CHURCH AND SPIEGEL: THE LEGISLATIVE SEQUEL

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As the court of last resort, the Supreme Court may be thought by some to be the "court of ultimate conjecture and final error."¹ But in tax—as in most other—questions, it is Congress which is supreme. It can correct the Supreme Court's errors or perpetuate them. And just as surely, Congress can see that the Supreme Court does not have the last word even when that word was a correct answer to a legislative question. In October of 1949, Congress exercised its prerogative of overruling the Supreme Court by adding a legislative sequel² to the *Church* and *Spiegel* cases,³ which had been decided nine months earlier. A bizarre story of two decades of legislative-judicial rivalry was thus brought to a close.

In 1930 the Supreme Court decided *May v. Heiner*.⁴ The decision saddled the estate tax law with a gross misinterpretation⁵ which, when

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1. The phrase was used by Chief Justice Hughes to describe the attitude of defeated litigants in patent cases toward the Circuit Courts of Appeals. Hughes, *The Patent Bar*, 12 J. PAT. OFF. SOC'Y 292, 293 (1930).

2. Pub. L. No. 378, 81st Cong., 1st Sess. (Oct. 25, 1949). The bill, H.R. 5268, was passed by the House on July 18, 1949, 95 CONG. REC. 9847, see SEN. REP. NO. 831, 81st Cong., 1st Sess., but was overhauled in all respects here relevant by the Conference Committee, see H.R. REP. NO. 1412, 81st Cong., 1st Sess., and, as amended, was passed by both Houses and approved by the President.

3. *Commissioner v. Church's Estate*, 335 U.S. 632 (1949); *Spiegel's Estate v. Commissioner*, 335 U.S. 701 (1949). The cases have been extensively commented on. The author's own article, Bittker, *The Church and Spiegel Cases: Section 811(c) Gets a New Lease on Life*, 58 YALE L.J. 825 (1949), will be frequently referred to hereafter in order to avoid repeating certain arguments set out there in detail. Among the many other discussions of the cases, in addition to those listed in note 12 of my previous article, are the following: Riehm, *Taxability of Irrevocable Inter Vivos Trusts*, 3 SOUTHWESTERN L.J. 107 (1949); Schuyler, *Escape From Spiegel*, 44 ILL. L. REV. 131 (1949); Note, *Church and Spiegel in Perspective*, 16 U. OF CHI. L. REV. 711 (1949). The most incisive analysis of the subject before the *Church* and *Spiegel* cases is to be found in PAUL, *FEDERAL ESTATE AND GIFT TAXATION* §§ 7.23-7.29 (Supp. 1946), and Eisenstein, *Estate Taxes and the Higher Learning of the Supreme Court*, 3 TAX L. REV. 395 (1948).

4. 281 U.S. 238 (1930).

5. 1 PAUL, *FEDERAL ESTATE AND GIFT TAXATION* § 7.14 (1942) and articles there cited; Surrey & Aronson, *Inter Vivos Transfers and the Federal Estate Tax*, 32 COL. L. REV. 1332 (1932).

its full import was unfolded by the Court a year later,⁶ was repudiated by Congress for transfers taking place in the future.⁷ In doing so, Congress set what must be an all-time speed record for the legislative rejection of a judicial doctrine; one day sufficed for the measure's passage by both Houses and its approval by the President. In January of 1949, nineteen years later, in deciding *Commissioner v. Church's Estate*, the Court confessed its error and overruled *May v. Heiner*. Nine months still later, Congress announced that the error was too deeply embedded to be fully corrected, overruled the *Church* case as to the estate there involved and others similarly situated, and reinstated in part the doctrine which nineteen years earlier—and perhaps even in 1949—no one was ready to defend.⁸ To the limited extent that Congress did accept the doctrine of the *Church* case, it opened a route by which it easily can be avoided.⁹

The legislative-judicial interplay was less striking in the *Spiegel* case, but its consequences run deeper. Here too an earlier decision was involved, *Reinecke v. Northern Trust Co.*,¹⁰ decided in 1929. But this decision was a more tenable one than *May v. Heiner*, and for two decades it went unchallenged by Congress or Court. In *Spiegel's Estate v. Commissioner*, however, the Court announced a doctrine which in application conflicted with *Northern Trust*. The cases could be reconciled in terms of legal theory, however, despite their practical inconsistency, and the Court did not openly overrule its earlier decision. Now Congress has alleviated the contrast between the two cases by overruling *Northern Trust* for future transfers while restricting *Spiegel* for past transfers.¹¹

In form the Court has not had the last word, and even in substance some of its views have been repudiated. Yet the estate tax system is more rational as a consequence of the *Church* and *Spiegel* cases, for the sweeping positions adopted there were the impetus to the action of Congress. And the "ultimate error" which remains is—in my opinion—the fault of Congress and not of the Court, though undoubtedly the mistakes of Congress derive in large part from the rhetoric of the dissenting Justices.¹²

The legislation is embodied in Sections 7 and 8 of Public Law 378, passed by the first session of the 81st Congress and approved by the

6. *Burnet v. Northern Trust Co.*, 283 U.S. 782 (1931); *Morsman v. Burnet*, 283 U.S. 783 (1931); *McCormick v. Burnet*, 283 U.S. 784 (1931).

7. The Joint Resolution of March 3, 1931 (46 STAT. 1516 (1931)).

8. See Section 7, Pub. L. No. 378, *supra* note 2.

9. See Section 8, Pub. L. No. 378, *supra* note 2.

10. 278 U.S. 339 (1929). Throughout this article, references to this decision are applicable only to the 1919 "five trusts" there involved, not to the two pre-1916 trusts.

11. Section 7, Pub. L. No. 378, *supra* note 2.

12. See Bittker, *supra* note 3, at 855-64; pp. 414-16 *infra*.

President on October 27, 1949. The statute has been called the "Technical Changes Act of 1949,"¹³ an example of misbranding, unless a change of substance becomes a "technical" change solely by reason of its complexity. The provisions responsive to the *Spiegel* case will be discussed first, followed by those evoked by the *Church* case.

THE SPIEGEL LEGISLATION

I. *The problem: conflict between the Northern Trust and Spiegel cases.* In *Reinecke v. Northern Trust Co.*,¹⁴ decided in 1929, the Supreme Court held that the corpus of a trust was not swept into the gross estate merely because "possession or enjoyment of the trust fund [passed] from the life tenants to the remaindermen after the testator's death, as directed." Although the Court conceded that such a transfer was intended to take effect in possession or enjoyment at or after death—the very test which Congress had established for taxability—it thought the transfer was an "absolute and complete gift" and that it would be "incongruous" to subject the transferred property to an *estate* (as distinguished from a gift) tax. This led the Court to the view that it was "at least doubtful" whether the possession or enjoyment clause of the taxing statute was intended by Congress to reach property other than that "passing from the possession, enjoyment or control of the donor at his death." Adding that a statutory inclusion of property which did not pass from the donor at death would arouse constitutional doubts, the Court rejected the estate tax where the transfer "takes the form of a life estate in one with remainder over to another at or after the donor's death."

Reinecke v. Northern Trust Co. has held sway ever since,¹⁵ notwithstanding later dissipation of the Court's constitutional fears.¹⁶ In 1948, however, the Court "requested" counsel to discuss its validity in rearguing the *Spiegel* and *Church* cases.¹⁷ On the reargument the Government, after assuring the Court that its position in the *Spiegel* and *Church* cases did not demand overruling the *Northern Trust* case, went on to assert that it had been wrongly decided because a trust which terminates upon the settlor's death is "a substitute for a testamentary disposition" and is both literally and in principle a transfer "intended 'to take effect in possession or enjoyment at or after

13. See, for example, CCH FED. EST. & GIFT TAX REP. Report Letter No. 21, November 1, 1949.

14. 278 U.S. 339 (1929).

15. The current regulations acknowledge allegiance to the decision by requiring as a condition of taxability, that the decedent or his estate have possessed some right or interest in the property. U.S. Treas. Reg. 105, § 81.17.

16. See *Helvering v. Bullard*, 303 U.S. 297 (1938); *Eisenstein*, *supra* note 3, at 497-500.

17. 68 S. Ct. 1522, 1524 (1947).

death.' " ¹⁸ Taxpayer counsel argued that the case was correctly decided because the settlor of such a trust retained no interest in the property, the federal estate tax, unlike state inheritance taxes, being levied upon the "transfer of property from the dead" and not upon "succession to property by a beneficiary." ¹⁹ In deciding the *Spiegel* case, the Court relegated *Reinecke v. Northern Trust Co.* to a footnote, leaving its present virility in inconvenient obscurity.²⁰ The Treasury Regulations which were promulgated in response to the *Spiegel* case conformed, as had the earlier Regulations, to *Reinecke v. Northern Trust Co.*²¹

Looking only to pure doctrine, the two cases were not in conflict: *Northern Trust* held that no tax could be levied if the settlor retained no interest in the property; *Spiegel* held that even an insignificant retained interest would cause a tax. Yet if the tax was not to lose touch with reality, either *Spiegel* or *Northern Trust* must give way. The dilemma was neatly posed in the *Spiegel* case, where the trust was to terminate on the settlor's death. This fact, under *Reinecke v. Northern Trust Co.*, was not enough to result in tax. In addition, the corpus would have reverted to the settlor if he had survived his children and their descendants. This possibility was infinitesimal: when the trust was created, the settlor had 17 chances in 1000 of surviving, and just before his death, the march of time had reduced his chances to 16 out of 100,000.²² Accepting the *Northern Trust* doctrine, then, it was only the existence of this fantastic reversionary possibility which cost *Spiegel*'s heirs \$450,000 in estate tax.

Since it is inconceivable that in the future anyone would retain such a reversionary interest with knowledge of its consequences, the tax would be exacted only where the settlor's draftsman lost his way among the "unwitty diversities" and "elusive and subtle casuistries" of property law which the Supreme Court once thought had no place in the law of taxation.²³ To take only one example, suppose the draftsman of a conveyance in trust provided for a series of successive remainders, with a remainder in the settlor's next of kin in the event that all preceding remainders should fail. If the remainder conferred upon the settlor's next of kin is effective, the settlor would have no reversionary interest in the corpus and (assuming, as did the Treasury Department, that *Spiegel* left *Northern Trust* unscathed) the transfer would not

18. Brief for Commissioner of Internal Revenue on Reargument, pp. 9-13, 16-26.

19. Petitioners' Supplemental Brief on Reargument (*Spiegel* case), pp. 9-16.

20. Bittker, *supra* note 3, at 843-5.

21. T.D. 5741, 1949 INT. REV. BULL. No. 18 at 10 (1949).

22. Brief for Petitioners, p. 4; see Mr. Justice Burton, dissenting, 335 U.S. 701, 733 (1949); findings of fact in opinion of Tax Court, 4 CCH TAX CT. DEC. 14, 424 (M) (T.C. 1945).

23. *Helvering v. Hallock*, 309 U.S. 106, 114 (1940).

be taxed. But if the doctrine of "worthier title" be applied to the conveyance,²⁴ the remainder in the settlor's next of kin would fail, a reversionary interest by operation of law would take its place, and the trust fund would be part of the gross estate. Thus imposition of the estate tax would hang on one of the most elusive of the "unwitty diversities" of property law.

If one's target is an estate tax system based not on "elusive and subtle casuistries" but upon reasons of policy, it becomes necessary to choose between *Spiegel* and *Northern Trust*. In the Government's view, a *Northern Trust* transfer is a "substitute for a testamentary disposition."²⁵ Of course, it is not so patently a substitute as a transfer with life estate reserved, where the donor has insured his own enjoyment of the property until his death.²⁶ The function of a will is to dispose of what one has not consumed during life; by retaining a life estate and creating a remainder one puts the corpus beyond reach but retains the freedom to use the income as he desires. But if the settlor has disposed for all time of both the life estate *and* the remainder, as did the settlor in *Reinecke v. Northern Trust Co.*, his death becomes only the dividing line between enjoyment of income by the life tenant and enjoyment of corpus by the remainderman. Indeed, these beneficial interests may be conferred upon the same person, in which case the settlor's death merely divides enjoyment of the income from enjoyment of the corpus and determines whether the life tenant-remainderman or his estate will receive the corpus. If the settlor's death has no more effect than this, is the transfer a "substitute for a testamentary disposition" which should be subjected to an estate tax rather than solely to a gift tax?

Since the retention of a life estate by the settlor would stamp the transfer as a testamentary substitute, perhaps the transfer should also be taxed where the donor, by bestowing the life estate on another, in effect has made an anticipatory assignment of the income.²⁷ Or the *Clifford*²⁸ principle might be summoned to bear witness that though the settlor has given away the income for his life, he continues to enjoy it, albeit vicariously, with the result that a *Northern Trust* transfer is as

24. *Morris, The Inter Vivos Branch of the Worthier Title Doctrine*, 2 OKLA. L. REV. 133 (1949).

25. See note 18 *supra*.

26. "It is true that an ingenious mind may devise other means of avoiding an inheritance tax, but the one commonly used is a transfer with reservation of a life estate." *Matter of Keeney's Estate*, 194 N.Y. 281, 287, 87 N.E. 428, 429 (1909); "if the donor reserves the income to himself during his life, it is as nearly the substitute for a bequest as it can be and still remain a gift at all. . . ." *Vanderlip v. Commissioner*, 155 F.2d 152, 154 (2d Cir. 1946), *cert. denied*, 329 U.S. 728 (1946).

27. See *Helvering v. Horst*, 311 U.S. 112 (1940).

28. *Helvering v. Clifford*, 309 U.S. 331 (1940).

much a testamentary substitute as the transfer with life estate retained.²⁹ If so, an appropriate legislative formula for ending the war between *Northern Trust* and *Spiegel* would be to overrule the former by taxing any property where possession or enjoyment shifts at or after the settlor's death.

On the other hand, it should not be overlooked that the beneficiary may have the equivalent of full ownership during the settlor's lifetime—ordinarily proof of a gift—though the trust does not terminate until at or after the settlor's death. Under four of the trusts in *Northern Trust*, for example, the beneficiary had the right to the income for the settlor's life and for five years thereafter, the right to receive the corpus if he survived that period, and the right to dispose of the corpus as he chose if he failed to survive it.³⁰ In recent years it has been thought a sign of healthy realism to equate a testamentary power to appoint property with full ownership of the property.³¹ And if the donee became the owner of the property during the settlor's life, the statutory scheme is a gift tax rather than an estate tax, except in the special instances of gifts in contemplation of death and life insurance.

But those who find the doctrine of *Reinecke v. Northern Trust Co.* more persuasive than the theory that such a trust is a "testamentary substitute" are faced with the troublesome issue of what to do about the *Spiegel* case. As already shown, absurdity springs from preserving it intact alongside of *Northern Trust*. But can *Spiegel* be limited without spawning other absurdities?

Proposals to tax only the actuarial value, just before death, of the settlor's reversionary interest³² overlook the fact that the entire corpus—both the reversionary interest and the remainder—are in suspense until death. In the case of a retained life estate, few would argue that only the value of that interest—which becomes valueless at death—ought to be included. No reason has been advanced for treating transfers with reversionary interests differently. Another possibil-

29. The courts have not gone so far; to have done so, of course, would have reduced the *Northern Trust* case to a nullity. But the *Clifford* case's expansive view of what constitutes "enjoyment" of income may suggest that *Northern Trust* creates a legal distinction without a factual difference between trusts where the settlor has reserved the income and those where, though he has given it away, he enjoys it vicariously.

30. Record, pp. 19-20, 22, 27-28, 30, 35, 37, 42-43, 45.

31. McDougal, *Future Interests Restated: Tradition Versus Clarification and Reform*, 55 HARV. L. REV. 1077, 1112 (1942). In fact, even under the pre-1942 version of Section 811(f), rigid as it was, no difference existed between a general power exercisable by deed and one exercisable only by will. Griswold, *Powers of Appointment and the Federal Estate Tax*, 52 HARV. L. REV. 929, 938 (1939).

32. See, e.g., H.R. 6712, 80th Cong., 2d Sess. (1948), passed by House of Representatives, 94 CONG. REC. 9217 (June 19, 1948); see H.R. REP. NO. 2087, 80th Cong., 2d Sess. (1948). For similar earlier proposals see SHATTUCK, AN ESTATE PLANNER'S HANDBOOK 258-9 (1948).

ity is to distinguish between interests expressly reserved and those arising by operation of law; it may be that interests in the latter category are ordinarily unintended by the settlor and of insignificant value.³³ Yet such a distinction would place an unwarranted premium on canny drafting; one trust would be taxed and another not, though exactly the same economic interests were conveyed, merely because the one achieved its result through an express provision while the other did so by judicious silence. There remains the possibility of treating some reversionary interests as *de minimis*, by selecting an arbitrary figure below which the reversionary interest will be ignored but above which it will result in tax. This proposal for reconciling the *Spiegel* principle with the *Northern Trust* doctrine was advanced by the author in an earlier article.³⁴

II. *The legislative solution.* The reconciliation actually adopted by the Congress in the Technical Changes Act is a *mélange*. For transfers after October 7, 1949,³⁵ the doctrine of *Reinecke v. Northern Trust Co.*, twenty years after its enunciation, is rejected. Even if the decedent reserves no interest in the transferred property, it will be included in his gross estate if the transferee must survive the decedent as a condition of obtaining possession or enjoyment of the property.³⁶ But for transfers on or before October 7, 1949, the Congress preserved *Reinecke v. Northern Trust Co.* and restricted the *Spiegel* case by imposing tax only if the decedent retained a reversionary interest (a) "arising by the

33. Note 68 *infra*.

34. Bittker, *supra* note 3, 839, 840.

35. I am indebted to Mr. Colin F. Stam, Chief of Staff, Joint Committee on Internal Revenue Taxation, for the following explanation of the selection of October 7, 1949, as the critical date: "the Senate and House conferees reached general agreement on the amendments to section 811(c) of the Code on Monday, October 3, 1949, and the principal points of the agreement were made public on that date. At that time the conferees set the dividing line between the estate tax treatment of past and future transfers at October 3. An outline of this agreement, in which the October 3 date forms the dividing line, is contained in a Commerce Clearing House report, 'Supplement to Federal Estate and Gift Tax Report Number 19,' dated October 4, 1949. When the conferees met again on Friday, October 7, 1949, they decided to shift the dividing line to between October 7 and October 8. This was done because of the possibility that some persons might have made transfers after October 3 in reliance on the *Reinecke* doctrine and in ignorance of the conference agreement announced on October 3. It was felt that the wide publicity given to the October 3 announcement by the tax services would provide sufficient notice by October 7. It was also felt that there was no danger that shifting the date ahead to October 7-8 would enable persons to make transfers prior to October 8 in the knowledge that they were avoiding the estate tax consequences on future transfers, since persons who were aware of the conference agreement between October 3 and October 8 were, during that period, under the impression that the dividing line would be set at October 3." (Letter from Mr. Stam to the author, December 30, 1949).

36. Section 7(a), Pub. L. No. 378, *supra* note 2. The section amends Section 811(c) of the Internal Revenue Code by adding a new subsection: 811(c)(3).

express terms of the instrument of transfer and not by operation of law" and (b) having a value immediately before his death exceeding 5% of the value of the transferred property.³⁷ In discussing the details of the legislation, the taxability of transfers after October 7, 1949, will be taken up first.

A. *Transfers after October 7, 1949.* The new legislation in effect defines the phrase "transfer . . . intended to take effect in possession or enjoyment at or after his death." Though the phrase has appeared in the federal estate tax law since its enactment in 1916,³⁸ and in state statutes since 1826,³⁹ its construction previously had been entrusted to the courts. For the first time, Congress has spelled out its own conception of the scope of the "possession or enjoyment" clause.

As amended by Section 7 of the Technical Changes Act,⁴⁰ Section 811(c) of the Internal Revenue Code now provides:

"An interest in property transferred by the decedent after October 7, 1949, shall be included in his gross estate . . . (whether or not the decedent retained any right or interest in the property transferred) if and only if—

(A) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent; or (B) under alternative contingencies provided by the terms of the transfer, possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the earlier to occur of (i) the decedent's death or (ii) some other event; and such other event did not in fact occur during the decedent's life."

1. *Section 811(c)(3)(A).* Clause (A), like T.D. 5512 (the "Hallock regulation")⁴¹ upon which it probably was patterned, looks to whether a beneficiary's possession or enjoyment is dependent upon surviving the decedent. The "Hallock regulation," however, also required that the decedent or his estate have retained an interest in the property; consequently no tax was imposed unless there was both a condition of survivorship and a reversionary interest. But the parenthetical clause in the new legislation eliminates the latter requirement, which, of course, stemmed from the doctrine of *Reinecke v. Northern Trust Co.* that property must pass "from the possession, enjoyment or control of the donor at his death."

37. *Ibid.* The section adds another new subsection: 811(c)(2).

38. Revenue Act of 1916, § 202(b), 39 STAT. 777 (1916), INT. REV. CODE § 811(c).

39. Leighton, *Origin of the Phrase, "Intended to Take Effect in Possession or Enjoyment At or After . . . Death"* (Section 811(c), Internal Revenue Code), 56 YALE L.J. 176 (1946).

40. Note 2 *supra*.

41. The regulation was promulgated on May 2, 1946, FED. REG. 4856, amending U.S. Treas. Reg. 105, § 81.17. The current regulations also embody the changes of September 8, 1949 (note 21 *supra*).

In illustration of the reach of Clause (A), the Conference Report⁴² gives as an example a trust to accumulate the income during the settlor's life and at his death to pay principal and accumulated income to his son or to the son's estate. The son must survive the settlor to obtain possession or enjoyment of the property; this results in tax, even though the alternate taker is not the decedent's estate but the son's own estate. If the distribution were to occur only x years after decedent's death, the corpus would be equally taxable. The settlor having no reversionary interest, trusts of these types would have escaped tax under the "Hallock regulations"; it provided that survivorship was a necessary but not a sufficient condition to the imposition of tax. But under Clause (A) of the amended statute a tax would be imposed; survival of the decedent by the beneficiary is both a necessary condition, and a sufficient condition as well.

The fate of *Shukert v. Allen*⁴³ under Clause (A) is obscure. There, it will be recalled, the settlor created a trust to accumulate the income for 30 years, and then to divide principal and accumulated income among his three children or their issue. The Commissioner argued that, since the settlor's life expectancy was sixteen years at the time of the transfer, it was intended to take effect in possession or enjoyment at or after his death. The Court, in an aimless opinion by Mr. Justice Holmes, held against a tax. The decision could have been bottomed on the decedent's failure to retain an interest in the transferred property, the doctrine soon to be announced in *Reinecke v. Northern Trust Co.*, but the opinion also dallies with the fact that the term of the trust was not expressly geared to the length of the testator's life.⁴⁴ The issue under Clause (A) of the amended statute is: can the settlor provide that the trust shall terminate at the end of a period equal to or longer than his life expectancy? At least at the time the trust is established, Clause (A) is not satisfied: the beneficiaries need not survive the decedent—it is enough that they survive the stated period.⁴⁵ Curiously, a more plausible case for inclusion of such a trust can be made

42. H.R. REP. No. 1412, 81st Cong., 1st Sess. 9, Example (3) (1949).

43. 273 U.S. 545 (1927).

44. In *Reinecke v. Northern Trust Co.*, *supra* note 10, Mr. Justice Stone explained *Shukert v. Allen* as involving a transfer not "intended" to take effect after the settlor's death. In the earlier case, it is true, Mr. Justice Holmes said only that if the settlor "thought about it, he would have contemplated the possibility or probability of his being dead before the emergency might arise."

45. A similar issue arises if the settlor reserves the income from transferred property for a period equal to or greater than his life expectancy. Under 811(c)(1)(B), the transfer would be taxable (a) if the period in fact ended before his death, or (b) if the stated interval can be considered as a period "not ascertainable without reference to his death." But this is by virtue of specific statutory language which was originally brought into the statute by the Revenue Act of 1932. For a discussion of the extent to which this language was declaratory of earlier law, see Bittker, *supra* note 3, 867-70.

out under the original statute (embracing transfers "*intended* to take effect in possession or enjoyment at or after death") than under the amended statute which defines that clause with the language quoted above. *Shukert v. Allen*, then, may be more strongly entrenched than before.

2. *Section 811 (c) (3)(B)*. Clause (B) of the amended statute, quoted above, provides that if by the terms of transfer possession or enjoyment can be obtained only by surviving the earlier of (i) decedent's death and (ii) some other event, the property is included if the "other event" has not in fact occurred at the time of decedent's death. An example in the Conference Report is a trust to accumulate the income, distribution to the settlor's son on his reaching the age of 30 or on the settlor's death, whichever occurs first.⁴⁶ The property would not be taxed under Clause (A), because survival of the decedent is not a *necessary* condition to the son's possession or enjoyment. But under Clause (B), the property is taxable if the son does not reach the age of 30 during his father's life. If he does reach that age before his father dies, however, the property passes free of tax. Imposition of the tax thus depends upon whether, as events ultimately unfold, the remainderman's possession or enjoyment was postponed in fact until the settlor's death.

This use of hindsight is to be contrasted with the treatment of the same problem under the "Hallock regulation."⁴⁷ It provided that where possession or enjoyment could be obtained either through surviving the decedent or through the occurrence of another event, the interest was subject to tax only if the other event was "unreal."⁴⁸ Thus in the trust above, the possibility of receiving the corpus by reaching the age of 30 is a "real" one, and therefore the "Hallock regulation" would not have taxed the property whether the remainderman received the property during the settlor's life or only on his death. The amended statute imposes a tax if in fact the remainderman had to wait until the settlor's death. On the other hand, suppose the remainderman were a member of the Communist Party and could take either by becoming President of Yale University or by surviving the settlor. Under the "Hallock regulation" no doubt the "other event" would be "unreal."

46. See H.R. REP., *supra* note 42, at 10, Example (5).

47. See note 41 *supra*.

48. "Where possession or enjoyment of the transferred interest can be obtained by beneficiaries either by surviving the decedent or through the occurrence of some other event or through the exercise of a power, subparagraph (1) [the requirement of survivorship] shall not be considered as satisfied unless from a consideration of the terms and circumstances of the transfer as a whole, the power or event is deemed to be unreal, in which case such event or power shall be disregarded." The "Hallock regulation," it will be noted, speaks of the occurrence of an "event" or the exercise of a power of appointment. The amended statute speaks only of the occurrence of an "event." But that it must be read to include also the exercise of a power, see H.R. REP., *supra* note 42, at 9.

Hence, the property would be taxed even if the remainderman achieved that eminence and received the property without awaiting the settlor's death. Under the amended statute, however, this transfer would escape tax.

It may be noted that if possession or enjoyment can be obtained only by surviving the *later* of (i) the decedent's death and (ii) another event, Clause (B) is inapplicable, but the transfer is taxed under Clause (A).

Neither Clause (A) nor Clause (B) imposes a tax unless possession or enjoyment is conditioned on survivorship. Thus, the amended statute accepts the principle of the "Hallock regulation" that not every reversionary interest results in tax. Only those reversionary interests are fatal which postpone possession or enjoyment by requiring the remainderman to survive the decedent. Example: a trust, income to the settlor's son for life, remainder to the son's surviving issue, with a reversion to the settlor or his estate if the son has no surviving issue. The "Hallock regulation" does not treat this as a transfer intended to take effect in possession or enjoyment at or after the decedent's death, because the decedent's reversionary interest does not necessarily postpone the remaindermen's possession and enjoyment until the settlor's death.⁴⁹ They will take if they are alive when *the life tenant* (the son) dies, whether his death occurs before or after the settlor's. The "Hallock regulation" provided for a tax only if the beneficiary was required to survive the *decedent* to take.⁵⁰ The promulgation of this regulation ended the Treasury's ecstatic dalliance with the theory, not borne out by the statute, that *any* reversionary interest would attract a tax.⁵¹ The *Spiegel* opinion was ambiguous, some of its language suggesting a renewed fascination with reversionary interests *per se*.⁵² But the issue was not before the Court, since there the reversionary interest was the kind which postponed the remaindermen's possession and enjoyment by conditioning them on surviving the settlor. The regulations issued after *Spiegel*, ignoring its loose language, continued to impose a tax only if survivorship of the settlor was necessary to pos-

49. See U.S. Treas. Reg. 105, § 81.17, Example (2).

50. "The establishment of this factor as an additional requirement for taxability is the principal contribution of T.D. 5512." Platt, *The New Hallock Regulation*, 2 TAX L. REV. 94, 95 (1946). Of course, if in the example given in the text the son had not reached the age of 30 during the settlor's life, then *upon the settlor's death* it would become apparent that possession or enjoyment *in fact* had been postponed until after the decedent's death. But this postponement was not the necessary result of the transfer; the son might well have received the property during the settlor's life. The transfer can hardly be regarded as a testamentary substitute if the settlor's death had only this accidental and perhaps even unpredictable connection with the transferee's possession or enjoyment.

51. See note 50 *supra*; Eisenstein, *The Hallock Problem: A Case Study in Administration*, 58 HARV. L. REV. 1141, 1144-8, 1178-81 (1945).

52. Bittker, *supra* note 3, at 840-3.

session or enjoyment.⁵³ The statute now reinforces that eminently proper requirement.⁵⁴

3. *Effect of a power of appointment: Goldstone v. United States.* Section 811(c)(3) includes a further provision, perhaps the most confusing to be found in the new legislation. What if a trust is to terminate upon the settlor's death, distribution to be made to the beneficiaries then alive, with a power of appointment in one of the beneficiaries exercisable even before the settlor's death? Realistically viewed, this is an outright gift to the beneficiary who is the donee of the power of appointment; his dominion over the property, even before the decedent's death, is surely the economic equivalent of "possession or enjoyment." Looking only to the statutory language of Clause (A) and (B) above, one might infer that the transferred property would not be taxed. The existence of the power of appointment—one might have thought—meant that possession or enjoyment had not been postponed, the power to appoint property being realistically a form of possession and enjoyment. And if possession and enjoyment were not postponed, the property would not be taxed by either Clause (A) or Clause (B).

Whatever might be thought if this were an original question, however, the matter is encumbered by a Supreme Court opinion and by a provision in the amended statute itself. The decision is *Goldstone v. United States*,⁵⁵ where the Court held in a muddled and unrealistic opinion that a reversionary interest in the settlor was fatal even though it could have been cut off by a beneficiary through exercise of a power of appointment. Taken in conjunction with the amended statute, the *Goldstone* case might be read to hold that possession or enjoyment is postponed until the settlor's death if a trust is to terminate then, even though a beneficiary has an unexercised power of appointment over the property; *i.e.*, that possession or enjoyment of a power of appointment is not possession or enjoyment of the appointable property. In that event, the transfer would be includible under Clause (B) of the new statute since possession or enjoyment could have been obtained only by surviving the earlier of (a) the decedent's death or (b) some other event (*viz.*, an exercise of the power of appointment) and the "other event" did not in fact occur during the decedent's life.⁵⁶

53. See note 21 *supra*.

54. Section 811(c)(3)(A) and (B). With respect to transfers on or before October 7, 1949, there is an endorsement in the Conference Report, *supra* note 42, at 8, of the "Hallock regulation's" insistence upon a condition of survivorship. Of course, a reversionary interest which survives the decedent's death will be includible, to the extent of its value, under Section 811(a).

55. 325 U.S. 687 (1945). See Eisenstein, *supra* note 3, at 479-81.

56. The Treasury Department seemingly did not press its victory in the *Goldstone* case; see U.S. Treas. Reg. 105, § 81.17, Example (8). (The case may have been thought to vary from the trust in the example because of the fact that the sacrifice of potential value which results from the surrender of an unmaturing insurance policy would

To avoid this result, the amended statute provides that Clauses (A) and (B) shall not be applicable if possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a power of appointment (as defined in section 811(f)(2)) which in fact was exercisable immediately prior to the decedent's death.⁵⁷

The Conference Report illustrates the scope of this proviso by a trust to accumulate the income for the settlor's life, with distribution to his children or his issue, but with an unrestricted power in his wife to amend, alter or revoke the trust.⁵⁸ The proviso saves the trust from *Goldstone v. United States*; without the proviso, as already indicated, it might be inferred from the *Goldstone* case that possession or enjoyment had been postponed until the decedent's death, despite the wife's power of appointment, with a consequent tax under Clause (B).

But provisos, in saving some situations from a general rule, often have the inconvenient property of confirming its applicability to other situations. It will be noted that the proviso affords an escape from tax where there is a power of appointment only if (a) possession or enjoyment was obtainable by a "beneficiary" through exercise of the power, (b) the power fits the definition of Section 811(f)(2), and (c) the power was exercisable immediately prior to the decedent's death. These limitations pose some nice questions and, since a non-complying power will not save the transfer from tax,⁵⁹ create some distinctions unrooted in rational policy.

(a) *The meaning of "beneficiary."* The proviso comes into play only if possession or enjoyment could have been obtained "by any beneficiary" through the exercise of a power of appointment. Presumably the donee himself need not be a beneficiary under the trust;⁶⁰ indeed, the Conference Report's illustration, mentioned above, so indicates.

deter such action by the beneficiary. Cf. *Guggenheim v. Rasquin*, 312 U.S. 254 (1941)). But the limited statutory repudiation of the *Goldstone* doctrine by the new statute will now serve to strengthen its application in other situations. Indeed, the Conference Report itself, *supra* note 42, at 9, indicates that Clause (B) requires a tax where possession or enjoyment is conditioned on the earlier to occur of (a) the decedent's death and (b) the exercise of a power which falls outside the definition of Section 811(f)(2).

57. Section 811(c)(3), last sentence. Although the proviso does not say so, it unmistakably points to immunity if the power has been exercised so that the appointees get the property before the settlor's death. And see note 59 *infra*.

58. See H.R. REP., *supra* note 42, at 10, Example (6).

59. Presumably the exercise of a power, complying or not, would immunize the property under Section 811(c)(3)(B); the "other event" would have occurred during the decedent's life. Thus is resurrected the ancient distinction between exercised and unexercised powers which was belatedly put to rest by Section 811(f) in 1942.

60. The use of the term "beneficiary" implies that the proviso is applicable only to transfers in trust; elsewhere Section 811 has sedulously specified transfers "in trust or otherwise," though of course the transfers commonly encountered are by trust rather than by other dispositive devices.

But must the donee have the power to appoint to a beneficiary of the trust? This seems to be the message of the proviso; otherwise the term "beneficiary" would be superfluous. Yet even a power to appoint only to persons who are not beneficiaries may be the equivalent of full ownership. Though the logic of the proviso is to exempt from tax property which in effect has been transferred outright, the language falls short of its purpose.⁶¹

(b) *The definition of "power of appointment."* In adopting the definition of power of appointment embodied in Section 811(f)(2), the proviso sacrifices rationality to brevity. To begin with, that definition is restricted to a power "exercisable by the decedent."⁶² That is the *one* type of power which is surely not meant to be included in the proviso, and the Conference Report's illustration exhibits a clear intention to embrace powers not exercisable by the decedent. Moreover, the adopted definition includes powers exercisable either alone or in conjunction with another person. It is not clear whether the proviso is intended to include jointly exercisable powers.

But the most astonishing aspect of the adoption of Section 811(f)(2)'s definition is that the distinctions there made (for another purpose) bear no relationship to the policy of the proviso. For the proviso was intended to exempt property from tax whenever the transfer was equivalent to an outright gift because the donee could unrestrictedly exercise the power for his own benefit. Yet there are a number of possible powers exercisable for the donee's own benefit which are not "powers" within the definition of Section 811(f)(2) and which, therefore, do not confer immunity though immunity would accord with the purpose of the proviso. If the power is to appoint within the decedent's family or within a restricted group, for example, it is not a "power" under Section 811(f)(2)—nor under the proviso, therefore—even though the donee is one of the possible appointees and therefore has absolute dominion over the property.⁶³ Even if the donee can appoint only

61. The statute grants immunity "if possession or enjoyment of the property could have been obtained by *any* beneficiary" through exercise of the power. The italicized adjective is ambiguous. Suppose that the donee of the power can appoint to *A, B, or C*, and that *C, D, and E* are beneficiaries. Does the power qualify? Or would it be necessary that *D and E* also be possible appointees?

62. Under Section 811(f), the decedent is also the donee of the power. But under Section 811(c), the decedent is the creator of the power. Most of the difficulties sketched in the text stem from the fact that the definition of Section 811(f) tacitly assumes the "decedent" to be the donee of the power, while Section 811(c) assumes to the contrary that the "decedent" was the creator of the power.

63. Of course, it may be argued that a power exercisable for the donee's own benefit is *ipso facto* a power to appoint to anyone, and that such a power is not within the meaning of Section 811(f)(2)(A) or (B). But literalism has triumphed under Section 811(f) itself (see *Schwab v. Allen*, 78 F. Supp. 234 (M.D. Ga. 1948), 22 So. CALIF. L. REV. 513 (1949)), where the issue can arise only under Section 811(f)(2)(A) and then only because of the omission, no doubt by inadvertence, of the phrase "other than the decedent"

within his family or some other restricted group and not to himself, he has what realistically is almost complete ownership. Yet this is not a "power of appointment" under Section 811(f)(2), for reasons which, however cogent they may be with respect to that section,⁶⁴ have no bearing on the policy of the proviso. And some of the restrictions of Section 811(f)(2) can only be described as nonsense when imported into the proviso of Section 811(c)(3). Suppose a transfer in trust to accumulate the income for the settlor's life, distribution on his death to named remaindermen, but with a power in the wife to alter, amend or revoke. If she can do so for the benefit of the remaindermen alone, she has a power which, under Section 811(f)(2)(B), is *not* a power of appointment. The condition of the proviso is not met and the property therefore is taxed. But if the wife can exercise her power either for the remaindermen *or for the decedent*, the power is a "power of appointment" under the definition and the property is exempt. The distinction is irrational. In both cases the donee has a large measure of ownership; but if any distinction is to be made, there is more reason to immunize the former transfer, where the property cannot go back to the settlor, than the latter, where he is a possible appointee. The language of the proviso, however, grants immunity in the latter case, but not in the former.

(c) "*Exercisable immediately prior to the decedent's death.*" What if the power must be exercised before a stated date, which passes without action by the donee? So far as the settlor was concerned, he entrusted the beneficiary with complete dominion over the property. Yet under the proviso, absolution from the *Goldstone* case is granted only if the power "in fact was exercisable immediately prior to the decedent's death." Why should not any power of appointment exercisable before the decedent's death confer immunity from tax? If the power has lapsed before the decedent's death, it was at the donee's wish. His power was complete when it existed.

Another example of the atrocious draftsmanship of this proviso is its failure to deal with a power which can be exercised only x months after the donee has given notice of his intention to exercise it. Is such a power "in fact . . . exercisable immediately prior to the decedent's death," as the proviso requires, if the donee has not yet given the

at several places. But the problem is multiplied when the definition of Section 811(f)(2) is imported into the newly enacted Section 811(c)(3). The reason, which may be more easily grasped by an examination of Section 811(f)(2) than by an explanation, is that nowhere in Section 811(f)(2) is there an express exclusion of the *donee* of the power from the exempt group. Thus, a power does not meet the literal terms of the statute—and hence confers no immunity under the proviso—if the appointees are either members of the family or a "restricted class" even though the donee is himself a member of the family or of the class and hence has absolute ownership because he can appoint to himself.

64. PAUL, *op. cit.* *supra* note 3, § 9.30.

requisite advance notice? Elsewhere the statute expressly equates a power exercisable only after notice with a power whose exercise is not so restricted.⁶⁵ Unless those express provisions can be regarded as declaratory, the want of a similar prescription in Section 811(c)(3) may unwarrantedly summon up the maxim *expressio unius est exclusio alterius*, leading to the conclusion that a power exercisable only after notice is not entitled to the tax immunity conferred by the proviso. The question could and should have been answered in advance.

B. *Transfers on or before October 7, 1949.* As with transfers after October 7, 1949, in dealing with transfers on or before that date Congress was forced to reconcile the *Spiegel* case with *Reinecke v. Northern Trust Co.* But instead of rejecting the *Northern Trust* case as to existing trusts, Congress expressly endorsed it, thus destroying the possibility that the Supreme Court might overrule the decision. The endorsement is embodied in a provision, Section 811(c)(2), that transfers on or before October 7, 1949, shall not be embraced by the "possession or enjoyment" clause unless the decedent has retained a reversionary interest in the property. The reconciliation with *Spiegel* takes the form of imposing tax only if the reversionary interest (a) arises by the express terms of the instrument of transfer and not by operation of law, and (b) has a value immediately before the decedent's death exceeding 5% of the value of the transferred property.⁶⁶

With respect to the dichotomy between interests expressly reserved and those arising by operation of law, the author has noted elsewhere his conviction that this is a distinction without a difference.⁶⁷ Indeed, in dissenting in the *Spiegel* case—where Mr. Justice Black rejected the dichotomy—Mr. Justice Burton asserted only that the lack of an express reservation is "negative evidence to the effect that such a reverter was not intended and not desired by the settlor,"⁶⁸ not even suggesting that such interests should have an automatic tax immunity. The draftsmen of the amended statute, however, have insured that the property will escape tax even if the transfer is comparable in every respect to the *Klein*⁶⁹ or *Hallock*⁷⁰ trust save only that the reversion results from judicious silence rather than from well-chosen words. Moreover, they have granted immunity even if the retention of that reversionary interest was the unmistakable purpose of the settlor. Form has indeed triumphed over substance.

As to the requirement that the reversionary interest be worth at least 5% of the value of the transferred property, this accords with a

65. Sections 811(d)(3) and 811(f)(3).

66. On the method of valuing an interest, see note 72 *infra*.

67. Bittker, *supra* note 3, at 834-5.

68. 335 U.S. 701, 731 (1949).

69. 283 U.S. 231 (1931).

70. *Helvering v. Hallock*, 309 U.S. 106 (1940).

proposal advanced by the author in his earlier comment on the *Spiegel* and *Church* cases.⁷¹ It has the defects of any mathematical remedy for a human difficulty. But if *Reinecke v. Northern Trust Co.* is not repudiated, the formula affords a method of applying the principle of the *Klein* and *Hallock* cases without running it into the ground by the relentless pursuit of infinitesimal reversionary interests.⁷²

The new legislation is not explicitly applicable to the proceeds of life insurance. These receipts will be affected nonetheless. For example, Section 811(g) provides for the inclusion of insurance proceeds receivable by beneficiaries if the decedent either paid the premiums or possessed at his death any incident of ownership other than a reversionary interest. If he did not pay the premiums or possess any incident of ownership, his retention of a reversionary interest would not be fatal *under* Section 811(g). But the regulations, responsive to legislative mandate, would bring the proceeds into the gross estate *under* Section 811(c) if the decedent retained a reversionary interest "whereby the proceeds are made payable to his estate if the transferees (or beneficiaries) do not survive him."⁷³ Under Section 811(c) as now amended, the reversionary interest will be fatal—with respect to policies trans-

71. Bittker, *supra* note 3, at 839-940. The author has heard indirectly, but cannot confirm, that Treasury computations disclosed that the 5% limit would separate reversionary interests dependent upon the settlor's surviving a spouse or a child from more remote interests. His own selection of 5% was quite arbitrary.

72. With respect to the method of valuing the reversionary interest, Section 811(c)(2) provides: "The value of a reversionary interest immediately before the death of the decedent shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Commissioner with the approval of the Secretary." According to the Conference Report, H.R. REP. No. 1412, 81st Cong., 1st Sess. 7 (1949), if the value is not ascertainable, it is to be treated as zero. It is true that the Supreme Court so held in *Robinette v. Helvering*, 318 U.S. 184 (1943), but it did so in quite another context. The Court was there concerned with the measurement of gift tax upon property in which the donor retained a reversionary interest of unascertainable value. The Court held that the full value of the property was taxable unless the donor could "establish the possibility of approximating what value" he retained. Presumably the rule was carried over to Section 811(c)(2) on the theory that what is sauce for the goose is sauce for the gander. But the situations are only superficially comparable. For Section 811(c)(2) is a relief measure, immunizing from tax a reversionary interest which is of trivial value. In order to get on the relief roll, the taxpayer ought to show that he comes within its intended scope. The burden ought not to be upon the tax collector to prove him a false claimant.

Inability to calculate the value of the reversionary interest may be not uncommon. The author is informed that there are no recognized actuarial tables showing the chances that a person will marry and have descendants. If a settlor must survive a presently unmarried life tenant and the life tenant's issue, for example, the value of the reversionary interest will be unascertainable and, according to the Conference Report, must be treated as zero.

73. U.S. Treas. Reg. 105, § 81.25; PAUL, FEDERAL ESTATE AND GIFT TAXATION § 10.39 (Supp. 1946).

ferred on or before October 7, 1949—only if it was expressly reserved and had a value just before death exceeding 5% of the value of the policy.

Refunds. The new rules for the inclusion of transfers on or before October 7, 1949, apply to the estates of decedents dying after February 10, 1939, the date of the Internal Revenue Code's enactment.⁷⁴ Where the tax has not yet been paid, it will be computed under the newly amended statute. But some estates of decedents who died after February 10, 1939 have already paid taxes computed by including property where the settlor's reversionary interest either arose by operation of law or was below the newly established 5% level. These estates will be entitled to a credit or a refund of the overpayments.⁷⁵

Presumably the aim of retroactive "relief" is to treat similar taxpayers similarly. But relief goes to those who persisted in retaining reversionary interests despite abundant storm warnings. What of those, less stubborn, who heeded the warnings? There is no provision for a refund to the settlor who, trying to comply with the growth of the law, relinquished his reversionary interest and paid a gift tax.⁷⁶ Indeed, if the property was—or in the future is—swept back into his estate as a gift in contemplation of death, there is apparently not even an escape from estate tax!⁷⁷ Will one relief provision now breed another?

The selection of February 10, 1939, as the critical date for retroactive relief is unexplained by the Conference Report, nor does a reason come to mind. It is both possible and likely that the estates of some persons who predeceased that date paid estate taxes, under the *Klein* and *Hallock* cases, for harboring reversionary interests which would be

74. Section 7(b), Pub. L. No. 378, *supra* note 2.

75. Section 7(c). Notwithstanding the statute of limitations on refunds and credits, claims may be filed until October 25, 1950. But refund or credit is not allowed if the estate's tax liability was fixed by closing agreement or compromise.

76. A payment of gift tax may be credited against the estate tax under Section 813 only if the donated property is brought back into the gross estate. Even then, the credit may be less than the amount of the gift tax paid and will not include interest on the advance payment.

77. A gift for the sole purpose of avoiding the estate tax is a transfer in contemplation of death, U.S. Treas. Reg. 105, § 81.16; *Vanderlip v. Commissioner*, 155 F.2d 152 (2d Cir. 1946), *cert. denied*, 329 U.S. 728 (1946). The touchstone being the settlor's intent, it would seem immaterial that a later change in the statute made the maneuver unnecessary. But the contemplation of death issue becomes unimportant if the decedent's release can be justified under *Allen v. Trust Co. of Georgia*, 326 U.S. 630, 636 (1946), as intended "to accomplish the purpose which he originally had, but which he later discovered had not been achieved . . . to make complete and absolute gifts to his [donees], freed of all claims, including taxes." Or it may be that the amount to be included in respect of a gift in contemplation of death is the value of the released interest, which in a particular case may be measurably slight. But see notes 70 and 165 in *Bittker, supra* note 3. The *Sullivan* case, there cited, has since been reversed *sub nom. Sullivan's Estate v. Commissioner*, 175 F.2d 657 (9th Cir. 1949).

exempt under the new statute if they died thereafter. In fact, if Spiegel himself had died only two years earlier, his estate would not have qualified for a refund! It is even possible that some estates are still open to which the draconic *Spiegel* case will be applicable *in the future* because the decedents died on or before the critical date.

THE CHURCH CASE

The congressional action precipitated by the *Church* case, unlike the legislation evoked by the *Spiegel* case, is aimed only at trusts which are already in existence. Indeed, the legislation embraces primarily trusts created on or before March 3, 1931. (Though a limited class of trusts created after that date but before June 7, 1932 is also affected, the discussion which follows is initially directed to the pre-March 3, 1931 trusts.)

The background of the legislation is easily stated, though the issues of policy are formidable. From its enactment in 1916 the estate tax statute embraced any transfer "intended to take effect in possession or enjoyment at or after" the settlor's death.⁷⁸ This language was almost universally thought, both under the federal law and under the state laws from which it was borrowed, to embrace a trust where the settlor reserved the income for his life, granting the beneficiaries the right to receive the corpus only upon his death.⁷⁹ Yet on April 14, 1930, in *May v. Heiner*,⁸⁰ the Supreme Court held that the statute did not reach a trust where the income was given to the settlor's husband for his life and then to the settlor, if living, for her life, with remainders to others. Any hope that this holding might be restricted to trusts where the settlor had only a "contingent" life estate was blasted on March 2, 1931, when the Court decided in three *per curiam* opinions that there was no tax even if the life estate was directly reserved by the settlor.⁸¹ As is well known, this judicial "bombshell"⁸² was dramatically answered the very next day. Both Houses of Congress, though on the verge of adjournment, adopted, and the President approved, a Joint Resolution, expressly taxing trusts of the kind held exempt by the Court.⁸³ Seven years later, in *Hassett v. Welch*,⁸⁴ the Court held

78. Revenue Act of 1916, § 202(b), 39 STAT. 777-8 (1916), INT. REV. CODE § 811(c).

79. See Note, 49 A.L.R. 864, 878 (1927); Brief for Petitioner, pp. 20-5, *Hassett v. Welch*, 303 U.S. 303 (1938); note 26 *supra*. State courts passing on the issue after *May v. Heiner*, 281 U.S. 238 (1930), have not adopted the Supreme Court's construction. *Blodgett v. Guaranty Trust Co.*, 114 Conn. 207, 158 Atl. 245 (1932), *aff'd*, 287 U.S. 509 (1933); *In re Kutsche's Estate*, 268 Mich. 659, 256 N.W. 586 (1934); *Rising's Estate v. State*, 186 Minn. 56, 242 N.W. 459 (1932).

80. 281 U.S. 238 (1930).

81. Note 6 *supra*.

82. 74 CONG. REC. 7078 (1931).

83. Note 7 *supra*.

84. 303 U.S. 303 (1938).

that the Joint Resolution was intended to apply only to transfers effected after its adoption. Thus transfers on or before March 3, 1931, were shielded from tax by *May v. Heiner*. Their shield was not pierced until January 17, 1949, when the Court overruled *May v. Heiner* in deciding the *Church* case.

Not attempting to defend *May v. Heiner* as a correct construction of the "possession or enjoyment" clause, the dissenters in the *Church* case urged instead that it should be left untouched (a) because taxpayers had relied upon it and (b) because subsequent action by Congress had made it "as much a part of the wording of the statute as if it had been written in express terms."⁸⁵ After the *Church* case, the American Bar Association urged that the rule of *May v. Heiner* should be restored, though it too made no effort to defend the case as properly decided on the merits.⁸⁶ The Treasury regulations, promulgated September 8, 1949, announced that the Commissioner would apply the *Church* victory only to the estates of decedents dying after the date of the decision, presumably on the theory that these settlors would be in a position to avoid the effect of the decision by relinquishing their life estates.⁸⁷ The legislation adopted by Congress deals less drastically with the *Church* case than the American Bar Association recommended but it relinquishes more of the fruits of victory than did the Treasury's amended regulations: by Section 7(b) of the Technical Changes Act, the decision is rejected (and *May v. Heiner* reinstated) as to decedents dying before January 1, 1950, while by Section 8 thereof settlors still alive are permitted to avoid the tax by a tax-free release or assignment of their income interests before 1951.

The policy of "relief." The action of Congress rests upon its view that settlors relied on *May v. Heiner* and that, therefore, its overruling by the *Church* case disappointed their reasonable expectations. I have set out in detail elsewhere my reasons for believing that "reliance" has not been established and that it probably has been widely exaggerated.⁸⁸ To summarize: Until *May v. Heiner*, and the three companion cases of March 2, 1931, the settlor of a trust with income reserved would have expected to pay—not to escape—an estate tax on the corpus.⁸⁹ The

85. 335 U.S. 632, 682 (1949).

86. Bittker, *supra* note 3, at 856 n. The proposal was endorsed by the Senate Finance Committee, SEN. REP. NO. 831, 81st Cong., 1st Sess. 7 (1949), but rejected by the Conference Committee, H.R. REP. NO. 1412, 81st Cong., 1st Sess. 6 (1949).

87. Note 21 *supra*. The concession was broader than the suggestion made in the course of the *Church* argument that if the Government won it might exempt from tax estates which could show reliance on *May v. Heiner*. 335 U.S. 632, 685 n.14. Under the Treasury's amended regulations *Church's* would have been the only pre-1949 estate to be taxed!

88. Bittker, *supra* note 3, at 855-64.

89. As to trusts created between April 14, 1930, when *May v. Heiner* was decided, and March 3, 1931, when the Joint Resolution was enacted, see Bittker, *supra* note 3, at note 163.

only conceivable reliance, therefore, must have occurred *after* those cases were decided⁹⁰ and must have taken the form of refraining from *relinquishing* the life estate now that immunity from tax had been assured by the Supreme Court. The Senate Finance Committee put it this way:

"Some persons might have surrendered their life estates after 1931 had they not relied on the interpretation of the estate tax law which has now been overruled and in some cases considerable hardship may result from application of the new interpretation presented in the Church case."⁹¹

But if the settlor was willing to accept the burden of an estate tax when he created the trust, why assume that after 1931—but for the Supreme Court's decisions—he would have relinquished his interest? Possibly because increases in estate tax rates after that date *might have* impelled a reconsideration of his tax position which *might have* led to a relinquishment of his income interest in order to immunize the corpus from tax. But a settlor who was dependent upon the income for his support could not have afforded to forego it, even to spare his heirs a future estate tax. So far, not a shred of evidence has been publicly adduced to prove that a substantial number of the settlors affected by the *Church* case would have been financially able to relinquish their income interests. It is as reasonable to assume that the income was indispensable to them as to assume, as do the advocates of legislative "relief," that relinquishment of life estates would have been a common practice.

Indeed, there is important evidence to the contrary. The period since 1931 has seen ever-mounting income tax rates. Ordinarily a relinquishment by the settlor of his right to the income of a trust would have effected a savings in income tax. Although during this period taxpayers as a group were indulging in a great variety of plain and fancy income splitting devices, the settlors here in question refused to give up their life estates. Is it not likely that a potential estate tax would have been equally unavailing to cause a relinquishment? Moreover, the relinquishment of a life estate would have been a taxable gift of its actuarial value and, the donee's purpose being to avoid an estate tax, it would have been a transfer in contemplation of death as well, engendering a

90. Moreover, until 1938, when the Court decided *Hassett v. Welch*, 303 U.S. 303, there was some reason to believe that the 1932 amendment to Section 811(c) applied retroactively as well as prospectively. Hence a prudent settlor could not have been confident until 1938 that his pre-1931 trust was immune. And that confidence should have been shaken as early as 1940, when the *Hallock* case was decided. See Bittker, *supra* note 3, at 859-60.

91. SEN. REP. NO. 831, 81st Cong., 1st Sess. 7-8 (1949), reporting H.R. 5268. See note 2 *supra*.

troublesome estate tax liability.⁹² These liabilities would have discouraged release of the life estate.

"Relief" has a seductive aura, however, and Congress, like the Treasury Department, succumbed to its allure, though surrender was not as complete as the American Bar Association urged. When Congress came to act, the Treasury Department, as stated above, had already amended its announced regulations to exempt from the *Church* case the estates of persons who died on or before January 17, 1949, the date of that decision. The Congress endorsed the principle of exemption but extended the date of grace so that the estates of decedents dying before January 1, 1950, are immune. The extension presumably stemmed from the simultaneous grant in Section 8 of the Technical Changes Act of the privilege of a tax-free relinquishment or assignment of the life interest; anticipating no doubt that a few months would elapse before settlors could avail themselves of that privilege, Congress stayed application of the *Church* case for those who might die in the interim.

"Relief" from tax on assignment or release of life estate. Settlers who die on or after January 1, 1950, then, are subject to the *Church* decision. But its effect can be avoided, since Congress provided that, for a limited time,⁹³ the relinquishment or assignment of the life estate will not be either a transfer subject to gift tax or a transfer in contemplation of death. "Relief" in the form of a privilege of tax-free transfer has become a familiar congressional device for adjusting to judicial or statutory innovations. Thus, in 1943, conceiving that *Estate of Sanford v. Commissioner*⁹⁴ disappointed the just expectations of taxpayers, Congress bestowed upon settlors the right to relinquish control over a trust so as to avoid estate tax under that decision without paying a gift tax on the transfer.⁹⁵ And the 1942 amendments to Section 811(f), taxing powers of appointment more heavily than before, were accompanied by a privilege of releasing non-conforming pre-1942 powers without payment of gift tax.⁹⁶

92. Note 77 *supra*. It is not clear whether the amount to be included in respect of the transfer in contemplation of death would be the actuarial value of the surrendered life estate or the value of the entire trust. See Bittker, *supra* note 3, at note 165.

93. Transfers in 1949 and 1950 escape gift tax; transfers "prior to 1951" escape the contemplation of death clause. The exemptions are granted by Section 8 of the Technical Changes Act, which is not added to the Internal Revenue Code itself. No extension of time is granted to settlors who presently lack legal capacity to release their life interests. Cf. Section 452(b)(2), Revenue Act of 1942, 56 STAT. 952 (1942).

94. 308 U.S. 39 (1939).

95. INT. REV. CODE, § 1000(c); see PAUL, FEDERAL ESTATE AND GIFT TAXATION § 17.07A (Supp. 1946).

96. INT. REV. CODE, § 1000(c). Originally the privilege was to expire on January 1, 1943, but it has since been extended, most recently to July 1, 1950 (Pub. L. No. 137, 81st Cong., 1st Sess. June 28, 1949) and it bids fair to become a permanent privilege.

But precedent does not necessarily sanctify practice. One seeks in vain for any justification for permitting relinquishment of the life estate free of gift tax. The sole basis for indicting the *Church* case is that it undermined *May v. Heiner*, upon which settlors allegedly had built their hopes.

But if *May v. Heiner* had gone the other way, settlors who wished to avoid the estate tax by releasing their life estates would have had to pay a gift tax for the privilege. Why should they escape the gift tax because, in reliance upon *May v. Heiner*, they retained their life estates until the *Church* case? Of course, *May v. Heiner* was decided on April 14, 1930, and the federal gift tax did not become effective until June 6, 1932; thus there was a brief period during which a settlor could have released his life estate free of gift tax. But since he retained his interest until *May v. Heiner*, in the face of an almost certain estate tax, he would hardly have relinquished immediately if that case, by going the other way, had merely confirmed what he already knew.

True, the estate tax rates, which allegedly would have prompted a release, were increased by the Revenue Act of 1932, but that very act brought the gift tax into being. Though the gift tax rates have been increased since 1932, settlors as a group probably have not been prejudiced by postponing a relinquishment; the rate increase would be offset by the decrease in the actuarial value of the life estate. The privilege of assigning or releasing the life estate free of gift tax liability, then, is not "relief." It is a charitable contribution to the wealthy.⁹⁷

The new statute also provides that a release of the life estate "prior to 1951" shall not "be deemed to have been made in contemplation of death."⁹⁸ The motivation behind this provision is clear, though its policy is even more deplorable than the grant of freedom from the gift tax. By hypothesis, any assignment or relinquishment of a life estate in response to the *Church* case is effected to avoid an estate tax. It is, therefore, a transfer in contemplation of death of at least the actuarial value of the life estate.⁹⁹ The amended statute conveniently—though improperly—saves the transfer from this fate. Yet the premise upon which "relief" is based is that had *May v. Heiner* gone the other way, settlors would have released their life estates to avoid an estate tax which came to have greater horrors than when the trust was created. But such a release would have been a transfer in contemplation of death, and as such taxable.¹⁰⁰ The amended statute now

97. Trusts created between April 14, 1930, and March 3, 1931, may be able to claim a special equity: if they were thought to be immune from tax when created, see Bittker, *supra* note 3, at note 163, it may seem harsh to exact a gift tax for a release motivated by a later change in the rules.

98. Section 8.

99. Notes 77 and 92 *supra*.

100. In the case of trusts created between April 14, 1930, and March 3, 1931, if

provides that a release will be *less* burdensome than formerly. Congress started out to insure that settlors would not be penalized for failing to relinquish their life estates in reliance upon *May v. Heiner*. It has ended by rewarding them.¹⁰¹

It was pointed out earlier that settlors who anticipated the *Spiegel* case are treated less generously by the new legislation than those who held out to the bitter end.¹⁰² The same paradox inheres in the legislation responsive to the *Church* case. For a settlor who paid a gift tax on releasing his life estate before 1949 because he or his advisers foresaw the demise of *May v. Heiner* cannot ask a refund; only releases in 1949 and 1950 are free of gift tax liability.¹⁰³ And if he has died, and his executor reported the transfer as a gift in contemplation of death, refund or credit is possible only if the statute of limitations has not run.¹⁰⁴

Transfers between March 3, 1931, and June 6, 1932. It will be recalled that the Joint Resolution of March 3, 1931, was replaced on June 6, 1932, by a more detailed statutory provision, Section 803 of the Revenue Act of 1932.¹⁰⁵ In *Hassett v. Welch*,¹⁰⁶ the 1932 amendment, like the Joint Resolution, was held by the Supreme Court to be prospectively applicable only. As a result, trusts created between March 3, 1931, and June 6, 1932, were taxable only if they were embraced by the Joint Resolution. If their terms escaped its clutches, they were immune, though identical trusts created after June 6, 1932, were taxed by the 1932 amendment. The differences between the two statutes are minor; the author attempted to work them out in an earlier article,¹⁰⁷ and there is no need to set them out again here. For present

they were reasonably thought to be immune from tax when created, see note 97 *supra*, a release of the life estate to insure achievement of the settlor's original purpose would probably not be a transfer in contemplation of death, *Allen v. Trust Co. of Georgia*, 326 U.S. 630 (1946).

101. Moreover, although the privilege of a tax-free release was created to enable settlors to bring themselves into compliance with the *Church* case without untoward tax consequences, Section 8's bounty is not expressly restricted to releases so motivated. It may be claimed, for example, by a settlor who released his life estate years ago solely because he thought death was imminent. The transfer, under Section 8, will "not be deemed to have been made in contemplation of death" unless the courts are astute in restricting the benefits of Section 8 to the situations which impelled its enactment.

102. Page 412 *supra*.

103. Note 76 *supra*.

104. If the statutory period has not expired, a refund will be in order. For Section 8 provides that an assignment or relinquishment "prior to 1951" is free of the contemplation of death clause, though curiously freedom from gift tax is granted if the transfer occurred in 1949 or 1950 but not if it took place earlier. But if the statutory period has run, there is no provision comparable to Section 7(c), *supra* note 75, extending the time for filing claims for refund.

105. 47 STAT. 279 (1932), now INT. REV. CODE § 811(c) (1) (B).

106. 303 U.S. 303 (1938).

107. Bittker, *supra* note 3, at 867-70.

purposes, it will suffice to give an example. Let us assume a trust under which the settlor gave the income during his own life to *A*, with remainder to *B* and his heirs. The settlor reserved only the right to designate other income beneficiaries with the consent of *A*. Such a trust would have been taxable under the 1932 amendment, but only if created after June 6, 1932; the amendment, as noted, was held in *Hassett v. Welch* to apply prospectively only. It would not have been taxed, however, by the more limited Joint Resolution of March 3, 1931; hence, a trust of this type if created between that date and June 6, 1932, would have been immune from tax.

The *Church* case did not detract from this immunity.¹⁰⁸ A trust created during the critical period which did not fall afoul of the Joint Resolution would be equally safe though *May v. Heiner* was overruled. The reason is that the purpose and effect of the Joint Resolution was to overrule—for the future—the doctrine of *May v. Heiner*. If a trust created thereafter was not embraced by the Joint Resolution, *ipso facto* its tax freedom did not depend upon the rule of *May v. Heiner*, and therefore it was not adversely affected by the overruling of that decision by the *Church* case.

The 1949 legislation impairs that immunity, however, though so little attention is given to the change in the Conference Report that it seems to have crept in almost by accident. The language of the 1932 amendment now appears as Section 811(c)(1)(B) of the Code and is made applicable "except as otherwise specifically provided" to all transfers regardless of date. Its effectiveness as a general rule is confirmed by the existence of one exception. Section 7(b)(2) of the Technical Changes Act provides that *if* the decedent dies before January 1, 1950, his transfers between March 3, 1931, and June 6, 1932, shall be included only if they were embraced by the language of the Joint Resolution. If the decedent dies on or after January 1, 1950, however, there is no such grant of grace. Thus the trust supposed above—formerly safe from estate tax—is now taxable, unless the settlor died before January 1, 1950. In thus subjecting transfers between March 3, 1931, and June 6, 1932, to the broad test of the 1932 language, the new law in effect is a partial legislative overruling of *Hassett v. Welch*. Although virtually unheralded, the change is the unmistakable result of the language employed.¹⁰⁹

108. The Conference Report, H.R. REP. No. 1412, 81st Cong., 1st Sess. 10-11 (1949), erroneously suggests that the *Church* case held that the original possession or enjoyment clause is as broad as the 1932 amendment. The *Church* case holds in effect that that clause is as broad as the Joint Resolution of March 3, 1931, but it is clear that the 1932 amendment was intended to reach transfers not reached by the Joint Resolution or by its predecessor, the postponed possession or enjoyment clause, Bittker, *supra* note 3, at 864-70.

109. It is a curious fact that the 1932 amendment, when originally adopted, seemed on

Parallel with the loss of tax immunity, however, is a privilege of limited duration to release or assign the now tainted interest tax-free. Just as a life estate reserved before March 3, 1931, can now be jettisoned without tax cost, so can the settlor's right under the hypothetical trust be released or assigned without danger. Under Section 8 the release or assignment will escape gift tax if it occurs in 1949 or 1950; moreover, it will "not be deemed" a transfer in contemplation of death if it occurs before 1951.

After December 31, 1950, then, the date June 6, 1932, will accompany the date March 3, 1931, into oblivion. For thereafter transfers before June 6, 1932, will be subject to estate tax as completely as though they had occurred after June 6, 1932, and the release of rights reserved under pre-1932 transfers will be subject to gift tax as completely as the release of rights reserved under post-1932 transfers.¹¹⁰

its face to be applicable both retroactively and prospectively. In order to confine its force to subsequent transfers, the Supreme Court in *Hassett v. Welch*, 303 U.S. 303 (1938), retraced its legislative background and employed several canons of statutory construction. A similar fate can hardly be in store for the new statute, for Section 7(b) (2) and the Conference Report, *supra* note 108, disclose an intent to give the now reenacted 1932 language a retroactive effect.

This will bring to the fore the constitutional issues dodged by the Court in *Hassett v. Welch*: if the trust was immune when created (between March 3, 1931, and June 6, 1932), is the imposition of tax at a later date unconstitutional for retroactivity? The settlor can still avoid the tax by ridding himself of the tainted interest, and he can do so tax-free under Section 8 of the Technical Changes Act. This may satisfy the requirement of substantive due process, even though the settlor can no longer restore the *status quo ante* by recapturing the transferred property, *Commissioner v. Chase National Bank*, 82 F.2d 157 (2d Cir. 1936), *denied*, 299 U.S. 552 (1936); *Estate of Thorp v. Commissioner*, 164 F.2d 966 (3d Cir. 1947). The retroactivity issue cannot be sidestepped so neatly if the settlor is under a disability preventing the release which would avoid the tax. See Cahn, *Time, Space and Estate Tax*, 29 GEO. L.J. 677, 688-94 (1941); Lowndes, *Tax Avoidance and the Federal Estate Tax*, 7 LAW AND CONTEMP. PROB. 309, 325 (1940).

110. This is on the assumption that the tax-free release privilege created by Section 8 is not extended from year to year. Perhaps the assumption is unwarranted: Section 452(c) of the Revenue Act of 1942 was once only a "relief" worker but bids fair, through annual amendment, to become a permanent employee.