." But there was this distinction, says Sugden: "when a power was executed, as the person in whose favour the appointment was made became invested with the use, he instantly gained the legal estate by force of the statute," adding that "to attract the legal estate under the statute, it is necessary that there should be a use *in esse*; whereas the uses to be raised under powers are not *in esse*, or defined, but until ascertained and limited under the power are merely tantamount to future or contingent uses." SUGDEN, POWERS, 8th ed., 18 (1861).

[5] Powers, properly so called, must be distinguished from trusts. The English authority, Sir George Farwell, quotes Wilmot, C. J., Wilmot 23 [FARWELL, POWERS, 3d ed., 10 (1916)]: "Powers are never imperative; they leave the act to be done at the will of the party to whom they are given. Trusts are always imperative, and are obligatory upon the conscience of the party intrusted." This is not wholly accurate. Certain powers are imperative in the sense that if the holder fails to exercise the power a court of equity will act. With regard to such a power, says Farwell, "the Court considers it as partaking so much of the nature and qualities of a trust, that if the person who has that duty imposed on him does not discharge it, the Court will to a certain extent discharge the duty in his room and place." Id. 525. Such a power is a power conferred upon a life tenant, *A*, to appoint at his death among his children without remainders in default of appointment, and *A* fails to appoint. Here the power is considered an imperative power and a court on application will divide the remainder among *A's* children. See 1 BOGERT, TRUSTS AND TRUSTEES, § 116, p. 363 (1935); Simes, "Powers in Trust and the Termination of Powers by the Donee," 37 YALE L. J. 63-65 (1927).

Thus spoke the New York Revisers in their Notes on the revision in 1829 of the law of powers.[6]

Sugden in his *Treatise on Powers* gives us the classical division of powers at the common law. Powers, says Sugden, are divided into three main classifications: (1) powers which are appendant or appurtenant; (2) powers collateral or in gross; and (3) powers simply collateral.[7] "Powers appendant or appurtenant," says Sugden, "are so termed because they strictly depend upon the estate limited to the person to whom they are given." Thus, where an estate is given for life and the life tenant has the power to grant leases in possession, it is a power appendant or appurtenant, since it "enables the party to create an estate which will attach on an interest actually vested in himself." Powers collateral or in gross are powers given to a person who either had an interest in the estate at the execution of the deed creating the power or to whom an estate was given in the deed, and which enables him to create estates which will *not* attach on the interest limited to him. Such a power is the power of a tenant for life to appoint the remainder among his children after his death. A power simply collateral was early defined by Sir Matthew Hale as "a power given to a party who has not, nor ever had, any estate in the land," as where a power is given to a complete stranger. But, says Sugden, "This definition, however, is not correct."[8] It would seem, he says, that a power given to a perfect stranger to charge the estate for his own benefit should not be deemed a power simply collateral. Accordingly he defines the power as "A power to a person not having any interest in the land, and to whom no estate is given, to dispose of, or charge the estate in favour of some other person." As an illustration he gives a power

[6] See Notes of the Original Revisers of the Revised Statutes on the New York Real Property Law, appearing as Appendix III of FOWLER, REAL PROPERTY LAW OF NEW YORK, 3d ed., 1298 (1909) [1st ed., 781 (1899)]. The full quotation follows: "The law of powers, as all who have attempted to master it will readily admit, is probably the most intricate labyrinth in all our jurisprudence. Few, in the course of their studies, have been called to enter it, who have not found it difficult to grope their way in its numerous and winding passages. In plain language, it abounds pre-eminently in useless distinctions and refinements, difficult to be understood, and difficult to be applied, by which a subject, in its own nature free from embarrassment, is exceedingly perplexed and darkened. We encounter this darkness at the very threshold of our inquiries, as the division or classification of powers, (which appears in the beginning of every elementary work on the subject,) seems industriously framed to confound all intelligence of their meaning and utility."

[7] SUGDEN, POWERS, 8th ed., 46 (1861).

[8] Id. 47.

to a stranger to revoke a settlement and appoint new uses to other persons designated in the deed.[9]

From time to time the classification of powers has been changed by statute and judicial decision. For example, in New York shortly after the turn of the nineteenth century a commission was appointed to make a careful study of the law of powers.[10] As of December 31, 1829, powers at the common law were abolished and thereafter "the creation, construction and execution of powers in respect of real property" were made the subject of statute.[11] A power is defined as "an authority to do an act" in relation to real property or to the creation or revocation of an estate therein, which the owner "granting or reserving the power" might himself lawfully perform. Thus the statute recognizes donated powers, or powers conferred by the owner upon another, and reserved powers, or powers retained by the original owner of the property. Speaking generally, powers under the New York statute are either reserved or donated, general or special, beneficial or in trust.[12]

[9] FARWELL, POWERS, 3d ed. (1916), adopts substantially the same classification. A power is appendant, says Farwell (p. 10), "when the estate created by its exercise overreaches and affects the estate and interest of the donee of the power. It is in gross when the estate so created is beyond, and does not affect the estate or interest of such donee." A collateral power (p. 9) "is a bare power given to a mere stranger who has no interest in the land." But Farwell recognizes another division, namely, a division into a general power and a limited (or special) power. "General powers," says Farwell (p. 8), "are such as the donee can exercise in favour of such person or persons as he pleases, including himself. Limited powers . . . are such as the donee can exercise only in favour of certain specified persons or classes." As examples, Farwell says that a power to appoint to whom the donee pleases, except *A*, has been held to be a general power so as to make the appointed fund assets for payment of debts (citing authorities), but not to be a general power within section 27 of the Wills Act. As indicating the character of a general power, the author says that the holder of a general power "may appoint to himself . . . or to his own executors and administrators," citing Irwin v. Farrer, 19 Ves. 86, 34 Eng. Rep. 450 (1812), and Mackenzie v. Mackenzie, 3 Mac. & G. 559, 42 Eng. Rep. 376 (1851).

[10] See note 6, supra.

[11] New York Real Property Law, art. 5, § 130 [49 N. Y. Consol. Laws (McKinney, 1937), § 130].

[12] Powers under the New York statute are classified as follows:

(1) A *general power* is a power which is exercisable in favor of any person whom the donee (he who holds the power) may select, including himself. N.Y. Real Prop. Law, art. 5, § 134.

(2) A *special or limited power* exists when it may be exercised only in favor of designated persons or a class of persons. N. Y. Real Prop. Law, art. 5, § 135.

(3) A *beneficial power*, whether general or special, is a power where only the donee has an interest in its execution. N. Y. Real Prop. Law, art. 5, § 136.

(4) A *general power* is *in trust* when it may be exercised in favor of any person,

But regardless of how powers may be classified in any particular jurisdiction, the important thing is to keep clearly in mind the relationship to the property subject to the power of the donor of the power and of the donee of the power and of the beneficial takers under the power.

In our more immediate body of law, we find today a sharp conflict in the conception of a power. The Circuit Court of Appeals for the Second Circuit has recently said that a power "is not a property right nor an interest in property."[13] On the other hand, Gray in his *Rule against Perpetuities*[14] implies that the donee of a general power possesses complete ownership, for he says that the holder of such a power "can deal with the property as if he owned it in fee."

In connection with their work on the revision of the law of powers, the New York Revisers considered with some care the use of powers as a device for fraud on creditors. Said the Revisers: "Thus a man may convey his estate in fee, and by means of a power of revocation, continue in himself the absolute dominion, leaving only a naked title to the alienee."[15]

After pointing out that by this device the lands are placed effectively beyond the reach of the creditors of the donee, the Revisers continued:

> "And to his own creditors, they are equally without redress; for as he has no estate or interest in the lands, but a bare authority to

provided the donee realizes no beneficial interest in the proceeds, such as a power of sale in an executor. N. Y. Real Prop. Law, art. 5, § 137.

(5) A *special power* is *in trust* where it may be exercised in favor of any person or class of persons other than the donee, or where someone other than the donee is entitled to the benefits, such as where a power is limited to a class composed of the children of the donee. N. Y. Real Prop. Law, art. 5, § 138.

The reason assigned by the New York Revisers for this reclassification is preserved to us. The original classification, said the Revisers, "overlooks entirely the nature and objects of the power itself, and regards solely the connexion between the party exercising the power and the lands which it embraces." FOWLER, REAL PROPERTY LAW OF NEW YORK, Appendix, 3d ed., 1299 (1909) [1st ed., 781 (1899)]. Accordingly, said the Revisers, "We propose, therefore, an entirely new division. . . . In order to classify powers, we look to their extent, and to the objects which they are meant to attain. . . . The most important circumstance evidently is, whether the power is to be exercised by the party for his own benefit, or the benefit of others, whether it is an interest or a trust; and it is to this distinction that the regulations we propose have a principal regard." Id. 1299-1300 [1st ed., 781-782].

[13] Farmers' Loan & Trust Co. v. Bowers (C. C. A. 2d, 1928) 29 F. (2d) 14 at 17.

[14] 3d ed., § 524 (1915).

[15] FOWLER, REAL PROPERTY LAW OF NEW YORK, Appendix, 3d ed., 1300 (1909) [1st ed., 782 (1899)].

dispose of them as he pleases, there is nothing on which their claims can attach. To treat a mere power as actual property, would be a plain violation of legal principles, and accordingly it is not considered as such, either in law or equity."[16]

These evils were in part the reason for the abandonment of the old common-law rules. "That a change of the existing law is here not merely proper, but necessary, will be admitted by all. . . ." The Revisers then go on to say:

"In reason and good sense, there is no distinction between the absolute power of disposition and the absolute ownership; and to make such a distinction, to the injury of creditors, may be very consistent with technical rules, but is a flagrant breach of the plainest maxims of equity and justice."

And again—

"It is an affront to common sense to say, that a man has no property in that which he may sell when he chooses, and dispose of the proceeds at his pleasure. We apprehend the legislature will have no difficulty in declaring, that so far as creditors and purchasers are concerned, the power of disposition shall be deemed equivalent to the actual ownership."

Are these comments which were directed at the use of the power device as a fraud on creditors applicable under our modern day theory of taxation, or is the similarity of problem more superficial than real? The immediate problem we are here considering is whether, for purposes of taxation, the existence of a power, whether exercised or unexercised, should be sufficient to subject the donee of the power to liability for taxes as if he were the owner of the property subject to the power, regardless of the character and the source of the power.

Whatever may be the rule in the case of creditors, certain it is that in considering the problems of taxation we should be very reluctant to impose a tax on the principle that the taxpayer's relation to the property should be deemed to be the equivalent of ownership when in actuality the relation is such as to negative the existence of such a relationship, either legalistically or viewed from the standpoint of eco-

[16] Id. At the common law, if the holder of a general power should exercise it in favor of a purchaser without consideration and then die, the purchaser must hold for the creditors, but if the holder of a power should die leaving the power unexecuted, the creditors were without remedy against the owner of the property. Quoting Sugden, "These distinctions may seem *refined*, but they are well established," the Revisers added "We confess that 'refined' does not seem to us the appropriate word."

nomic benefits. If, for example, the relation existing between the holder of a power over property and the property subject to the power is such that the holder possesses virtually the same rights in respect of the property as an owner possesses, it is not inappropriate to tax him as though he were the owner. On the other hand, if the nature of the power is such that the relationship between the holder and the property subject to the power is not in reality one of ownership, the holder should not be taxed as if he were in fact the owner.

Two extreme cases will perhaps serve to make this clear. Suppose *A*, the owner of a fee, creates a trust, reserving a life estate in himself, with a general power of appointment by deed and by will. Or suppose *X*, owning the fee, creates a trust for *Y* for life, with remainders over to *Y*'s named children, and confers upon *A* a special power to appoint by will or by deed the remainder among *Y*'s children as he shall determine. In the former case, by creating the trust *A* has neither diminished nor increased his ownership or control over the property, whether viewed from the legal or economic standpoint, and it may readily be that the power of disposition over the property which *A* has retained should be treated as the equivalent of ownership for purposes of taxation. *A* was the owner, and, practically and effectively, he remains the owner. But in the second case it is certainly not true that the power of disposition over the property, even though it may be exercised broadly either by deed or by will, is the equivalent of ownership, or should be so treated for tax purposes. *A* originally did not have any estate, and when the power was lodged in him he acquired nothing beneficial for himself. At common law, such a power is a power simply collateral, while under the New York statute it is a special, nonbeneficial power in trust. To treat *A* as the owner of the property because he had full power and control over its disposition for the use of others would be to impute to him something which he did not have.

At the present time, neither the federal revenue statutes nor the adjudicated cases have undertaken to impute the full effects of ownership to one who does not otherwise have an estate or interest in property, simply because of the existence of a power of appointment over the property. The decisions under the estate tax act for years have emphasized the shifting of the economic benefits of the property as distinguished from the ownership of any technical estates.[17] But even

[17] As early as Saltonstall v. Saltonstall, 276 U. S. 260, 48 S. Ct. 225 (1928), the Supreme Court said: "So long as the privilege of succession has not been fully exercised it may be reached by the tax. . . . And in determining whether it has been

under this established conception neither the statute nor the decisions have gone so far as to hold that the existence of a power of appointment at death, in and of itself, requires the inclusion of the property subject to the power in the gross estate.

The federal estate tax act recognizes powers by express language in only two instances. Subdivision (d) of the section defining the gross estate requires the inclusion of any interest of which the decedent has made a "transfer" in trust or otherwise, where "the enjoyment" of the property was subject at the date of decedent's death—

> "to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death. . . ."[18]

Subdivision (f) covers the case of—

> "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, or (3) by deed"[19]

where the decedent has "retained" for any period measured by his life certain rights over the property or the income therefrom.[20]

The significance of these two provisions is that the powers covered by (d) are limited to *reserved* powers as distinguished from *donated* powers, while the powers covered by (f) are *general* powers[21] and

so exercised technical distinctions between vested remainders and other interests are of little avail, for the shifting of the economic benefits and burdens of property, which is the subject of a succession tax, may even in the case of a vested remainder be restricted or suspended by other legal devices."

[18] 53 Stat. L. 121, § 810 (d) (1), 26 U. S. C. (Supp. 1939), § 810 (d) (1). Prior statutes were substantially the same.

[19] Id., § 810 (f). Italics added.

[20] The full text of the present statute is: "or (3) by deed under which he has retained for his life or any period not ascertainable without reference to his death or for any period which does not in fact end before his death (A) the possession or enjoyment of, or the right to the income from, the property, or (B) 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; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. . . ."

[21] Whether or not a particular power is a general power within the meaning of (f) has given rise to some controversy. The latest edition of the regulations, Treas. Reg. 80, art. 24 (1937), undertakes to define as a general power a power which "is exer-

then only when *exercised* and the property *passes* under the power; if by will, the powers may be either reserved or donated, and if by deed, either reserved or donated when executed in contemplation of death, but only when reserved in the case of the remaining powers covered, as where the owner creates a trust, reserving a life estate with a power of appointment over the remainder. The law is entirely silent with respect to the *nonexercise* of a general power, and it does not even mention a *special* power, whether *exercised* or *unexercised*.

There is still another provision of the estate tax act which conceivably might have been applied to powers, and the failure of the courts to so apply it is not without its significance. Subdivision (a), which appeared in the original enactment in 1916, covers any "interest" in property of the decedent at death. Following this enactment the Treasury promulgated regulations which provided that "where a decedent exercises a general power of appointment as donee under the will of a prior decedent the property so passing is part of the gross estate of the decedent appointor."[22] But the Supreme Court refused to uphold this regulation, saying that a general power did not "vest any estate in the donee" and that the property appointed under the power was not "subject to distribution as part of his estate."[23] This regula-

cisable in favor of the donee, his estate, or his creditors." Clearly a power is general although it is exercisable by will only. In certain states a power may be general even though the property interest subject to the power is less than a fee. The New York rule and the rule in certain other states is otherwise. N. Y. Real Prop. Law, art. 5, §§ 134-135. For estate tax purposes, the rule of the present regulations seems a perfectly appropriate rule, for a power to come within it must be broad enough to confer upon the donee full control over the property *for himself*, thus giving him complete dominion and power of disposition. See, in general, Griswold, "Powers of Appointment and the Federal Estate Tax," 52 HARV. L. REV. 929 at 939 et seq. (1939).

Uniform interpretation rather than any peculiarity of state law should, it seems to me, govern in determining whether a power is a general power. It would be unfortunate if the state rule should determine in applying a nationwide taxing statute. In Burnet v. Harmel, 287 U. S. 103 at 110, 53 S. Ct. 74 (1932), the Supreme Court said, in considering a tax statute: "State law may control only when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law." On the other hand, in determining whether a power has or has not been exercised, or the effect under the power of any act taken, it would seem that the state law should control, for this is a matter of legal effect on the property of an act done by the holder of the power, and the later cases have so held. Johnstone v. Commissioner, (C. C. A. 9th, 1935) 76 F. (2d) 55, cert. denied, 296 U. S. 578, 56 S. Ct. 89 (1935); Old Colony Trust Co. v. Commissioner, (C. C. A. 1st, 1934) 73 F. (2d) 970; Emma S. Cone, Ex'x v. Commissioner, 31 B. T. A. 515 (1934).

[22] T. D. 2477, 19 Treas. Dec. Int. Rev. 84 (1917).

[23] United States v. Field, 255 U. S. 257 at 263, 264, 41 S. Ct. 256 (1921).

tion no doubt was the forerunner of what now appears as subdivision (f).[24]

Shortly after its enactment, subdivision (f) came under the Supreme Court review for the first and last time. In *Helvering v. Grinnell*,[25] a resident of New York created a testamentary trust for his daughter, the income of which was to be paid to her during her life and upon her death the property was to be "applied to such persons and such uses as she might appoint by last will and testament," and in default of any appointment the property went share and share alike to the daughter's children or issue, by right of representation, or in default of such issue to her next of kin. The daughter had no children surviving her and her next of kin were her two sisters. In her will she exercised the power of appointment by directing that the property should go to her two sisters, share and share alike. The sisters renounced the right to receive the property under the will and elected to take under the provisions of the primary will. Although conceding that the power was exercised, the Supreme Court held that the property did not "pass" under the power, but in view of the renunciation it passed under the original will, and therefore the property subject to the power was not within (f). Technically, the decision is correct, for under the established doctrine of renunciation, the taking occurred under the prior will.

Unlike (f), subdivision (d) has been the subject of considerable litigation. The leading case is *Porter v. Commissioner*.[26] In the *Porter*

[24] In H. REP. 767, 65th Cong., 2d sess. (1918), pp. 21-22, there is the following statement: "There has also been included in the gross estate the value of property passing under a general power of appointment. This amendment as well as that preceding is for the purpose of clarifying rather than extending the existing statute. A person having a general power of appointment is, with respect to disposition of the property at his death, in a position not unlike that of its owner. The possessor of the power has full authority to dispose of the property at his death, and there seems to be no reason why the privilege which he exercises should not be taxed in the same degree as other property over which he exercises the same authority. The absence of a provision including property transferred by power of appointment makes it possible, by resorting to the creation of such a power, to effect two transfers of an estate with the payment of only one tax." A similar statement appears in the corresponding Finance Committee Report of the Senate, S. REP. 617, 65th Cong., 3d sess. (1919).

[25] 294 U. S. 153, 55 S. Ct. 354 (1935).

[26] 288 U. S. 436, 53 S. Ct. 451 (1933). In the course of its opinion in the Porter case, the Court pointed out (288 U. S. at 442) that prior to the enactment of section 302 (d) covering transfers subject at death to a power "to alter, amend or revoke," it had already held that the existence at death of a power of revocation over a trust required the inclusion of the corpus in the gross estate within subdivision (c) taxing "transfers" intended to take effect on death, citing Reinecke v. Northern Trust

case, Porter, the decedent, had created certain inter vivos trusts in favor of his children, reserving to himself the power at any time to alter or modify the indenture, but expressly excepting any change in favor of himself or his estate. The Supreme Court held that the property subject at death to the power was within (d) and sustained the constitutionality of the section. In the course of its opinion, the Court said:

> "We need not consider whether every change, however slight or trivial, would be within the meaning of the clause. Here the donor retained until his death power enough to enable him to make a complete revision of all that he had done in respect of the creation of the trusts even to the extent of taking the property from the trustees and beneficiaries named and transferring it absolutely or in trust for the benefit of others."[27]

The power in the *Porter* case was a reserved power; it was nonbeneficial in the sense that the donor could no longer exercise it for his own benefit, but it was otherwise unlimited. Here for the first time we find the Supreme Court recognizing two different benefits accompanying ownership of property, the benefit arising out of the enjoyment for one's self, and the benefit derived from the owner's control over the use by others. So long as the latter exists, even though the former has been relinquished, a sufficient interest in the property remains to justify the inclusion of the property in the gross estate at death. But it must be remembered that the power here involved represented the residuum of the full and complete ownership once enjoyed. It was a reserved and not a donated power.

The federal gift tax act imposes a simple tax upon "any transfer" when made by gift, whether directly or indirectly, and contains none of the refinements of the estate tax act. The act is wholly silent as to powers of appointment, and yet the very simplicity of the incidence of the tax conceivably may permit the courts to give to the act a broader application in respect of the effect of powers. We have had only two important decisions in this field. In the *Guggenheim* case,[28] the owner of property conveyed the property to trustees in trust, reserving the

Co., 278 U. S. 339 at 345, 49 S. Ct. 123 (1928). Accordingly (c) and (d) overlap to the extent that both cover transfers subject to a power of revocation. Subdivision (d) goes beyond (c) in including a transfer subject to a nonbeneficial power to alter or amend.

[27] 288 U. S. at 443.

[28] Burnet v. Guggenheim, 288 U. S. 280, 53 S. Ct. 369 (1933).

power to revoke. Later the donor surrendered the reserved power. The Supreme Court held that a taxable gift occurred not when the revocable gift was created but when the power of revocation was surrendered, saying that the statute is "aimed at transfers of the title that have the quality of a gift, and a gift is not consummate until put beyond recall."[29]

In the *Sanford* case,[30] the court went one step further. There the donor had created an irrevocable trust (originally revocable and later made irrevocable), reserving the power to alter except for his own benefit, the reservation being similar to the reservation in the *Porter* case. Later, the donor surrendered the reserved power. The Supreme Court upheld the imposition of a gift tax on the date of the surrender, saying that so long as power over the ultimate disposition of the enjoyment of the property existed, the gift was not complete, although in a prior year the donor had irrevocably lost the right to enjoy the property for himself.

Here again, as in the *Porter* case, the Supreme Court distinguished between the benefits which the owner of property may enjoy for himself and the benefits which he may enjoy through continued control over the property for the use of others.[31] And here

[29] Id., 288 U. S. at 286.

[30] Sanford v. Commissioner, 308 U. S. 39, 60 S. Ct. 51 (1939).

[31] On principle, the Sanford case seems wrong, particularly when considered in the light of the rule obtaining for income taxes. When the owner of property disposes of the property in such a fashion that he no longer can enjoy the property for himself, it would seem that he has made "a gift" of the property, certainly as the word "gift" is usually employed. Moreover, such an interpretation of the gift tax act is directly in accord with the income tax rule, for ever since the Revenue Act of 1924 by statutory provision, Treasury regulation, and court decision, it has been the rule that where the owner of property surrenders all further use of and enjoyment over the property for himself, the obligation to pay income taxes on the income of the property shifts from the grantor to the trust estate and falls either upon the beneficiaries or upon the trustee. Sec. 219 (g) of the Income Tax Title, Revenue Act of 1924, 43 Stat. L. 277; Knapp v. Hoey, (C. C. A. 2d, 1939) 104 F. (2d) 99; Downs v. Commissioner, 36 B. T. A. 1129 (1937). But since the reserved power surrendered represented one form of the benefits of ownership, namely, the power to determine who should enjoy the property and the income therefrom, I have no quarrel with the decision from the standpoint of the law of powers.

The decision has, however, produced a very incongruous situation. So long as the power to modify remains outstanding, there is no gift. Yet since the power to retake for himself has been surrended, the burden of the income tax passes from the donor to the trust estate as donee. This means that by creating an irrevocable trust but reserving the power to modify, an individual may avoid the gift tax and at the same time free himself from burdensome income taxes. Moreover, since no gift has occurred, the income from the property when paid over to the donee presumably con-

again, as in the *Porter* case, the settlor originally held the entire fee, and it was the final act of relinquishment of the benefits of ownership which was held to constitute the severance of interest. If the donee of the power had been a complete stranger to the property, it is inconceivable that the surrender of the power would have given rise to a gift tax.

In the field of income taxes, the federal statute has concerned itself with powers in only two sections, expressly in section 166 and inferentially in section 167. Both have to do with reserved powers. Section 166 of the Internal Revenue Code (originally section 219 (g) of the 1924 Act) provides that where the grantor of a trust, either alone or in conjunction with anyone not having a substantial adverse interest in the trust, has "the power to revest in the grantor title to any part of the corpus of the trust," the income from the trust shall be included in the grantor's income. This language is simple and unambiguous. Under it, the income of a trust, although received by someone other than the grantor, nevertheless is taxable to the grantor where the grantor retains "the power to revest in himself title to any part of the corpus of the trust." The principle underlying the rule is that on account of the reserved power the grantor can at any time retake the corpus, and hence exercises complete control for himself over the income.[82] On the other hand, under the clear implication of the language, when the grantor no longer has the power to revest in himself the title to any part of the corpus, that is to say, when he can no longer enjoy the property (or the income from the property) *for himself*, the burden of paying the income tax shifts from the grantor to the trust estate, even though the grantor continues to retain the power to designate those who shall enjoy the corpus and the income. This very case arose in *Knapp v. Hoey*,[83] and both the district court and the Circuit Court of Appeals for the Second Circuit absolved the grantor from any obligation to pay income taxes on the trust property income after he had lost "the power to revest in himself title to any part of the corpus." In the course of his opinion, the District Judge said:

"It requires no great discernment to see that the plaintiff in

stitutes a taxable gift. The donee of a gift is secondarily liable in the event the donor fails to pay, so that in respect of the income from the property in trust the beneficiaries of the trust might have to pay both a gift tax and an income tax in respect of the identical payment.

[82] See Corliss v. Bowers, 281 U. S. 376, 50 S. Ct. 336 (1930).

[83] (D. C. N. Y. 1938) 24 F. Supp. 39, affd. (C. C. A. 2d, 1939) 104 F. (2d) 99.

setting up this trust had an eye on the revenue laws. While he went far in retaining control of the property, he stopped short of control broad enough to render the income taxable as his own. The fact that the creation of the trust was a plan for reducing his income tax and at the same time retaining a measure of control over the property does not make the income of the trust taxable as his income under existing laws." [34]

Here again, as in the *Porter* case and the *Sanford* case, the power was a power conferred by the owner of property upon himself, a reserved and not a donated power. Originally, he enjoyed the full benefits of ownership, and so long as he did so, he should be subject to the full burdens of ownership, including the income tax. But once he surrendered the enjoyment of the economic benefits for himself, a change occurred in his relationship to the property. He could still control the enjoyment by others but he had lost the power to use the property or the income for himself, his creditors or his estate. A graduated income tax on principle rests on the theory of ability to pay. Should Congress by amendment of the income tax statute attempt to add the income from such a trust to the other income of the grantor when he no longer can use the income for his own purposes, we shall have departed flagrantly from our conception of taxation depending upon ability to pay. The citizen would be taxed because of income he once had, and not because of any income he enjoys when the tax is laid.

There are two others cases of more than ordinary interest, for certain dicta in these cases may be seized upon as a justification for the enlargement of our statutes, particularly the estate tax act, when in fact the language used was intended to have no such implication. In *Curry v. McCanless*,[35] a Tennessee resident held a general power of appointment over property located outside the limits of Tennessee. That state undertook to impose an estate tax in respect of the property. In upholding the right of Tennessee to tax, the Supreme Court said that a general power of appointment is regarded as "equivalent to ownership of the property subject to the power." [36] Again, in *Graves v. Elliott*,[37] the Supreme Court said that "the power of disposition of property is the equivalent of ownership." But in both these cases the holder of the power was both the donor and the donee of the power, a

[34] Id., 24 F. Supp. at 41. But see Commissioner v. Buck, decided by the Second Circuit, June 6.

[35] 307 U. S. 357, 59 S. Ct. 900 (1939).

[36] Id., 307 U. S. at 371.

[37] 307 U. S. 383 at 386, 59 S. Ct. 913 (1939).

fact which the Court took pains to emphasize in the course of its opinion. So the Court was considering a *reserved* power as distinguished from a *donated* power.

In fact it seems to me that the most important division in the classes of powers under a just system of taxation is the distinction between reserved powers and donated powers. For example, where he who owns a piece of property conveys it outright to another or in trust for others but reserves a general power of appointment, it is quite proper to say that the donor of the property is still the owner of the property. Here the donee of the power *continues to retain* complete dominion and control over the property. To recognize the estate held by the transferee is to regard form and not substance. But suppose *A* creates a trust, naming *B* the life tenant with remainder over to *B's* four children share and share alike, and confers upon *X*, a complete stranger, a power to appoint the remainder among *B's* children, either by deed or by will. This is a power simply collateral under the old common-law nomenclature, and a special nonbeneficial power in trust under the New York classification. *X*, the holder of the power, does not have, *and never did have*, any estate or interest in the property. Surely the existence of the power, whether exercised or unexercised, should not be treated as the equivalent of ownership for tax purposes. Again, suppose the power which *A* confers upon *X*, a stranger, is a power to appoint to anyone, save only to himself, the power still is a power merely collateral, or a special, nonbeneficial power in trust, and again it should not be deemed ownership.

Or take an even more common situation. If *A*, the owner, creates an inter vivos trust, reserving a life estate for himself, with remainder to designated persons, and retains a power of appointment by will, whether general or special, on *A's* death the entire fee is part of his gross estate. But suppose *A* sets up a trust, giving *X* a life estate with remainder to designated persons, and confers upon *X* a general power of appointment by will. *X* dies without exercising the powers, and the property passes to the remaindermen under the original deed. As the statute now stands, the property is not part of *X's* estate. Should the law be amended to cover such a situation?

In one sense *X's* power of enjoyment of the property may become absolute, for he has the estate for life and if he exercises the power he will have designated those who shall take the remainder as he selects. But whether or not he exercises the power, *X's* control over the property is not absolute, for he never did have the power of immediate alienation, which is one of the most important of the bundle of rights;

but, more important, if *X* dies without exercising the power, at no time has he exerted the full extent of the control over the property which was offered to him. The only legal estate he has, or ever had, in the property was a life estate terminable at his death. If *X* had been given a life estate only, no one would contend that on his death the entire fee should be taxed as part of his estate. But even where he holds a testamentary power of appointment as well, while he may control the disposition of the fee on his death, if he dies without exercising the power, the property passes, not under the power, but under the prior will or deed.[38] It would, it seems to me, constitute an unconscionable burden to tax *X* with the entire fee on his death when he never even enjoyed the economic benefit of designating who should take, simply on the narrow ground that if he had wanted to he might have done so. If he withholds his hand because the estate goes the way it pleases him under the original will, to lay a tax on him at his death would be to impose an excise, not on a privilege, or anything that bears the slightest resemblance to a privilege, but on failure to exercise a privilege, certainly a novel kind of an estate tax. From the standpoint of the remaindermen, it is, of course, true that *X's* death without the exercise of the power is the source of valuable assurance that the fee is theirs. But the death here is not the "source of valuable assurance *passing from the dead to the living*" within the principle of the *Porter* case. There the power was a reserved power, and there was in fact a "passing" on the death from the dead to the living. Here on the death there was no "passing" from this particular decedent, for the decedent passed nothing on. At most, the death assures the right of succession. But there is no succession through the decedent. The incidence of the estate tax should be circumscribed accordingly.[39]

But what of a donated general power of appointment exercisable by deed and by will? Should the existence of such a power, unexercised, be considered the equivalent of ownership for tax purposes? Suppose *A* transfers property in trust to *B* for life with remainder over to designated persons and confers upon *X*, a stranger, a general power of

[38] Helvering v. Grinnell, 294 U. S. 153, 55 S. Ct. 354 (1935); Matter of Lansing, 182 N. Y. 238, 74 N. E. 882 (1905); Kent v. Armstrong, 6 N. J. Eq. 637 (1850).

[39] The New York Revisers expressed grave doubt as to whether a power of this character should be considered the equivalent of ownership, for they said: "It may perhaps be doubted, whether a general power to devise, annexed to a previous estate, should be considered an absolute power of disposition. . . ." FOWLER, REAL PROPERTY LAW OF NEW YORK, Appendix, 3d ed., 1301 (1909) [1st ed., 783 (1899)].

appointment by deed and by will, so that under it *X* may at any time appoint to himself. Even here there are cogent reasons why *X* should not be treated as the owner, *so long as he does not exercise the power.* The title to and the economic enjoyment of the property continue without let or hindrance, until *X* does an affirmative act. So long as the power is unexercised, *X* is like a person who has been offered a deed of property but has not accepted it. He must do something affirmatively before he acquires any legal or economic estate, or any right to the income. On the death of *X* (with the power still unexercised) should the property be taxed to *X* as part of his estate? No change in the economic use of the property occurs by virtue of *X's* death. *X* at any time might have changed the enjoyment of the property and hence the income. But until he exercises the power he has not availed himself of either one of the main benefits of ownership, namely, the use for himself or a designation of those who shall use. The right exists, but *X* has not exerted it in any respect. If *X* should be offered a deed to Black Acre and declines, even though the offer be a continuing one *X* certainly is not considered as the owner of Black Acre for tax purposes. Yet the holder of a general power of appointment over Black Acre is in no different position so long as the power is not exercised. As in the case of a life estate coupled with a donated general testamentary power, on the death of the holder nothing in reality "passes" from the dead to the living. An existing right terminates, but no shifting of interest has occurred bearing any resemblance to the exercise of any privilege. To tax *X* as if he were the owner of the fee would be to lay an excise upon an event which did not occur.

But as soon as a general power of appointment is exercised, a wholly different situation exists. Then a "transfer" unquestionably has occurred. *X* has exerted dominion over the property, whether he appoints to himself or to another, and the transfer quite appropriately may attract a gift tax in the case of an inter vivos appointment to another, or an estate tax in the case of a testamentary appointment.

A power of appointment which, under the New York classification, is a general power may very readily be made into a special power without seriously restricting the latitude of the holder's scope of appointment. For example, a power under which the holder may appoint to anyone (including himself) except to *A* and his descendants, or to anyone (including himself) except to charitable corporations, is a special power under the New York classification. Where the scope of the holder's appointment under a special power of appointment is such that it amounts virtually to a complete power of disposition, and the

power is exercised, the power should, it seems to me, be treated the same way as a general power of appointment for tax purposes. There is no magic in any distinction between a general and a special power as such; the treatment should depend upon the relationship between the holder of the power and the property subject to the power. If the power is of such a character that the donee has virtual control over the disposition of the property and the power is exercised, the donee should be treated as the owner of the property for tax purposes, for he has exerted the rights of an owner. This may be accomplished either by broadening and making more specific the definition of a general power now appearing in the federal estate tax act,[40] or by adding to the statute a clause taxing property passing under a special power of appointment, with appropriate restrictions defining the power. But, as in the case of a general power, the existence of a special power unexercised should not, it seems to me, be treated as the equivalent of ownership.

In the case of a donated special power in trust, whether or not accompanied by a life estate, there appears to be no justification for the imposition of an inheritance tax on the death of the holder, either where the power is exercised or where it is unexercised. By its nature, a special power in trust confers upon the holder at most the right to select among a limited group, not including himself. If, as in the case in respect of such a donated power, the holder is an entire stranger to the property, his rights in respect of the property are really insignificant. Such a power usually is conferred upon another as a special mark of trust and confidence in order to carry out a preeminently social purpose, rather than any evidence of the donor's bounty. If nevertheless the holder of such a power, whether exercised or unexercised, were treated for tax purposes as the owner of the property, real injustice would be done. It would deprive society of the benefits of the use of such a power in a large degree, for no one knowingly would wish to accept the designation if by doing so he must assume a heavy financial outlay in the form of estate taxes. It might readily operate as a trap for the unwary or ignorant, for in view of the state of the existing authorities it may well be doubted whether the holder of a power who has no beneficial interest in its exercise may renounce it,[41] and such a holder might easily be

[40] This is virtually what the present Treasury Regulations seek to accomplish as now drawn. See note 21, supra.

[41] Chase Nat. Bank v. Chicago Title & Trust Co., 271 N. Y. 602, 3 N. E. (2d) 205 (1936); Matter of Matthews' Will, 255 App. Div. 80, 5 N. Y. S. (2d) 707 (1938); Columbia Trust Co. v. Christopher, 133 Ky. 335, 117 S. W. 943 (1909); Thorington v. Thorington, 82 Ala. 489, 1 So. 716 (1887); Grosvenor v. Bowen, 15

designated without his knowing it, or even against his will.

These are only a few of many considerations involved in the taxation of property and the income of property which is subject to a power. Before we indulge in any sweeping changes in our taxing acts relative to powers of appointment, the problems involved should be carefully considered and fully weighed. Any superficial or hasty treatment inevitably will lead to great injustice and abuse.

R. I. 549, 10 A. 589 (1887); Atkinson v. Dowling, 33 S. C. 414, 12 S. E. 93 (1890); Baker v. Wilmert, 288 Ill. 434, 123 N. E. 627 (1919); Lyon v. Alexander, 304 Pa. 288, 156 A. 84 (1931); Saul v. Pattinson, 55 L. J. (Ch.) 831 (1886); In re Dunne's Trust, L. R. 1 Irish 516 (1878); Eyre v. Eyre, 49 L. T. 259 (Ch. Div. 1883); Gray, "Release and Discharge of Powers," 24 HARV. L. REV. 511 at 516 (1911); 1 SIMES, FUTURE INTERESTS, § 281 (1936); 3 TIFFANY, REAL PROPERTY, 3d ed., § 708 (1939); annotation, 76 A. L. R. 1430 at 1437 et seq. (1932).