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ESTATE TAX CONSEQUENCES OF *INTER VIVOS* TRANSFERS OF STOCK IN A CLOSELY- HELD CORPORATION

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For purposes of determining the amount of the federal estate tax, a decedent's¹ gross estate² includes not only the value of all transmissible property interests beneficially owned by him at the time of his death,³ but also the value of all property gratuitously transferred by him during his lifetime, to the extent that such transfers are considered to be "testamentary dispositions."⁴ Generally speaking, an *inter vivos* transfer is treated by the Internal Revenue Code of 1954⁵ as a "testamentary disposition" if it was made "in contemplation of" the transferor's death,⁶ or if the transferee's "possession or enjoyment" of the property transferred or his interest therein is postponed until the death of the transferor.⁷ As transfers in contemplation of death

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1. For purposes of this article, a "decedent" is a deceased individual who was a citizen or resident of the United States at the time of his death.

2. The "gross estate" may be defined broadly as the totality of property interests enumerated, expressly or by implication, in INT. REV. CODE of 1954, §§ 2033-42. INT. REV. CODE of 1954, § 2031(a). A decedent's "gross estate" less certain allowable deductions and exemptions equals his "taxable estate," upon the transfer of which at his death the federal estate tax is imposed. INT. REV. CODE of 1954, §§ 2051, 2001.

3. INT. REV. CODE of 1954, § 2033; Treas. Reg. § 20.2033-1; C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES §§ 4.1, 4.8, 4.9 (2d ed. 1962).

4. See INT. REV. CODE of 1954, §§ 2035-38. See also INT. REV. CODE of 1954, §§ 2039, 2040, 2042. N.B. Since a transfer can be a "testamentary disposition," within the meaning of §§ 2035-38, only if, and to the extent that, it is not a "bona fide sale for an adequate and full consideration in money or money's worth," the word "transfer," as used in this article, shall be deemed to refer to a transfer which is not a "bona fide sale for an adequate and full consideration in money or money's worth," except as otherwise expressly indicated. *Id.* § 2035(a).

5. Hereinafter referred to in the text of this article as "the Code."

6. INT. REV. CODE of 1954, § 2035.

7. Such postponement occurs if (a) the transferor, in connection with the transfer, retains during his lifetime either (i) "the possession or enjoyment of, or the right to the income from, the property," INT. REV. CODE of 1954, § 2036(a)(1), or (ii) "the right . . . to designate the persons who shall possess or enjoy the property or the income therefrom," INT. REV. CODE of 1954, § 2036(a)(2), or (iii) "a reversionary interest in the property . . . and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property," INT. REV. CODE of 1954, § 2037(a)(2), and "possession or enjoyment of the property can, through ownership of such interest [the interest transferred], be

are outside the scope of this article, the term "testamentary disposition" hereafter will be used to refer only to transfers under which "possession or enjoyment" is postponed.

Ever since Congress introduced the "testamentary disposition" concept into the federal estate tax law,⁸ tax-conscious transferors have sought unceasingly for the "ideal" *inter vivos* transfer. The "ideal" *inter vivos* transfer is one which is not a testamentary disposition within the meaning of the Code, even though the transferor retains during his lifetime, or possesses at his death, sufficient interest in, or control over, the property transferred that, as a practical matter, the transferee's possession or enjoyment of the transferred property or his interest therein must await the transferor's death. Although this search has not been notably successful in the long run, some of its fruits presently approximate the ideal. One of these is the *inter vivos* transfer of stock in a closely-held corporation, under which the transferor attempts to reserve effective control over the transferred stock, directly or indirectly, by a means other than a retention of interest in, or control over, the transferred stock which clearly would render the transfer a "testamentary disposition." The purpose of this article is to determine the extent to which the treatment of this device as an ideal *inter vivos* transfer is justifiable.

A transfer of stock in a closely-held corporation may be absolute,⁹ or it may be qualified by the transferor's express or implied¹⁰ retention of rights, direct or indirect,¹¹ in or over the transferred stock. A prospective transferor of such stock who has a desire to retain rights in or over the transferred stock and an equally strong desire to avoid the inclusion of the transferred stock in his estate at his death, is confronted by a dilemma. The greater the degree to which he retains rights in or over the transferred stock, the greater becomes the risk that the transfer later will be characterized as a testamentary disposition. For example, the retention of an income¹² or reversionary¹³ interest

obtained only by surviving the decedent," INT. REV. CODE of 1954, § 2037(a)(1); or (b) the transferor, at the date of his death, can change the enjoyment of the interest(s) transferred by the exercise of a power to "alter, amend, revoke, or terminate," INT. REV. CODE of 1954, § 2038(a)(1).

8. By way of the Revenue Act of 1916, ch. 463, § 202(b), 39 Stat. 777, which defined the gross estate of a decedent to include the value of all transfers made by him during his lifetime "in contemplation of or intended to take effect in possession or enjoyment at or after his death." 39 Stat. at 778.

9. In the sense that it is not subject to any *express* retention of rights thereunder by the transferor.

10. An implied retention of rights under a transfer results from the transferor's failure to divest himself of such rights under or in connection with the transfer. *Helvering v. Mercantile-Commerce Bank & Trust Co.*, 111 F.2d 224 (8th Cir. 1940), *cert. denied*, 310 U.S. 654 (1940); *Estate of Skinner v. United States*, 197 F. Supp. 726 (E.D. Pa. 1961), *aff'd*, 316 F.2d 517 (3d Cir. 1963); *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6.

11. Rights in or over the transferred stock or interests therein are direct if in or over the transferred stock itself or interests therein, and are indirect if in or over the corporation as such, so as to be equivalent to rights in or over the transferred stock itself or interests therein. See *Estate of James Gilbert*, 14 T.C. 349 (1950); *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946).

12. INT. REV. CODE of 1954, § 2036(a)(1); Treas. Reg. § 20.2036-1.

13. As defined by INT. REV. CODE of 1954, § 2037(b), but only if "the value of such reversionary interest immediately before the death of the decedent exceeds 5

in the transferred stock, a general discretionary power¹⁴ "to alter, amend, revoke, or terminate"¹⁵ the transfer, in whole or in part, or specific discretionary powers to invade corpus¹⁶ or to distribute or accumulate income and add it to corpus¹⁷ clearly would render the transfer a testamentary disposition within the meaning of the Code.¹⁸ Conversely, the greater the degree to which he ensures avoiding a later characterization of the transfer as a testamentary disposition, the more completely he must forego the retention for his life of rights in or over the transferred stock.

The ideal *inter vivos* transfer of stock in a closely-held corporation is an attempt to resolve this dilemma, rather than an attempt merely to avoid one of its horns, at the cost of being impaled on the other. Such a transfer is understandably alluring because the rights retained, while they do not clearly render the transfer testamentary, seem to

percent of the value of [the transferred] property," INT. REV. CODE of 1954, § 2037 (a) (2), and "possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent," INT. REV. CODE of 1954, § 2037(a) (1). N.B. Even if the transferor's retention of a reversionary interest in the property transferred does not render the transfer a "testamentary disposition" by virtue of § 2037, the value of the reversionary interest still will be includible in the transferor's gross estate under § 2033, if such interest survives his death. Treas. Reg. § 20.2037-1(e), Ex. (1); C. LOWNDES & R. KRAMER, *supra* note 3, § 4.5.

14. For purposes of this article, a "discretionary power" is a power whose exercise is not controlled by external standards enforceable by a court having equity jurisdiction.

15. INT. REV. CODE of 1954, § 2038(a) (1); INT. REV. CODE of 1954, § 2036(a) (2), if the retained power enables the transferor "to designate the persons who shall possess or enjoy the [transferred] property or the income therefrom."

16. Retention by the transferor of a discretionary power to invade corpus renders the transfer a "testamentary disposition" under (a) §§ 2036(a) (2) and 2038, (i) if the power is to be exercised for the benefit of one who is neither an income beneficiary nor a remainderman under the transfer [3 J. MERTENS, THE LAW OF FEDERAL GIFT AND ESTATE TAXATION § 24.34, at 564-65 & n.93 (1959); W. WARREN & S. SURREY, FEDERAL ESTATE AND GIFT TAXATION, CASES AND MATERIALS 260, 262-63 (1961)], or (ii) if the power is to be exercised for the benefit of the remainderman, and the income beneficiary and the remainderman are different persons [C. LOWNDES & R. KRAMER, *supra* note 3, § 8.19, at 155 (discussing INT. REV. CODE of 1954, § 2036(a) (2)); see *Lober v. United States*, 346 U.S. 335 (1953) (applying INT. REV. CODE of 1954, § 2038)]; and (b) § 2038 (but probably not § 2036(a) (2)), if the power is to be exercised for the benefit of the income beneficiary, regardless of whether the income beneficiary and the remainderman are the same person or are different persons [*Lober v. United States*, *supra* (applying INT. REV. CODE of 1954, § 2038); C. LOWNDES & R. KRAMER, *supra* note 3, § 8.19, at 155-56 and § 9.13, at 186; 3 J. MERTENS, *supra*, § 24.33, at 551-52 and § 25.49, at 753-55].

17. Retention by the transferor of a discretionary power to either distribute or accumulate income and add it to corpus renders the transfer a "testamentary disposition" under §§ 2036(a) (2) and 2038, regardless of whether the income beneficiary and the remainderman are different persons [*Industrial Trust Co. v. Commissioner*, 165 F.2d 142 (1st Cir. 1947); *Estate of Cyrus C. Yawkey*, 12 T.C. 1164 (1949) (by implication), *acquiesced in*, 1949-2 CUM. BULL. 3], or the same person [*United States v. O'Malley*, 383 U.S. 627 (1966); *Joy v. United States*, 404 F.2d 419 (6th Cir. 1968), *aff'd and remanding* 272 F. Supp. 544 (E.D. Mich. 1967)]; Treas. Reg. § 20.2038-1(a). See also the following cases in which the transferor retained both a power to accumulate or distribute income and a power to invade corpus for the benefit of the income beneficiary: *Lober v. United States*, 346 U.S. 335 (1953); *Struthers v. Kelm*, 218 F.2d 810 (8th Cir. 1955); *Ritter v. United States*, 297 F. Supp. 1259 (S.D.W. Va. 1968); *Estate of Russell Harrison Varian*, 47 T.C. 34 (1966), *aff'd*, 396 F.2d 753 (9th Cir. 1968), *cert. denied*, 393 U.S. 962 (1968)].

18. This article will not discuss, as such, *inter vivos* transfers of closely-held corporate stock under which the transferor retains rights whose retention clearly renders the transfer a "testamentary disposition."

promise the transferor considerable ability to control until his death his transferee's complete possession or enjoyment of the transferred stock. Rights in this category are rights in or over the corporation whose stock is transferred¹⁹ and certain rights in or over the transferred stock itself.²⁰

19. An *inter vivos* transfer of closely held corporate stock which is qualified *only* by the transferor's *implied* retention thereunder, and/or possession at his death, of rights in or over the corporation as such appears *not* to be a "testamentary disposition" within the meaning of the Code, irrespective of whether it is outright or in trust. Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6 (managerial powers as president and director of the corporation were the rights over the corporation impliedly retained by the transferor under transfers in trust; §§ 2036(a)(1), (2) held to be inapplicable, on the grounds that the transferor did not retain voting control of the corporation, and the transferees were absolutely free to dispose of the transferred stock, the managerial powers of the transferor not being referred to); Estate of C. Dudley Wilson, 13 T.C. 869 (1949), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951) (noncontrolling beneficial interest in other stock of the corporation, and managerial powers as officer of the corporation, were the rights over the corporation impliedly retained by the transferor under transfers both outright and in trust; Int. Rev. Code of 1939, ch. 3, §§ 811(c), (d), 53 Stat. 120 [hereinafter cited in footnotes as INT. REV. CODE of 1939 and in text as the 1939 Code] (reenacted without substantial change as INT. REV. CODE of 1954, §§ 2036(a)(2), 2037, 2038), held to be inapplicable); Estate of Alexander K. Sessoms, 8 CCH Tax Ct. Mem. 1056 (1949) (managerial power as president of the corporation was the right over the corporation impliedly retained by the transferor under transfer in trust; Int. Rev. Code of 1939, §§ 811(c), (d) (reenacted without substantial change as INT. REV. CODE of 1954, §§ 2037, 2038), and the "Clifford doctrine" which would have required inclusion of the transferred property in the gross estate under Int. Rev. Code of 1939, § 811(a) (reenacted without substantial change as INT. REV. CODE of 1954, § 2033), held to be inapplicable); Estate of George H. Burr, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946) (beneficial ownership of an option to acquire a controlling voting stock interest in the corporation, and of indebtedness of the corporation, were the rights over the corporation impliedly retained by the transferor under outright transfers; Int. Rev. Code of 1939, §§ 811(c), (d) (reenacted without substantial change as INT. REV. CODE of 1954, §§ 2036(a)(1), (2), 2037, 2038), held to be inapplicable, the court implying that the result would have been the same had the transferor in fact owned the controlling voting stock interest in the corporation after the transfer). *Cf., e.g.,* Estate of Maxcy v. Commissioner, 71-1 U.S. Tax Cas. ¶ 12,765 (5th Cir. Apr. 13, 1971), *rev'g* 28 CCH Tax Ct. Mem. 783 (1969) (beneficial ownership of other stock in the corporation, and corporate managerial powers as an officer and director of the corporation, were the rights over the corporation impliedly retained by the transferor under an outright transfer; INT. REV. CODE of 1954, § 2033, held inapplicable); *Rosen v. Commissioner*, 397 F.2d 245 (4th Cir. 1968), *rev'g* 48 T.C. 834 (1967), *nonacquiesced in*, Rev. Rul. 69-344, 1969-1 CUM. BULL. 225 (beneficial ownership of controlling voting stock interest in the corporation and managerial powers as directors of the corporation were the rights over the corporation impliedly retained by the transferors; transfers in trust of the closely-held corporate stock were held to be completed gifts of both the income and principal interests therein, and the transferors were held to be entitled to use of the "annual per donee exclusion" under § 2503(b) in computing the taxable value of the gifts of the income interests, despite the fact that the corporation never had paid dividends); *Gardner v. Delaney*, 103 F. Supp. 610 (D. Mass. 1952), *aff'd on this point and vacated and remanded on other grounds*, 204 F.2d 855 (1st Cir. 1953) (property transferred outright to closely-held non-stock membership corporation by one who was incorporator, member and director of corporation; membership in corporation and managerial powers as director were the rights over the corporation impliedly retained by the transferor; Int. Rev. Code of 1939, §§ 811(c), (d) (reenacted without substantial change as INT. REV. CODE of 1954, §§ 2036(a)(1), (a)(2), 2038), held inapplicable). *But cf. Landorf v. United States*, 408 F.2d 461 (Ct. Cl. 1969) (group life insurance policy irrevocably assigned by one who was an officer, and who owned fifty percent of the voting stock of the corporation to which the master group life insurance policy was issued; INT. REV. CODE of 1954, § 2042(2), held to be inapplicable, although the court implied that § 2042(2) would apply, on the theory that the transferor retained "incidents of ownership" in the assigned

Rights retained in or over the corporation as such consist of beneficial ownership of other of its stock, its corporate indebtedness or an option to acquire other stock. They also may consist of managerial powers over the corporation by reason of the transferor's position as an officer or director. However, only if the holder of one or more of these rights is thereby in a position to control the value of the transferred stock or the amount of dividends paid thereon are such retained rights equivalent to rights in or over the transferred stock itself.²¹ Consequently, only a transferor who, after the transfer of some of his stock, has a controlling²² voting stock interest in the corporation possesses

policy, "if the corporation is wholly-owned or if it is proved that a particular stockholder has control over a sufficient number of other stockholders to effectuate a cancellation [of the master policy] at his will." 408 F.2d at 471.); Elise McK. Morgan, 42 T.C. 1080 (1964), *aff'd per curiam*, 353 F.2d 209 (4th Cir. 1965), *cert. denied*, 384 U.S. 918 (1966), *acquiesced in*, 1966-2 CUM. BULL. 6, holding that the owners of a controlling voting stock interest in a closely-held corporation were not entitled to an income tax deduction or a gift tax deduction or exclusion for transfers in trust of non-voting stock in the corporation, a twenty-year income interest in the trust being payable to charity, since the donors could at any time deny the income to the charity by refraining from declaring dividends; Rev. Rul. 71-463, 1971 INT. REV. BULL. No. 42, at 25, holding that life insurance proceeds paid to a closely-held corporation upon the death of its president-controlling stockholder are includible in the decedent's gross estate under § 2042(2), since the decedent possessed "incidents of ownership" in the policy by virtue of his control, as majority stockholder, over its economic benefits. The Ruling cited Treas. Reg. § 20.2042-1(c)(2), *approved in* Cockrill v. O'Hara, 302 F. Supp. 1365 (M.D. Tenn. 1969). An *inter vivos* transfer of closely-held corporate stock which is qualified *only* by the transferor's *express* retention thereunder, and/or possession at his death, of rights in or over the corporation as such, likewise appears *not* to be a "testamentary disposition" within the meaning of the Code. Estate of William L. Belknap, 10 CCH Tax Ct. Mem. 769 (1951). *Cf.* Estate of Meyer Goldberg, 10 CCH Tax Ct. Mem. 977 (1951).

20. See notes 188-261 *infra* and accompanying text.

21. See Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; Estate of James Gilbert, 14 T.C. 349 (1950); Estate of C. Dudley Wilson, 13 T.C. 869 (1949), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951); Estate of George H. Burr, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946). *Cf.* Landorf v. United States, 408 F.2d 461 (Ct. Cl. 1969); Yeazel v. Coyle, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); Reeves' Estate v. Commissioner, 180 F.2d 829 (2d Cir. 1950), *cert. denied*, 340 U.S. 813 (1950). See also Estate of William L. Belknap, 10 CCH Tax Ct. Mem. 769 (1951). *But see* Byrum v. United States, 440 F.2d 949 (6th Cir. 1971), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971), holding, *inter alia*, that voting control of a corporation is not equivalent to a right in or over the transferred stock itself or interests therein; Gardner v. Delaney, 103 F. Supp. 610 (D. Mass. 1952), *aff'd on this point and vacated and remanded on other grounds*, 204 F.2d 855 (1st Cir. 1953), and Estate of William F. Hofford, 4 T.C. 790, *modifying* 4 T.C. 542 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8, implying that corporate managerial powers cannot in any event be equivalent to a right in or over the transferred stock itself or interests therein. Rights in or over the corporation which are equivalent to rights in or over the transferred stock itself are indirect rights in or over the transferred stock. Note 11 *supra*.

22. For purposes of this article, the terms "voting control" and "controlling voting stock interest" mean the right to vote more than fifty percent of the voting stock of the corporation. The estate tax consequences of effective voting control, through the right to vote fifty percent or less of the corporate voting stock, is not considered here. While effective voting control, as distinguished from legal voting control, might not be deemed a § 2036(a)(2) or § 2038 power in any event [see Landorf v. United States, 408 F.2d 461 (Ct. Cl. 1969); Rev. Rul. 71-463, 1971 INT. REV. BULL. No. 42, at 25], it should be deemed such a power. There is little real difference, for tax purposes, between legal voting control and effective voting control. N.B. There is no attribution doctrine in the estate tax area.

rights equivalent to rights in or over the transferred stock itself.²³ This is so because, as a practical matter, only he is in a position ultimately to direct corporate policy affecting the value of the transferred stock and the dividends paid thereon.

More obvious in its effects, yet not clearly testamentary, is the retention of certain rights in or over the transferred stock itself. These rights consist of powers, exercisable in either a fiduciary or nonfiduciary capacity, to vote the transferred stock or to control its disposition.²⁴ They may also consist of administrative powers over the transferred stock, exercisable only in a fiduciary capacity, including but not limited to the power to allocate receipts between income and corpus.²⁵

While the control over the transferred stock afforded the transferor by his retention of one or more of the above rights can be considerable, the courts have been hesitant to characterize a transfer involving the retention of such rights as a testamentary disposition.²⁶ This judicial reluctance has been based on one or more of the following theories: (1) an implied retention of rights in or over the corporation as such is not a *retention under the transfer* of rights in or over the transferred stock within the meaning of section 2036 or section 2037 of the Code or their progenitors;²⁷ (2) rights in or over the corporation as such are not in any event within any of the classes of rights in or over the transferred stock itself described in sections 2036-38 of the Code and their progenitors,²⁸ or alternatively, cannot come within any of such classes of rights unless, at the very least, the transferred stock is unmarketable or its disposition is subject to control by the transferor;²⁹ (3) the exercise of the powers afforded the transferor by his retention

23. See *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; *Estate of James Gilbert*, 14 T.C. 349 (1950); *Estate of C. Dudley Wilson*, 13 T.C. 869 (1949), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951); *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946); Rev. Rul. 67-54, 1967-1 CUM. BULL. 269. Cf. *Delaney v. Gardner*, 204 F.2d 855 (1st Cir. 1953), *aff'g in part and vacating and remanding in part* 103 F. Supp. 610 (D. Mass. 1952); *Reeves' Estate v. Commissioner*, 180 F. 2d 829 (2d Cir. 1950), *cert. denied*, 340 U.S. 813 (1950); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Landorf v. United States*, 408 F.2d 461 (Ct. Cl. 1969).

24. Discussed *infra* pp. 221-34.

25. *Id.*

26. Cases cited in note 19 *supra*; notes 106-261 *infra* and accompanying text.

27. *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946). Cf. *Gardner v. Delaney*, 103 F. Supp. 610 (D. Mass. 1952), *aff'd in part and vacated and remanded in part*, 204 F.2d 855 (1st Cir. 1953).

28. *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946). See *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971). Cf. *Gardner v. Delaney*, 103 F. Supp. 610 (D. Mass. 1952), *aff'd in part and vacated and remanded in part*, 204 F.2d 855 (1st Cir. 1953); *Estate of William F. Hofford*, 4 T.C. 790, *modifying* 4 T.C. 542 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8.

29. *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6. See *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); Rev. Rul. 67-54, 1967-1 CUM. BULL. 269. Cf. *Rosen v. Commissioner*, 397 F.2d 245 (4th Cir. 1968), *rev'g* 48 T.C. 834 (1967), *non-acquiesced in*, Rev. Rul. 69-344, 1969-1 CUM. BULL. 225; *Richard P. Makoff*, 26 CCH Tax Ct. Mem. 83 (1967); *Estate of James Gilbert*, 14 T.C. 349 (1950). See also *Estate of William L. Belknap*, 10 CCH Tax Ct. Mem. 769 (1951).

of rights in or over the corporation or in or over the transferred stock itself is controlled by external standards enforceable by a court of equity and, therefore, is nondiscretionary in the hands of the transferor.³⁰ The discussion to follow will treat these issues by analyzing the cases in which they have arisen, examining closely the authoritative value of their conclusions and the merit of their reasoning.

I. RETENTION UNDER THE TRANSFER

In *Estate of George H. Burr*,³¹ the only case which actually decided this point, the Tax Court held that the transferor's implied retention of rights in or over the corporation as such was not a *retention under the transfer* of rights in or over the transferred stock within the meaning of a predecessor of section 2036 of the Code,³² for the reason that "[s]uch potential powers as the decedent had to obtain stock control of Monide, Ltd., were acquired in a transaction with the corporation [an option granted to him prior to his making the transfers in question] and, accordingly, were not reserved by him in the transfers in question."³³ Similarly, in *Gardner v. Delaney*,³⁴ the federal district court held that a person who transferred property to a closely-held non-stock membership corporation, of which she then was a member and director, did not *retain under the transfer* any rights in or over the transferred property, since "[a]ny indirect interest [in such property] she may thereafter have had, arose not from the transfer but solely from her membership in a previously existing corporation and from the charter and by-laws defining the rights of such members."³⁵ These decisions, however, are not in accord with the now prevailing view that section 2036 of the Code "applies not only where the reservation of rights or control over the property is expressed in the instrument of transfer but also where the right is retained in connection with, or as an incident to, the transfer,"³⁶ or its corollary, that a transferor retains a right under a transfer if he does not thereby surrender such right.³⁷ Consequently, assuming that rights in or over the corporation

30. See notes 134-261 *infra* and accompanying text.

31. 4 CCH Tax Ct. Mem. 1054, *petition for review dismissed* (2d Cir. Dec. 18, 1946).

32. Int. Rev. Code of 1939, § 811 (c).

33. Estate of George H. Burr, 4 CCH Tax Ct. Mem. 1054, 1064 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946).

34. 103 F. Supp. 610 (D. Mass. 1952), *aff'd in part and vacated and remanded in part*, 204 F.2d 855 (1st Cir. 1953).

35. 103 F. Supp. at 616.

36. Estate of Harry H. Beckwith, 55 T.C. 242, CCH 1970 TAX CT. REP. (55 T.C.) Dec. No. 30,401, at 3462 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6, *citing* Estate of McNichol v. Commissioner, 265 F.2d 667 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959).

37. Estate of Spiegel v. Commissioner, 335 U.S. 701, 705 (1949); *Helvering v. Mercantile-Commerce Bank & Trust Co.*, 111 F.2d 224 (8th Cir. 1940), *cert. denied*, 310 U.S. 654 (1940) (the court stating, "we think the words 'retained the right to the income' [as used in the Revenue Act of 1926, ch. 27 § 302(c), 44 Stat. 70 [hereinafter cited as Revenue Act of 1926] (as amended, INT. REV. CODE of 1954, § 2036)] are used in the context to mean the opposite of 'surrender the right to the income,'" 111 F.2d at 226); Estate of Skinner v. United States, 197 F. Supp. 726 (E.D. Pa. 1961), *aff'd*, 316 F.2d 517 (3d Cir. 1963) (the court stating, "[s]ection 811(c)(1)(B)(i) [of Int. Rev. Code of 1939 (now INT. REV. CODE of 1954, §

as such are held to be within a class of rights in or over the transferred stock itself described in sections 2036-38, their implied retention undoubtedly will be held to be a retention under the transfer of indirect rights in or over the transferred stock within the meaning of at least section 2036 of the Code.³⁸

II. RETENTION OF VOTING CONTROL OF THE CORPORATION: A RETENTION OF RIGHTS IN OR OVER THE TRANSFERRED STOCK WITHIN THE MEANING OF SECTIONS 2036-38

The question of whether rights in or over the corporation as such should be classified as rights in or over the transferred stock itself, such as would bring the transfer within the scope of any one or more of sections 2036-38 of the Code, is not as easy to resolve. The answer in part depends on whether the holder of rights in or over the corporation has voting control of the corporation. As previously indicated,³⁹ only rights in or over the corporation as such which arise from the retention of a controlling voting stock interest are important to this discussion, for only they are indirect rights in or over the transferred stock.⁴⁰ Other rights in or over the corporation are not in any sense rights in or over the transferred stock itself, because they do not enable their holders ultimately to control the value of the transferred stock or dividends paid thereon.⁴¹ Consequently, they cannot be considered rights in or over the transferred stock within the meaning of sections 2036-38.⁴² Of course, it could be argued that retention of

2036(a)(1)] says that enjoyment must be 'retained' by the settlor. The word 'retained' implies that the settlor has not given something away at the time he signed the trust agreement," 197 F. Supp. at 729; Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6. Cf. Estate of McNichol v. Commissioner, 265 F.2d 667 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959), *distinguishing on its facts* Estate of George H. Burr, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946); Reeves' Estate v. Commissioner, 180 F.2d 829 (2d Cir. 1950), *cert. denied*, 340 U.S. 813 (1950).

38. See Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; Rev. Rul. 67-54, 1967-1 CUM. BULL. 269.

39. Cases cited in notes 21 & 23 *supra* and text accompanying notes 21-23.

40. Note 11 *supra*.

41. See cases cited in notes 21 & 23 *supra* and accompanying text.

42. See *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; Estate of George H. Burr, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946). Cf. *Lober v. United States*, 346 U.S. 335 (1953); *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929); Estate of Stewart v. Commissioner, 436 F.2d 1281 (3d Cir. 1971), *rev'g* 52 T.C. 830 (1969), *cert. denied*, 40 U.S.L.W. 3162 (U.S. Oct. 12, 1971); *State St. Trust Co. v. United States*, 263 F.2d 635 (1st Cir. 1959); *Delaney v. Gardner*, 204 F.2d 855 (1st Cir. 1953), *aff'g in part and vacating and remanding in part* 103 F. Supp. 610 (D. Mass. 1952); Estate of Edward E. Ford, 53 T.C. 114 (1969), *aff'd per curiam*, 71-2 U.S. Tax Cas. ¶ 12,813 (2d Cir. Nov. 12, 1971); Estate of John J. Round, 40 T.C. 970 (1963), *aff'd*, 332 F.2d 590 (1st Cir. 1964); Estate of Milton J. Budlong, 7 T.C. 756 (1946), *aff'd on this point and rev'd and remanded in part sub nom. Industrial Trust Co. v. Commissioner*, 165 F.2d 142 (1st Cir. 1947). N.B. Although four cases, from their facts, can be said to hold that a transferor's implied retention of rights in or over a closely-held corporation as such does not, of itself, require his transfer of stock therein to be characterized as a "testamentary disposition," one of them, Estate of George H. Burr, *supra*, involved an implied retention of indirect rights in or over the transferred stock or

a controlling voting stock interest in the corporation is not essential to application of section 2036(a)(2) or section 2038. A literal interpretation of these sections would encompass rights in or over the corporation held by one who does not have voting control of the corporation since these sections apply to rights over the transferred property which are exercisable "only in conjunction with another person or persons, whether or not having an adverse interest."⁴³ Although such a view would be consistent with the letter of the statute,⁴⁴ assuming that indirect rights over the transferred stock are deemed to be within the scope of sections 2036(a)(2) and 2038, the courts probably will not so hold, at least in the foreseeable future. Such a holding, it would be argued, would not be consistent with the spirit of the statute, since "[i]f the Government's argument were carried to its logical conclusion, the donor of the stock in a closely-held corporation would be required to divorce himself of all remaining interest in the corporation in order to make his gift effective for tax purposes. The sweep of section 2036(a) is not that broad."⁴⁵

interests therein. The others, Estate of Harry H. Beckwith, *supra*; Estate of C. Dudley Wilson, 13 T.C. 869 (1949), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951); and Estate of Alexander K. Sessoms, 8 CCH Tax Ct. Mem. 1056 (1949), while involving an implied retention of rights in or over the corporation as such which were not indirect rights in or over the transferred stock or interests therein [see note 19 *supra*], either gave no reason for expressly holding that such retention does not, of itself, require the transfer to be characterized as a "testamentary disposition" [Estate of C. Dudley Wilson, *supra*], or so held by implication [Estate of Harry H. Beckwith and Estate of Alexander K. Sessoms, *supra*].

43. Treas. Reg. §§ 20.2036-1(b)(3)(i), 20.2038-1(a)(ii) (interpreting INT. REV. CODE of 1954, §§ 2036(a)(2), 2038, respectively).

44. INT. REV. CODE of 1954, § 2036(a), which provides, in part, "The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer . . . under which he has retained . . . (2) the right, either alone or *in conjunction with any person*, to designate the persons who shall possess or enjoy the property or the income therefrom" (emphasis added), and § 2038(a), which provides, in part, "[t]he value of the gross estate shall include the value of all property — (1) . . . [t]o the extent of any interest therein of which the decedent has at any time made a transfer . . . where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power . . . by the decedent alone or by the decedent *in conjunction with any other person* . . . to alter, amend, revoke, or terminate . . ." (emphasis added). See *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85 (1935), holding that the phrase "in conjunction with any person," as used in the Revenue Act of 1926, § 302(d) (now INT. REV. CODE of 1954, § 2038), includes a person or persons having a substantial adverse interest in the exercise of the power, as well as a person or persons having no such interest.

45. *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524, at 87,387 (N.D. Ill. 1968). *Accord*, *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971). *Cf.* *Landorf v. United States*, 408 F.2d 416 (Ct. Cl. 1969). *Contra*, *Howard v. United States*, 125 F.2d 986, 990 (5th Cir. 1942): "We have been cited to no authority, and we are aware of none, to the effect that the Revenue Act has no application to property otherwise subject to the tax because the taxpayer is powerless to deal therewith in a manner that will place it beyond the coverage of the Act." It also may be argued that the power of a holder of rights in or over a corporation as such to control the value of stock therein transferred by him, and the amount, if any, of dividends paid thereon, *if, but only if, he acts in concert with other holders of such rights*, is merely a power conferred upon him by state law, and therefore cannot be the basis of inclusion of the value of the transferred stock, or interests therein, in the transferor's gross estate, at least insofar as § 2038 is concerned. *Cf.* *Gardner v. Delaney*, 103 F. Supp. 610 (D. Mass. 1952), *aff'd on this point and vacated and remanded in part*, 204 F.2d 855 (1st Cir. 1953), *citing Helvering v.*

Of the few cases⁴⁶ which can be said to hold that a transferor's implied retention of rights in or over a corporation as such does not require his transfer of stock to be characterized as a testamentary disposition, *Estate of George H. Burr*⁴⁷ is the only one in which the rights retained included voting control and thus were in fact indirect rights in or over the transferred stock.⁴⁸ In *Burr*, the decedent caused the formation of a Canadian corporation with an authorized capital of 20,000 shares of Class A voting stock, none of which ever was issued, and of 70,000 shares of Class B voting stock. Almost immediately thereafter he obtained, in exchange for property transferred to the corporation, corporate promissory notes in a principal amount in excess of \$2,000,000 and the issuance to his nominee of approximately 9,000 shares of the Class B voting stock. On the same day, 400 shares of the Class B voting stock were issued to his secretary, and an option to purchase the remaining authorized but unissued 60,600 shares of Class B voting stock was granted him by the corporation. Five months later, he made outright gratuitous transfers to members of his family, friends, and charitable organizations of all of the shares of Class B voting stock previously issued to his nominee. A little over a year later he exercised his option in part, purchasing another 1,100 shares of the Class B voting stock, all of which he promptly transferred by gift to members of his family and friends (300 shares outright and 800 shares to two trusts in which he had no interest, over which he had no power, and of which he was not a fiduciary). He died eight months later, still owning corporate promissory notes in the face amount of \$830,000 and possessing the power to acquire a controlling voting stock interest in the corporation by virtue of his option to

Helmholz, 296 U.S. 93 (1935), and Treas. Reg. 105, § 81.20 (now Treas. Reg. § 20.2038-1(a)(2)). This argument, however, should not, and in all probability will not, be accepted. See *Howard v. United States*, 125 F.2d 986 (5th Cir. 1942), which held that the value of an *inter vivos* gift by one spouse to the other was includible in the transferor's gross estate under § 302(d)(1) of the Revenue Act of 1926 (now INT. REV. CODE OF 1954, § 2038), on the theory that the transfer was a revocable one within the meaning of this statute, even though the transfer was revocable solely by virtue of a Louisiana statute which provided that all gifts made between husband and wife during the marriage always shall be revocable by the donor, distinguishing *Helvering v. Helmholz*, *supra*, on the ground that the power involved in the *Helmholz* case not only was vested in the transferor by state law, but also was exercisable by him only in conjunction with all persons having an interest in the transferred property. *Accord*, *Vaccaro v. United States*, 149 F.2d 1014 (5th Cir. 1945).

46. *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; *Estate of C. Dudley Wilson*, 13 T.C. 869 (1949), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951), *Estate of Alexander K. Sessoms*, 8 CCH Tax Ct. Mem. 1056 (1949); *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946).

47. 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946).

48. *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; *Estate of C. Dudley Wilson*, 13 T.C. 869 (1949), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951); and *Estate of Alexander K. Sessoms*, 8 CCH Tax Ct. Mem. 1056 (1949) in fact involved only an implied retention of rights in or over the corporation as such which were not indirect rights in or over the transferred stock or interests therein [see notes 19 & 42 *supra*], although *Estate of Harry H. Beckwith*, *supra*, discussed the implied retention of indirect rights in or over the transferred stock or interest therein.

purchase the remaining 59,500 authorized but unissued shares of the Class B voting stock. A deficiency in estate tax was determined on the ground, *inter alia*, that the value of all of the Class B voting stock transferred by decedent to his family and friends was includible in his gross estate. The Government's contention was that, by reason of his retention of ownership of indebtedness of the corporation and of an option to purchase a controlling voting stock interest therein, the transfers were "intended to take effect in possession or enjoyment at or after death";⁴⁹ the transferred stock was subject to the decedent's retained "right, either alone or in conjunction with any person to designate the persons who shall possess or enjoy the property or the income";⁵⁰ and the enjoyment of the transferred stock "was subject at the date of his death to any change through the exercise of a power . . . to alter, amend, revoke or terminate."⁵¹ As noted earlier, the Tax Court held that no part of the value of the transferred stock was includible in the decedent's gross estate, on the theory that the retention was not "under the transfer."⁵² The court, however, did not rely on this theory alone. It also apparently based its decision on the theory that rights in or over the corporation as such are not in any event within *any* of the classes of rights in or over the transferred stock described in sections 811(c) and (d) of the Internal Revenue Code of 1939.⁵³ On this point the court stated:

Obviously, such power [voting stock control of the corporation] would not entail revocation of the transfers. We do not think such power otherwise fills the requirements of the language of section 811(c) and (d), or warrants inclusion in the estate of the entire stock interest transferred, as here urged. The same is true of the power through ownership of notes. The language of the controlling section should not be extended so far. Petitioner's economic interest in the stock passed beyond recall when the transfers were made and, consequently, there was nothing to pass at the time of, or after, his death.⁵⁴

Insofar as *Burr* holds that a transferor's implied retention of indirect rights in or over the transferred stock does not, of itself, cause the transfer to be either one which is "intended to take effect in possession or enjoyment at or after his death"⁵⁵ or one "under which he has retained

49. 4 CCH Tax Ct. Mem. at 1062, paraphrasing that portion of Int. Rev. Code of 1939, § 811(c), which evolved into INT. REV. CODE of 1954, § 2037.

50. 4 CCH Tax Ct. Mem. at 1062, quoting, albeit slightly inaccurately, that portion of Int. Rev. Code of 1939, § 811(c), which thereafter was reenacted without substantial change as INT. REV. CODE of 1954, § 2036(a)(2).

51. 4 CCH Tax Ct. Mem. at 1062, quoting Int. Rev. Code of 1939, § 811(d)(1) (now INT. REV. CODE of 1954, § 2038(a)(1)).

52. See text accompanying notes 31-33 *supra*.

53. Now INT. REV. CODE of 1954, §§ 2036-38.

54. 4 CCH Tax Ct. Mem. at 1064.

55. Int. Rev. Code of 1939, § 811(c) (quoted portion evolved into INT. REV. CODE of 1954, § 2037).

. . . the possession or enjoyment of, or the right to the income from, the property" transferred,⁵⁶ it clearly is correct.

It seems to be well settled that a transfer is not "intended to take effect in possession or enjoyment at or after [the transferor's] death," within the meaning of section 811(c) of the 1939 Code and its predecessors, unless the transferor retains thereunder a beneficial interest in, or a beneficial power over, the transferred property which passes from him at his death.⁵⁷ By definition, however, indirect rights in or over the transferred stock fall in neither category.⁵⁸ Since the transferor's possession of indirect rights in or over the transferred stock, of itself, enables him only to control the value of the transferred stock and dividends paid thereon,⁵⁹ it does not give him any property interest in the transferred stock, nor does it enable him to use the transferred stock for his own benefit. As was stated by the Tax Court in *Burr*, "[p]etitioner's economic interest in the stock passed beyond recall when the transfers were made and, consequently, there was nothing to pass at the time of, or after, his death."⁶⁰ Consequently, a transferor's retention of indirect rights in or over the transferred stock cannot, of itself, render the transfer one which is "intended to take effect in possession or enjoyment at or after his death."⁶¹

56. Int. Rev. Code of 1939, § 811(c) (quoted portion subsequently reenacted without substantial change as INT. REV. CODE of 1954, § 2036(a)(1)). The Commissioner apparently did not assert, in the *Burr* case that the decedent, by retaining indirect rights in or over the stock transferred by him, to wit, corporate indebtedness and the power to obtain voting stock control of the corporation, "retained . . . the possession or enjoyment of, or the right to the income from, the [transferred] property," [Int. Rev. Code of 1939, § 811(c) (quoted portion reenacted without substantial change as INT. REV. CODE of 1954, § 2036(a)(1))]. It is not clear from the decision therein whether the Tax Court undertook to hold expressly that the decedent retained no such rights. However, the Tax Court did state that "[e]ven if the option had been exercised to the extent of obtaining stock control of the corporation, the powers thus acquired would not have . . . given him any right, alone or in conjunction with another, to possess the property transferred, i.e., the stock, or enjoy the income therefrom." 4 CCH Tax Ct. Mem. at 1064. In support of its decision, moreover, the Tax Court cited *Estate of William F. Hofford*, 4 T.C. 542, modified, 4 T.C. 790 (1945), acquiesced in and nonacquiesced in, 1945 CUM. BULL. 4, 8, which involved solely the question of whether the decedent therein "retained . . . the possession or enjoyment of, or the right to the income from, the property" transferred by him, within the meaning of Int. Rev. Code of 1939, § 811(c).

57. *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929).

58. Note 11 *supra* and cases cited therein; text accompanying notes 21-23 *supra*. See *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), cert. granted, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), acquiesced in, 1971 INT. REV. BULL. No. 9, at 6; *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), petition for review dismissed (2d Cir. Dec. 18, 1946).

59. *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), cert. granted, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), petition for review dismissed (2d Cir. Dec. 18, 1946). See *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), acquiesced in, 1971 INT. REV. BULL. No. 9, at 6.

60. 4 CCH Tax Ct. Mem. at 1064.

61. *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929); *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), petition for review dismissed (2d Cir. Dec. 18, 1946).

This conclusion, moreover, is not affected by changes in the above statutory language made in the course of its evolution into the present section 2037 of the Code. Like its predecessors, section 2037 requires, as a condition precedent to its applicability, that the transferor retain a "reversionary interest" in the property transferred.⁶² The term reversionary interest is defined by section 2037 to include "a possibility that property transferred by the decedent — (1) may return to him or his estate, or (2) may be subject to a power of disposition by him,"⁶³ and such power of disposition need not be beneficial in order to be a reversionary interest.⁶⁴ The statute further provides, however, that "such term [reversionary interest] does not include a possibility that the income alone from such property may return to him or become subject to a power of disposition by him."⁶⁵ Since indirect rights in or over the transferred stock are neither beneficial interests therein nor beneficial powers thereover,⁶⁶ they can be reversionary interests for purposes of section 2037(a)(2) only if they are considered to be nonbeneficial powers of disposition within the meaning of section 2037(b)(2) of the Code. Such indirect rights, however, consist at most of only the powers to control the value of the transferred stock and the dividends paid thereon.⁶⁷ The power to control the amount of dividends paid on the transferred stock, since it is equivalent to a power to accumulate or defer the income from the transferred property,⁶⁸ is a power of disposition over the income alone from such property.⁶⁹ Therefore, by the express language of the statute,⁷⁰ it is not a section 2037(b) reversionary interest. Arguably, however, retained voting control gives some power to control the value of the transferred stock itself, for example, by controlling business and investment policies. This power to affect the value of the transferred stock would appear not to be a section 2037(b)(2) power of disposition, either on the theory that it is analogous to a power in the grantor of a trust to direct the investment policy of the trustee, which generally has been held not to be a power to alter, amend, revoke, or terminate within the meaning of section 2038 of the Code,⁷¹ or on the theory that, even if it is analogous to a power in the grantor of a trust to make substitutions for the securities constituting its corpus,

62. INT. REV. CODE of 1954, § 2037(a)(2).

63. INT. REV. CODE of 1954, § 2037(b).

64. C. LOWNDES AND R. KRAMER, *supra* note 3, § 7.5, at 108-09; 3 J. MERTENS, *supra* note 16, § 23.32, at 419-20.

65. INT. REV. CODE of 1954, § 2037(b).

66. See note 11 *supra* and cases cited therein; text accompanying notes 21-23 *supra*; cases cited note 59 *supra* and accompanying text.

67. See text accompanying notes 21-23 *supra*; cases cited note 59 *supra* and accompanying text.

68. Cases cited notes 84-85 *infra* and accompanying text.

69. *Industrial Trust Co. v. Commissioner*, 165 F.2d 142 (1st Cir. 1947) and cases cited therein; 3 J. MERTENS, *supra* note 16, § 25.48.

70. INT. REV. CODE of 1954, § 2037(b), quoted in text accompanying note 65 *supra*.

71. *E.g.*, *Estate of George W. Hall*, 6 T.C. 933 (1946), *acquiesced in*, 1946-2 CUM. BULL. 3; *Estate of Henry S. Downe*, 2 T.C. 967 (1943), *petition for review dismissed nolle pros.* (2d Cir. June 1, 1944), *nonacquiesced in*, 1944 CUM. BULL. 37.

which is a section 2038 power if purely discretionary,⁷² it is removed from the scope of section 2037(b)(2) by the fact that it is held by the transferor in a fiduciary capacity.⁷³

Likewise, it appears to be firmly established that a transferor will be deemed to have retained "the possession or enjoyment of, or the right to the income from, the property" transferred, within the meaning of section 2036(a)(1) of the Code and its predecessors,⁷⁴ only if he has retained a "substantial present economic benefit"⁷⁵ from the property transferred, that is, the beneficial use thereof,⁷⁶ either in law or in fact.⁷⁷ A transferor's possession of indirect rights in or over the transferred stock of itself, however, gives him no property interest in the transferred stock, nor does it enable him to use the transferred stock for his own benefit.⁷⁸ As the Tax Court said in *Burr*, "[e]ven if the option had been exercised to the extent of obtaining stock control of the corporation, the powers thus acquired would not have . . . given him [the decedent-transferor] any right, alone or in conjunction with another, to possess the property transferred, i.e., the stock, or enjoy the income therefrom. . . . Petitioner's economic interest in the stock passed beyond recall when the transfers were made"⁷⁹ Thus, a retention of indirect rights in or over the transferred stock is not, in and of itself, a retention of "the possession or enjoyment of, or the right to the income from, the property" transferred, within the meaning of section 2036(a)(1) of the Code.⁸⁰

72. *Commonwealth Trust Co. v. Driscoll*, 50 F. Supp. 949 (W.D. Pa. 1943), *aff'd*, 137 F.2d 653 (3d Cir. 1943), *cert denied*, 321 U.S. 764 (1944).

73. See 3 J. MERTENS, *supra* note 16, § 23.33, at 427. Cf. *Byrum v. United States*, 440 F.2d 949 (6th Cir.), *cert granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Fifth Avenue Bank v. Nunan*, 59 F. Supp. 753 (E.D.N.Y. 1945); *Estate of Willard v. King*, 37 T.C. 973 (1962), *nonacquiesced in*, 1963-1 CUM. BULL. 5.

74. Including Int. Rev. Code of 1939, § 811(c).

75. *Estate of McNichol v. Commissioner*, 265 F.2d 667 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959), the court stating, in 265 F.2d at 671, that "[e]njoyment as used in the death tax statute is not a word of art but is synonymous with substantial present economic benefit"; *Byrum v. United States*, 311 F. Supp. 892, 894 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. Mar. 18, 1968). See *Estate of Cyrus C. Yawkey*, 12 T.C. 1164 (1949), *acquiesced in*, 1949-2 CUM. BULL. 3; *Estate of William F. Hofford*, 4 T.C. 790, *modifying* 4 T.C. 542 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8.

76. See cases cited note 75 *supra* and Treas. Reg. § 20.2036-1(b)(2).

77. *Estate of McNichol v. Commissioner*, 265 F.2d 667 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959); *Estate of Skinner v. United States*, 197 F. Supp. 726 (E.D. Pa. 1961), *aff'd*, 316 F.2d 517 (3d Cir. 1963).

78. See note 11 *supra* and cases cited therein; text accompanying notes 21-23 *supra*; cases cited note 59 *supra* and accompanying text.

79. 4 CCH Tax Ct. Mem. at 1064.

80. This conclusion is not determinative of the question [discussed in the text accompanying notes 188-209 *infra*] whether a transferor's retention of the right to vote the transferred stock is a retention of "the possession or enjoyment of, or the right to the income from, the property" transferred, within the meaning of § 2036(a)(1) of the Code. For, while a transferor's possession of indirect rights in or over the transferred stock presupposes his possession of a controlling voting stock interest in the corporation [cases cited notes 21-23 *supra* and accompanying text], such voting control, by definition, is not in any event *dependent* upon a power in him to vote the transferred stock, since such power would be a direct right thereover [note 11 *supra* and cases cited therein], and does not, in fact, involve a power in him to vote the transferred stock, when he possesses *only* indirect rights in or over such stock [note 11 *supra* and cases cited therein].

On the other hand, to the extent that *Burr* holds that a transferor's implied retention of indirect rights in or over the transferred stock does not of itself under any circumstances cause the transfer to be one "under which he has retained . . . 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,"⁸¹ or cause the enjoyment of any interest transferred to be "subject at the date of his death to any change through the exercise of a power . . . by the decedent alone or by the decedent in conjunction with any other person . . . to alter, amend, revoke, or terminate,"⁸² it would seem to be incorrect. The power to control the amount of dividends paid on the transferred stock, which is inherent in the transferor's possession of indirect rights in or over such stock,⁸³ involves the power to defer the payment of income therefrom.⁸⁴ It therefore is tantamount to a power to accumulate or distribute the income from the transferred property,⁸⁵ which, if discretionary, is "the right . . . to designate the persons who shall possess or enjoy the [transferred] property or the income therefrom," within the meaning of section 2036(a)(2) of the Code,⁸⁶ if retained by the transferor under the transfer. Furthermore, it is a power to alter or amend the enjoyment of the income interest in the trans-

81. Int. Rev. Code of 1939, § 811(c) (quoted portion subsequently reenacted without substantial change as INT. REV. CODE of 1954, § 2036(a)(2)).

82. Int. Rev. Code of 1939, § 811(d)(1) (now INT. REV. CODE of 1954, § 2038(a)(1)).

83. See notes 21-23 *supra* and accompanying text.

84. *Reeves' Estate v. Commissioner*, 180 F.2d 829 (2d Cir. 1950), *cert. denied*, 340 U.S. 813 (1950); *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; *Elise McK. Morgan*, 42 T.C. 1080 (1964), *aff'd per curiam*, 353 F.2d 209 (4th Cir. 1965), *cert. denied*, 384 U.S. 918 (1966), *acquiesced in*, 1966-2 CUM. BULL. 6; Rev. Rul. 67-54, 1967-1 CUM. BULL. 269. See *Estate of James Gilbert*, 14 T.C. 349 (1950). As the court stated in *Yeazel*, *supra* at 87,387, "by reason of retaining the voting rights, Mrs. Crowley remained in the position of controlling the dividend policy of the corporation and the distribution of income to the beneficiaries. . . . Mrs. Crowley could have prevented the corporation from paying a dividend . . ." And, according to Rev. Rul. 67-54, 1967-1 CUM. BULL. 269, 270, "[w]here a decedent transfers nonvoting stock in trust and holds for the remainder of his life voting stock giving him control over the dividend policy of the corporation, he has retained, for a period which did not in fact end before his death, the right to determine the income from the nonvoting stock." N.B. A transferor's possession of indirect rights in or over the transferred stock presupposes his possession of a controlling voting stock interest in the corporation. Cases cited notes 21 & 23 *supra* and accompanying text.

85. *United States v. O'Malley*, 383 U.S. 627 (1966); *Joy v. United States*, 404 F.2d 419 (6th Cir. 1968), *aff'g and remanding* 272 F. Supp. 544 (E.D. Mich. 1967). See *Lober v. United States*, 346 U.S. 335 (1953); *Struthers v. Kelm*, 218 F.2d 810 (8th Cir. 1955); *Ritter v. United States*, 297 F. Supp. 1259 (S.D.W. Va. 1968); *Estate of Russell Harrison Varian*, 47 T.C. 34 (1966), *aff'd*, 396 F.2d 753 (9th Cir. 1968), *cert. denied*, 393 U.S. 962 (1968). *Contra*, 3 J. MERTENS, *supra* note 16, § 24.28, at 534-36 & n.32 (1959 & Supp. 1969), and § 25.37, at 707-08 & n.28 (1959 & Supp. 1969).

86. *United States v. O'Malley*, 383 U.S. 627 (1966); *Joy v. United States*, 404 F.2d 419 (6th Cir. 1966), *aff'g and remanding* 272 F. Supp. 544 (E.D. Mich. 1967); *Industrial Trust Co. v. Commissioner*, 165 F.2d 142 (1st Cir. 1947); *Ritter v. United States*, 297 F. Supp. 1259 (S.D.W. Va. 1968); *Estate of Cyrus C. Yawkey*, 12 T.C. 1164 (1949), *acquiesced in*, 1949-2 CUM. BULL. 3. See *Struthers v. Kelm*, 218 F.2d 810 (8th Cir. 1955); *Estate of Russell Harrison Varian*, 47 T.C. 34 (1966), *aff'd*, 396 F.2d 753 (9th Cir. 1968), *cert. denied*, 393 U.S. 962 (1968).

ferred property within the meaning of section 2038, if exercisable by the transferor at the date of his death.⁸⁷ Consequently, a transferor's possession of indirect rights in or over the transferred stock should, at least under some circumstances, cause the inclusion of the entire value of the transferred stock⁸⁸ or, alternatively, only the value of the income interest in the transferred stock, in his gross estate under section 2036(a)(2) or section 2038(a)(1) of the Code, respectively.⁸⁹ This conclusion, moreover, is not affected by those cases which can be said to hold that the powers possessed by a transferor over the transferred stock solely by virtue of his retention of voting control of the corporation do not render the transfer subject to section 2036(a)(2)⁹⁰ or section 2038(a)(1)⁹¹ since, in view of the bases of decision therein, none of these cases should be deemed conclusive on either of these issues.

Burr, which was the first of these cases to be decided, did not even discuss the proposition that a transferor's retention of voting control of the corporation enables him to defer the payment of income from the transferred stock, and therefore brings the transfer within the scope of sections 2036(a)(2) and 2038(a)(1) of the Code. In fact, the Commissioner did not even argue it. Although the Commissioner "contended that through the decedent's ownership of notes of Monide, Ltd., he could control the payment of dividends, and thus retained the right to designate the persons who could possess or enjoy the stock transferred and the power to 'alter, amend, revoke or terminate,'" ⁹² his contention with respect to the decedent's option to purchase a controlling voting stock interest in the corporation was *only* that the decedent thereby

could obtain complete control over the corporation and by exercising such control completely destroy, or greatly diminish, the equity in the 8844 shares in controversy here by causing the corporation to pay his notes in full and prevent the other stockholders from selling their stock without his consent. . . . [and thus had] the power "to designate the persons who shall possess or enjoy the

87. *Industrial Trust Co. v. Commissioner*, 165 F.2d 142 (1st Cir. 1947); *Estate of Cyrus C. Yawkey*, 12 T.C. 1164 (1949), *acquiesced in*, 1949-2 CUM. BULL. 3. *See Lober v. United States*, 346 U.S. 335 (1953); *Joy v. United States*, 404 F.2d 419 (6th Cir. 1968), *aff'g and remanding* 272 F. Supp. 544 (E.D. Mich. 1967); *Struthers v. Kelm*, 218 F.2d 810 (8th Cir. 1955); *Estate of Russell Harrison Varian*, 47 T.C. 34 (1966), *aff'd*, 396 F.2d 753 (9th Cir. 1968), *cert. denied*, 393 U.S. 962 (1968).

88. *See Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; Rev. Rul. 67-54, 1967-1 CUM. BULL. 269.

89. § 2036(a)(2) of the Code normally would be utilized to the exclusion of § 2038(a)(1), if both are applicable to a particular transfer, since application of § 2036(a)(2) normally will result in the inclusion of a larger amount in the transferor's gross estate.

90. *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946).

91. *Estate of George H. Burr*, 4 CCH Tax Ct. Mem. 1054 (1945), *petition for review dismissed* (2d Cir. Dec. 18, 1946).

92. *Id.* at 1062.

property or the income therefrom," and to change the enjoyment, which constitutes a power "to alter, amend, revoke, or terminate."⁹³

Moreover, the Tax Court, in its decision, dealt only with the express contentions of the Commissioner, and then only in a compartmentalized manner.

More specifically, in holding that the decedent's retention of indebtedness of the corporation did not, of itself, render the transfers subject to either section 811(c)⁹⁴ or section 811(d)⁹⁵ of the 1939 Code, the Tax Court stated,

[s]uch powers in the donor were no more than the rights possessed by any creditor of a corporation and did not affect the finality of the gifts or the title the donees had in the stock, or deprive the donees of their rights, as stockholders, to dividends, when earnings were available and dividends were declared. The stock was received, subject to the charge of the notes as a liability of the corporation and any rights decedent saw fit to waive as a holder of the notes, instead of depriving the stockholders of any enjoyment, etc., operated to give the corporation extra income to pass on to them by way of dividends, and gave the stockholders additional rather than less enjoyment of the stock.⁹⁶

It is clear from this language that the court addressed itself here only to the Commissioner's argument that the decedent's retention of the corporation's indebtedness enabled him to control the payment of dividends.⁹⁷ In so doing, it ignored decedent's power to obtain a controlling voting stock interest in the corporation. Consequently, neither the court's holding on this point, nor the above-quoted reasoning on which it was based, is authority for the proposition that a transferor's retention of voting control of a corporation does not bring his transfers of its stock within the scope of section 2036(a)(2) or section 2038 of the Code. Rather, it is authority only for the proposition that ownership of indebtedness of a corporation by a transferor of stock therein does not, *of itself*, render the transfer subject to either section 2036(a)(2) or section 2038, since it enables the transferor to affect the enjoyment of the transferred stock only beneficially, to wit, by cancelling part or all of the indebtedness, thereby possibly increasing the corporate surplus available for distribution as dividends.⁹⁸

93. *Id.* at 1063.

94. Relevant portion reenacted without substantial change as INT. REV. CODE of 1954, § 2036(a)(2).

95. Now INT. REV. CODE of 1954, § 2038.

96. 4 CCH Tax Ct. Mem. at 1062-63.

97. See text accompanying note 92 *supra*.

98. This proposition appears to be correct. Corporate dividends generally are payable only out of earnings or surplus. H. BALLANTINE, BALLANTINE ON CORPORATIONS §§ 235, 239, 243-50 (rev. ed. 1946). Surplus "is the excess of the assets over the liabilities and capital stock of an enterprise." G. MACFARLAND & R. AYARS, ACCOUNTING FUNDAMENTALS 334 (1st ed. 1936). See H. BALLANTINE, *supra*, §§ 223, 224, 227a. Thus, enforcement of the payment of corporate indebtedness by the holder thereof cannot adversely affect the amount of corporate surplus technically available for the payment of dividends. Such surplus will be the same as it would have been had he not enforced such payment, since any decrease in the amount of cor-

Likewise, when the court did in fact consider decedent's power to obtain voting control of the corporation, and held that such power did not, of itself, bring the transfers within the scope of either section 811(c)⁹⁹ or section 811(d)¹⁰⁰ of the 1939 Code, it limited itself to a discussion solely of the Commissioner's contention that such power in the decedent rendered sections 811(c) and (d) of the 1939 Code applicable to the transfers because it enabled him to diminish, or even destroy, the value of the transferred stock.¹⁰¹ This is clear from the court's reasoning in support of its holding on this issue:

[e]ven if the option had been exercised to the extent of obtaining stock control of the corporation, the powers thus acquired would not have enabled the decedent to recall or modify in any way the terms of the transfers Moreover, it is clear that any exercise of a power, through exercise of the option, to secure approximately six-sevenths of the corporate stock . . . and so to . . . control the corporation, would be at most an indirect control over the stock, and would be only partial, merely affecting value. The transferees of the stock, as such, would remain owners, and entitled to at least a substantial interest in the stock. Obviously, such power would not entail revocation of the transfers.¹⁰²

Since such reasoning fails to take account of the fact that voting control of a corporation enables its holder to defer the payment of income from the stock,¹⁰³ it follows that the court's holding on this point cannot be regarded as conclusive. This is particularly true in light of the subsequent evolution of the doctrine that a discretionary power to accumulate or distribute income is both a right to designate

porate assets, due to their use to satisfy the indebtedness, is balanced by a corresponding decrease in the amount of such indebtedness. Moreover, although the holder of corporate indebtedness, by cancelling it gratuitously, possibly can beneficially affect the amount of corporate surplus technically available for the payment of dividends, since the resulting decrease in corporate indebtedness is not balanced by a corresponding decrease in the amount of corporate assets, the power to affect beneficially the enjoyment of a transferred income interest would appear not to bring the transfer within the scope of either § 2036(a)(2) or § 2038 of the Code. See *Central Trust Co. v. United States*, 167 F.2d 133 (6th Cir. 1948); 3 J. MERTENS, *supra* note 16, § 25.14.

99. Relevant portion reenacted without substantial change as INT. REV. CODE of 1954, § 2036(a)(2).

100. Now INT. REV. CODE of 1954, § 2038.

101. See text accompanying note 93 *supra*.

102. 4 CCH Tax Ct. Mem. at 1064. In addition, see the language used by the court in determining the value of the corporate notes owned by the decedent at his death:

. . . decedent . . . could at any time acquire legal control by reason of his option to acquire stock for a nominal price. Thus the decedent could, indirectly, by waiving interest, cancelling notes, and otherwise administering the financial transactions of the corporation, divert income to noteholders or stock holders at his pleasure. . . .

The decedent, by exercise of his option to gain control of the corporation through ownership of a large majority of its stock, could have brought about the liquidation of the corporation at any time prior to his death and in such manner obtained payment of his notes. (This would not enable him to recall or enjoy the stock he had previously transferred.)

Id. at 1066.

103. Cases cited note 84 *supra*.

within the meaning of section 2036(a)(2) of the Code,¹⁰⁴ and a power to alter or amend, within the meaning of section 2038.¹⁰⁵

*Yeazel v. Coyle*¹⁰⁶ and *Byrum v. United States*,¹⁰⁷ the other cases in this category, differ from *Burr* primarily in three respects. First, the transfers in question were made in trust, whereas in *Burr* they were outright.¹⁰⁸ Second, they involved an express retention of direct rights, as well as an implied retention of indirect rights, in or over the transferred stock, whereas *Burr* involved only an implied retention of indirect rights.¹⁰⁹ Third, the decisions therein, unlike that in *Burr*, expressly addressed themselves to the argument that a transferor's retention of voting control of the corporation whose stock he transfers renders section 2036(a)(2) of the Code applicable to the transfer, since it enables him to defer the payment of income from the transferred stock.

In *Yeazel*, the decedent was the sole stockholder, as well as the president, of a corporation prior to the transfers in question. In October, 1957, she created an irrevocable trust of approximately fifty-nine percent¹¹⁰ of the issued and outstanding stock of the corporation, for the benefit alone of four of her relatives. She made herself the sole trustee thereof and impliedly retained, until her death, the beneficial ownership of the remaining forty-one percent of the stock and the presidency of the corporation. In addition, she expressly retained, in her capacity as trustee, the right to vote the transferred stock, as well as other so-called administrative powers, such as the right to sell the stock and invest the proceeds. Consequently she retained the power to control the disposition of the transferred stock.¹¹¹ Under the terms of the trust, its entire net income was payable currently to the four named beneficiaries in equal shares. The entire principal of the trust was to be distributed to these beneficiaries in equal shares on December 30, 1967, a little more than ten years after the creation of the trust. Although the opinion in *Yeazel* did not expressly set forth the disposition to be made of the trust principal in the event that one or more of the named beneficiaries failed to survive the trust's termination, it would seem that the share of a predeceased named beneficiary was

104. Cases cited notes 85 & 86 *supra* and accompanying text.

105. Cases cited notes 85 & 87 *supra* and accompanying text.

106. 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968).

107. 440 F.2d 949 (6th Cir. 1971), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971).

108. The form of the transfer, *i.e.*, whether outright or in trust, is relevant only to the question of whether the retention of voting control alone has estate tax consequences. Cases cited notes 176-87 *infra* and accompanying text.

109. Neither the method by which, nor the capacity in which, voting control is retained should have any effect upon the estate tax consequences of such retention. Cases cited notes 188 *et seq. infra* and accompanying text.

110. 1,680 of the 2,850 issued and outstanding shares of stock of the corporation.

111. She did not, however, expressly retain, in any capacity, any other powers over the transferred stock; nor did she retain, either expressly or impliedly, any beneficial interest whatever therein, either direct or indirect.

As the court noted: "All of the income [from the trust] was to be paid to the named beneficiaries. The corpus of the trust was irrevocably earmarked for the four beneficiaries. The trust instrument explicitly stated that 'in no event shall the grantor herein share in the benefits or in any manner enjoy the principal of the trust estate or income arising therefrom.'" 68-1 U.S. Tax Cas. ¶ 12,524, at 87,386-87.

payable either to his estate or to the surviving named beneficiaries,¹¹² but probably the former.¹¹³ Decedent died in April, 1959. A deficiency in estate tax was determined, on the ground, *inter alia*, that the entire value of the stock transferred by decedent to herself as trustee was includible in her gross estate under section 2036(a) of the Code.¹¹⁴ More specifically, the Government contended that, "with her voting rights in her own stock as well as the stock held by her as trustee, this placed [the decedent] in the same voting position which she occupied before the trust agreement, with an ability to control the corporation, including the distribution of dividends."¹¹⁵ Accordingly, it was argued that she retained, for a period which did not in fact end before her death, "the possession or enjoyment of" the transferred stock, within the meaning of section 2036(a)(1) of the Code, and "the right . . . to designate the persons who shall possess or enjoy the [transferred] property or the income therefrom," within the meaning of section 2036(a)(2).

The district court held that no part of the value of the transferred stock was includible in the decedent's gross estate under either section 2036(a)(1) or section 2036(a)(2) of the Code.¹¹⁶ In support of its holding with respect to section 2036(a)(2),¹¹⁷ the court stated only that

[m]y attention is also called to *Rev. Rul. 67-54* . . . which I am urged to regard as stating that a grantor with control over both the dividend policy of a company and the assets of the trust is able to designate who benefits from the property or income. As applied to the facts of this case, however, *I cannot agree with this view of the statute since it is clear that only the four named beneficiaries can benefit from the stock.*¹¹⁸

Consequently, the court never in fact reached the specific question of whether the retention of voting control, either alone or in conjunction with a power to control the disposition of the transferred stock, is a section 2036(a)(2) "right . . . to designate the persons who shall possess or enjoy the property or the income therefrom." Rather, its reasoning was directed only to the general questions of whether a power can be a section 2036(a)(2) right to designate if the possible designees constitute a limited class, or if the income beneficiary and

112. According to the court, "[t]he corpus of the trust was irrevocably earmarked for the four beneficiaries," 68-1 U.S. Tax Cas. ¶ 12,524 at 87,386, and "only the four named beneficiaries can benefit from the stock." *Id.* at 87,387.

113. See the court's statement that "the beneficiaries were in a position to receive the economic benefit of the stock since they could use it as security for a loan which would provide them with cash until the end of the ten year period, at which time they would receive the stock itself." 68-1 U.S. Tax Cas. ¶ 12,524, at 87,387.

114. The Government also contended that the transfer was made "in contemplation of death," within the meaning of § 2035.

115. 68-1 U.S. Tax Cas. ¶ 12,524, at 87,386.

116. The court, however, also held that the entire value of the transferred stock was includible in the decedent's gross estate under § 2035 as a transfer "in contemplation of death."

117. The court's reasoning in support of its holding with respect to § 2036(a)(1) is discussed in note 199 *infra* and the accompanying text.

118. 68-1 U.S. Tax Cas. ¶ 12,524, at 87,387 (emphasis added).

the remainderman are the same person. Furthermore, to the extent that it answered these questions in the negative, the court in *Yeazel* was clearly incorrect for two reasons. First, since the decision in *Industrial Trust Co. v. Commissioner*,¹¹⁹ the prevailing doctrine has been that section 2036(a)(2) of the Code applies to a power restricted to choosing only among a limited class.¹²⁰ Second, it seems settled that section 2036(a)(2) applies to a power to accumulate income even if, due to the fact that the income beneficiary and the remainderman are the same person, the power is one to defer the payment of income to the income beneficiary, rather than one to deny it to him.¹²¹ It follows, therefore, that *Yeazel*, like *Burr*, cannot be considered as conclusive authority on the issue of whether corporate voting control involves a section 2036(a)(2) right to designate.

In *Byrum*, the decedent, prior to the transfers in question, was the controlling stockholder of three closely-held corporations¹²² and, apparently, an officer thereof.¹²³ In December, 1958, he created an irrevocable trust¹²⁴ of a portion of his stock in each of these corporations¹²⁵ for the benefit alone of his children. In so doing, he impliedly retained until death the beneficial ownership of the remainder of such stock. In addition, although he designated a corporation as sole trustee, he expressly retained in his individual capacity the powers to vote the transferred stock, to veto any sale or other disposition of such stock by the trustee, to veto investments made by the trustee, and to remove the named trustee and appoint a successor corporate trustee.¹²⁶ As in *Yeazel*, the decedent in *Byrum* had, after the transfer, the right to vote precisely the same number of shares in each of the corporations as he could have voted prior to the transfer. In *Yeazel*, however, it was the shares held by the decedent as trustee which, of themselves, constituted voting control of the corporation. In *Byrum*, on the other hand, in the case of one of the closely-held corporations, it was the shares impliedly retained which, of themselves, constituted voting control. In the case of the other two corporations, it was the decedent's right to vote the stock he impliedly retained, *combined with* his expressly retained right to vote the transferred stock, which gave him

119. 165 F.2d 142 (1st Cir. 1947).

120. *E.g.*, *United States v. O'Malley*, 383 U.S. 627 (1966); *Estate of Cyrus C. Yawkey*, 12 T.C. 1164 (1949), *acquiesced in*, 1949-2 CUM. BULL. 3.

121. *United States v. O'Malley*, 383 U.S. 627 (1966); *Joy v. United States*, 404 F.2d 419 (6th Cir. 1966), *aff'd and remanding* 272 F. Supp. 544 (E.D. Mich. 1967); *Ritter v. United States*, 297 F. Supp. 1259 (S.D.W. Va. 1968). See *Struthers v. Kelm*, 218 F.2d 810 (8th Cir. 1955).

122. 440 F.2d 949 (6th Cir. 1971). More specifically, he owned 1,020 shares of the 1,440 outstanding shares of stock of one corporation, 478 shares of the 574 outstanding shares of another corporation, and 595 shares of the 678 outstanding shares of another corporation. *Id.* at 953 (Phillips, C.J., dissenting).

123. 440 F.2d 949, 953 (6th Cir. 1971) (Phillips, C.J., dissenting).

124. The relevant portions of the trust agreement are set forth in 440 F.2d at 950-51.

125. To wit, he transferred to the trust 165 of his 1,020 shares of one corporation, 276 of his 478 shares of another corporation, and 308 of his 595 shares of another corporation. *Id.* at 953 (Phillips, C.J., dissenting).

126. He did not, however, expressly retain, in any capacity, any other powers over the transferred stock. Nor, apparently, did he retain, either expressly or impliedly, any beneficial interest whatever therein, direct or indirect.

voting control. That is, in the case of the latter two transfers, neither the shares retained by the decedent nor the shares transferred by him of themselves constituted voting control.¹²⁷ Decedent died in September, 1964, and a deficiency in estate tax was determined on the ground that the entire value of the transferred stock was includible in his gross estate, under sections 2036(a)(1)¹²⁸ and 2036(a)(2) of the Code, by reason of the combination of those powers expressly retained by the decedent under the trust agreement and those resulting from his implied retention of the balance of his stock interest in the corporations whose stock he had transferred. With respect to section 2036(a)(2), the Government contended, as it did in *Yeazel*, "that since the grantor remained in voting control of the corporation he could, by electing the Board of Directors, determine dividend policies and thus the grantor could indirectly regulate or control who enjoyed the income from the property."¹²⁹ As in *Yeazel*, the Government based this contention on Revenue Ruling 67-54,¹³⁰ which states:

the value of nonvoting corporate stock transferred to a trust is includible in the gross estate of a deceased grantor . . . under section 2036 of the Code where the grantor owned the voting stock for the remainder of his life and was therefore able to control the income from the transferred property, and where the trustee was restricted in his power to dispose of the transferred property and held it at the grantor's death. The grantor thereby retained for his life or for a period which did not in fact end before his death the right to designate the persons who shall possess or enjoy the transferred property or the income therefrom.¹³¹

The district court, however, in a decision recently affirmed by the Court of Appeals for the Sixth Circuit, held that no part of the value of the transferred stock was includible in the decedent's gross estate under either section 2036(a)(1) or section 2036(a)(2) of the Code.

III. VOTING CONTROL OF THE CORPORATION: A NONDISCRETIONARY POWER?

A unique approach to the problem of retained voting control emerged from *Byrum*. Although the district court's conclusion with respect to section 2036(a)(2) that "Revenue Ruling 67-54 cannot operate to make includible this trust property in the decedent's estate"¹³² was preceded by quotation of the *Yeazel* court's reasoning on this issue,¹³³ it was followed immediately by the court's statement that "[t]he decedent's power to control the trust property was not without

127. See notes 122 & 125 *supra*.

128. The Government's contentions with respect to § 2036(a)(1) and the holdings of both the district court and the court of appeals with respect thereto, are discussed in note 199 *infra* and at notes 197-209 *infra*.

129. 440 F.2d at 952.

130. 1967-1 CUM. BULL. 269.

131. *Id.* at 270.

132. 311 F. Supp. at 896.

133. *Id.* The court's language in *Yeazel* is set forth in full in the text accompanying note 118 *supra*.

limitation and the Court considers that sufficient control was relinquished, and sufficient checks were retained on what control was retained, to avoid the application of Section 2036 to the facts in the instant case. See, generally, *Jennings v. Smith*, 161 F.2d 74 (2nd Cir. 1947) and 3 J. Merten's Estate and Gift Tax § 24.30.¹³⁴ It would appear, both from the court's language and from the authorities it cited, that the primary basis of this holding is that the powers retained by the decedent were not discretionary; that is, their exercise was controlled by determinable external standards enforceable by a court having equity jurisdiction, whereas only a discretionary power can be a section 2036(a)(2) right to designate. It is not clear, however, whether the court considered these powers to be nondiscretionary in the decedent's hands on the theory that the powers expressly retained by him in his individual capacity over the transferred stock itself were held by him as a quasi-trustee;¹³⁵ or on the theory that the exercise of his compound power to control corporate dividend policy was limited indirectly by the fiduciary duty of a corporate board of directors to all of the shareholders.

In affirming the district court's decision, the court of appeals apparently relied on both theories. In holding that none of the powers expressly retained by the decedent over the transferred stock itself — that is, the power to vote it, the power to veto its sale, and the power to substitute corporate trustees — rendered the value thereof includible in his gross estate under section 2036 of the Code, the court apparently relied on the quasi-trustee theory.¹³⁶ On the other hand, in holding that the decedent's retention of voting control of the corporations whose stock he transferred did not bring the transfers within the scope of section 2036(a)(2) irrespective, apparently, of whether or not such control arose from, or was dependent upon, a retained right in the decedent to vote the transferred stock, it relied upon the theory that the exercise of decedent's power was indirectly limited by the fiduciary duty of the corporations' boards of directors. On the latter issue the court stated:

the grantor by retaining the voting right of the stock only controlled who could serve as directors of the corporation. These individual directors would then be under a fiduciary obligation to exercise sound business judgment in declaring dividends and could not act in bad faith to the injury of the beneficial owners of

134. 311 F. Supp. at 896.

135. This theory is discussed in detail *infra* pp. 225-34.

136. 440 F.2d at 952. This holding is discussed *infra* pp. 222-34. N.B. It is unclear whether the court so held on the basis of § 2036(a)(1) or § 2036(a)(2) or both. On the one hand, the court prefaced its holding on this point by stating that "[t]he Government's principal argument is that the powers retained by grantor made the value of the shares of stock transferred into trust includible in his estate because the grantor retained for his life 'the possession or enjoyment of * * * the property . . . ' 26 U.S.C. § 2036(a)(1)." 440 F.2d at 952. On the other hand, of the cases cited by the court in support of its holding, only one, *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929), can possibly be said to stand for the proposition that the powers retained by the decedent do not constitute "the possession or enjoyment of . . . the property" within the meaning of § 2036(a)(1); the others all involve the application only of § 2036(a)(2) and/or § 2038.

the stock. This obligation is governed by an ascertainable standard and is analogous to the situation which exists in cases where the grantor retains broad managerial control of a trust . . . and does not result in making these assets includible in the grantor's estate.¹³⁷

To the extent that this language can be said to hold that a transferor's retention of voting control does not invest him with a section 2036(a)(2) right to designate because it does not empower him to determine corporate dividend policies, it ignores both the realities of the situation¹³⁸ and their heretofore consistent recognition by the federal courts in estate and gift tax cases.¹³⁹ Furthermore, to the extent that this language can be said to hold that a transferor's retention of voting control does not invest him with a section 2036(a)(2) right to designate because his resultant power to determine the dividend policies of the corporation, and thereby defer the payment of income from the transferred stock, is not discretionary, it rests upon a false analogy.¹⁴⁰ For, while the court was technically correct in stating that corporate directors are "under a fiduciary obligation . . . in declaring dividends,"¹⁴¹ this obligation, contrary to the court's assertion, is not "governed by an ascertainable standard"¹⁴² within the meaning of *Jennings v. Smith*¹⁴³ and its progeny.

Jennings v. Smith established the rule that a power cannot be a section 2036(a)(2) right to designate, or a section 2038 power to

137. 440 F.2d at 952. In addition, the court of appeals stated that, "[w]hile Revenue Ruling 67-54 . . . strictly construed, is distinguishable from the facts in this case . . . [i]nsofar as such Ruling might be applied to the facts of this case, it is in conflict with the law as interpreted by the courts and should be disregarded." *Id.* at 952-53.

138. See H. BALLANTINE, *supra* note 98, §§ 182, 184c, 185, 337; Hornstein, *Corporate Control and Private Property Rules*, 92 U. PA. L. REV. 1, 3-11, 27-31 (1943); Cf. Murray, *Legal and Financial Aspects of Dividend Policy*, 23 BAYLOR L. REV. 7, 13-18 (1971).

139. *Reeves' Estate v. Commissioner*, 180 F.2d 829 (2d Cir. 1950), *cert. denied*, 340 U.S. 813 (1950); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, INT. REV. BULL. No. 9, at 6; Richard P. Makoff, 26 CCH Tax Ct. Mem. 83 (1967); Elise McK. Morgan, 42 T.C. 1080 (1964), *aff'd per curiam*, 353 F.2d 209 (4th Cir. 1965), *cert. denied*, 384 U.S. 918 (1966), *acquiesced in*, 1966-2 CUM. BULL. 6; *Estate of James Gilbert*, 14 T.C. 349 (1950). See *Landorf v. United States*, 408 F.2d 461, 471 (Ct. Cl. 1969); *Rev. Rul. 71-463*, 1971 INT. REV. BULL. No. 42, at 25, *citing* *Treas. Reg. § 20.2042-1(C)(2)*, *approved in* *Cockrill v. O'Hara*, 302 F. Supp. 1365 (M.D. Tenn. 1969). Cf., e.g., *Fetzer Refrigerator Co. v. United States*, 27 Am. Fed. Tax R.2d ¶ 71-401 (6th Cir. 1971) (involving application of the doctrine of "constructive receipt" under INT. REV. CODE of 1954, § 267(a)(2)).

140. This discussion of the analogy drawn by the court between the retained voting control situation and "the situation which exists in cases where the grantor retains broad managerial control of a trust" [*Byrum v. United States*, 440 F.2d 949, 952 (6th Cir. 1971)] assumes the validity of the court's basic premise that a transferor's exercise of his retained administrative powers over the property transferred by him in trust is sufficiently controlled by external standards, enforceable in equity, to preclude the application to the transfer of either § 2036(a)(2) or § 2038 of the Code, regardless of both the capacity in which he holds these powers and whether they are considered alone or in the aggregate. Whether this premise in fact is valid is discussed *infra* pp. 225-34.

141. 440 F.2d at 952.

142. *Id.*

143. 161 F.2d 74 (2d Cir. 1947). This case is cited by both the district court and the Sixth Circuit Court of Appeals in support of their decisions in *Byrum*.

alter, amend, revoke, or terminate, unless it is discretionary, and that it is not discretionary if its exercise is controlled by determinable external standards, enforceable by a court having equity jurisdiction, which leave the holder of the power no real discretion in its exercise.¹⁴⁴ It does not follow, however, despite some apparent authority to the contrary,¹⁴⁵ that every power whose exercise can be compelled, prevented or reviewed by a court of equity is, for that reason, limited by a determinable external standard within the meaning of this rule and, therefore, nondiscretionary. It is true that equity can control the exercise of every power, mandatory or discretionary, which is held subject to a fiduciary obligation with respect to its exercise by reviewing such exercise, and compelling or preventing it in order to remedy a breach of duty or an abuse of discretion;¹⁴⁶ and that all trustees are under a fiduciary obligation with respect to the exercise of all powers, whether mandatory or discretionary, held by them as such.¹⁴⁷ It is clear, however, that the fact that a transferor retains powers over the transferred property as a trustee, rather than in his individual capacity, will not, of itself, prevent the application of either section 2036(a)(2) or section 2038 of the Code.¹⁴⁸ From the authorities¹⁴⁹ requiring inclusion on the basis of powers which are held in a fiduciary capacity, it necessarily follows that no power whose exercise is controlled only by those criteria by which *all* fiduciary powers are controlled is limited by a determinable external standard within the meaning of *Jennings v. Smith*. In other words, in order to be nondiscretionary, a fiduciary power must be subject to limitations other than, or in addition to, those imposed equally upon all fiduciary powers.

Of the three criteria used by equity to determine whether the holder of a fiduciary power has abused his discretion in exercising or failing to exercise it, two — that he must act (or fail to act) in good faith and from proper motives — apply equally to all fiduciary powers,¹⁵⁰ and therefore, do not render them nondiscretionary. The third criterion, however — that the holder of a fiduciary power must act within the bounds of reasonable judgment¹⁵¹ — applies only if there is a standard by which the reasonableness of the power-holder's judgment can be determined.¹⁵² If there is no such standard, or if the requirement of reasonableness is dispensed with by the terms of the

144. *E.g.*, Michigan Trust Co. v. Kavanagh, 284 F.2d 502 (6th Cir. 1960).

145. Estate of Willard V. King, 37 T.C. 973 (1962), *nonacquiesced in*, 1963-1 CUM. BULL. 5. *Cf.* Old Colony Trust Co. v. United States, 423 F.2d 601 (1st Cir. 1970); Estate of Edward E. Ford, 53 T.C. 114 (1969), *aff'd. per curiam*, 71-2 U.S. Tax Cas. ¶ 12,813 (2d Cir. Nov. 12, 1971); Estate of Marvin L. Pardee, 49 T.C. 140 (1967).

146. 2 A. SCOTT, THE LAW OF TRUSTS § 185 (3d ed. 1967); 3 A. SCOTT, *supra*, §§ 185A-87.5.

147. 2 A. SCOTT, *supra* note 146, § 185; 3 A. SCOTT, *supra*, §§ 185A-87.5.

148. *E.g.*, Joy v. United States, 404 F.2d 419 (6th Cir. 1968), *aff'g and remanding* 272 F. Supp. 544 (E.D. Mich. 1967). *See, e.g.*, United States v. O'Malley, 383 U.S. 627 (1966); Lober v. United States, 346 U.S. 335 (1953); Treas. Reg. §§ 20.2036-1(b)(3), 20.2038-1(a)(3).

149. Cases cited note 148 *supra*.

150. 2 A. SCOTT, *supra* note 146, § 185; 3 A. SCOTT, *supra*, §§ 187-87.5.

151. *See* note 150 *supra*.

152. 3 A. SCOTT, *supra* note 146, § 187.2.

instrument creating the power, only the first two criteria will apply.¹⁵³ It follows then that only those fiduciary powers to which the third criterion applies can be considered nondiscretionary, and not even all of these are in fact controlled by determinable external standards within the meaning of *Jennings v. Smith*.¹⁵⁴ Moreover, it would seem that, even if there is a standard by which to judge the reasonableness of the power-holder's judgment, the power is not nondiscretionary unless equity will in fact remedy a failure to act in accordance with these standards as well as a failure to act in good faith or from proper motives.¹⁵⁵

The basic defect in the court's reasoning in *Byrum* was the drawing of an analogy between the situation where the only powers retained are those which constitute "broad managerial control" of a trust¹⁵⁶ and the situation where corporate voting control is retained. The two situations are in fact only partly analogous. Just as a trustee holds his powers subject to a fiduciary obligation with respect to their exercise, so does a holder of corporate voting control — both directly, as "majority shareholder,"¹⁵⁷ and indirectly, by reason of the fact that he thereby can control the actions of the board of directors, which itself has a fiduciary obligation to the shareholders.¹⁵⁸ To this extent, therefore, a retention of corporate voting control is analogous to a retention of managerial control of a trust. The analogy breaks down, however, when it is asserted that the exercise of both types of powers is controlled by determinable external standards that are enforceable in equity. In the situation in which managerial control of a trust is retained, regardless of the merits of the position that the powers constituting such control are nondiscretionary, it is clear that there are standards by which the reasonableness of the power-holder's judgment can be determined, and that equity in fact will remedy a failure to act in accordance with these standards, as well as a failure to act in good faith or from proper motives.¹⁵⁹ For example, it has been held more often than not that one such standard is that the exercise of a trustee's managerial powers should not affect the relative rights of the income beneficiaries and remaindermen.¹⁶⁰

On the other hand, there is grave doubt as to whether there in fact are standards by which to judge the reasonableness of the action

153. *Id.*

154. See *Michigan Trust Co. v. Kavanagh*, 284 F.2d 502 (6th Cir. 1960). Compare, e.g., *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970), *Estate of Marvin L. Pardee*, 49 T.C. 140 (1967), and *Estate of Cyrus C. Yawkey*, 12 T.C. 1164 (1949), *acquiesced in*, 1949-2 CUM. BULL. 3, with 3 A. SCOTT, *supra* note 146, § 187.2.

155. See *United States v. Powell*, 307 F.2d 821 (10th Cir. 1962); *Estate of Marvin L. Pardee*, 49 T.C. 140 (1967).

156. E.g., the powers to sell, veto or direct the sale of, retain, invest and reinvest the property transferred in trust; to allocate the receipts between income and principal; and to vote securities held as part of the trust principal.

157. H. BALLANTINE, *supra* note 98, § 278, at 655; cf. Murray, *supra* note 138.

158. H. BALLANTINE, *supra* note 98, § 66; cf. Murray, *supra* note 138.

159. 3 A. SCOTT, *supra* note 146, § 187.2; cf. Murray, *supra* note 138.

160. *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970); *United States v. Powell*, 307 F.2d 821 (10th Cir. 1962). See, e.g., *Estate of Ralph Budd*, 49 T.C. 468 (1968). *Contra*, *State St. Trust Co. v. United States*, 263 F.2d 635 (1st Cir. 1959).

of a corporate board of directors in declaring or failing to declare dividends.¹⁶¹ Moreover, equity normally will remedy only those abuses of discretion by corporate directors arising from actions in bad faith or from improper motives¹⁶² — and then only in “very clear and extreme cases.”¹⁶³ For example, although it can be said that corporate directors are “under a fiduciary obligation to exercise sound business judgment in declaring dividends,”¹⁶⁴

[t]he mere fact that a corporation reports a substantial surplus or large profits out of which a dividend might lawfully be declared is not of itself sufficient ground to compel the directors to make a dividend. They have a wide discretion to use the corporate resources to expand the business, to increase executive compensation by bonuses and profit sharing contracts and to establish various reserves if they consider it to the interests of the corporation to do so.¹⁶⁵

In fact “[t]he courts hesitate to substitute their judgment on complicated questions of business policy for that of the elected managers of the business,”¹⁶⁶ with the result that this obligation, in practice, amounts to little more than a requirement that the directors act in good faith and from proper motives.¹⁶⁷ Thus, while

[t]here is an obligation implied, and to some slight extent equitably enforced, to exercise not only good faith but also a reasonable business discretion in the distribution of available profits to the investor . . . the great practical difficulty of regulating the exercise of this managerial discretion leaves the shareholder with no clearly defined right to a return but rather an indefinite expectation that the directors will do the right thing by them on grounds of business policy.¹⁶⁸

Hence, in the retained voting control situation, unlike the retained trust control situation, there appear to be no ascertainable standards for determining the reasonableness of the directors' judgment, in declaring or failing to declare dividends, which equity in fact will enforce. Consequently, the power to defer the payment of income from the transferred stock, which results from the transferor's retention of corporate voting control, clearly is not nondiscretionary within the rule in *Jennings v. Smith*. Therefore, since the court of appeals decision in *Byrum* with respect to the effect of a retention of corporate voting control rests upon the validity of an analogy between this situation and the one in which managerial control of a trust is retained, *Byrum*, like *Burr* and *Yeazel*, cannot be considered as conclusive on

161. H. BALLANTINE, *supra* note 98, §§ 231, 232.

162. H. BALLANTINE, *supra* note 98, §§ 231, 232; *cf.* Murray, *supra* note 138.

163. H. BALLANTINE, *supra* note 98, § 231, at 551; *cf.* Murray, *supra* note 138.

164. *Byrum v. United States*, 440 F. 2d 949, 952 (6th Cir. 1971). *See* H. BALLANTINE, *supra* note 98, §§ 231, 232.

165. H. BALLANTINE, *supra* note 98, § 231, at 552; *cf.* Murray, *supra* note 138.

166. H. BALLANTINE, *supra* note 98, § 231, at 552; *cf.* Murray, *supra* note 138.

167. H. BALLANTINE, *supra* note 98, §§ 231, 232; *cf.* Murray, *supra* note 138.

168. H. BALLANTINE, *supra* note 98, § 231, at 551; *cf.* Murray, *supra* note 138.

the issue of whether corporate voting control involves a section 2036(a)(2) right to designate.

Despite the fact that a transferor's retention of corporate voting control appears to be sufficient of itself to bring the transfer within the scope of sections 2036(a)(2) and 2038 of the Code,¹⁶⁹ at least if such retention is implied,¹⁷⁰ there is some authority to the effect that his resultant power to defer the payment of income from the transferred stock cannot be a section 2036(a)(2) right to designate or a section 2038 power to alter, amend, revoke, or terminate unless, at the very least, the transferred stock is unmarketable or its disposition is subject to control by the transferor.¹⁷¹ In *Estate of Harry H. Beckwith*,¹⁷² for example, the court held that no part of the value of the stock which the decedent had transferred in trust was includible in his gross estate under either section 2036(a)(1) or section 2036(a)(2) of the Code, even though the decedent had retained voting control of the corporation from the inception of the trusts until his death. With respect to the applicability of section 2036(a)(2) the court stated:

the trustees were free to sell the [transferred] stock. The right to control the dividend policy of a corporation can be a right to designate the income recipient of a trust holding its stock only if the corporation is of necessity a source of the trust income. Where a third-party trustee has unfettered power to dispose of the stock, then the donor retains no right to designate the income recipient of the trust; any influence which he may have over the disposition of the trust income depends on the will of a third party, *i.e.*, a decision to retain the stock.¹⁷³

Likewise, according to Revenue Ruling 67-54:¹⁷⁴

Where a decedent transfers nonvoting stock in trust and holds for the remainder of his life voting stock giving him control over the dividend policy of the corporation, he has retained . . . the right to determine the income from the nonvoting stock. If he also retains control over the disposition of the nonvoting stock,

169. Since it enables him to defer the payment of income from the transferred stock. Cases cited notes 84-87 *supra* and accompanying text.

170. If such retention is express, either in whole or in part, so that the transferor's voting control arises from, or is dependent upon, a right retained by him to vote the transferred stock, it gives rise to the additional question of whether the transferor's resultant power to determine corporate dividend policy thereby is rendered nondiscretionary and, therefore, not within the scope of either § 2036(a)(2) or § 2038. This question is discussed *infra* pp. 225-34.

171. *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6. See *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); Rev. Rul. 67-54, 1967-1 CUM. BULL. 269. Cf. *Rosen v. Commissioner*, 397 F.2d 245 (4th Cir. 1968), *rev'g* 48 T.C. 834 (1967), *nonacquiesced in*, Rev. Rul. 344, 1969-1 CUM. BULL. 225; Richard P. Makoff, 26 CCH Tax Ct. Mem. 83 (1967); *Estate of James Gilbert*, 14 T.C. 349 (1950).

172. 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6.

173. CCH 1970 TAX CT. REP. (55 T.C.) Dec. No. 30,401, at 3,463. N.B. The quoted language is in the nature of dictum. The basis of decision in the *Beckwith* case was that the decedent did not *retain* his voting control of the corporation.

174. 1967-1 CUM. BULL. 269.

whether as trustee, [or] by restriction upon the trustee . . . he has in fact made a transfer whereby he has retained for his life the right to designate the persons who shall possess or enjoy the transferred property or the income therefrom.¹⁷⁵

It should be noted, however, that the principle enunciated in the above quotations from *Beckwith* and Revenue Ruling 67-54 applies only to transfers in trust. Moreover, only to the extent that its application is so limited does this principle appear to be a correct construction of sections 2036(a)(2) and 2038 of the Code.

As previously demonstrated, an *inter vivos* transfer of stock under which the transferor retains voting control of the corporation literally is "a transfer . . . by trust or otherwise, under which [the transferor] has retained . . . the right . . . to designate the persons who shall possess or enjoy the property or the income therefrom,"¹⁷⁶ since such retention enables the transferor to defer the payment of income from the transferred stock. Likewise, and for the same reasons, this type of transfer literally is "a transfer . . . where the enjoyment [of the property interest transferred] was subject . . . to . . . change through the exercise of a power . . . to alter, amend, revoke, or terminate . . ." ¹⁷⁷ Consequently, the only possible basis for holding that such a transfer is not within the scope of section 2036(a)(2) or section 2038, regardless of whether it is outright or in trust, unless the transferred stock is unmarketable or its disposition is subject to control by the transferor, is that for these sections of the Code to apply, it is not sufficient that the transferor retain merely the power "to designate the persons who shall possess or enjoy the property or the income therefrom,"¹⁷⁸ or the power to change the enjoyment of the property interest transferred.¹⁷⁹ Rather, he must retain the power to affect adversely *his transferee's* possession or enjoyment of "the [transferred] property or the income therefrom,"¹⁸⁰ or the power to change *his transferee's* enjoyment of the property interest transferred.¹⁸¹ Therefore, for his control over the transferred property or its income to be a power to affect *his transferee's* enjoyment thereof, the transferor must have the power to prevent his transferee from disposing of the transferred property or his interest therein and thereby obtaining the unrestricted economic benefit thereof.

This theory clearly is untenable. There is no express requirement, in either section 2036(a)(2) or section 2038, that the transferor must retain a power to affect his transferee's enjoyment of the transferred property or its income. Nor can any be implied, since it appears that sections 2036 and 2038 apply in cases in which the transferred interest is freely transferable by the transferee without the

175. *Id.* at 270.

176. INT. REV. CODE of 1954, § 2036(a)(2).

177. *Id.* § 2038(a)(1).

178. *Id.* § 2036(a)(2).

179. *Id.* § 2038(a)(1).

180. *Id.* § 2036(a)(2).

181. *Id.* § 2038(a)(1).

transferor's consent.¹⁸² Moreover, it even appears that these sections apply where the transferred interest is disposed of by the transferee prior to the death of the transferor,¹⁸³ unless such disposition eliminates the transferor's control over the transferred property or the income therefrom.¹⁸⁴

Nonetheless, it would appear that *Beckwith* and Revenue Ruling 67-54 are correct in asserting that, where a transferor retains voting control of the corporation and the transfer is in trust, neither section 2036(a)(2) nor section 2038 of the Code will apply to the transfer unless the transferred stock is unmarketable or its disposition is subject to control by the transferor. This follows from the theory, applied consistently in cases involving problems of valuation under the transfer sections of the Code,¹⁸⁵ that where a transfer is made in trust, "the assets considered to be transferred are not the specific assets comprising the trust corpus but rather the corpus itself."¹⁸⁶ Thus the conclusion is compelled that if the property transferred is the trust corpus rather than the specific property comprising it, and the transferor's retained control pertains only to the specific property transferred, such control cannot be deemed to be control of the property transferred within the meaning of the transfer sections of the Code unless the specific property necessarily forms part of the trust corpus. This reasoning, however, does not apply where the transfer is outright rather than in trust since, in this situation, the property transferred is the specific property over which the transferor retains control.¹⁸⁷ It follows, therefore, that a transferor's retention of voting control of a corporation of *itself* renders sections 2036(a)(2) and 2038 of the Code applicable to outright transfers, at least if such retention is implied.

182. See *Burr v. Commissioner*, 156 F.2d 871 (2d Cir. 1946) (upholding application of § 811(c) of the 1939 Code (now INT. REV. CODE of 1954, § 2036(a)(1)) to an irrevocable assignment of the insurance portion of a life insurance-annuity combination, the assignee having the power to reassign or surrender the insurance policy), *overruled on other grounds*, *Fidelity-Philadelphia Trust Co. v. Smith*, 356 U.S. 274 (1958); *Howard v. United States*, 125 F.2d 986 (5th Cir. 1942) (upholding application of a precursor of § 2038 of the Code to a revocable outright transfer of property thereafter disposed of by the transferee); *Peek v. United States*, 38 F. Supp. 826 (E.D. Pa. 1941) (upholding application of precursor of § 2036(a)(1) to an outright transfer of realty under which the grantor reserved a ground rent for life, the grantees having not only the right to dispose of the transferred realty itself, but also the right to extinguish the ground rent upon payment to the grantor of a stated sum). Cf. *Estate of Lillie G. Hutchinson*, 20 T.C. 749 (1953). *But cf. Smith v. United States*, 158 F. Supp. 344 (D. Colo. 1957). N.B. While no case in point involving § 2036(a)(2) has been found, "the power to designate income or possession under Section 2036(a)(2)" must be equated "with the direct retention of income or possession under Section 2036(a)(1)." C. LOWNDES & R. KRAMER, *supra* note 3, at 160.

183. *Howard v. United States*, 125 F.2d 986 (5th Cir. 1942) (involving application of a precursor of § 2038 of the Code). Cf. *Estate of Lillie G. Hutchinson*, 20 T.C. 749 (1953) (involving application of a precursor of § 2036(a)(1)).

184. See *Howard v. United States*, 125 F.2d 986 (5th Cir. 1942); *Estate of Lillie G. Hutchinson*, 20 T.C. 749 (1953).

185. *Gorman v. United States*, 288 F. Supp. 225 (E.D. Mich. 1968); C. LOWNDES & R. KRAMER, *supra* note 3, at 435; 3 J. MERTENS, *supra* note 16, § 22.79.

186. *Gorman v. United States*, 288 F. Supp. 225, 231 (E.D. Mich. 1968). *Accord*, C. LOWNDES & R. KRAMER, *supra* note 3, at 435; 3 J. MERTENS, *supra* note 16, § 22.79.

187. Authorities cited note 185 *supra*.

IV. THE EXPRESS RETENTION OF DIRECT RIGHTS IN OR OVER THE TRANSFERRED STOCK ITSELF: DISCRETIONARY VS. NONDISCRETIONARY POWERS

The focus of attention to this point for the most part has been restricted to the estate tax consequences of a transferor's retention of indirect rights in or over the transferred stock by virtue of his implied retention of voting control of the corporation whose stock he transferred. More complicated, however, is the problem of a transferor's express retention of direct rights in or over the transferred stock itself. Such direct rights may consist of powers, exercisable in either a fiduciary or nonfiduciary capacity, to vote the transferred stock or to control its disposition. In addition, they also may consist of administrative powers over the transferred stock which are exercisable only in a fiduciary capacity. Under a given transfer these direct rights may constitute the only powers retained by the transferor, or they may be in addition to indirect rights expressly or impliedly retained by the transferor.

Although a transfer characterized by the express retention of one or more of the above-mentioned direct rights in or over the transferred stock itself should not bring the transfer within the scope of section 2036(a)(1) of the Code, such retention very well may cause the application of sections 2036(a)(2) and 2038 to the transfer. The application of these latter sections of the Code should depend on the following additional factors: the form of the transfer, the particular rights retained, whether the transferor prior to the transfer was the controlling shareholder of the corporation, and the portion of the transferor's stock interest that is transferred.

The Government has long and persistently contended that an *inter vivos* transfer of closely-held corporate stock, under which the transferor retains voting control of the corporation whose stock is transferred, is a "transfer . . . under which . . . he has retained . . . the possession or enjoyment of, or the right to the income from, the [transferred] property,"¹⁸⁸ at least if such control arises from or is dependent upon a retained right to vote the transferred stock.¹⁸⁹ The Government also has contended, with equal vigor and perseverance, that regardless of whether he retains voting control of the corporation, if the transferor in connection with his transfer of stock retains the right to receive an income from the corporation pursuant to a contract for his employment in a managerial capacity, he likewise has retained "the possession or

188. INT. REV. CODE of 1954, § 2036(a)(1).

189. *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; *Estate of William F. Hofford*, 4 T.C. 542, *modified*, 4 T.C. 790 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8; *Estate of Pamela D. Holland*, 47 B.T.A. 807 (1942), *modified*, 1 T.C. 564 (1943). *Cf. Estate of James F. Foster*, 13 B.T.A. 496 (1928). The question of whether voting control of a corporation involves "the possession or enjoyment of, or the right to the income from" its transferred stock, within the meaning of § 2036(a)(1) of the Code, where such control results solely from the transferor's implied retention of the right to vote corporate stock other than that transferred by him, is discussed *supra* p. 204.

enjoyment of, or the right to the income from the [transferred] property," within the meaning of section 2036(a)(1) of the Code.¹⁹⁰ Yet perseverance, like other virtues, must be its own reward. With but one exception,¹⁹¹ the courts uniformly have held these contentions to be without merit,¹⁹² and insofar as their results are concerned, these decisions clearly are correct.

It is basic corporation law that a transferor of stock, who retains only the powers to vote it and to control its disposition, or other "administrative" powers over it, and even, perhaps, indirect rights as well, has not retained "the right to the income" therefrom, even if he thereby retains voting control of the corporation.¹⁹³ Consequently, in order for such a transfer to be taxable under section 2036(a)(1) of the Code, the powers so retained would have to be deemed to constitute "the possession or enjoyment of" the transferred stock, within the meaning of this section. As previously demonstrated,¹⁹⁴ it is well-established that in order for a retained interest to be "the possession or enjoyment of" the transferred property, within the meaning of section 2036(a)(1), it must be a beneficial interest¹⁹⁵ in a pecuniary sense.¹⁹⁶ Thus, in order for a transferor to be deemed to have retained "the possession or enjoyment of" the transferred property, he must be shown to have retained the "substantial present economic benefit"¹⁹⁷ thereof.

190. Estate of William L. Belknap, 10 CCH Tax Ct. Mem. 769 (1951); Estate of William F. Hofford, 4 T.C. 542, *modified*, 4 T.C. 790 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8; Estate of Pamela D. Holland, 47 B.T.A. 807 (1942), *modified*, 1 T.C. 564 (1943). *Cf.* Estate of Meyer Goldberg, 10 CCH Tax Ct. Mem. 977 (1951).

191. Estate of Pamela D. Holland, 47 B.T.A. 807 (1942), *modified*, 1 T.C. 564 (1943). *See* Estate of James Gilbert, 14 T.C. 349 (1950).

192. *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); Estate of William L. Belknap, 10 CCH Tax Ct. Mem. 769 (1951); Estate of William F. Hofford, 4 T.C. 542, *modified*, 4 T.C. 790 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8. *Cf.* Estate of Meyer Goldberg, 10 CCH Tax Ct. Mem. 977 (1951); Estate of James F. Foster, 13 B.T.A. 496 (1928). *But see* Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6.

193. Compare Estate of McNichol v. Commissioner, 265 F.2d 667 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959) (interpreting the phrase "the right to the income from, the [transferred] property"), with *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971), and *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968) (elucidating the nature of the rights accruing to the holder of corporate voting control).

194. Cases cited notes 75-77 *supra* and accompanying text.

195. Estate of McNichol v. Commissioner, 265 F.2d 667 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959); *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); Estate of Skinner v. United States, 197 F. Supp. 726 (E.D. Pa. 1961), *aff'd*, 316 F.2d 517 (3d Cir. 1963). *See* Estate of Cyrus C. Yawkey, 12 T.C. 1164 (1949), *acquiesced in*, 1949-2 CUM. BULL. 3; Estate of William F. Hofford, 4 T.C. 790, *modifying* 4 T.C. 542 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8.

196. *See* cases cited notes 75-77 *supra* and Treas. Reg. § 20.2036-1(b)(2).

197. Estate of McNichol v. Commissioner, 265 F.2d 667, 671 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959). *Accord*, *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219

It seems clear, however, that even his retention of all of the above-enumerated powers¹⁹⁸ does not endow the transferor with a pecuniary benefit from the transferred stock,¹⁹⁹ regardless of whether he thereby retains voting control of the corporation²⁰⁰ and, if he does, regardless of whether such control arises from,²⁰¹ is dependent upon,²⁰² or is in-

(U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Estate of Skinner v. United States*, 197 F. Supp. 726 (E.D. Pa. 1961), *aff'd*, 316 F.2d 517 (3d Cir. 1963).

198. The power to vote the transferred stock, the power to veto or otherwise control its disposition and other administrative powers and indirect rights thereover.

199. *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929); *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968). See *Estate of James F. Foster*, 13 B.T.A. 496 (1928). *But see Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6. N.B. Of the cases which hold that a transferor's retention of the powers enumerated in note 198 *supra* was not the retention of a beneficial interest in the transferred stock, and, therefore, was not the retention of "the possession or enjoyment" thereof, within the meaning of § 2036(a)(1) of the Code, at most two [*Yeazel v. Coyle*, *supra*, and, possibly, the district court opinion in *Byrum v. United States*, *supra*,] apparently so held on the theory that the transferor's retained powers gave him no *pecuniary* benefit from the transferred stock. The holding in *Estate of Harry H. Beckwith*, *supra*, was based upon the court's finding that the transferor's powers were *not retained* by him under the transfer. *Estate of William F. Hofford*, 4 T.C. 790, *modifying* 4 T.C. 542 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8, and *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971), *aff'd* 311 F. Supp. 892 (S.D. Ohio 1970), apparently so held on the theory that the transferor's retained powers to vote the transferred stock and to control its disposition, were nondiscretionary, since they were held by him in a fiduciary capacity and were, therefore, nonbeneficial. There are indications, moreover, that *Yeazel* was decided, insofar as § 2036(a)(1) is concerned, on the nondiscretionary power theory rather than on the nonpecuniary benefit theory. Compare *Yeazel v. Coyle*, *supra*, with the district court opinion in *Byrum v. United States*, *supra*. Although the result reached in *Byrum*, *Yeazel* and *Hofford* with respect to the applicability of § 2036(a)(1) are correct, the reasoning upon which they are based is erroneous to the extent that it is dependent upon the nondiscretionary power theory. This certainly is true in *Byrum*, wherein the transferor's powers were retained by him in his individual capacity and, after the transfer, he continued to own beneficially a substantial amount of stock of the corporations whose stock he transferred. This probably is also true in both *Hofford*, wherein the transferor's powers were retained by him as trustee of the trust to which he transferred all of the issued and outstanding corporate stock, and in *Yeazel*, wherein the transferor's powers were retained by her as trustee of the trust to which she transferred the majority of the issued and outstanding corporate stock. The validity of this reasoning is discussed *infra* pp. 225-34.

200. *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929) (voting control not retained); *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971) (voting control retained); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968) (voting control retained); *Estate of William F. Hofford*, 4 T.C. 542, *modified*, 4 T.C. 790 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8 (voting control retained). See *Estate of William L. Belknap*, 10 CCH Tax Ct. Mem. 769 (1951) (voting control not retained); *Estate of James F. Foster*, 13 B.T.A. 496 (1928) (voting control not retained).

201. *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Estate of William F. Hofford*, 4 T.C. 542, *modified*, 4 T.C. 790 *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8. In both cases the stock transferred by the decedents to themselves as trustees constituted voting control of the respective corporations.

202. *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971) (insofar as two of the three corporations involved were concerned, neither the transferred stock which the transferor retained the right to vote, nor the stock whose ownership was retained by him constituted voting control, although his combined right to vote both the transferred stock and the stock retained did constitute voting control).

dependent of²⁰³ his retained right to vote the transferred stock. Moreover, even if it be conceded that the right to vote the transferred stock is of substantial present economic benefit to the transferor, either because it enables him to enjoy the power represented by the transferred stock,²⁰⁴ or because it enables him to control the distribution of dividends,²⁰⁵ or because it "assured [the transferor] a position as a salaried officer of the corporations for as long as he desired . . . [and] [h]e could increase his salary or fringe benefits . . . [and] could control all corporate decisions affecting him financially,"²⁰⁶ such right cannot be deemed to be "the possession or enjoyment of" the transferred stock. For where, as here, the property transferred is income-producing property, it would appear that the transferor must retain the income from the transferred property for him to be held to have retained "the possession or enjoyment" thereof.²⁰⁷ As was stated in *Estate of McNichol v. Commissioner*,²⁰⁸ "[i]f, as was said in *Commissioner v. Estate of Church* . . . the most valuable property attribute of stocks is their income, it is no less true that one of the most valuable incidents of income-producing real estate is the rent which it yields. He who receives the rent in fact enjoys the property."²⁰⁹ This conclusion is supported further by the line of cases involving a transferor who, in connection with his transfer of closely-held corporate stock, enters into a contract for his employment by the corporation in a managerial capacity at a stated salary, either in addition to, or instead of, retaining voting control of the corporation. These cases²¹⁰ properly hold that the contractual arrangement is not the retention of "the possession or enjoyment of, or the right to the income from" the transferred stock, within the meaning of section 2036(a)(1), so long as the salary stipulated is reasonable and is a debt of the corporation rather than a charge upon the transferred stock.²¹¹

On the other hand, a transferor's express retention of the right to vote the transferred stock should, despite the uniform case authority

203. *Id.* (insofar as one of the three corporations involved was concerned, the stock whose ownership was retained by the transferor constituted voting control).

204. *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6.

205. *Byrum v. United States*, 311 F. Supp. 892 (S.D. Ohio 1970), *aff'd*, 440 F.2d 949 (6th Cir.), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968).

206. *Byrum v. United States*, 440 F.2d 949, 954 (6th Cir. 1971) (Phillips, C.J., dissenting), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971).

207. *See Commissioner v. Estate of Church*, 335 U.S. 632, 645 (1949); *Estate of McNichol v. Commissioner*, 265 F.2d 667, 671 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959); *Estate of Skinner v. United States*, 197 F. Supp. 726 (E.D. Pa. 1961), *aff'd*, 316 F.2d 517 (3d Cir. 1963); *Treas. Reg. § 20.2036-1(b)(3)*.

208. 265 F.2d 667 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959).

209. 265 F.2d at 671.

210. *Estate of William L. Belknap*, 10 CCH Tax Ct. Mem. 769 (1951); *Estate of William F. Hofford*, 4 T.C. 542, *modified*, 4 T.C. 790 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8. *Cf. Estate of Meyer Goldberg*, 10 CCH Tax Ct. Mem. 977 (1951). *Compare Estate of Pamela D. Holland*, 47 B.T.A. 807 (1942), *modified*, 1 T.C. 564 (1943), *with the cases cited supra*.

211. It appears to be well established that a retained right to income is not the "right to the income from" the transferred property unless it is a charge upon the transferred property itself. *Gardner v. Delaney*, 103 F. Supp. 610 (D. Mass. 1952), *aff'd on this point and vacated and remanded in part*, 204 F.2d 855 (1st Cir. 1953).

to the contrary,²¹² bring the transfer within the scope of sections 2036(a)(2) and 2038 of the Code, provided the transferor thereby retains voting control of the corporation, at least if he also retains the right to control the disposition of the transferred stock. As previously shown, a transferor's *implied* retention of corporate voting control should render his transfer of closely-held corporate stock subject to these sections of the Code — of itself, if the transfer is outright, or, if the transfer is in trust, provided the transferred stock is unmarketable or its disposition is subject to the transferor's control. Consequently, where the transferor's retention of voting control arises from or is dependent upon his express retention of the right to vote the transferred stock, the case would appear to be even stronger for the application of section 2036(a)(2), since the question of whether the transferor's powers over the transferred stock in fact were retained under the transfer thereby is eliminated.

Most of the minute case authority involving the express retention of direct rights in or over the transferred stock has held or implied that the application of section 2036 cannot be based upon the transferor's powers to vote the transferred stock and control its disposition because such powers are nondiscretionary in his hands, within the meaning of *Jennings v. Smith*,²¹³ regardless of whether the transferor retained them in his individual capacity or as trustee.²¹⁴ This reasoning apparently is based upon two theories, neither of which properly can be applied to a controlling shareholder's express retention of direct rights in or over the transferred stock. The first of these is that a transferor who retains "administrative" or managerial powers over property transferred by him in trust holds such powers subject to a

212. *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968). *Cf.* Estate of William F. Hofford, 4 T.C. 790, *modifying* 4 T.C. 542 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8; Estate of James F. Foster, 13 B.T.A. 496 (1928). *But see* Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6. *Cf.* Estate of James Gilbert, 14 T.C. 349 (1950).

213. 161 F.2d 74 (2d Cir. 1947). This rule is discussed *supra* at notes 144-47.

214. *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971) (so held with respect to both § 2036(a)(1) and § 2036(a)(2) of the Code; transferor not trustee); *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968) (so held with respect to § 2036(a)(1); refusal to apply § 2036(a)(2) erroneously based on the fact that only the named transferees could benefit from the transferred stock [discussed *supra* at notes 116-121]; transferor trustee); Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6 (could be said to so imply with respect to § 2036(a)(2); refusal to apply § 2036 in fact based on transferor's failure to *retain* the powers in question; transferor trustee of some, but not all, of the transferred stock); Estate of William F. Hofford, 4 T.C. 790, *modifying* 4 T.C. 542 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8 (so held with respect to a precursor of § 2036(a)(1); § 2036(a)(2) not involved; transferor trustee). *But cf.* Estate of James Gilbert, 14 T.C. 349 (1950) (transfer outright; transferor retained the power to control the disposition of the transferred stock; transferee bound to will the stock to the corporation at her death; unclear whether the transferor had the right to vote the transferred stock; §§ 2036(a)(1) and 2037 held applicable); Estate of James F. Foster, 13 B.T.A. 496 (1928) (transfer outright; transferor retained right to vote transferred stock; transfer held not one made to take effect in possession or enjoyment at or after the transferor's death, since transfer made prior to effective date of the taxing act).

fiduciary obligation with respect to their exercise, regardless of whether he holds them in his individual capacity or as trustee.²¹⁵ The second, which is dependent upon the first,²¹⁶ is that a transferor's retention of "administrative" or managerial powers over property transferred by him in trust does not, of itself, bring the transfer within the scope of either section 2036(a)(2) or section 2038 of the Code,²¹⁷ regardless

215. *Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968) (transferor trustee); *Fifth Ave. Bank v. Nunan*, 59 F. Supp. 753 (E.D.N.Y. 1945) (transferor not trustee); *Estate of Marvin L. Pardee*, 49 T.C. 140 (1967) (transferor trustee); *Estate of Willard V. King*, 37 T.C. 973 (1962), *nonacquiesced in*, 1963-1 CUM. BULL. 5 (transferor not trustee); *Estate of William F. Hofford*, 4 T.C. 790, *modifying* 4 T.C. 542 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8 (transferor trustee); 2 A. SCOTT, *supra*, note 146, § 185. *But see* *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6.

216. 2 A. SCOTT, *supra* note 146, § 185. *See, e.g., Yeazel v. Coyle*, 68-1 U.S. Tax Cas. ¶ 12,524 (N.D. Ill. 1968); *Fifth Ave. Bank v. Nunan*, 59 F. Supp. 753 (E.D.N.Y. 1945); *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6; *Estate of Marvin L. Pardee*, 49 T.C. 140 (1967); *Estate of Willard V. King*, 37 T.C. 973 (1962), *nonacquiesced in*, 1963-1 CUM. BULL. 5; *Estate of William F. Hofford*, 4 T.C. 790, *modifying* 4 T.C. 542 (1945), *acquiesced in and nonacquiesced in*, 1945 CUM. BULL. 4, 8.

217. *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971) *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971) (transferor not trustee; transferor retained in individual capacity powers to vote the transferred stock and veto its disposition by trustee; § 2036(a)(2) held inapplicable); *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970) (transferor as trustee retained broad administrative or management powers over the trust; such powers held not to render either § 2036(a)(2) or § 2038 of the Code applicable to the transfer, although these sections were held applicable to the transfer on other grounds); *United States v. Powell*, 307 F.2d 821 (10th Cir. 1962) (transferor as trustee retained the power to control investment of the trust property, § 2038 held inapplicable); *Fifth Ave. Bank v. Nunan*, 59 F. Supp. 753 (E.D.N.Y. 1945) (transferor not trustee; transferor retained in individual capacity the power to control investment of the trust property; § 2038 held inapplicable); *Estate of Edward E. Ford*, 53 T.C. 114 (1969), *aff'd per curiam*, 71-2 U.S. Tax Cas. ¶ 12,813 (2d Cir. Nov. 12, 1971) (transferor as trustee retained the powers to direct the investment and sale of the trust property, to vote stock held in trust, and to allocate trust receipts between income and principal; §§ 2036(a)(2) and 2038 held inapplicable); *Estate of Ralph Budd*, 49 T.C. 468 (1968) (transferor as trustee retained the powers to direct the investment and sale of the trust property and to allocate trust receipts between income and principal; §§ 2036(a)(2) and 2038 held inapplicable); *Estate of Marvin L. Pardee*, 49 T.C. 140 (1967) (transferor as trustee retained the power to allocate trust receipts between income and principal; § 2036(a)(2) held inapplicable); *Estate of James H. Graham*, 46 T.C. 415 (1966) (transferor as trustee retained the power to control the investment and sale of the trust property; § 2038 held inapplicable); *Estate of Aline Peters Peters*, 23 Tax Ct. Mem. 994 (1964) (transferor as trustee retained broad administrative and managerial powers over the trust property; §§ 2036(a)(2) and 2038 held inapplicable); *Estate of Willard V. King*, 37 T.C. 973 (1962), *nonacquiesced in*, 1963-1 CUM. BULL. 5 (transferor not trustee; transferor retained in individual capacity the powers to direct the management, investment and sale of the trust property and to direct the voting by the trustee of all stock held as part of the trust property; §§ 2036(a)(2) and 2038 held inapplicable); *Estate of George W. Hall*, 6 T.C. 933 (1946), *acquiesced in*, 1946-2 CUM. BULL. 3 (transferor not trustee; transferor retained, in individual capacity, the power to direct the investment of the trust property; precursor of § 2038 held inapplicable); *Estate of Henry S. Downe*, 2 T.C. 967 (1943), *petition for review dismissed nolle pros.* (2d Cir. June 1, 1944), *nonacquiesced in*, 1944 CUM. BULL. 37 (transferor not trustee; transferor retained in individual capacity the powers to direct the investment and sale of the trust property and to vote all stock held in trust; precursor of § 2038 held inapplicable); *Estate of Laura B. Alexander*, 2 Tax Ct. Mem. 1156 (1943) (transferor not trustee; transferor retained in individual capacity power to direct the sale and investment of the trust property; transfer held not to be one made to take effect in possession or enjoyment at or after the transferor's death). *Contra*, *State St. Trust Co. v. United States*, 263 F.2d 635 (1st Cir. 1959) (transferor as

of whether such powers are considered individually or in the aggregate,²¹⁸ since their exercise is limited by ascertainable external standards, enforceable in equity.²¹⁹

The first of the above theories clearly is valid as a general rule.²²⁰ In fact, even if the transfer is outright, the transferor's retained power to vote the transferred stock or to control its disposition may be held to be a power of attorney,²²¹ whose exercise by him would be subject to a fiduciary obligation.²²² It is equally clear, however, that a transferor who reserves to himself in his individual capacity "administrative" or managerial powers over the transferred property is not under a fiduciary obligation with respect to their exercise if he is found to have retained such powers solely for his own benefit, regardless of whether the transfer is outright or in trust.²²³ In such a case, the transferor's exercise of the power is subject to no equitable control whatsoever.²²⁴ Furthermore, despite some apparent authority to the contrary,²²⁵ it would appear that the beneficial nature of the transferor's retained powers can be implied from the surrounding circumstances.²²⁶ It need not be express. In fact, according to *Scott on Trusts*,

trustee retained broad administrative and managerial powers over the trust property; powers, considered as a whole, held to require application of § 2036(a) (2); by implication, § 2038 likewise applicable). *But see* Commissioner v. Hager's Estate, 173 F.2d 613 (3d Cir. 1949), *rev'd and remanding* 5 Tax Ct. Mem. 972 (1946), *appeal dismissed*, 337 U.S. 937 (1949). *Cf.* Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6.

218. *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971) *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971) (powers considered individually); *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970) (powers considered in the aggregate); Estate of Edward E. Ford, 53 T.C. 114 (1969), *aff'd per curiam*, 71-2 U.S. Tax Cas. ¶ 12,813 (2d Cir. Nov. 12, 1971) (powers considered individually and in the aggregate); Estate of Ralph Budd, 49 T.C. 468 (1968) (powers considered individually and in the aggregate); Estate of Willard V. King, 37 T.C. 973 (1962), *nonacquiesced in*, 1963-1 CUM. BULL. 5 (powers considered in the aggregate). *Contra*, *State St. Trust Co. v. United States*, 263 F.2d 635 (1st Cir. 1959) (powers considered in the aggregate held to require application of § 2036(a) (2) and, inferentially, § 2038 even though powers considered individually would not require application of these sections).

219. *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971) (by implication), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970); *United States v. Powell*, 307 F.2d 821 (10th Cir. 1962); *Fifth Ave. Bank v. Nunan*, 59 F. Supp. 753 (E.D.N.Y. 1945); Estate of Edward E. Ford, 53 T.C. 114 (1969), *aff'd per curiam*, 71-2 U.S. Tax Cas. ¶ 12,813 (2d Cir. Nov. 12, 1971); Estate of Ralph Budd, 49 T.C. 468 (1968) (by implication); Estate of Marvin L. Pardee, 49 T.C. 140 (1967); Estate of Willard V. King, 37 T.C. 973 (1962), *nonacquiesced in* 1963-1 CUM. BULL. 5 *Contra*, *State St. Trust Co. v. United States*, 263 F.2d 635 (1st Cir. 1959). *But cf.* Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6.

220. Authorities cited note 215 *supra*.

221. Estate of James F. Foster, 13 B.T.A. 496 (1928).

222. G. G. BOGERT & G. T. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* §§ 15, 481 (2d ed. 1965, 1960).

223. *Fifth Ave. Bank v. Nunan*, 59 F. Supp. 753 (E.D.N.Y. 1945); 2 A. SCOTT, *supra* note 146, § 185.

224. 2 A. SCOTT, *supra* note 146, § 185.

225. *Fifth Ave. Bank v. Nunan*, 59 F. Supp. 753 (E.D.N.Y. 1945). According to the district court, "[t]o be exercisable for the sole benefit of the settlor, the power must be express and unambiguous; it cannot be implied." *Id.* at 757.

226. 2 A. SCOTT, *supra* note 146, § 185. *Cf.* Estate of Fruehauf v. Commissioner, 70-1 U.S. Tax Cas. ¶ 12,688 (6th Cir. June 3, 1970), *aff'g* 50 T.C. 915 (1968); Estate of John J. Round, 40 T.C. 970, 981 (1963), *aff'd*, 332 F.2d 590 (1st Cir. 1964).

... if the settlor owned all of the stock of a corporation and created a trust of half the stock for the benefit of his children, and provided that the trustee should not sell the stock without his consent, he would not be under any duty to the beneficiaries to consent even though the sale would be clearly advantageous to the trust, since it is fair to suppose that he reserved the power to prevent a sale for the purpose of protecting his own interest in the stock which he retained.²²⁷

This statement, moreover, applies with equal accuracy where the transferor retains the power to vote the transferred stock regardless of whether he also retains the power to control its disposition.

It follows, therefore, that where a transferor of stock retains a beneficial interest in the corporation, whether in voting or nonvoting stock, his retained power to vote the transferred stock or to control its disposition should be deemed beneficial in his hands, and therefore nonfiduciary, at least where the transferred stock is voting stock and the transferor has voting control of the corporation after the transfer. For in this situation, as in Scott's example, it must be presumed that the transferor retained his powers over the transferred stock to protect his beneficial interest in the stock he retained. Likewise, where the transferor transfers his entire stock interest, his retained powers to vote the transferred stock and to control its disposition should be considered beneficial in his hands, and therefore nonfiduciary, at least if they invest him with voting control of the corporation. In this situation, it must be presumed that the transferor retained his powers over the transferred stock in order to preserve his power to be or become a director or officer of the corporation, which offices carry with them substantial economic benefits, as well as corporate control.²²⁸ If the transferred stock is nonvoting stock, the transferor's express retention of the power to control its disposition, when considered in conjunction with his implied retention of voting control, requires the raising of a presumption that the power to control its disposition was retained either to give him unrestricted control over his transferee's enjoyment of the income from the stock transferred,²²⁹ which is an absolutely discretionary power to accumulate or distribute income, or to protect his own beneficial interest in the corporation, or both. Furthermore, even where a transferor retains "administrative" or managerial powers over the transferred property as trustee thereof, or otherwise is considered to hold such powers subject to a fiduciary obligation, it is clear that he is free to exercise these powers for his own benefit, subject only to the requirement that such exercise is in good

227. 2 A. SCOTT, *supra* note 146, § 185, at 1478-79.

228. *Byrum v. United States*, 440 F.2d 949, 953-54 (6th Cir. 1971) (Phillips, C.J., dissenting), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971).

229. *Estate of John J. Round*, 40 T.C. 970, 981 (1963), *aff'd*, 332 F.2d 590 (1st Cir. 1964). See notes 83-87 *supra* and accompanying text; notes 235-61 *infra* and accompanying text. Cf. *Estate of Harry H. Beckwith*, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6.

faith,²³⁰ if his retention of these powers creates a conflict between his individual interests and his fiduciary interests.²³¹ Moreover, where as here the only limitation upon the exercise of a fiduciary power is that it must be in good faith, such exercise is not controlled by determinable external standards, enforceable by a court having equity jurisdiction, within the meaning of *Jennings v. Smith*.²³² Consequently, if a transferor of stock retains a beneficial interest in the corporation, whether in voting or nonvoting stock, his reserved fiduciary powers to vote the transferred stock or to control its disposition should be deemed discretionary in his hands, within the meaning of *Jennings v. Smith*, at least where the transferred stock is voting stock and he has voting control of the corporation after the transfer, since his retention of fiduciary powers creates a conflict between his individual and fiduciary interests.²³³ Similarly, where a transferor transfers his entire interest in stock, his retained fiduciary powers to vote the transferred stock and to control its disposition should be considered discretionary in his hands, within the meaning of *Jennings v. Smith*, at least if they invest him with voting control of the corporation. For in this situation, the transferor's reservation of fiduciary powers engenders a conflict between his individual interest in retaining his position as a director or officer of the corporation and his fiduciary interest. Furthermore, if the transferred stock is nonvoting stock, the transferor's expressly retained fiduciary power to control the disposition of the transferred stock, combined with his implied retention of corporate voting control, should be deemed a discretionary power to accumulate or distribute the income from the transferred stock, within the meaning of *Jennings v. Smith*.²³⁴

Every power whose exercise can be compelled, prevented, or reviewed by a court of equity apparently is considered to be limited by ascertainable external standards for estate tax purposes, unless it enables its holder to affect the relative rights of the income beneficiary and the remainderman.²³⁵ If it does so empower its holder, it is non-

230. See *O'Hayer v. de St. Aubin*, 30 App. Div. 2d 419, 293 N.Y.S.2d 147 (2d Dep't 1968); *In re Pincus' Estate*, 378 Pa. 102, 105 A.2d 82 (1954); *In re Steele's Estate*, 377 Pa. 250, 103 A.2d 409 (1954); *Flagg's Estate*, 365 Pa. 82, 73 A.2d 411 (1950).

231. See *Estate of Fruehauf v. Commissioner*, 70-1 U.S. Tax Cas. ¶ 12,688 (6th Cir. 1970), *aff'g* 50 T.C. 915 (1968); *O'Hayer v. de St. Aubin*, 30 App. Div.2d 419, 293 N.Y.S.2d 147 (2d Dep't 1968); *In re Pincus' Estate*, 378 Pa. 102, 105 A.2d 82 (1954); *In re Steele's Estate*, 377 Pa. 250, 103 A.2d 409 (1954); *Flagg's Estate*, 365 Pa. 82, 73 A.2d 411 (1950); G. G. BOGERT & G. T. BOGERT, *supra* note 222, § 543(U); 2 A. SCOTT, *supra* note 146, §§ 170.9, 170.24.

232. Discussed *supra* pp. 214-16.

233. See *Estate of Fruehauf v. Commissioner*, 70-1 U.S. Tax Cas. ¶ 12,688 (6th Cir. 1970), *aff'g* 50 T.C. 915 (1968); cases cited note 230 *supra*.

234. See notes 235-261 *infra* and accompanying text.

235. *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970). See *United States v. Powell*, 307 F.2d 821 (10th Cir. 1962); *Estate of Ralph Budd*, 49 T.C. 468 (1968); *Estate of Marvin L. Pardee*, 49 T.C. 140 (1967). Compare *Estate of Willard V. King*, 37 T.C. 973 (1962), *nonacquiesced in*, 1963-1 CUM. BULL. 5, *with Estate of Cyrus C. Yawkey*, 12 T.C. 1164 (1949), *acquiesced in*, 1949-2 CUM. BULL. 3. N.B. A power exercisable by its holder for his own benefit *per se* enables him to affect the relative rights of the income beneficiary and the remainderman.

discretionary for estate tax purposes only if *expressly* limited by a determinable external standard.²³⁶ Thus, considered individually, a transferor's fiduciary powers to vote the transferred stock²³⁷ and to control its disposition²³⁸ properly are held to be nondiscretionary, even absent an express imposition on their exercise of an ascertainable external standard, where the transferor does *not* have voting control of the corporation after the transfer. If, however, the transferor possesses corporate voting control after the transfer, his expressly retained powers to vote the transferred stock and to control its disposition, when considered in conjunction with each other and with the fact of retained voting control, amount to an impliedly reserved power to accumulate or distribute the income from the transferred stock.²³⁹ Since a power to accumulate or distribute the income from transferred property enables its holder to affect the relative rights of the income beneficiary and the remainderman,²⁴⁰ it is nondiscretionary only if *expressly* limited by an ascertainable external standard.²⁴¹ If it is not so limited, its retention by the transferor renders the transfer subject to both sections 2036(a)(2) and 2038 of the Code.²⁴² This conclusion, moreover, is not affected by the fact that the power to accumulate or distribute income impliedly arises from the express or implied reserva-

236. Cases cited note 235 *supra*.

237. *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); Estate of Edward E. Ford, 53 T.C. 114 (1969), *aff'd per curiam*, 71-2 U.S. Tax Cas. ¶ 12,813 (2d Cir. Nov. 12, 1971); Estate of Willard V. King, 37 T.C. 973 (1962), *non-acquiesced in*, 1963-1 CUM. BULL. 5. See *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970); Estate of Aline Peters Peters, 23 Tax Ct. Mem. 994 (1964). With the exception of *Byrum*, none of the above cases involved a situation in which the transferor, after the transfer, had voting control of the corporation(s) whose stock he transferred. The *Byrum* theory, that the fiduciary relationship between corporate directors and shareholders, causes the exercise of corporate voting control to be limited by an ascertainable external standard, is discussed in notes 136-68 *supra* and accompanying text. *But cf.* Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971 INT. REV. BULL. No. 9, at 6.

238. *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); *United States v. Powell*, 307 F.2d 821 (10th Cir. 1962); *Fifth Ave. Bank v. Nunan*, 59 F. Supp. 753 (E.D.N.Y. 1945); Estate of Edward E. Ford, 53 T.C. 114 (1969), *aff'd per curiam*, 71-2 U.S. Tax Cas. ¶ 12,813 (2d Cir. Nov. 12, 1971); Estate of Ralph Budd, 49 T.C. 468 (1968); Estate of James H. Graham, 46 T.C. 415 (1966); Estate of Willard V. King, 37 T.C. 973 (1962), *non-acquiesced in*, 1963-1 CUM. BULL. 5; Estate of George W. Hall, 6 T.C. 933 (1946), *acquiesced in*, 1946-2 CUM. BULL. 3; Estate of Henry S. Downe, 2 T.C. 967 (1943), *petition for review dismissed nolle pros.* (2d Cir. June 1, 1944), *non-acquiesced in*, 1944 CUM. BULL. 37; Estate of Laura B. Alexander, 2 Tax Ct. Mem. 1156 (1943). See *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970); Estate of Aline Peters Peters, 23 Tax Ct. Mem. 944 (1964); textual matter in note 237 *supra*.

239. See notes 83-87, 137-87 *supra* and accompanying text; text following note 212 *supra*. See *Byrum v. United States*, 440 F.2d 949, 953 (6th Cir. 1971) (Phillips, C.J., dissenting); Estate of John J. Round, 40 T.C. 970, 981 (1963), *aff'd*, 332 F.2d 590 (1st Cir. 1964).

240. Estate of John J. Round, 40 T.C. 970 (1963), *aff'd*, 332 F.2d 590 (1st Cir. 1964); Estate of Milton J. Budlong, 7 T.C. 756 (1946), *aff'd on this point and rev'd and remanded in part sub nom.* Industrial Trust Co. v. Commissioner, 165 F.2d 142 (1st Cir. 1947). See, e.g., *United States v. O'Malley*, 383 U.S. 627 (1966); *Joy v. United States*, 404 F.2d 419 (6th Cir. 1968), *aff'g and remanding* 272 F. Supp. 544 (E.D. Mich. 1967).

241. Cases cited note 235 *supra*.

242. See note 17 *supra*.

tion of other powers, rather than from its express retention as such.²⁴³ Nor is this conclusion affected by the fact that the powers which must be aggregated to imply the retention of a power to accumulate or distribute, if considered individually, are or may be nondiscretionary.

The principle that an aggregation of nondiscretionary powers can be deemed a discretionary power first was articulated in *State St. Trust Co. v. United States*.²⁴⁴ The transferor in *State Street* retained as trustee exceedingly broad "administrative" and managerial powers over the transferred property. The Court of Appeals for the First Circuit held that the retained powers, considered in the aggregate, required the application of a predecessor of section 2036(a)(2) of the Code to the transfer, even though such retained powers probably would not require the application of this section if they were considered individually. On this issue the court stated:

Perhaps no single power conferred by the decedent on the trustees would be enough to warrant inclusion of the corpora of the trusts in his estate. But we believe that the powers conferred on the trustees, considered as a whole, are so broad and all inclusive that within any limits a Massachusetts court of equity could rationally impose, the trustees, within the scope of their discretionary powers, could very substantially shift the economic benefits of the trusts between the life tenants and the remaindermen.²⁴⁵

For many years the judicial attitude toward the *State Street* principle was one which can best be described as passive resistance. Until recently, the courts, though not denying the validity of the principle, consistently have distinguished *State Street* on its facts.²⁴⁶ Recently, however, the Court of Appeals for the First Circuit, in *Old Colony Trust Co. v. United States*,²⁴⁷ purported to overrule *State Street*. In *Old Colony Trust Co.*, the transferor, like the transferor in *State Street*, reserved as trustee exceedingly broad "administrative" and managerial powers over the transferred property. In holding that the transferor's retention of these powers did not require the application of either section 2036(a)(2) or section 2038 of the Code to the transfer, the court stated:

If *State Street Trust Co. v. United States* . . . was correctly decided in this aspect, the government must prevail because of the Article 7 powers. . . .

243. Estate of John J. Round, 40 T.C. 970, 981 (1963), *aff'd*, 332 F.2d 590 (1st Cir. 1964). See *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971).

244. 263 F.2d 635 (1st Cir. 1959).

245. *Id.* at 639.

246. *E.g.*, Estate of Edward E. Ford, 53 T.C. 114 (1969), *aff'd per curiam*, 71-2 U.S. Tax Cas. ¶ 12,813 (2d Cir. Nov. 12, 1971); Estate of Ralph Budd, 49 T.C. 468 (1968). See *Byrum v. United States*, 440 F.2d 949 (6th Cir. 1971), *aff'g* 311 F. Supp. 892 (S.D. Ohio 1970), *cert. granted*, 40 U.S.L.W. 3219 (U.S. Nov. 9, 1971); Willard V. King, 37 T.C. 973 (1962), *nonacquiesced in*, 1963-1 CUM. BULL. 5.

247. 423 F.2d 601 (1st Cir. 1970).

. . . .

The government's position, to be sound, must be that the trustee's powers are beyond the court's control. Under Massachusetts law, however, no amount of administrative discretion prevents judicial supervision of the trustee. . . .

. . . .

. . . We do not believe that trustee powers are to be more broadly construed for tax purposes than the probate court would construe them for administrative purposes. . . . We hold that no aggregation of purely administrative powers can meet the government's amorphous test of "sufficient dominion and control" so as to be equated with ownership.²⁴⁸

Although, on the basis of the above language, *Old Colony Trust Co.* arguably could be said to stand for the proposition that, if retained "administrative" and managerial powers are nondiscretionary when considered individually, they remain nondiscretionary when considered in the aggregate, it does not in fact do so. When taken in context, the above language in fact holds only that *State Street* was wrong in its conclusion that Massachusetts law permits the retained powers to be exercised in such a way as to "substantially shift the economic benefits of the trusts between the life tenants and the remaindermen."²⁴⁹ Likewise, to the extent that *Old Colony Trust Co.* holds that "[t]he government's position [that a transferor's retention of an aggregation of administrative powers requires application of sections 2036(a)(2) and 2038], to be sound, must be that the trustee's powers are beyond the court's control,"²⁵⁰ it clearly is erroneous.²⁵¹ If, on the other hand, *State Street* was buried by *Old Colony Trust Co.*, it recently was resurrected by *Estate of Stewart v. Commissioner*,²⁵² and now is enjoying a vigorous renaissance.²⁵³

The decedent in *Stewart* created two trusts, naming a bank as sole trustee. She retained for life the income from both trusts. The ultimate remaindermen of each trust were named charities which met the donee requirements of the estate tax charitable deduction.²⁵⁴ The trust agreements gave broad administrative powers to the trustee. The

248. *Id.* at 602-03.

249. 263 F.2d at 639. See *Estate of Stewart v. Commissioner*, 436 F.2d 1281 (3d Cir. 1971), *cert. denied*, 40 U.S.L.W. 3162 (U.S. Oct. 12, 1971).

250. 423 F.2d at 603.

251. See notes 144-55 *supra* and accompanying text.

252. 436 F.2d 1281 (3d Cir. 1971), *cert. denied*, 40 U.S.L.W. 3162 (U.S. Oct. 12, 1971).

253. See *Rand v. United States*, 71-2 U.S. Tax Cas. ¶ 12,797 (2d Cir. July 22, 1971); *Peoples Trust Co. v. United States*, 71-1 U.S. Tax Cas. ¶ 12,786 (3d Cir. June 9, 1971); *First Nat'l Bank v. United States*, 71-1 U.S. Tax Cas. ¶ 12,777 (5th Cir. May 7, 1971), *cert. denied*, 40 U.S.L.W. 3264 (U.S. Dec. 7, 1971); *Miami Beach First Nat'l Bank v. United States*, 71-1 U.S. Tax Cas. ¶ 12,774 (5th Cir. Apr. 30, 1971), *cert. denied*, 40 U.S.L.W. 3264 (U.S. Dec. 7, 1971); *Estate of Toulmin v. United States*, 71-1 U.S. Tax Cas. ¶ 12,775 (S.D. Ohio Mar. 19, 1971), *appeal docketed by Gov't*, 6th Cir. 1971.

254. Set forth in INT. REV. CODE of 1954, § 2055.

corpora of these trusts was, of course, included in the decedent's gross estate under section 2036(a)(1) of the Code. At issue, however, was an estate tax charitable deduction claimed under section 2055 for the value of the remainders in these trusts. The Commissioner denied the charitable deduction on the ground that the trustee's broad administrative powers over the trusts precluded the value of the charitable remainders therein from being presently ascertainable. The Court of Appeals for the Third Circuit, relying specifically on *State Street*, upheld the Commissioner because, under applicable state law, the trustee's exercise of its administrative powers was not "limited by an ascertainable standard."²⁵⁵ In discussing this issue, the court stated:

[T]he Government argues that the trustee for the Stewart trusts may well act with the purest motives and always in good faith, but state law will not provide any fixed and ascertainable standard of investment and management conduct for the trustee. Here the decedent's dispositive intent does not reveal any desire to favor the life tenants over the remaindermen, but decedent's administrative intent was to rely solely upon the trustee's judgment and discretion rather than upon the normal rules of state law governing the administration of trusts. Such broad powers have been previously recognized as enabling a trustee, acting safely within his prerogatives, to shift "very substantially * * * the economic benefits of the trusts between the life tenants and the remaindermen." *State Street Trust Co. v. United States*²⁵⁶

Although *Stewart* involves the allowability of the estate tax charitable deduction, rather than the applicability of section 2036(a)(2) or section 2038 of the Code, it clearly reaffirms and reestablishes the *State Street* principle that an aggregation of nondiscretionary "administrative" or managerial powers can be deemed a discretionary power if, under applicable state law, the holder of the powers can by their combined exercise shift the economic benefits of the trust among its beneficiaries without breaching his fiduciary duty.²⁵⁷ Moreover, in view of some of the cases decided after *Stewart*,²⁵⁸ this principle did not

255. 436 F.2d at 1285.

256. *Id.* at 1288.

257. *E.g.*, *Peoples Trust Co. v. United States*, 71-1 U.S. Tax Cas. ¶ 12,786 (3d Cir. June 9, 1971), in which the Third Circuit, on a set of facts substantially similar to that involved in *Stewart*, reaffirmed its holding therein, but allowed the estate tax charitable deduction on the theory that, under applicable state law, *i.e.*, that of New Jersey, the trustee's exercise of the administrative powers in question, considered in the aggregate, was limited by a fixed and ascertainable standard.

258. *Rand v. United States*, 71-2 U.S. Tax Cas. ¶ 12,797 (2d Cir. July 22, 1971); *First Nat'l Bank v. United States*, 71-1 U.S. Tax Cas. ¶ 12,777 (5th Cir. May 7, 1971), *cert. denied*, 40 U.S.L.W. 3264 (U.S. Dec. 7, 1971); *Miami Beach First Nat'l Bank v. United States*, 71-1 U.S. Tax Cas. ¶ 12,774 (5th Cir. Apr. 30, 1971), *cert. denied*, 40 U.S.L.W. 3264 (U.S. Dec. 7, 1971); *Estate of Toulmin v. United States*, 71-1 U.S. Tax Cas. ¶ 12,775 (S.D. Ohio Mar. 19, 1971), *appeal docketed by Gov't*, 6th Cir. 1971. Although *Peoples Trust Co. v. United States*, 71-1 U.S. Tax Cas. ¶ 12,786 (3d Cir. June 9, 1971), applied this principle, it did so on the basis of *Estate of Stewart v. Commissioner*, 436 F.2d 1281 (3d Cir. 1971), *cert. denied*, 40 U.S.L.W. 3264 (U.S. Dec. 7, 1971).

originate in *State Street*, although it was first articulated therein. Rather, it seems to be inherent in estate tax jurisprudence. The Second²⁵⁹ and Fifth Circuits,²⁶⁰ for example, recently applied this principle to disallow the charitable deduction without reference to *State Street*, *Stewart*, or each other. In fact, it is implicit in their decisions that these circuits regard this principle as too well established to require discussion.²⁶¹ It follows that the fact that the powers which must be aggregated to raise the implication of retention by a transferor of the power to accumulate or distribute are, or may be, nondiscretionary if considered individually will not prevent such implication.

V. CONCLUSION

An *inter vivos* transfer of closely-held corporate stock under which the transferor retains voting control of the corporation whose stock is transferred, clearly affords the transferor rights in or over the transferred stock. While such rights can be considerable, not all such transfers are necessarily testamentary dispositions within the meaning of sections 2036-38 of the Code. For example, since such a transfer, absent other factors, does not involve the retention of an income²⁶² or reversionary²⁶³ interest, a retention of voting control without more does not bring a transfer within the scope of either section 2036(a)(1) or section 2037, respectively. However, as corporate voting control does enable its holder ultimately to control the amount of dividends paid on the transferred stock,²⁶⁴ such resultant power is in effect a power to accumulate or distribute income,²⁶⁵ which, if discretionary, is both a section 2036(a)(2) right to designate²⁶⁶ and a section 2038 right to alter or amend.²⁶⁷ Therefore, such a transfer should, under certain circumstances at least, be characterized as a testamentary disposition within the scope of sections 2036(a)(2) and 2038.²⁶⁸

In the case of an outright transfer of stock under which corporate voting control is impliedly retained, such retention, of itself, should cause the application of sections 2036(a)(2) and 2038 to the transfer.²⁶⁹ Where, however, the transfer is in trust, neither of these sections should apply unless the transferred stock is unmarketable or its disposition is subject to control by the transferor.²⁷⁰ This distinc-

259. *Rand v. United States*, 71-2 U.S. Tax Cas. ¶ 12,797 (2d Cir. July 22, 1971).

260. *First Nat'l Bank v. United States*, 71-1 U.S. Tax Cas. ¶ 12,777 (5th Cir. May 7, 1971), *cert. denied*, 40 U.S.L.W. 3264 (U.S. Dec. 7, 1971); *Miami Beach First Nat'l Bank v. United States*, 71-1 U.S. Tax Cas. ¶ 12,774 (5th Cir. Apr. 30, 1971), *cert. denied*, 40 U.S.L.W. 3264 (U.S. Dec. 7, 1971).

261. See cases cited notes 259 & 260 *supra*.

262. See cases cited notes 75-80 *supra* and accompanying text; cases cited notes 189-211 *supra* and accompanying text.

263. See cases cited notes 57-73 *supra* and accompanying text.

264. See notes 21-23 *supra* and accompanying text.

265. Cases cited notes 84 & 85 *supra* and accompanying text.

266. Cases cited note 86 *supra*.

267. Cases cited note 87 *supra*.

268. See note 88 *supra* and text accompanying notes 88 & 89 *supra*.

269. See notes 176-87 *supra* and accompanying text.

270. *Id.*

tion with respect to the mode of transfer is necessitated by the theory that property transferred in trust, for purposes of the transfer sections of the Code, is the trust corpus itself rather than the specific assets comprising it.

The question of whether a transferor's retained power over the transferred stock is nevertheless a nondiscretionary power, and therefore not within the scope of either section 2036(a)(2) or section 2038, may arise in two situations. It may arise, as it did in *Byrum*, with respect to the transferor's power to control corporate dividend policies, or it may arise with respect to the transferor's express retention of so-called administrative powers over the transferred stock itself, such as the right to vote it or to control its disposition. Contrary to the holding in *Byrum*, the fiduciary duty of a corporate board of directors in determining dividend policies is not controlled by a determinable external standard so as to render the controlling shareholder's power over the transferred stock nondiscretionary.²⁷¹ Similarly, although "administrative powers" over the transferred stock itself generally have been held to be nondiscretionary, if the transferor retains voting control of the corporation in addition to the power to control the disposition of the transferred stock this combination of powers in the hands of the transferor should render discretionary that which otherwise might be considered nondiscretionary.²⁷²

The established meaning of the words of sections 2036(a)(2) and 2038 thus requires the conclusion that a retention of corporate voting control affords a transferor a power over the transferred stock which is both a "right . . . to designate" and a "right to alter, amend, revoke, or terminate." Those decisions arguably to the contrary lack authoritative value with respect to this issue or are incorrect. The Supreme Court has agreed to review *Byrum*. Hopefully, the court's forthcoming decision will provide a much needed opinion of authoritative value which will clarify the estate tax consequences of an *inter vivos* transfer of corporate stock.

271. See notes 137-68 *supra* and accompanying text.

272. See notes 212-61 *supra* and accompanying text.