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The Tax Reform Act of 1976: Ruminations on Section 2036 and the Aftermath of Byrum

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THE TAX REFORM ACT OF 1976: RUMINATIONS ON SECTION 2036 AND THE AFTERMATH OF *BYRUM*

*J. Allen Smith**

"It has been noted . . . that the Reform Act amendments of the estate and gift taxes are exceedingly complex, technically flawed in many respects, and frequently reflect policy judgments of questionable soundness."

Professor John H. McCord[1]

"The perhaps surprising conclusion compelled by our findings is that today's millionaires, as well as persons of lesser wealth, no more need pay a stiff estate and gift tax than did their predecessors. It may be that the real certainties of this world are death and tax avoidance."

Professor George Cooper[2]

I

A. *Introduction*

The two quotations at the head of this article are examples of the malaise within the legal profession concerning the lack of clarity in the gift and estate tax laws. The difficulties do not arise within the context of the two goals of the gift and estate tax statutes: to raise revenue and to equalize the distribution of wealth. Rather, the main problems inhere in the conceptual differences that decision makers demonstrate in defining and giving operational indices to such words as "property," "power," "rights," "controls," "enjoyment," "transfer," and "intent." These terms are construed to hamper as well as to assist the larger goals of revenue raising and of breaking down entrenched wealth.

In this article, Part I discusses primarily one section of the Internal Revenue Code, section 2036,[3] its interpretation by the Su-

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1. J. McCord, 1976 Estate and Gift Tax Reform 1 (1977). This book reaffirms the current relevance of Lowndes, Kramer & McCord, Federal Estate and Gift Taxes (3d ed. 1974).

2. Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance,* 77 Colum. L. Rev. 161, 163 (1977).

3. I.R.C. § 2036. References in this article are to the Internal Revenue Code of 1954, as amended. The discussion will indicate whether the case in point involved the code before or after the Tax Reform Act of 1976.

preme Court in the important case of *United States v. Byrum,*[4] and the amendment in the Tax Reform Act of 1976, passed by Congress in response to the *Byrum* decision. *Byrum* provides an excellent example of the confusion surrounding the definition of the above-mentioned terms and also the different conceptual approaches to the problem of interpreting the Code provisions relating to wealth transfer. Several decisions, both before and after *Byrum,* are discussed in order to further illustrate judicial responses to this basic conceptual conflict.

In response to the *Byrum* decision, Congress enacted an amendment which expanded the reach of section 2036 to include the retention of a right to vote stock after the stock has been transferred to a trust. Part I concludes with a discussion of thirteen variations on the theme of stock transfers in a closely-held corporation. Some of these variations are now precluded by the amendment.

Part II deals with the problems raised in Part I on a more general level and recommends several possible solutions. It suggests wide discussion of these problems in public forums with the hope of reform at two levels: (1) minor reforms that might immediately attract the attention of estate planners and judges; and (2) major reforms to abide the time when Congress again, in a decade or so, studies the entire topic of inheritance taxation and donative transactions, whether inter vivos or testamentary.

1. A Preview of BYRUM

In 1972, the Supreme Court of the United States, in *United States v. Byrum,* held specifically that an owner of stock in three closely held corporations could make a gift of the stock in trust to others and thus avoid the estate tax, even though the grantor retained the right to vote the stock in the governance of the corporations. In reaching its decision, the Court construed sections 2036(a)(1) and 2036(a)(2) of the Code and discussed the term "managerial and administrative" powers. This term is used in the literature to suggest the control over wealth that a donor can keep without subjecting himself to the estate tax.

In *Byrum*-type situations, non-taxable administrative and managerial powers, in addition to retained voting rights in stock, are of four types. In some instances, the settlor has been able to retain broad investment powers by his ability to influence investment policy as sole trustee of the stock, or as one of several trustees.[5] The

4. 408 U.S. 125 (1972).

5. Yeazel v. Coyle, 21 A.F.T.R. 2d 1681 (N.D. Ill. 1968); Estate of Willard v. King, 37 T.C. 973 (1962).

argument which the government has made unsuccessfully in contesting the tax free character of these transfers, insofar as the estate tax is concerned, is that through the investment power, the settlor can favor one beneficiary over another and therefore designate the persons who shall "possess or enjoy the property or income therefrom" within the meaning of 2036(a)(2). The second power that the settlor of a trust can retain is the power to remove and appoint trustees other than himself.[6] A third broad managerial power courts have left untaxed is the ability to allocate receipts between principal and income.[7] The fourth, and final, untaxed power a grantor can exercise is the retention of the privilege of buying from and selling to the trust.[8]

A divided Court in *Byrum* reflected the difficulties of coming to a decision, difficulties that had troubled the lower courts.[9] In

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6. Old Colony Trust Co. v. United States, 423 F.2d 601 (1st Cir. 1970). One authority prior to *Byrum* had questioned the appropriateness of defining this power as purely administrative at least in some circumstances. Lewis, *Powers Retained by the Settlor of a Trust: Their Income Estate and Gift Tax Treatment*, 5 REAL PROP. PROB. & TR. J. 1, 15 n.111 (1970), citing income tax decisions. This author lists two administrative powers in addition to retained voting rights: "the right to choose the trust investments and to allocate receipts and expenditures between the income and the principal." *Id.* at 15.

7. Estate of Ford v. Commissioner, 53 T.C. 114 (1969); Estate of Pardee v. Commissioner, 49 T.C. 140 (1967).

8. Estate of Budd v. Commissioner, 49 T.C. 468 (1968); Estate of Ford v. Commissioner, 53 T.C. 114 (1969). These examples that are not taxed by the estate tax may nevertheless be taxable under the income tax provisions under sections 674 and 675 of the Internal Revenue Code. For an excellent analysis showing a lack of symmetry among the three codes—estate, gift, and income, see Lewis, *Powers Retained by the Settlor of a Trust: Their Income, Estate and Gift Tax Treatment*, 5 REAL PROP., PROB. & TR. J. 1 (1970).

9. Justice Powell wrote the majority opinion for himself, Chief Justice Burger and Justices Marshall, Stewart, Rehnquist and Douglas. Justice White, in dissent, was joined by Justices Brennan and Blackmun. In the district court Judge Kinneary found for Byrum's estate, largely on the basis of Yeazel v. Coyle, 21 A.F.T.R.2d 1681 (N.D. Ill. 1968), in which the settlor of the trust retained the right to sell and invest corpus, and to vote without retaining the "possession or enjoyment of or the right to income from the property." 311 F. Supp. 892 at 894 (1970). In the court of appeals, Byrum v. United States, 440 F.2d 949 at 952 (1971), the majority felt that "[t]he only power retained by the grantor which may possibly have made the transferred assets includable in his estate was the power to vote the unlisted shares of the stock." *Id.* at 952. The majority went on to hold that, unlike the grantor's powers in United States v. O'Malley, 383 U.S. 627 (1966), the settlor in *Byrum* did not retain the right to regulate the income flow. Byrum's powers were indirect; even if he could have elected the directors, their actions were subject to fiduciary obligations. Chief Justice Phillips dissented from the majority:

> In addition to reserving the right to vote the stock, he retained the power to veto any sale of the stock by the trustee and the right to remove the trustee and appoint a new trustee.
>
> It is not determinative . . . that anyone of these retained rights, standing alone in a different factual situation, might not have subjected the stock to the federal estate tax as a part of the taxable estate of the decedent. I would hold that the retained powers in the aggregate . . . operated to reserve to the settlor the enjoyment of the

Byrum, the settlor, Milliken C. Byrum, transferred to an irrevocable, inter vivos trust a substantial portion of his stock in three small corporations. In each of these corporations, he was the principal owner. His control of these corporations consisted, in the formal sense, of his ownership at the time of the transfer of at least 71% of the outstanding stock of each. In the trust agreement, Byrum gave to the trustee broad powers to manage and control the assets of the trust, all for the benefit of Byrum's children or their issue. The trustee, for example, could sell property and invest the proceeds without "any limitation whatsoever as to the character of investment under any statute or rule of law."[10] In addition, the trustee could make leases, apportion receipts between principal and income and exercise broad discretionary powers to apply income and principal for the "education, care, maintenance and support"[11] of the beneficiaries of the trust until the trust terminated when the beneficiaries reached the age of 35. Notwithstanding the transfer of all of these powers to the trustee, Byrum, by language in the trust agreement, kept four powers: (1) to vote the shares of unlisted stock held in the trust estate; (2) to disapprove the sale of the stock held by the trust; (3) to approve investments; and (4) to remove the trustee and designate another corporate successor.[12]

At the time that Byrum died, he owned 59% of the stock in one corporation and the trust owned 12%, giving him the ability to vote 71%.[13] In the second corporation, Byrum owned 35% of the stock and could vote for the trust an additional 48%, resulting in a total voting power of 83%.[14] The figures for the third corporation indicated that Byrum could vote 88% of the stock. He owned 42% of the stock at his death and could vote an additional 46% of the stock which was in the trust.[15] Thus, these figures clearly reflect the important fact that Byrum had not relinquished voting control in any of the three corporations. Moreover, he received a salary as an executive of the corporations.

The opinion of the majority considered both paragraphs of subsection 2036(a) and first found that Byrum, in passing the stock

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shares and the right to designate the persons who would enjoy the income from them within the meaning of 2036(a)(1) and (2). . . .

440 F.2d at 953.

10. 408 U.S. at 127 n.1.

11. *Id.*

12. 408 U.S. at 127. These administrative powers are the same as are included in those powers described in text accompanying notes 5, 6, 7 & 8, *supra*.

13. 408 U.S. at 130 n.2.

14. *Id.*

15. *Id.*

to the trust had not, under section 2036(a)(2), retained the power "to designate the persons who shall possess or enjoy the property or the income therefrom."[16] The majority further concluded that Byrum had not, under 2036(a)(1), retained the possession or enjoyment of the property.[17]

2. A Preview of the Amendment

Recently, in the Tax Reform Act of 1976, Congress overruled one aspect of the *Byrum* case by amending section 2036(a)(1) to specifically include the retention of voting rights within the meaning of "enjoyment" of such stock. The entire statute with both sections and the amendment now reads:

> (a) GENERAL RULE. 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 (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—
> (1) The possession or enjoyment of, or the right to the income from, the property, or (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. *For purposes of paragraph (1), the retention of voting rights in retained stock shall be considered to be a retention of the enjoyment of such stock.*[18]

In writing the amended portion, Congress meant to state "transferred" stock rather than "retained" stock. "Retained" stock has long been taxable under section 2033 as property owned by the decedent at death. We anticipate the early passage by Congress of a technical amendment to make plain that *transferred* stock is taxed if the donor *retains* voting rights.[19] Other modifications discussed later in this article have already been introduced in Congress.

B. The BYRUM *Decision: Majority and Dissenting Perspectives*

Returning to *Byrum* and ruminating over the opinions authored by Justices Powell and White, it becomes clear that the split in the

16. 408 U.S. at 144.
17. *Id.*
18. I.R.C. § 2036.
19. In Tilman v. Commissioner, 547 F.2d 32 (1976), the Second Circuit Court of Appeals in a per curiam opinion at footnote 9 noted the error by quoting the amendment: "For purposes of [Sec. 2036(a)] the retention of voting rights in [transferred] stock shall be considered to be a retention of the enjoyment of such stock." *Id.* at 35 n.9.

Court is attributable to three disagreements: (1) the construction of section 2036, with its two divisions, 2036(a)(1) and 2036(a)(2); (2) the interpretation of case law construing the statutes which preceded section 2036; and (3) the resolution of the question of whether a majority shareholder of a given corporation has the capacity to dictate the policy of the corporation. These disagreements occur primarily because the courts have, over the years, failed to clarify the values they wish to promote in construing the Internal Revenue Code. Apparently, both the courts and Congress are unaware of the complexity of the wealth transmission process which encompasses numerous tax statutes. Irreconcilable views, scarcely articulated at a policy level, appear in the confines of a narrow situation, forced on the court, of course, by the one case before it. The *Byrum* case is additionally rigid in that its development led the Court to reason within the small categories of the two sections of 2036, taking each at a time, with the result that an analyst gets the surrealistic impression of a two-time trip down separate lanes of the same highway. Much of the reasoning under 2036 (a)(2),[20] which the Court discussed more fully than when it took up 2036(a)(1), becomes *déjà vu* at the second stage, when the Court, in turn, takes up the latter provision. For our purposes, it is useful to follow the government argument under 2036(a)(2), then to take up the responses of the majority and minority opinion, and then to repeat the process with 2036(a)(1).

The linchpin of the government's argument under 2036(a)(2) was that Byrum could vote a majority of the stock of the three corporations whose shares he had had transferred in trust and, as a consequence, dictate the dividend policies of the corporations. This control over dividends resulted from the fact that Byrum's ability to vote a majority of the stock in each corporation enabled him to elect a majority of the board of directors. And inasmuch as he could select persons who could be responsive to his wishes he was assured a board that would implement a dividend policy he liked. Moreover, since Byrum retained a power to preclude the trustee from alienating any of the transferred stock, he could assure his continued control over corporate dividends, and thus "regulate the 'flow of income to the trust' and thereby shift or defer beneficial enjoyment of trust income between the present beneficiaries and the remaindermen."[21] Since the government saw Byrum's power as equivalent to the

20. As the majority points out, the government placed primary reliance on section 2036(a)(2) in arguing for the taxability of the trust. 408 U.S. at 131-32.

21. 408 U.S. at 132.

power to accumulate income, it argued that the case was controlled by *United States v. O'Malley,*[22] where the Court had held that the settlor's designation of himself as one of three trustees of an inter vivos trust under which the trustees were "authorized . . . to pay income to the life beneficiary or to accumulate it as part of the principal of the trust 'in their sole discretion,' " subjected the settlor's estate to tax for the amount of income actually accumulated by the trustees and applied to principal.[23] The minority in *O'Malley* had dissented from the majority's conclusion that the transferor had not *transferred* the income but only the principal in the trust.

In rejecting the government's argument, Justice Powell, strictly construing the statute, concluded that the use of the word "right" in section 2036(a)(2) evinced a congressional intent that only the reservation of a "right," as opposed to a mere "power," to determine who shall enjoy the transferred property or resulting income would trigger the tax.[24] As to what specifically constitutes a "right" under the statute, the Court indicated that the term encompassed powers which were both "ascertainable and legally enforceable," as was the power in *O'Malley.*

Applying that notion of a "right" to the power attributed to Byrum to regulate the flow of income to the trust by controlling the corporations' dividends, Justice Powell found that neither the aspect of ascertainability nor that of legal enforceability was present: "The 'right' [attributed to Byrum] was neither ascertainable nor legally enforceable and hence was not a right in any normal sense of that term."[25]

More specifically, concerning the nonexistence of an ascertainable standard, the Court noted that the "control rationale . . . would create a standard . . . so vague and amorphous as to be impossible of ascertainment in many instances,"[26] and that the "concept of 'control' is a nebulous one . . . too variable and imprecise to constitute the basis *per se* for imposing tax liability under

22. 383 U.S. 627 (1966). Justices Stewart and Harlan dissented on a strict reading of the statute, which uses the word "transfer." Justice White, who wrote the majority opinion in *O'Malley,* concluded that the income increments in the trust were derived from the original transfer and the exercise of the power of accumulation.

23. The question whether the value of the securities originally placed in trust was subject to tax had been answered in the affirmative by the district court. 408 U.S. at 152.

24. That section 2036(a) requires that the settlor "must have retained for his life . . . (2) the right . . . to designate the persons who shall possess or enjoy the property or the income therefrom." *Id.* at 136.

25. *Id.* at 136-37.

26. *Id.* at 137 n.10.

27. *Id.* at 138 n.13.

2036(a)."[27] In support of this position, the majority pointed out that even if one assumes that a controlling stockholder can elect a majority of the board of directors, in most states such control would not necessarily extend to all corporate transactions.[28]

While this observation seems to suggest that "control" is a variable notion to the extent that it may impart different practical powers from state to state, the majority makes a more telling observation concerning the imprecise and amorphous quality of control in the election of directors when it suggests that it is difficult to perceive who has it. It is usually taken that an owner of essentially all of the stock of a corporation controls the corporation in the sense of being able to elect a majority of the board of directors. An illustration of this is found in *Yeazel v. Coyle.*[29] It follows that the person who can vote a majority of stock can elect the majority of the board. However, Justice Powell's opinion suggests a qualification to this proposition. Specifically, recognizing that the capacity to vote in excess of 50% of the stock of a corporation will enable the shareholder to elect a majority of its directors, he adds the phrase "in most circumstances." Although he does not set out the circumstances that could prevent a person voting a majority share of stock from selecting a majority of the board, a person would not have de facto control if in fact these limiting circumstances existed. The determination of control is compounded in Justice Powell's view by a second consideration, namely, in some circumstances the capacity to vote less than 50% of the stock may nonetheless confer the capacity to elect a majority of the board and thus to control the corporation.[30] Here the Court is recognizing, in a truncated fashion, the panoply of arrangements indicated by thirteen variations of *Byrum*-type situations to be discussed later in this article.[31]

Regarding the nonenforceability of Byrum's power, the major-

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28. "Under most circumstances, a stockholder who has the right to vote more than 50% of the voting shares of a corporation 'controls it' in the sense that he may elect the board of directors. *But such a stockholder would not control, under the laws of most states, certain corporate transactions such as mergers and sales of assets.*" (emphasis added) *Id.* at 138-39 n.13. It is somewhat confusing as to how precisely the emphasized language, which merely states that control over the directors does not confer upon the shareholder absolute power, supports the majority's proposition that the concept of control is both "variable and imprecise." The less-than-absolute nature of control bears no relation to the question of whether or not "control" is an imprecise concept.

29. Yeazel v. Coyle, 21 A.F.T.R. 2d 1681 n.13 (N.D. Ill. 1968).

30. Moreover, control—in terms of effective power to elect the board under normal circumstances—may exist where there is a right to vote far less than 50% of the shares. This will vary with the size of the corporation, the number of shareholders, and the concentration (or lack of it) of ownership.

31. *See* text accompanying note 104 *infra*.

ity stressed that Byrum could not *legally* compel the directors to carry out whatever wishes he might have regarding the corporate dividend policy. Whereas the government had urged that *O'Malley* had supported its position, Justice Powell found the case consistent with his analysis of the statute, since in his view the settlor had reserved a "right" covered by the statute.[32] Since the majority had determined that Byrum had not retained an enforceable "right" to allocate income, it distinguished his case from *O'Malley:* "His [Byrum's] ability to affect, but not control, trust income, was a qualitatively different power from that of the settlor in *O'Malley,* who had a specific and enforceable right to control the income paid to the beneficiaries."[33]

The majority found support for its position in *Reinecke v. Northern Trust Co.,*[34] which recognized that a settlor's retention of broad powers of management does not necessarily subject an inter vivos trust to the federal estate tax, and in *Estate of King v. Commissioner,*[35] where the settlor's retention of broad managerial and investment powers was held not to subject the trust to estate tax under the predecessor statute to 2036(a)(2). Specifically, since the majority reasoned that the power which Byrum exercised was essentially the same managerial power retained by the settlors in *Northern Trust* and in *King,* it viewed the cases as precedent in ruling for the nontaxable nature of Byrum's trust. Justice Powell also noted that these cases were significant because they justifiably convinced many draftsmen of trusts to rely on them to provide safeguards against tax liability.[36] The majority took the view that set patterns should be changed by the legislature, since it has superior access to factfinding devices and can give taxpayers advance warning of change.

Having ruled that Byrum's power over corporate dividend policy was not a "right" covered by section 2036(a)(2), the majority, had it stopped there, would have been susceptible to the criticism that it had elevated form over substance. If Byrum could have exerted sufficient *influence* over the directors to affect the dividend policy, then an opinion based only upon a finding that Byrum's

32. *O'Malley* was covered precisely by the statute for two reasons: (1) there the settlor had reserved a legal right, set forth in the trust instrument; and (2) this right expressly authorized the settlor, "in conjunction" with others, to accumulate income and thereby "to designate" the persons to enjoy it.

33. 408 U.S. at 143.

34. 278 U.S. 339 (1929).

35. 37 T.C. 973 (1962).

36. *See* Brief of Howard Gilman *et al.* Executors, as *amicus curiae* at 5-10, U.S. v. Byrum, 408 U.S. 125 (1972).

power did not constitute a "right" within the meaning of section 2036(a)(2) would signify a curious possibility. Thus, a settlor, by retaining a formal right over the allocation of income between present beneficiaries and remaindermen, would have his estate subject to a tax, but a settlor who accomplishes the *same control* through indirect means would escape tax. Presumably, in an effort to deflate such a criticism, the majority argued that a shareholder who is able to vote a majority of stock is constrained in his capacity to influence corporate dividend policy and is controlled in his power to regulate the flow of income to the trusts.

The Court set forth three specific restraints upon the shareholder's power to influence the manner in which dividends are set. First, the economic fortunes of the corporations might have been such that there would be no earnings from which to pay dividends—an eventuality which would unquestionably preempt the settlor from exercising control over the flow of income to the trust. Second, since the directors would owe fiduciary duties to all of the shareholders, a decision regarding dividends which was intended to accommodate Byrum's wishes vis-à-vis his trust but which adversely affected the interests of the corporation would subject them to possible derivative suits. Third, Byrum, as a majority shareholder, was himself subject to a fiduciary duty to his fellow shareholders, the breach of which would provide the latter with a cause of action against him. Finally, the majority added that even if Byrum could have controlled the flow of income to the trust, he would not have had unlimited power over the allocation of trust income since it was within the trustee's discretion to pay out of accumulated income.

For the minority, Justice White in his opinion answered each of the arguments of the majority. He first noted that sections 2036(a)(1) and 2036(a)(2), taken together, should require the imposition of a tax upon any transfer which is not a complete and absolute surrender of the donor's interest in the transferred property. Having adopted the chief contention raised by the government that, whether by a "right" or by a "power," a majority shareholder can control dividend policy, Justice White appears to have reasoned that since Byrum could control the manner in which the trust beneficiaries enjoyed the income from the shares placed in trust by controlling the flow of dividend income to the trust, his transfer was not only covered by the letter of section 2036(a)(2), but also by its spirit, since the transfer was rendered less than absolute and unequivocal in nature.

Turning to the majority's analysis, Justice White rejected the distinction made by the majority between a "right" and a "power."

He would not limit the definition of the word "right" within section 2036(a)(2) to situations in which the settlor's capacity to designate who shall enjoy either the trust's principal or income, or both, is a function of the retention. He would define the term "right" within the statute to include some unenforceable powers which, despite their unenforceability, nonetheless provided the settlor with real economic control over the trust. Thus, the government and the minority argued for an economic reality test, or as it is sometimes called, the de facto test. In support of its analysis, the minority argued that the formalistic interpretation offered by the majority was inconsistent with the history of the bill and its enactment. The circumstances of the passage suggested a wider, more comprehensive interpretation. Additionally, the dissenting opinion pointed to the legislative history of the predecessor statute to 2036(a)(2) and argued that this earlier law demonstrated that the word "right" was intended to have an expansive rather than a constricted meaning.

The minority argued that its position concerning section 2036(a)(2) and the difference between a "right" and a "power" was supported by *O'Malley* in that the imposition of a tax in that case did not turn on whether the settlor had retained a "right" to allocate income, but instead on whether in fact the settlors could determine who would enjoy the fruits of the trust.

The specific teaching of *O'Malley,* in Justice White's view, is that it established the position "that a settlor serving as a trustee is barred from retaining the power to allocate trust income between a life income tenant and remainderman if he is not constrained by more than general fiduciary requirements."[37] The dissent, having found that Byrum's capacity to vote in excess of 50% of the stock did enable him to allocate trust income through regulation of the flow of income to the trust, reasoned that not holding Byrum's trust subject to a tax could not be reconciled with *O'Malley*.

With respect to the Court's argument that Byrum and other prospective settlors may have justifiably relied upon prior cases to conclude that trusts established in *Byrum*-type fashion would not be taxable, Justice White made two responses. First, he dismissed the relevance of such reliance, assuming *arguendo* it could have been shown to exist, since it would permit "artful claims of past understanding to frustrate present rationalization of the law. . . ."[38] Second, Justice White argued that none of the cases cited by the Court could have been justifiably relied upon by Byrum

37. 408 U.S. at 157.
38. 408 U.S. at 163.

as a basis for concluding his trust would avoid taxation. *Northern Trust,* on which the majority depended for its reliance doctrine, was inapposite because it dealt with a statute which contained no counterpart to 2036(a)(2) and, quoting Cardozo, it was a decision as "mouldy as the grave from which counsel brought it forth to face the light of a new age."[39] The dissent further submitted that *Northern Trust* was based on a "conceptual framework" which is no longer valid, since it depended on *May v. Heiner,*[40] now overruled by *Commissioner v. Estate of Church.*[41]

Justice White also contended that the lower court opinions that buttress a reliance, stare decisis theory involved cases in which the settlor retained control by naming himself trustee. In those cases the settlor-trustee was subject to strict, judicially enforceable, fiduciary duties to treat the beneficiaries of the trust in accordance with standards set forth in the document and in addition in accordance with general principles of fiduciary law. Such duties, he observed, could be used by the beneficiaries as a basis to sue the settlor-trustee in the event he attempts to utilize his control over the trust's investments to produce an allocation of funds between the life beneficiaries and remaindermen in a manner inconsistent with the trust document. Justice White submitted that since Byrum's alleged control over the trust through the determination of the corporation's dividend policies arguably provided him with more freedom to manipulate the flow of income between present beneficiaries and remaindermen, in that he would not be constrained by the threat of being the subject of derivative suits based upon a fiduciary duty, Byrum was not entitled to assume that his trust would be controlled by the settlor-trustee cases.[42]

39. B. Cardozo, The Growth of the Law, in Selected Writings 244 (M. Holl ed. 1947).

40. 281 U.S. 238 (1930). In this case a wife had passed property to an inter vivos trust and had directed the trustees to pay the income to her husband for life, then to herself for life, and then to divide the remainder among her children. The Court held that the transfer in trust was not a testamentary transfer and subject to the estate tax upon the death of the settlor.

41. 335 U.S. 632 (1949). See Bittker, *The Church and Speigel Cases: Section 811(c) Gets a New Lease on Life,* 58 Yale L.J. 825 (1949); Bittker, *Church and Spiegel: The Legislative Sequel,* 59 Yale L. J. 395 (1950).

42. The dissent finally argued that since at the time Byrum drafted his trust, State Street Trust Co. v. United States, 160 F. Supp. 877 (1958), had been decided holding, in the district court, that a settlor could not maintain powers of management of a trust even as a trustee without assuming tax liability. Byrum was on notice that the law was uncertain with respect to a settlor's retention of control over the trust's stock. In State Street Trust Co. v. United States, 263 F.2d 635 (1st Cir. 1959), the court of appeals affirmed the district court. It was only years later that *State Street* was reversed by Old Colony Trust Co. v. United States, 423 F.2d 601 (1st Cir. 1970).

The majority, relying upon *Commissioner v. Estate of Holmes*,[43] found that the term "enjoyment" as used in section 2036(a)(1) was intended to connote a "substantial present economic benefit."[44] Justice Powell described the guarantee of future employment as an insubstantial benefit, and viewed the capacity to determine whether or not to effect a merger as too speculative to be a present benefit. His conclusion for the Court was that notwithstanding whatever benefit Byrum may have derived from the retention of voting power, he had not retained the "enjoyment" of such stock within the meaning of section 2036(a)(1).

As to what precise benefits fall within the scope of section 2036(a)(1), the Court observed: "The statutory language plainly contemplates retention of an attribute of the property transferred—*such as a right to income, use of the property itself, or a power of appointment with respect either to income or principal.*"[45] Justice Powell also found that the government's argument failed on a second statutory ground. He reasoned that in order for a retained benefit to be enjoyed within the meaning of section 2036(a)(1), it had to be a benefit associated with the property *transferred.* Apparently having read the government's brief as stating that the attribute of the transferred property which Byrum retained and enjoyed was the element of "control," Justice Powell concluded that Byrum could not have retained the attribute of "control" with respect to the *transferred* stock inasmuch as he never placed in trust in excess of 50% of the stock of any of his corporations. Whatever control Byrum had he kept by owning a majority of the stock or by keeping enough stock to influence the corporation if added to the voting rights he retained in the trustee's stock. He did not transfer the majority of stock.

The majority relied heavily upon case law in arriving at its construction of section 2036(a)(1). In addition to citing *Estate of Holmes*[46] for the proposition that the term "enjoyment" was intended to connote a "substantial present economic benefit," the majority found in *Commissioner v. Estate of Church*[47] and cases dependent upon its meaning, that "enjoyment" had been applied only to situations in which an income interest or lifetime use of property was retained by the seller. The majority also relied on

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43. 326 U.S. 480 (1946).
44. *Id.* at 486.
45. 408 U.S. at 149 (emphasis added).
46. 326 U.S. 480 (1946).
47. 335 U.S. 632 (1949).

Reinecke v. Northern Trust Co.[48] as demonstrative of a case in which the retention of managerial powers, similar to those retained by Byrum, was held not to trigger tax as a "trust, 'intended to take effect in possession or enjoyment at or after his death.' "[49] Finally, the Court distinguished *Estate of Holland v. Commissioner.*[50] This case, upon which the government had relied, held taxable a trust in which the settlor had retained inter alia, the right to vote stock transferred in trust. The majority based its distinction on the grounds that the settlor had also retained a right to income. The government in *Holland* and again in *Yeazel v. Coyle*[51] sought to move the Court by the array of power in the donor.

As in the case of its consideration of section 2036(a)(2), Justice Powell rejected the notion that Byrum, as a consequence of being able to vote a majority share of stock, could control, without restraint, the employment policies of the corporations so as to secure his own future employment. Restraints would include the rights of minority stockholders and the surveillance of the Internal Revenue Service.

As with the issue of whether Byrum's trust was taxable under section 2036(a)(2), Justice White, relying on *Estate of Church* for the minority, determined that subsections (1) and (2), viewed together, mandated that a transfer of property constitute an absolute surrender of all interests in such property. With respect to section 2036(a)(1), the minority found that Byrum had retained enjoyment of the property inasmuch as his continued ability to vote the transferred shares enabled him to control the corporation and, in so doing, to secure for himself a compensated position with two of the corporations. In view of this continuing benefit (along with the right to regulate the flow of income to the trust), Justice White concluded: "[T]o me it is thus clear that Byrum's shares were not truly, totally, 'absolutely, unequivocally' alienated during his life."[52]

In addition to his reliance on *Estate of Church* to arrive at a comprehensive reading of both sections of 2036 requiring a *complete* transfer of property, Justice White's reference to the case under his discussion of section 2036(a)(1) also included his contention that *Northern Trust*, relied upon in the majority opinion, did not govern the case before the Court because in *Northern Trust*, the settlor did

48. 278 U.S. 339 (1929).
49. 408 U.S. at 146.
50. 1 T.C. 564 (1943).
51. 21 A.F.T.R. 2d 1681 (N.D. Ill. 1968). *See* note 29 *supra*.
52. 408 U.S. at 153.

not have the capacity to vote a controlling share of the stock of the corporation whose stock he had placed in trust.

C. *The* Byrum *Decision: Philosophical Underpinnings*

The foregoing discussion, setting forth the specific reasoning of the majority and dissenting opinions, is useful in identifying the fundamental conceptual disagreement that divides the Court and the legal profession. The majority, in the legal positivist tradition, decided the case by first engaging in a rigid and formalistic interpretation of statutory language in a manner consistent with the principles articulated in its previous decisions, and then applied that analysis to the facts before it. Under this view the Court believes that if changes are warranted, they can best be made by a response of Congress by way of statutory amendment. Such congressionally initiated change would have the advantage of providing the taxpayer with advance warning. Under that approach, the determination of whether a tax is to be imposed rests primarily upon the formal nature of the power retained over the trust (if a *right,* then taxed; if a mere power, then no tax) or upon the specific nature of the enjoyment retained (if a "present substantial benefit," then a tax is imposed; if the benefit is of a lesser nature, then no tax is triggered). In assessing the reasons why the formalistic approach embodied in the majority opinion garnered a plurality of the Justices, it is fair to assume that the opinion not only satisfied those on the bench who subscribed to the notion that the formalism of the legal positivist method assured that innovation in the tax code would be initiated by Congress rather than the courts, but also was appealing to those of the Justices who, for policy reasons, were reluctant to impose a tax which would adversely affect the close corporation as an institution. Their strongest point is that in a democracy, tax policy is for Congress to determine. This view reflected, perhaps, on Justice Frankfurter's dissent in *Church.* Their weakest point is their failure to shape tax policy from goals that Congress reasonably can be said to hold.

The minority eschewed such emphasis upon a formalistic interpretation of the statute. Instead, with respect to 2036(a)(2), the dissent saw as determinative the economic reality of the settlor's relation to the trust. The imposition of tax would turn upon whether the settlor could in actuality control the beneficiaries' enjoyment of the trust income, whether accomplished by formal right or by de facto control, and not upon the form by which power over the trust was exercised. And with respect to section 2036(a)(1), the minority rejected the formal distinction raised by the majority opinion between substantial present benefits and other interests, preferring

instead to find retained enjoyment wherever there was less than a total relinquishment of interests in the transferred property. The minority approach called for a less rigid application of the principle of stare decisis. Thus, looking, for example, to their treatment of *O'Malley,* one finds the minority was willing to extract from that decision what it considered to be its central principle, and then to apply that principle as controlling to a somewhat different factual situation. The majority, conversely, appeared unwilling to so extrapolate, finding that the difference in factual contexts rendered the earlier opinion inapposite to the latter. Two other major disagreements between the majority and the dissent in *Byrum* arise from the differences in attitude toward the institutions upon which the rules operate, the close corporation and the trust.

The two factions of the Court possess fundamentally different conceptions of how the institution of the closely held corporation operates in actual practice. Specifically, while the minority viewed this entity as capable of being dominated by its principal owner, the majority found that various legal and economic constraints prevent such a one man rule. Just as there was no consensus with respect to the workings of the closely-held corporation, so too there was an absence of agreement regarding the operation of the institution of the trust. Consequently, while Justice White believed that the trust document set forth a standard which effectively constrained the trustee's capacity to use his investment powers to allocate income between the trust's beneficiaries, Justice Powell viewed the typical trust document as presenting such a wide range of discretion as to the choice of investments as not to impose the kind of restraint envisioned by the minority.

The basic conceptual difference found in *Byrum* between reliance upon a formalistic analysis of the requirements of the statute on the one hand, and emphasis upon the economic reality or de facto control exercised by the settlor on the other, is a tension which reappears throughout the cases. We now turn to the exploration of some of these instances.

D. *The Aftermath of* Byrum

All of the tension between form and substance inherent in *Byrum* has continued since that decision and the subsequent anti-*Byrum* amendment. The tension shows a fundamental conceptual difference that has appeared in numerous judicial interpretations of the code. We turn to several cases, most of which, but not all, were decided after *Byrum*.

Estate of Beckwith v. Commissioner,[53] decided by the Tax Court in 1970, presents variation numbers 9 and 10 noted in the next section of this article.[54] This case must now be read with the understanding of *Byrum* and the anti-*Byrum* amendment. In *Beckwith,* the settlor of several irrevocable trusts, transferred to them all of his stock, which at the time of transfer represented 76% of the shares of the corporation. Although Beckwith, whom Judge Featherston described as having a "forceful and dynamic" personality, retained no voting rights, he was a trustee of several of the trusts that held stock representing 37% of the outstanding shares. There is little doubt that the anti-*Byrum* amendment would apply to these shares, since the estate tax laws apply to powers which the holder can exercise "with any other person," including an adverse trustee.[55]

Another problem, however, still remains: whether the remaining 39% of the transferred stock that Beckwith in fact voted by proxies came within the reach of section 2036. Since he received the voting power after the transfer, the argument could easily be made that he did not *retain* a power, but rather later received one. The Tax Court agreed with Beckwith that he had not retained the possession or enjoyment of the stock he voted by proxy, since he had parted with it at the time of transfer. The government had urged the court to find that the settlor had retained enjoyment, "just as surely as if the trust had never been made."[56] The government advocated an economic control test rather than one dependent on legally enforceable rights. The court defined "possession" as a word that would require an underlying agreement that the transferees of the stock would vote as told or give proxies to the transferor. The agreement would not have to be in writing, but the arrangement would have had to be understood at the outset. The "enjoyment" the government sought to tax was, in essence, the control of the corporation, not the income from the stock. Had Beckwith retained the income, the court could well have found an implied agreement.[57] A

53. 55 T.C. 242 (1970).

54. *See* notes 112-14 *infra.*

55. Helvering v. City Bank Farmers Trust Co., 246 U.S. 85 (1935); Treas. Reg. section 20.2036-1(b)(3) (1976). Professor John H. McCord makes the careful observation that the amendment applies to section 2036(a)(1) which goes to possession or enjoyment, and a distinction could be made that a retained power by one trustee in conjunction with another trustee is not within the contemplation of that section of section 2036, but rather of section 2036(a)(2). *See* J. McCord, *supra* note 1 at 222. He does not, however, believe that the distinction should be drawn. *See also* Surrey, Warren, McDaniel & Gutman, *infra* note 88 at 358.

56. 55 T.C. at 250.

57. Estate of McNichol v. Commissioner, 265 F.2d 667 (3d Cir. 1959). In Estate of Skinner v. United States, 316 F.2d 517 (3d Cir. 1963), the court held that the agreement does not have to be in writing. Chief Judge Biggs quoted district Judge Layton: [T]he court is

strong argument can be made, however, that if the enjoyment of income raises an inference of a prearrangement, the control of the corporation should also raise the same inference. The task would be to find substantial control, with or without formally enforceable legal rights. The phenonmenon of income shifting demonstrates that the receipt of income is not in many situations an important element in the control of wealth. Apparently, the courts are not yet prepared to see property as an aspect of an underlying power, unless the nexus is there in the nature of a legally enforceable right, such as, most obviously, the receipt of income.

The *Byrum* majority answered this proposition concerning de facto control by indicating that the control test would create a standard not specified in the statute, a standard so vague and amorphous as to be impossible of ascertainment in many instances. Justice Powell defined the present standard: "The statutory language plainly contemplates retention of an attribute of the property tranferred—such as a right to income, use of the property itself, or a power of appointment with respect to either income or principal."[58]

If we add to that test, as a consequence of the anti-*Byrum* amendment, "and retained voting rights," we have the present narrow approach. The statute catches some controls but not all, with broad highways available for the ingenious planners to take a "coach and four through the act."[59]

In *Beckwith*, the Tax Court also rejected an argument that the trustees of the Beckwith trusts were subservient to Beckwith, dependent upon him and, if not under orders, at least acting in concert with him. The court, however, emphasized that the trustees were serious business associates and refused to draw an inference of a retained right to control the trust. The court upheld the principle that an *agreement* to control would have been sufficient to constitute retained enjoyment but failed to find a presumption of an agreement based on Beckwith's forceful personality, which had been argued in *Estate of Skinner*.[60]

The subordinate doctrine adopted by the court in *Skinner* could be extended to the similar phenomenon of family control present in *Beckwith* and in many closely-held corporations. The person in a corporation who is the chief moving force, and who becomes the

aware that the holding in the case places a heavy burden upon the estate of a settlor of a discretionary trust to avoid the inference of secret prearrangements with the trustee when the settlor has in fact received an income during his life." *Id.* at 520.

58. 408 U.S. at 149.

59. Lindley, L.J., Queen v. Registrar of Joint Stock Companies, 61 L.J.R. 6 (Q.B. 1891).

60. 316 F.2d 517 (3d Cir. 1963).

transferor, maintains control, in fact, even though, in form, he has passed over the stock to others. The control he retains, though not formal, is observable but difficult to measure in economic terms. Even if the control is primarily psychological, does it not represent an "enjoyment" of the property?

Usually these dominant transferors, though denuded of stock ownership, do have salaries. These salaries may be contested, as in *Gilman v. Commissioner,*[61] discussed later, and disallowed as legitimate expenses for income tax purposes, but a reasonable salary is not income derived from ownership of the corporation.

The dilemma, as to whether de facto control of subordinates should be recognized, surfaced again in the 1972 case of *Harris v. United States.*[62] There the decedent owned less than 9% of the stock and in fact made no attempt to dispose of it. The issue was rather whether a contract made between him and the company, under which his widow was to receive death benefits, left him with enough control, through his ability to make changes, as to constitute a taxable power. The government had urged that the decedent did have such control in the form of a section 2033 power. While this case involved a different section of the code the issue is analogous to that inherent in section 2036.

The court rejected the government's argument that the decedent had sufficient control to change the contract, in an enforceable sense, even though he had influence over the other stockholders who were twelve related persons.

In *Byrum,* the government vigorously relied on the family doctrine and cited as major authority *United States v. Sunnen.*[63] The Supreme Court gave little attention to the argument based on *Sunnen,* which was an income tax case.[64] If this argument had pre-

61. 65 T.C. 296 (1975), *aff'd per curiam,* 547 F.2d 32 (2d Cir. 1976).

62. 29 A.F.T.R. 2d 1558 (C.D. Cal. 1972).

63. 333 U.S. 592 (1947). *See* Petitioner's Brief for Certiorari; United States v. Byrum, 408 U.S. 125 (1972).

64. In *Sunnen,* the taxpayer entered into an agreement with a corporation of which he owned 89% of the stock and of which his wife owned 10%. Moreover, the taxpayer and his wife were two of the five directors. Three directors had to agree in order to take binding action. Under the agreement, the taxpayer received royalties on patents, which he assigned to his wife, who received the income as her own. The court found that the taxpayer had retained, through cancellation provisions in his agreement with the company and by his relationship with his assignee, his wife, "the substance of all the right which he had prior to the assignments." 333 U.S. at 610. In *Sunnen,* of course, there were subsisting contract rights.

The Supreme Court in *Byrum* did not answer the government's brief except with footnote 14:

> In advocating this *de facto* approach, the Government relies on our opinion in Commissioner v. Sunnen, 333 U.S. 591 (1948). *Sunnen* was a personal income tax case in which the Court found the taxpayer had made an assignment of income. The

vailed, a barrier would have fallen to permit the gathering together and coherent arrangement of similar sections throughout the estate, gift, and income tax codes. The brief was a brilliant long shot, but lost.

In line with *Beckwith* and relying on it, the Tax Court stated in 1971, in *Estate of Barlow*,[65] that section 2036(a)(1) applies:

> only where the possession or enjoyment of, or the right to the income from the property is "retained" at the time the transfer is made. It does not apply where arrangements, not previously contemplated, are made after a transfer has been completed to permit the transferor to enjoy the benefits of the property.[66]

In *Barlow*, parents gave a farm to their children and then rented it back at a fair rental value. The court rejected the argument of the government that the parents had retained a life estate, since the parents regained possession by a separate transaction, at a later date than that of their gift to the children. The key point is that the parents paid a fair rental value for the lease, which changed the pre-existing economic situation. It could have been otherwise if the rentals had been a sham or if the lease had been for less than the fair market value as in *Dupont v. Commissioner*.[67] Recently, the Tax Court in *Estate of Green*,[68] has reaffirmed the position that the court of appeals had taken in *McNichol*,[69] that the court could imply an agreement to retain the life estate in the situation where the donor does in fact receive, later on, a life income. The easy distinction in the alleged powers in these cases and the retained power in *Beckwith* is that the receipt of income has always been considered a receipt of property; in connection with other rights or powers, the courts have been reluctant to give them a "property" definition.

In 1976, after *Byrum* and after the anti-*Byrum* amendment, the

> reasoning relied on the *de facto* power of a controlling shareholder to regulate corporate business for his personal objectives. This case is an estate tax case, not an income tax case. Moreover, unlike assignment-of-income cases, in which the issue is who has the power over income, this case concerns a statute written in terms of the "right" to designate the recipient of income. The use of the term "right" implies that restraints on the exercise of power are to be recognized and that such restraints deprive the person exercising the power of a "right" to do so.

408 U.S. at 139.

The problem of substantial economic interest as distinct from legal title or control needs to always view the underlying meaning of United States v. Grace, 395 U.S. 316 (1969).

65. 55 T.C. 666 (1971).
66. *Id.* at 670.
67. 63 T.C. 746 (1975).
68. 64 T.C. 1049 (1975).
69. 265 F.2d 667 (3d Cir. 1959). *See also* Estate of Skinner, 316 F.2d 517 (3d Cir. 1963).

Court of Claims had before it *Estate of Tully v. United States.*[70] This case raised a question under both sections 2038 and 2033 regarding whether a death benefit that a company paid to the widow of the deceased should have been included in his gross estate. *Tully* is important here only insofar as it discusses *Byrum* and indicates a view of the Court of Claims about section 2036.[71] Edward A. Tully, Sr., the decedent, had owned 50% of a corporation; one other person had owned the other half. In this sense, the case represents an example of variations 9 and 10 set forth in the next section except that rather than a transfer of stock in trust, there is a contract.[72] Tully and the other stockholder were principal officers and they entered into a contract under which the company agreed to pay death benefits to their widows. Upon Tully's death, the company paid to his widow $104,000, which the government sought to include in his gross estate.

The government construed the employment contract, under which the widow obtained her benefits, as either (1) leaving Tully with the right "to alter, amend, revoke or terminate" the interest, thereby bringing the transaction within 2038(a)(1); or else (2) that Tully at his death still had an interest in the benefits under the contract, bringing the transaction within section 2033. The argument in favor of including the benefits in the estate was essentially that Tully, as a major officer and stockholder, could have convinced the other stockholder to go along with him to make amendments in the contract confining rates. The contract, in effect, was an assignment, or gift, of a part of Tully's future earnings; the government felt that Tully had in fact possessed the power to amend the terms of the agreement, or the de facto control argument.

The court found that Tully's chance of persuading the other 50% stockholder was speculative and that a section 2038(a)(1) power applies only to powers that are "demonstrable, real, apparent, and evident."[73] The court further held the possibility too vague that

70. 528 F.2d 1401 (Ct. Cl. 1976).

71. The *Tully* case today would have to be reviewed with reference to sections 2035, 2037 and 2042, as well as section 2036 and section 2033. *See* Estate of Kramer v. United States, 406 F.2d 1363 (Ct. Cl. 1969); Hinze v. United States, 29 A.F.T.R. 2d 1553 (C.D. Cal. 1972). Especially note the amendment to section 2039(c) to remove lump sum distributions from the exclusion. *See also* I.R.C. § 402(e)(4).

72. See text accompanying footnotes 112-14 *infra*.

73. 528 F.2d at 1404. The court relies on Harris v. United States, 29 A.F.T.R. 2d 1558 (C.D. Cal. 1972) involving an annuity to a widow. The court in *Harris* found against the government. The decedent owned only 8.85% of the outstanding stock, but there was evidence of family control. Similarly, the court in *Tully* relied on Hinze v. United States, 29 A.F.T.R. 2d 1553 (C.D. Cal. 1972).

Tully might have divorced his wife, married another, and thereby changed the person who would have been the beneficiary. The court rather summarily dismissed the arguments by the government under section 2033 based on the court's understanding that section 2038 discussed a "power," section 2033, an "interest." The key to section 2033 is whether the decedent retained an enforceable contract right in favor of himself. The court thought of an "interest" as an economic benefit, a property right, and that Tully had transferred these interests to his wife, and that "he could not reach them for his own use."[74] The court concluded that the associations that Tully had with the retirement plan were *de minimis.*[75]

It is worth stressing the court's view of *Byrum* as set out in an important footnote:

> In effect, [the government] asks us to hold that corporate control constitutes a section 2038(a)(1) "power." In [Byrum] . . . the Supreme Court rejected the government's argument that the corporate control could provide a section 2036 right to alter beneficial enjoyment of trusts. The court specifically noted the vagaries and uncertainty which a corporate control test would produce in the estate tax area . . . .
>
> Since we find that Tully did not have control of the corporation, we need not reach the equally complex question of whether corporate control might give rise to a section 2038(a)(1) "power."[76]

In limiting the corporate control test in *Tully,* the Court of Claims rejected the test that Judge Philips had urged in the court of appeals in *Byrum* and that has been essentially rejected all along the way, unless *O'Malley* can still be given that reading. The decision emphasized and endorsed the opinion of the court in *Byrum.*

A year after *Tully,* the Court of Claims, in *Estate of Farrel v. United States,*[77] discussed the precise situation in which a testator had, at least implicity, retained in the trust instrument the right to appoint herself or others as a trustee should a vacancy occur. She twice appointed other persons to fill vacancies and under the state law, whether she knew it or not, she did retain the power to appoint herself as a trustee. Acting in the capacity of trustee, she would have

74. 528 F.2d at 1406. *See* Estate of Bogley v. United States, 514 F.2d 1027 (Ct. Cl. 1975), where the court found no enforceable contract.

75. If a court is going to take a strictly formal approach, it might as well go all the way as in Estate of Spiegel v. Commissioner, 335 U.S. 701 (1949). Rev. Rul. 70-304 1970-1 C.B. 163 indicates that the commissioner is abandoning his attempt to tax employee death benefits under section 2033 and is proceeding entirely under section 2038(a)(1).

76. 528 F.2d at 1404 n.8.

77. 553 F.2d 637 (Ct. Cl. 1977).

had the power to choose the payments of income and principal among a group of beneficiaries, as well as to vary the times at which the beneficiaries would receive their final payments. The power was nevertheless contingent on a vacancy among the trustees, a somewhat more restricted situation than that in *Byrum*. The court held that this contingent power was taxable under 2036(a)(2). There is evidence that the decision is a harsh one, since the trust instrument did not expressly give the settlor the right to appoint herself and since she may never have thought that she had such a right.

The decision also upheld the reading of Regulation 20.2038-1(b), in which the Commissioner accepted the reasoning that some contingent powers are not affected by 2038 if the decedent could not have exercised them at death. In *Farrel,* the decedent could not, at the time of her death, have changed the beneficiaries of the trust, since at that time no trustee vacancy existed. Thus, they found no section 2038 "power." However, the same power was sufficient to constitute a taxable power under 2036(a), since twice during the decedent's life she could have filled an existing vacancy.[78] This game of identifying the effective taxing provision is one of the sources of confusion in the tax code.

The *Farrel* court, in the majority opinion, stressed that the settlor's contingent right to designate herself a trustee, although not expressly stated in the agreement, was unlike the de facto powers in *Byrum* and *Tully.* The court found, instead, a formal, legally enforceable right, that Mrs. Farrel could have exercised. In concurring, Judge Kunzig distinguished his view of *Farrel* from the unanimous opinion of the court which he wrote in *Tully,* by application of the phrase "demonstrable, real, apparent, and evident." He characterized the interest retained in *Farrel* as real. The subtle distinction found by Judge Kunzig between *Tully* and *Farrel* could become increasingly significant if efforts continue to establish economic reality as the test of what constitutes a taxable power under section 2036. This view might facilitate the solution of the puzzle as to

78. The opinion states: "it is not unreasonable to regard 2036(a), in the way the Treasury does, as a blanket overall sweeping-in of property over which the decedent still has at death some significant, though contingent, power to choose those who shall have possession or enjoyment." *Id.* at 642. In LOWNDES, KRAMER, & MCCORD, *supra* note 1 at 719-20, the authors interestingly note that by conceding the non-taxability of contingent powers under section 2038 unless the contingency has occurred at the settlor's death, "the symmetry . . . is marred" by seeking to tax these same powers under sections 2036 or 2037. *See also* Heckerling, *Tax Aspects of Power to Remove, Substitute and Appoint Trustees,* 8 REAL. PROP., PROB. AND TR. J. 545 (1973). Rev. Rul. 77-182 does permit a grantor with impunity to appoint a successor trustee if the trustee is restricted to a corporate trustee inasmuch as the grantor in this situation cannot appoint himself as trustee.

which clusters of human energies are characterized as "enforceable," although in reality they are unimportant, and which are characterized as "nonenforceable," but practically speaking, constitute substantial de facto powers.

Gilman v. Commissioner,[79] decided before *Tully* and *Farrel,* is the most important case to arise since *Byrum.* In *Gilman,* the government sought unsuccessfully to distinguish the two cases. In *Gilman,* the decedent Charles had owned six shares of common stock which represented 60% of the voting stock in a large family corporation. His four sisters each owned one share. The stock structure of the corporation also included 25,000 shares of preferred nonvoting stock, of which, in 1944, the company owned 15,099 shares. Charles owned 5,241 shares, and his four sisters each owned 1,140 shares. Charles, since his father's death, had been the chief executive officer. In an effort to get control of the company, Charles, among other acts, placed his six shares in an irrevocable trust of which he was one of three trustees, along with his son and his lawyer. Under the trust instruments all decisions were to be made by majority vote, and the income of the trust was payable to Charles' two sons for life, with remainders to their issue. The effect of this arrangement was that Charles had no reversion in the principal, received no income, and retained no powers, including the right to vote the stock, all of which had individually constituted "enjoyment" of stock, in prior decisions, under 2036(a)(1).[80] The trustees, including Charles, voting by majority, could vote the stock in corporate matters, but since *Gilman* was decided before the anti-*Byrum* amendment, the tax court could rule for the estate, in reliance on *Byrum,* where the taxpayer's power to vote the stock alone was not found to trigger the tax. The court of appeals, affirming the lower court's decision, added: "Indeed, the facts of Charles Gilman's trust actually add strength to the taxpayer's case, for here the decedent's authority over the trust was . . . formally limited by the existence of the two co-trustees."[81]

The Tax Court noted that section 2036(a)(2) requires a "right," which according to *Byrum* "connotes an ascertainable and legally

79. 65 T.C. 296 (1975), *aff'd per curiam,* 547 F.2d 32 (2d Cir. 1976). The case reached the court of appeals after the anti-*Byrum* amendment which, however, did not apply to his earlier case.

80. Charles retained the right to appoint successor trustees; the trustees "were given broad management and investment powers, including 'full power and authority to grant, bargain, sell, assign, transfer, and convey all or part of the trust estate.' Included among these management powers was the right to vote the stock held in trust." 65 T.C. at 300.

81. 547 F.2d at 35.

enforceable power."[82] The Tax Court found that all powers that might have been ascribed to Charles were fiduciary.

As with *Byrum*, this case, today, would be moot because of the anti-*Byrum* amendment. Suppose, however, that Charles had not been a trustee. It is in this respect that the case is significant. The tax court divided, with four judges dissenting, and the tone of the several opinions shows the seriousness of the different approaches to these matters, even after *Byrum*.

Judge Raum's dissenting opinion, with which Judges Simpson and Wilbur agreed, describes a family situation of turmoil and friction and quotes Charles as having said to his father that "I wanted first and uppermost to be put in a position where I would run the company, because I felt I was the only one that could run the company. When I say 'run it,' have control of it."[83] To get control, Judge Raum argued, Charles obtained the six shares of stock, two from an option he had obtained from his father, and four he had acquired earlier. He thus "enjoyed" the control of the corporation. The judge felt that retention of control was implicitly understood or even actually agreed upon. The judge did not find the testimony of Charles' attorney credible regarding the fact that no such understanding existed. Impressed by this evaluation of the evidence, Judge Tannewald also wrote a dissent, which Judge Wilbur joined, stressing that the court should have upheld the *trier of fact,* Judge Raum, who found that there was an understanding between the settlor and the trustees that secured to the settlor the "enjoyment" of property within the meaning of 2036(a)(1). Certainly one can derive from Judge Tannewald's view support for establishing a presumption of a plan where stock is transferred in a situation in which the retention of control of the corporation may be logically inferred.[84]

The majority, in rejecting the existence of a pre-existing plan, stressed that when Charles set up the trust in 1948, the other stockholders (his sisters) had no inclination to sell their shares. It was only in 1957, following the corporation's redemption of shares, that Charles was freed from the constraint of potential opposition from

82. 65 T.C. at 316.

83. 65 T.C. 319. Judge Tannewald's opinion clearly expresses a hope that *Byrum* will not be "mandated into a rigid doctrine." 65 T.C. at 323. In a curious, undeveloped portion of his opinion, he attempts to limit *Gilman* by calling it *sui generis,* apparently for the reason that the only real value of the trusteed stock was the vote—the control. 65 T.C. at 323-24.

84. The majority took into account Treas. Reg. 20.2036-1(a)(ii) (1976) which provides: "an interest or right is treated as having been retained or reserved if at the time of the transfer there was an understanding, expressed, or implied, that the interest or right would later be conferred." 65 T.C. at 307 n.4. The court also cited Estate of Skinner v. United States, 316 F.2d 517 (3d Cir. 1963).

a significant minority of unrelated stockholders to actions by the trustees, taken on the basis of an underlying agreement. Although his sisters were of course related, they were hostile. Since the majority discussed this question of pre-existing arrangement, although it did not find that one existed, it may be possible that in a different fact situation they might apply the doctrine of corporate control.[85] And the fact that the decision was a close one indicates that this view may be gaining support. The tone of the majority, however, does not support the corporate-control test to judge one or more legally enforceable powers. The majority fully agrees with the majority opinion in *Byrum*.

In a concurring opinion, Judge Goffe, joined by two other judges, found the fact situation squarely within *Byrum* and added that the exercise of fiduciary powers could not be equated with enjoyment. Certainly *Gilman* must be taken as a strong affirmation of *Byrum*, if not, indeed, an extension. Other cases clearly uphold the theme of *Byrum* and do not draw distinctions that might limit it.[86]

The importance of *Gilman* lies not so much in whether it can properly be distinguished from *Byrum;* rather, its chief significance lies in its indication, albeit *sub silentio,* of the great tax savings that accrue to a taxpayer under selected forms of stock recapitalization. The familiar form, used widely both before and after *Byrum,* is that of the preferred stock capitalization plan. Under it, the principal owner of a family, closely-held corporation creates in the recapitalization process two classes of stock. He then retains sufficient preferred stock (with specially created voting rights) to allow him to keep control of the business. He further sets a low income level, as with limited dividends, to the class of preferred voting stock and then transfers the common stock to beneficiaries at a low gift tax rate, or optimally at no gift tax at all. The features of this plan, with their difficulties and choices, are discussed in several recent articles of high order.[87] The preferred stock plan is not identical with the

85. Estate of Goodwyn v. Commissioner, 32 T.C.M. 740 (1973); Estate of Chalmers v. Commissioner, 31 T.C.M. 792 (1972).

86. Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance,* 77 COLUM. L. REV. 161, 170-77 (1977); Burch & Hemmerling, *Estate Planning in an Inflation Economy,* 27 U.S.C. TAX INST. 489 (1975); Moore, *Byrum Revisited,* 27 U.S.C. TAX INST. 489 (1975); Pressment, *Effect of Tax Court's Gilman Decision on Estate Planning for the Close Corporation,* 44 J. TAX 160 (1976).

87. The matter of motive in connection with transfers under section 2036 requires a study of the implications of United States v. Grace, 395 U.S. 316 (1969) which arose under the predecessor statute section 811(c)(1)(B), 1939 Code. Although the intent may not be determinative of fair taxability if the economic realities require it, the intent does indicate the existence and purpose of a prearranged plan.

plan in *Gilman,* which today would have the defective feature of the retention of an ability to vote the stock. The two are similar in their purpose, which is to keep control in the hands of the transferor, not all the control, but some control, a control that is observable, the desire for which motivated the arrangements, and a control that should be subject to a future estate tax.

E. The 1976 Amendment and BYRUM

The amendment to section 2036(a)(1) has not, however, eliminated other problems raised in the *Byrum* decision, although today the stock that Byrum transferred would be taxed as a part of his estate. Congress apparently agreed with numerous commentators,[88] without making it clear what theory it wished the courts to follow, that Byrum had retained de facto control of the corporation, or at least a present interest in the corporation, that exceeded his own retained shares. Congress did make it clear that it would now tax all stock transfers with retained voting rights. The result is that the tax now applies to the transfer of small amounts of stock in large corporations, transfers that do not in any functional way affect the control of the corporation, as well as to significant transfers of stock as in *Byrum, i.e.,* transfers that define control of closely-held corporations. In order to eliminate the overbroad reach of the amendment, however, Congress now appears to be moving towards the government's position of taxing only substantial transfers which affect control.

Although the issue raised concerning retained voting rights is now settled, a disinterested observer may still see in the *Byrum* situation an interesting and instructive flow of events that, if analyzed, can be of use in solving both short-term and long-term problems inherent in the transfer of wealth. These arrangements typify efforts on the part of successful businessmen and women to pass on their wealth to their families and successors, and, at the same time, maintain control over the family corporation. The drama is classical. As Cardozo expressed it: "Seldom do the living mean to forego

88. In SURREY, WARREN, McDANIEL & GUTMAN, FEDERAL WEALTH TRANSFER TAXATION 295 (1977), the authors state: "By resorting to the most strained legalisms and by adopting a singularly unrealistic view of the operation of closely held corporations, the majority blessed this tax avoidance scheme." In LOWNDES, KRAMER & McCORD, FEDERAL ESTATE AND GIFT TAXES 217 (1974), the authors state: "The reasoning of the court in *Byrum* is not entirely satisfactory." Note, 50 DEN. L.J. 227 (1973). Professor Alice A. Soled has given a thorough analysis of the problem prior to the Supreme Court's opinion in *Byrum* in Soled, *Estate Tax Consequences of Inter vivos Transfers of Stock in a Closely Held Corporation,* 31 MARYLAND L. REV. 191 (1971). A provocative brief analysis is available in STEPHENS, MAXFIELD & LIND, FEDERAL ESTATE AND GIFT TAXATION 4-88 (1974).

the power of disposition. . . ."[89] Memories of King Lear are real; or as both Professors Thomas Shaffer and George Cooper have quoted Sartre, "I am what I own."[90]

Today, owners such as Byrum cannot, since the anti-*Byrum* amendment and the new uniform credit,[91] get the same tax advantages they could have obtained a few years ago if they had employed the same method. They can, however, still approximate, under *Byrum* rules, the same idea; they can avoid some taxes and keep some control, a modified version of the "heads, I win; tails, you lose" exercise. Property owners may still obtain four advantages by making early gifts, even though the new unified credit eliminates the former principal advantage of transfers before death, *i.e.*, that the estate tax was 25% higher than the gift tax.[92]

The first of the four remaining advantages that donors may enjoy by making inter vivos gifts is that of the annual exclusion still allowable under section 2503.[93] This $3,000 exclusion, $6,000 for married persons,[94] is still important to careful planners.[95] It is entirely possible, by annual giving over a long period of time, to pass on large sums of money, especially in the form of insurance and stocks.[96] Specifically, the courts are presently permitting a majority

89. Doctor v. Hughes, 225 N.Y. 305, 313, 122 N.E. 221, 223 (1919).

90. T. Shaffer, Death, Property and Lawyers 8 (1970); Cooper, *supra* note 2.

91. The theme of the new uniform tax seeks to combine, at the same rates, all taxable transfers. It introduces a generous uniform credit, and the single transfer tax that considerably lessens the burden of the middle class. The middle class is benefited in that now a person's estate will not be subject to any federal transfer tax at all if, for example, the person is single and transfers less than $175,625; and, if married, transfers less than $425,625. These figures are those that will apply in 1981, after a phase-out period and which take into account the full use of the marital deduction ($175,625 as an exclusion, plus $250,000 marital deduction, gives $425,625). The upper reach of the tax is now 70% rather than 77% and if the transfers are all made at the death of the transferor, the tax is lower under the new law for the rich as well as for the well-to-do. The gift taxes, however, are now higher, so that the very rich, at least, who used to depend on the 25% difference between the gift tax rate and the estate tax rate, will now have to pay somewhat more for transfers, unless they use the methods of tax avoidance or make tax deductible gifts to charities. Congress is assuming, and probably rightly so, that the middle class had never taken much advantage of the cheaper gift tax rates.

92. Although the Tax Reform Act of 1976 introduces a generation skipping tax that could have a far reach, the present significance of the reform goes to the rate of tax rather than to the type of transfers that are taxed. Even though all gifts and testamentary transfers may be seen as one taxable process, estate planners must still work within the basic provisions of the gift tax provisions on the one hand and the estate tax provisions on the other.

93. I.R.C. § 2503.

94. If the split gift election is made under I.R.C. § 2513.

95. Indeed if it were going to grant an exclusion at all, it is rather odd that Congress left the amount at $3,000, since the new unified credit takes into account inflationary tendencies in middle size estates. The $3,000 figure has remained constant since 1943, and earlier it had been higher.

96. *See* Cooper, *supra* note 2 at 191-95. If gifts are made to minors this problem requires

stockholder to pass on to his beneficiaries minority stock rights, so long as he does not retain the voting rights of the stock which is transferred. If he continues to hold a majority of the stock himself, he does not need the votes of his beneficiaries. In these situations donors continue to control dividend decisions through their power over retained stock and, as a consequence of the retained power, allow future dividends to pass to their donees as wealth taxable to these donees, usually at lower rates. There are difficulties with this maneuver if the donors seek to get the $3000 annual exclusion on stock in corporations that have not paid dividends for years.[97]

In addition to the $3,000 annual exclusion, there is a second reason which makes it advantageous for donors to give away property rather than have it pass at death, despite the payment of tax at the time of the gift. This second advantage is based on the traditional preference for inter vivos giving and is derived from the new code provision, section 2001(b)(2).[98] The benefit is that payment of gift taxes will reduce an estate by the amount of the gift taxes paid. Moreover, this amount would have been taxed at a presumably higher marginal estate tax rate at death.[99] This advantage does not apply to gifts made within three years of death, even though these gifts made late in life, formerly called gifts in contemplation of death, are still granted the $3,000 exclusion. In addition, the gift tax paid by the decedent on any gift made within three years of death[100] is included in the gross estate; this is referred to as "grossing up" the gift tax.

The third advantage of inter vivos giving is that it reduces the marginal tax base of the donor for income tax purposes. A good example is that of a donor in a fifty percent income tax bracket. Future dividends will escape the higher income tax rate of the donor. In these cases, the spreading of the income is favorable to both donors and donees, and unfavorable to the government.

careful study of section 2503(c) and the lessons of Crummy v. Commissioner, 397 F.2d 82 (9th Cir. 1968). *See* LOWNDES, KRAMER & MCCORD, *supra* note 1 at 823-38.

97. Stark v. United States, 345 F. Supp. 1263, 30 A.F.T.R.2d 5876 (W.D. Mo. 1972), *aff'd per curiam*, 477 F.2d 131, 31 A.F.T.R. 2d 1457 (8th Cir. 1973). *Cf.* Rev. Rul. 69-344, 1969-1 C.B. 225, disallowing the annual deduction of trusteed stock, the income from which, though payable to a beneficiary may be invested in non-income producing property and life insurance.

98. I.R.C. § 2001(b)(2).

99. *See* J. MCCORD, *supra* note 1 at 28; Cooper, *supra* note 2, at 171. A disadvantage of the early inter vivos gift is that the donor must then pay the tax. This hardship may be compensated for by the passing on of future earnings to a donee with a lower tax base.

100. I.R.C. § 2035, if the wife has joined in, her half portion of the tax is not "grossed up." I.R.C. § 2513.

A fourth advantage that donors may achieve through inter vivos gifts, though somewhat more speculative than the other advantages, is avoidance of estate tax on future profits. Because future income (interest, dividends, rent, and similar items) is paid to the donee, any of such income which the donee retains until the donor dies (or the value of any property which the donee purchases with such income) will not be included in the donor's estate tax base.[101] Also, any appreciation in value of the gifted property between the date of gift and the date of the donor's death will not be included in the donor's estate tax base.[102]

A fifth advantage of inter vivos giving is the ability to shift to the donee the income tax burden of any appreciation between the donor's purchase cost and the fair market value at the time of gift.[103]

If these remaining advantages of early giving are important to a donor, he may need to consider the impact of *Byrum* and its probable effect on future court decisions. Other persons, seeking changes in tax policies and decisions, should also be concerned with the aftermath of *Byrum*. It is helpful for both potential donors and tax reformers to understand at least thirteen variations on the theme of stock transfers in a closely-held corporation. Appreciation of the complexity of this subject will help explain the growing confusion in the doctrines and decisions throughout the entire wealth transmission process. These variations show decidedly that donors keep varying amounts of control while passing on other rights and powers. The pragmatic question is where to draw the line for the taxfree transfers, tax free in the sense of avoiding the estate tax, although the transferor may, of course, still have to pay a gift tax. Specifically, then, the variations are:

1. X, owning a *majority* interest in a company, transfers in trust a *minority* interest with retained voting power and keeps a *majority* interest. This was one of two situations in *Byrum*.[104]

2. X, owning a *majority* interest in a company divides that interest and transfers in trust a *minority* interest with retained vot-

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101. This rule applies even when the donor dies within three years of the date of gift. J. MERTENS, 3 LAW OF FEDERAL GIFT & ESTATE TAXATION § 22.80 (Rev. ed. 1973 & Cum. Supp. 1977).

102. The date of gift value will be included in the estate tax base as "adjusted taxable gifts," under section 2001(b)(B), but the date of death value will not be considered for estate tax purposes (unless of course the donor dies within three years of making the gift, in which case the date of death value is used to compute the donor's gross estate. I.R.C. § 2035(a)).

103. Section 1015(a) establishes that the donee's basis for determining gain upon later disposition is the donor's adjusted basis at the time of gift, increased by the donor's gift tax paid in accordance with section 1015(d).

104. *See* H.R. No. 94-1180, 94th Cong. 2d Sess. (August 2, 1976).

ing power and keeps a *minority* interest. This was the second of the two situations in *Byrum.*

3. X, owning a *majority* interest in a company, transfers in trust a *majority* interest with retained voting power and retains a *minority* interest.[105]

4. X, owning a *majority* interest in a company, transfers in trust his *entire* interest, retaining voting power over all or a majority share of the stock transferred.

5. X, owning a *majority* interest in a company, transfers in trust his *entire* interest, retaining voting power over a minority share of the stock transferred.

6. X, owning a *minority* interest in a company, transfers in trust a *minority* interest, retaining voting power over all or a portion of the stock.[106]

7. X, owning a *minority* interest in a company transfers his *entire* interest, retaining voting power.

An important distinction between variations 3 and 4 on the one hand, and 5, 6, and 7 on the other goes to the certainty of whether the settlor exercises de facto control over the corporation following his creation of the trust. With respect to 3 and 4, observers can well assume that the settlor, by virtue of controlling a majority interest, will be able to elect a majority of the board of directors, and to that extent control the corporation. Regarding 5, 6, and 7, however, the question of whether the settlor controls the corporation is more problematical. While in many instances a minority share of stock will be sufficiently small to prevent the settlor from electing a majority of the board, in other situations, as pointed out in the majority opinion in *Byrum,* a minority interest may confer such electoral power on the settlor.[107] Because a mere tallying of the votes at the

105. This factual pattern did not occur in *Byrum* but Justice Powell referred to it, if at all apposite, as relevant only to section 2036(a)(1) and not to section 2036(a)(2), 408 U.S. at 148-49.

106. The anti-*Byrum* amendment would now tax this transfer, as well as variation seven, under the estate tax. But as an original proposition the government was willing to concede its nontaxability because of its unimportant minority characteristic. *Id.* at 137 n.10. This type of transfer would not become unimportant if it reflected de facto control. See especially variations 9, 10, & 11.

107. The Government uses the terms "control" and "controlling stockholder" as if they were words of art with a fixed and ascertainable meaning. In fact, the concept of "control" is a nebulous one. Although in this case Byrum possessed "voting control" of the three corporations (in view of his being able to vote more than 50% of the stock in each), the concept is too variable and imprecise to constitute the basis *per se* for imposing tax liability under § 2036(a). *Under most circumstances, a stockholder who has the right to vote* more than 50% of the voting shares of a corporation "controls it" in the sense that he may elect the board of directors. But such a stockholder would not control, under the laws of most States, certain corporate transactions such as

settlor's disposal will not in every instance reveal the existence of the settlor's control over a corporation, judges may wish to evaluate not only the percentage of stock in a corporation that the settlor possesses, or over which he retains voting rights, but also the settlor's retention of administrative and managerial powers, and even the settlor's dominant psychological, intellectual, and economic position in the corporation.[108] If, as in *Byrum*, the settlor not only retains the right to vote the shares but also reserves the power to prevent the trustee from selling the stock, then a disinterested observer might conclude that the settlor did own a controlling interest in the corporation. The theory behind attributing control to the settlor in such an instance stems from a likely motivation of the settlor—that of maintaining the benefits which accrue to a controlling block of stock by tying the hands of the trustee. This view is consistent with the following observation made by Justice White in his dissent in *Byrum:* "He [Byrum] obviously valued control because he forbade the bank that served as trustee to sell the trust shares in these corporations without his—Byrum's approval, whatever their return, their prospects, their value, or the trust's needs."[109]

Following the 1976 amendments, which are applicable to gifts made and to estates of decedents dying after December 31, 1976, it is clear that all of the transfers in variations 1-7 would be taxed. A proposed amendment would tax only stock transfers with retained voting rights in situations where the decedent and his relatives own as much as 20% of a closely-held corporation. Thus, the taxability *vel non* of variations 6 and 7 would depend upon the size of the minority interest.

The Code as interpreted would still seek to tax only formally retained voting rights rather than de facto control.[110] The government in all these variations has consistently focused on de facto economic control and has been willing to waive taxation on minor

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> mergers and sales of assets. Moreover, control—in terms of effective power to elect the board under normal circumstances—may exist where there is a right to vote far less than 50% of the shares. This will vary with the size of the corporation, the number of shareholders, and the concentration (or lack of it) of ownership.

Id. at 138-39 n.13 (emphasis added).

108. *See* Macdonald, *The Wealth Tax—The Wrong Tool for the Job*, 1975 British Tax Rev. 283. The best systematic development for understanding the relationships affected by wealth transmission is Lasswell & McDougal, *Legal Education and Public Policy: Professional Training in the Public Interest*, 52 Yale L.J. 203 (1943).

109. 408 U.S. at 155.

110. *See, e.g.*, the discussion of Estate of Hilton W. Goodwyn, note 112, *infra*.

transfers, although formal, because minor voting rights do not affect the government objective which is the taxation of economic control. We continue with the variations:

8. X transfers stock in trust in accordance with any one of the preceding variations, but retains no voting rights. Instead, X names himself either as sole trustee or as one of several trustees.[111]

9. X transfers stock in trust in accordance with any one of the first six variations, but retains no voting powers. Instead, he appoints as trustee a "related and subordinate"[112] party, who is subser-

111. A settlor does not incur tax liability merely because he names himself trustee. Jennings v. Smith, 161 F.2d 74 (2d Cir. 1974). He must as trustee hold a power which is taxable. Old Colony Trust Co. v. United States, 423 F.2d 601 (1st Cir. 1970).

112. Elaboration is necessary with respect to the intended use of the term "related and subordinate" party. Although the phrase is not incorporated in the estate tax provisions of the Code, it does appear within the income tax statutes. Specifically, I.R.C. § 674 provides that certain powers vested in the trustee(s) of an irrevocable, inter vivos trust, over the distribution of trust income and corpus, will not result in attribution of trust income to the grantor, provided: (1) the grantor is not a trustee, and (2) not more than one-half of the trustees are "related and subordinate parties who are subservient to the wishes of the grantor." I.R.C. § 672, in turn, defines a "related and subordinate" party as follows:

> Related or Subordinate Party. For purposes of this subpart, the term "related or subordinate party" means any nonadverse party who is
>
> (1) the grantor's spouse if living with the grantor;
>
> (2) any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.
>
> For purposes of sections 674 and 675, a related or subordinate party shall be presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on him unless such party is shown not to be subservient by a preponderance of the evidence.

Our use of "related and subordinate" party, however, is intended to be more expansive than the foregoing definition. Since our purpose in enumerating these variations on *Byrum* is to point out situations in which the settlor passes on wealth while retaining control over the transferred assets, our definition of a "related and subordinate party" is intended to be sufficiently broad to include any individual who, by virtue of the nature of his relationship with the settlor, finds himself predisposed to do the settlor's bidding, thereby enabling the latter to effectively control the assets placed in trust. And it is obvious that the definition set forth in section 672(c) is not so broad.

The narrowness of section 672(c) is brought home in Estate of Hilton W. Goodwyn, 32 T.C.M. (C.C.H.) 740 (1973) [hereinafter *Goodwyn I*] and Estate of Hilton W. Goodwyn, 77 T.C.M. (P-H) 1011 (1967) [hereinafter *Goodwyn II*].

Those cases involved the same facts. Two attorneys were appointed successor trustees of various irrevocable, inter vivos trusts created by Hilton Goodwyn and were given broad discretionary powers over the distribution of trust income as well as over the investment and distribution of trust assets. The trustees proceeded to entrust these powers to Goodwyn so that he "exercised complete control with respect to the purchase and sale of trust assets, investment of any proceeds, and the determination of the amounts, if any, to be distributed to the respective beneficiaries." 32 T.C.M. (C.C.H.) at 752.

vient to the grantor's wishes.[113]

10. X transfers stock in trust to a "related and subordinate" trustee without formally retaining voting powers and without an agreement with the trustee that he (the trustee) would vote the stock in accordance with the settlor's wishes, and yet, despite the absence of such an understanding, the trustee delivers the proxies to the settlor.[114]

11. X transfers stock to a "related or subordinate" party with an understanding that the donee would vote the stock in a manner

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In *Goodwyn I* the principal question was whether the de facto power over the trust exercised by the grantor caused it to be taxable to the grantor's estate under section 2036(a)(2). *Goodwyn II* raised the issue of whether the same power warranted attribution of trust income to the grantor under section 674. In *Goodwyn I*, it should be noted, the court characterized the trustees as unrelated and in *Goodwyn II* the trustees were found to be "independent" within the meaning of section 674. In the former case, the court, placing reliance upon *Byrum* held that Goodwyn's exercise of trust powers "through the cooperation of unrelated trustees" was not an enforceable right and therefore triggered no tax. In *Goodwyn I* the court similarly reasoned that the grantor's de facto control did not constitute a right or legally enforceable power and therefore no attribution of trust income was warranted:

> Because of Goodwyn's failure to have a legally enforceable right, we have already held, following Byrum, that the assets of these trusts were not includable in the decedent's estate under 2036(a)(2). Since a similar legal right or power is a prerequisite under section 674(a), consistency appears to require the same decision with respect to the applicability of this section.

77 T.C.M. (P-H) at 1025.

For present purposes, the *Goodwyn* cases are significant because they teach us that even though the trustee is "independent" within the meaning of section 674, he still can be susceptible to the influences of the settlor and hence allow the settlor to control transferred assets. For the very fact that the trustees had turned over their fiduciary power "lock, stock and barrel" to the grantor, Goodwyn, indicated their inclination to abide by the wishes of the latter. Indeed, the court itself, in *Goodwyn I*, implicitly recognized this when it observed: "It would be indeed an unusual situation for a grantor to appoint trustees, whether corporate or otherwise, in the expectation that such trustees would, where given a choice, act contrary to the wishes of the donor." 32 T.C.M. (C.C.H.) at 754.

Goodwyn I and *II* suggest, then, that in order to encompass all those situations in which the grantor is able to control transferred assets through exercising influence over the trustee, our definition of a "related and subordinate party" cannot be limited to the parties enumerated in section 672(c), but must include a trustee who, based upon the facts of his relationship with the settlor, is shown to be predisposed to carrying out the settlor's wishes. It is in this sense that we employ the term, "related and subordinate party." We recognize the difficulty in some contexts of placing a value in traditional accounting methods on "influence," but at this stage we will hold that problem in abeyance.

113. This situation is discussed in text accompanying notes 53-65 *supra*, in connection with Estate of Beckwith v. Commissioner, 55 T.C. 242 (1970). Administrative powers are more easily taxed under the income tax provisions than under the estate tax provisions. I.R.C. § 675; Brogan, *Use of Grantor Trusts Imperiled by Maze of Disparate Income and Estate Tax Rules*, 44 J. TAX. 69 (1976).

114. *Cf.* Estate of Tully v. United States, 528 F.2d 1401 (Ct. Cl. 1976), discussed in text accompanying note 70 *supra;* McNichol v. Commissioner, 265 F.2d 667 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959)(income retained); similarly, *see* Skinner v. United States, 316 F.2d 517 (3d Cir. 1963).

reflective of X's wishes.[115]

12. X, by reorganizing the capital structure of the corporation into two classes of stock, passes the large number of shares, the non-voting stock, to others, who will obtain the benefits of growth while keeping the voting, non-growth stock, that gives him control.[116]

13. X transfers stock to an "independent" trustee, for example, one that is not "related or subordinate" to the grantor. Such a situation would incorporate the fact that section 674(c) of the Income Tax Code permits, for income tax purposes, an independent trustee to hold extremely broad powers to distribute or accumulate income and/or corpus without requiring taxation to the grantor. In this type of situation the trustee's discretion need not be established by any "ascertainable standard." The section would be utilized by grantors to appoint their attorney or accountant, considered "independent" of them, as the trustee. However, it is also extremely likely that these individuals will follow the requests of the grantor in the exercise of their discretion as trustees. The question arises then as to whether or not this can be done for estate tax purposes to circumvent *Byrum?*

Although some of these variations do not constitute taxable transfers and still others may in the future invoke taxable consequences, we emphasize here a process, employed through careful manipulation by estate planners, to place their dispositive instruments on the non-taxable side of a statute. Whether or not these specific variations will be reached by the tax code in the future, they suggest the type of arrangements that draftsmen will utilize in the face of new situations.

II

The foregoing review of the question of retained powers, as illustrated by *Byrum* and related cases, indicates acrid disagreement among responsible judges, unclarified congressional and judicial policy and a failure by the Commissioner to both put across his arguments and to establish a new approach to decisions. The voluminous literature on retained rights is permeated with a sense of dismay over the lack of coherent results that flow from donative transfers. The situation is bleak when viewed along with the inadequacies of the 1976 Reform Act, and especially when taking into account the anemic anti-*Byrum* amendment. In Part II of this

115. *See* discussion note 112 *supra.*

116. *See* Estate of Gilman v. Commissioner, 65 T.C. 296 (1975) *aff'd per curiam,* 547 F.2d 32 (1976); see also text accompanying note 79 *supra.*

essay, we join in with those who seek serious, deep, pervasive reform. We set out, rather than develop, a series of suggestions towards the aim of a future major overhaul of the system, as well as towards the aim of a few precise corrections of difficulties.

A. A Call for a National Debate

On a general level, we call for the commencement of a debate to begin among members of bar committees throughout the country, which optimally, with the aid of the informational media, will develop into discussions of national concern of the problems and policies of gift and estate taxes. This debate, which could well last a decade or more, should invoke the financial support of both the government and the large private agencies. This bold national undertaking should be approached with the utmost seriousness, with an understanding of its political nature, and with a commitment to identify the purposes of the transfer tax, and its relationship to the basic framework of our society. Towards the realization of a successful national debate, we propose two systematic supports: (1) a preliminary study of materials available to all, and (2) a comprehensive policy-science study.

Initially, in order to begin the debate at a high level, we suggest that interested groups take as a model for study and discussion the article by Professor George Cooper of the Columbia Law School that appeared last year entitled, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance.*[117] Although many persons may disagree with some of the conclusions in this now widely circulated monograph, it has the incalculable advantage of thoroughness. It demonstrates conclusively, through evidence and analysis, that our transfer-tax program in this country is not working well. Moreover, the article treats most problems that are currently arising so that each of us has reference points to which to respond. Professor Cooper's conclusions and recommendations, as distinguished from his presentation of factual patterns, although not universally agreed upon, are arranged in a manner which will easily enable debators and other analysts to present their own views. In order that each of us can be heard and our views can be consolidated into a presentation to encourage congressional action, it is suggested that this article by Professor Cooper be used as a common work paper.[118]

117. Cooper, *supra* note 2.

118. This study is available through the Brookings Institute at a nominal cost.

B. The Need for a Policy-Science Study

In addition to a national seminar based on studies of the Cooper variety, we propose a second research and debate project, a policy-science study. Congress and the large foundations should commence a complementary major policy inquiry based on political and social science data and theory. A full-scale study of a sophisticated nature would include the relevant work of some of America's distinguished social scientists, as well as incorporate the experiences of other countries with progressive transfer tax systems. Much of this enlightened scientific material is widely available, but is rarely utilized in the legal process, whether congressional or judicial. Utilization of a successful study of this scope would permit both the legislature and the courts to define and clarify policy in this area. Immediate reforms and long range planning can go together. We are dealing with topics about which we must ask at least the following questions: (1) To what extent is the purpose of the transfer tax to reallocate wealth, to achieve a redistribution of citizens' claims to wealth, respect, and power; (2) To what extent is the transfer tax needed for revenue purposes; (3) To what extent do special units in the economy, such as the farm or, as in *Byrum,* the close corporation, need special shoring up? What does fairness or uniformity mean in these tax situations?

We suggest here a study based on the analysis of Professors Harold Lasswell and Myres S. McDougal as they apply to the tax area. Theirs is an elaborate system which delineates the policy variables with the same degree of thoroughness as Professor Cooper has delineated the factual problems. The two studies should be taken as complementary. The Lasswell-McDougal proposals are most readily available for group discussions in their early article, *Legal Education and Public Policy: Professional Training in the Public Interest,*[119] although this article is only suggestive of the full system. Work on the Lasswell-McDougal system has now reached major proportions, and has attracted a school of followers. This system has been applied to studies in criminal law, areas of property law, such as future interests; land use planning; and especially, international law.[120] Although not everyone can be expected to accept each aspect

119. 52 YALE L.J. 203 (1943).

120. Social scientists would know well how to structure a national study based on the Lasswell-McDougal system. A few suggested readings for those not familiar with the system would include: H. LASSWELL, A PREVIEW OF POLICY SCIENCES (1971); M. MCDOUGAL, H. LASSWELL & J. MILLER, THE INTERPRETATION OF AGREEMENTS AND WORLD POLITICAL ORDER (1967); H. LASSWELL, WORLD REVOLUTIONARY ELITES (1965); M. MCDOUGAL & D. HABER, PROPERTY, WEALTH, LAND (1948).

of this system, or to apply it similarly to each factual example, it would serve magnificently as the overall reference point in incorporating and assimilating material. Such a major study would presumably lead to political resolutions which might otherwise be carelessly contrived preferences, rigidly embodying simplistic right-wing views of inheritance. If the reformers win out, Congress would carefully and thoroughly recast the three codes: income, estate, and gift. Meanwhile, immediate and intermediate reforms should go forward.

C. A Call for Amendment to Section 2036

On the particular immediate level of *Byrum* and of what to do about retained rights, section 2036, with its anti-*Byrum* amendment, ought to be further revised. Meanwhile, the House of Representatives has passed the Technical Corrections Bill of 1977, which may soon be enacted into law. It is inadequate in reach but would make two changes which we quote from the proposed text:

> Voting Rights:
> "(1) IN GENERAL—For purposes of subsection (a)(1), the direct or indirect retention of voting rights with respect to a controlled corporation shall be considered to be a retention of the enjoyment of transferred property.
> "(2) CONTROLLED CORPORATION—For purposes of paragraph (1), a corporation shall be treated as a controlled corporation if, at any time after the transfer of the property and during the 3-year period ending on the date of the decedent's death, the decedent owned (with the application of section 318), or had the right (either alone or in conjunction with any person) to vote stock possessing at least 20 percent of the total combined voting power of all classes of stock.[121]

Although the first point is good, it does not go far enough. The amendment should extend to all forms of control—contractual and partnership forms as well as those of the corporation. Not as sound is that portion of the amendment, the twenty percent provision, which accepts in some measure the older position of the government of a willingness to waive a claim to retained rights that are insubstantial as measured by an economic de facto test. A better solution is twofold: (1) to tax all retained stock, whether substantial or insubstantial; and (2) at the same time, to reach all interests, whether

121. Staff of House Comm. on Ways and Means, 95th Cong., 1st Sess., Technical Corrections Act of 1976 Written Comments 65-66 (Comm. Print 1977). Received by Committee on Ways and Means.

described as powers or rights where there is a de facto retention of economic control.

We urge that section 2036 (or even the companion sections of 2037 and 2038) be further and much more broadly amended to include not only retained voting rights but the other administrative and managerial powers as well. The Act should also reach these powers whether discovered in a corporate form or in another form such as an express or implied contract. These powers, four in number, are: (1) the power to choose investments; (2) the power to allocate receipts and expenditures between income and principal; (3) the power to disapprove the sale or transfer of trust assets; and (4) the power to remove the trustee and to designate another.[122]

122. The debate as to the wisdom of the proposed technical amendment has begun. Those who represent interests who seek to narrow the scope of the present version of section 2036 find fault with the proposed amendment. Representatives of this group note the proposal may fail to limit the imposition of tax liability to instances in which the settlor-controlling-shareholder retains voting rights in the stock transferred in trust; that because the phrase "retention of voting rights" in proposed subsection 2036(b)(1) is now followed by a phrase such as "in the transferred stock," the provision could tax a shareholder who, despite having placed corporate stock in trust without retaining the voting rights, maintains the right to vote other shares of stock, of the same corporation, which shares were not placed in trust.

Conversely, other critics seek to broaden the coverage. In note 121 *supra*, at 118-25 Professor William J. Brown fears that the use of the phrase "for purposes of subsection (a)(1)" might not reach subsection (a)(2). He argued that inasmuch as the retention of voting rights is as likely to result in the settlor's being able to designate the beneficial enjoyment of the transferred property as it is to enable him to enjoy the transferred property, the statute should reach both the enjoyment of property by the settlor and the beneficial enjoyment by others. Professor Brown proposes that the reference to subsection (a)(1) in the proposed subsection (b)(1) be amended by the deletion of "(1)." We prefer instead that the proposed subsection (b)(1) be modified in the following manner:

> (1) IN GENERAL—The direct or indirect retention of voting powers with respect to a controlled corporation shall be considered: (i) for purposes of subsection (a)(1) to be a retention of the enjoyment of transferred property and (ii) for purposes of subsection (a)(2) a retention of the power to designate the beneficial enjoyment of the transferred property.

We also disapprove, with Professor Brown, the distinction between rights and powers drawn by the Court in *Byrum*. In subsection (a)(2), the word "power" should be substituted for "right." Such a change is similarly reflected in our proposed language of subsection (b)(1). Moreover, we also agree, as stated in the text *supra*, with Professor Brown's observation that the retention of the capacity to vote any stock is a power which has value and therefore should be taxed irrespective of the number of shares at the settlor's disposal. To reflect this goal the reference above to "with respect to a controlled corporation" should be excised and, consequently, as Professor Brown points out, the need for proposed subsection (b)(1) would be obviated. A third appealing criticism by Professor Brown is that of the use of the terms "retention" and "rights" in the phrase "retention of voting rights" in proposed subsection (b)(1). This usage could perpetuate the distinction between rights and powers made by the Court in *Byrum*. Under such an approach, only the formal right to vote stock would be taxable with some de facto powers exempt from taxation. The use of the term "retention" is also bad, because it fails to reach the *Beckwith* situation where the settlor who does not formally retain the voting right is delivered proxies by a cooperative trustee after the creation of the trust. The insertion of the phrase "on acquisition" after the word "retention" in proposed subsec-

D. A Call for Broader Judicial Interpretation

If a statute were to include all of these managerial powers, we could then expect that, perhaps with the additional help of another word or two such as "other powers" or "advantageous incidents," the court might and should return to the view of the court of appeals in *State Street*[123] and find new taxable powers as new contexts arise, or find in the whole a weight greater than the separate parts. The courts could put aside once and for all the aphorism, quoted by the court in *Old Colony* from Judge Magruder's dissent in *State Street,* that with reference to trustee powers "nothing is to be gained by lumping them together,"[124] that, as Judge Aldrich continued, "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."[125] The courts could go on to accept further taxable powers beyond those just enumerated that may, in an analogous common law fashion, emerge into the matrix of power. The specific future "power" that a court may wish to reach does not have to be defined today. That case, again to quote Cardozo, "can abide the event." In deciding new cases, the courts could embark on a more adventurous search for tax avoidance. There would then emerge the exhilirating possibility that the courts would assume the path of exploration defined by the chain of cases starting at least as far back as *Church,* through *State Street, Grace, O'Malley,* and the dissenting opinions in *Byrum,* both the opinion of Justice White and, in the court of appeals, of Judge Briggs. It is clear from the theoreticians that property needs to be constantly redefined. The courts have been slow to follow up the breakthrough on the definition of property made earlier by Maitland with his "bundle of

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tion (b)(1) would improve this situation.

Another point made by Professor Brown, is that subsection 2036(a)(2) should be amended to reach the retention by a settlor of management powers which enable him to build greater value into already transferred assets. Professor Brown suggests that subsection 2036(a)(2) could incorporate aspects of I.R.C. §§ 674-75. We agree with this broader approach, although our final hope is in the judicial process.

Professor George Cooper has additional excellent suggestions that go to the drafting of provisions which would not only reach the *Byrum*-type situation, but would also subject to estate taxation the various methods by which an owner can freeze the size of his estate by passing on future growth in property, while maintaining control over it. In offering possible changes in existing statutes, Professor Cooper focuses on the recapitalization technique, which he finds an appropriate "model of estate freezing strategy." Cooper, *supra* note 2, at 236. We also enthusiastically endorse this proposal. *See also,* Pedrick, *Grantor Powers and the Estate Tax: End of An Era?,* 71 N.W.L. Rev. 704(1977).

123. State Street Trust Co. v. United States, 263 F.2d 635, 642 (1st Cir. 1959).

124. *Id.*

125. Old Colony Trust Co. v. United States, 423 F.2d 601, 603 (1st Cir. 1970).

rights"[126] or even with the *Restatement's* understanding of property, as inconclusive as that is, with its emphasis on relationships among persons rather than on "things."[127] In seeking to define property and to evalute the importance of claims to it, we need more work of the order of Philbrick, whose great essay remains dormant.[128] We need to seek new strength from such writers as McDougal, Robert Lynn, John Van Doren, Jessie Dukeminier, Charles Reich, and of course, such earlier scholars as Walter Hamilton, Gulliver, and Mechem. No one, however, expects a scholarly revolution in property concepts at this time. What might well be hoped for is an open-ended judicial process that would allow the courts on a case by case method to reach for new definitions of property in order to reach such matters as the one at hand, which is tax avoidance.

"Control," "influence," "powers," "rights," "interest,"—these words that describe relationships among persons over wealth must all be understood as "property," though not always easily measureable in the accounting sense. They are better viewed as important rights among persons over things (claims to wealth) and are part of the property whole. They should be subject to taxation upon their relinquishment. Their retention should postpone the taxation of the underlying assets such as the larger claims to income and corpus, until the death of the creator or transferor. We take the position that all of these claims, whether defined in the more specific and narrower sense as "property," or in the more general, even problematic sense, as "power," when identified at all, should delay taxation so that the alleged transfer does not allow growth value to escape the estate tax.[129] The firm test, if a donor seeks to obtain the still consid-

126. Maitland, *The Mystery of Seisin,* 2 LAW QUARTERLY REV. 481, 489 (1886). "[B]ut every gift is a transfer of ownership, and ownership is a right or a bundle of rights. . . .[a] gift is a transfer of rights." *Id.* at 489, (the relinquishment of certain rights by the donor and the acquisition of certain rights by the donee).

127. RESTATEMENT OF PROPERTY, Ch. 1, at 3 (1936).

128. Philbrick, *Changing Conceptions of Property in Law,* 86 U. PA. L. REV. 691, 696 (1938).

129. The argument there assumes but does not depend on a preference for the "hard to complete" rule as distinguished from the "easy to complete" rule in taxing inter vivos transfers. If a donor retains a power, influence, a right, or an interest then we prefer the "hard to complete" rule, somewhat along the lines of the recommendations of the American Bankers Association, so that the tax on property with retained powers should be taxed at the time of death. *Hearings on the General Tax Reform before the House Ways and Means Comm.*, 93d Cong., 1st Sess. 3733, 3870-78 (1973). If, however, the "easy to complete" view is accepted, as with the recommendations of the American Law Institute in ALI, FED. ESTATE AND GIFT TAXATION RECOMMENDATIONS 41-47, 188-89 (1969) and the Treasury Department in HOUSE WAYS AND MEANS COMM. AND SENATE FINANCE COMM. 91ST CONG., 1ST SESS., UNITED STATES TREASURY DEPT. TAX REFORM STUDIES AND PROPOSALS 384 (Comm. Print 1969), then a follow-through on the valuation problems of the retained rights and powers needs to be stressed. A

erable benefits of the gift tax, must be that he has undergone the "wrench of delivery,"[130] to use the phrase of Mechem, and that, as put by Justice Murphy, he has retained nothing "more than a memory."[131]

For this view, the courts should mold into tax analysis much of the older property learning going to problems of delivery, with its variations on constructive delivery, symbolic delivery, conditional delivery, and to see the disadvantages of a mechanical application of authoritative dogma and, at the same time, the importance of ritual in the authentication of intent.[132] It is wrong to take more seriously than as an example of cavalier dictum, Justice Frankfurter's statement that the solution of modern tax problems cannot turn on the unwitty diversities of the law of property.[133] Rather, it is more useful to contemplate the thought, well expressed by Professor Robert Lynn: "Might not a greater proportion of our best legal minds, carefully trained in the property lessons of the past, devote their talents to recognizing the emerging forms of wealth, to delineating their characteristics, and to making them more serviceable than their traditional counterparts."[134] Statutory change should include, of course, contracts in which the employee held the power to influence the terms of the contract. New progressive interpretations must reach contracts as well as trusts. The employee benefits described in the *Tully* and *Farrel* cases would indeed be taxed as testamentary transfers. A final look at *Tully* leads to the conclusion that the courts must raise a presumption in favor of retained powers (and as a consequence in favor of characterizing a transfer as testamentary rather than inter vivos in situations where the decedent enjoyed at some time during his life or at death, powers of persuasion, a high position in the company, and where arrangements in-

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suggestive article on this point is that of Pressment, *Effect of Tax Court's Gilman Decision on Estate Planning for the Close Corporation*, 44 J. TAX. 160 (1976). We recognize that grave problems are shifted over for later discussion regarding the tremendous problem of valuation. Ultimately analysts will have to restudy such landmarks as Estate of Speigel v. Commissioner 335 U.S. 701 (1949), United States v. Estate of Grace, 395 U.S. 316 (1969) and United States v. Allen, 293 F.2d 916 (10th Cir.), *cert. denied*, 368 U.S. 944 (1961). For an interesting discussion of valuation problems in an income tax situation see Johnson, *Tax Models for Nonrecourse Employee Liability*, 32 TAX. L. REV. 359 (1977).

130. Mechem, *The Requirement of Delivery in Gifts of Chattels and of Choses in Action Evidenced by Commercial Instruments*, 21 ILL. L. REV. 341, 348 (1926); *see also* Mechem, *The Rule in Lemayne v. Stanley*, 29 MICH. L. REV. 685 (1931).

131. Commissioner v. Sunnen, 333 U.S. 591, 608 (1948).

132. Gulliver & Tilson, *Classification of Gratuitous Transfers*, 51 YALE L.J. 1 (1941).

133. Helvering v. Hallack, 309 U.S. 106, 118 (1940).

134. Lynn, *Legal and Economic Simplifications of the Emergence of Quasi-Public Wealth*, 65 YALE L.J. 786 (1956).

volve related and dependent parties). All these should raise a presumption of an underlying agreement. These are the techniques that at common law, in torts for example, with the newly developing application of products liability, the courts have been especially successful with shaping modern policy.

As courts use their innovative powers of interpretation in response to a progressive statutory opening by Congress, the administration can renew, with hope of victory, some of its prior arguments based on broader but clearly analogous situations. At the very least the courts should treat consistently the three codes: estate, gift, and income. The courts should readily and favorably accept, as relevant to the estate tax, those cases that have helped decide apposite income tax matters. Two examples here will indicate the importance of this type of analogous thinking. First, the *Sunnen* case that has for long been brushed aside needs a focusing into the picture of estate tax; and second, the argument that carried the court of appeals in *Krause v. Commissioner*[135] needs wider circulation and better understanding. In *Krause* the Commissioner succeeded in taxing the settlor of a trust on trust income, since the settlor had retained incidents of ownership. The court felt that the settlor had retained stronger incidents in *Krause* than in *Byrum*, but the court in *Krause* also relied on the position that *Byrum*, being an estate tax case, was not controlling in an income tax matter. Whatever the specific form of anti-*Byrum* amendments, they should be broad enough to eliminate such unconvincing and unwholesome distinctions.

Counsel and judges should begin to apply, in new tax settings, the learning that has developed over centuries in the area of property law known as the Rule Against Perpetuities, and its principal injunction as stated in Lord Nottingham's appealing cry that perpetuities "do fight against God."[136] In a prescient article, Professor John Van Doren put the point: "Historically, taxation (or feudal incidents) and anti-future interest doctrine have been used in tandem to adjust wealth and power concentration."[137] This theme is developed not only in the work of Van Doren, but by a sturdy school of policy-trained property scholars, using principally the overall

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135. 497 F.2d 1109 (6th Cir. 1974).

136. The Duke of Norfolk's Case, 3 Ch. Cas. 1, 30 (1682).

137. Van Doren, *Redistributing Wealth by Curtailing Inheritance: The Community Interest in the Rule Against Perpetuities and the Estate Tax*, 3 FLA. STATE U.L. REV. 33, 39 (1975). Professor Van Doren reviews the idea of Adophe Berle that "control" may be continued through self-perpetuating elite boards and officers, and not really by stock ownership. This approach is of more interest in reaching the power base of the large corporation than of the closely held family business, but Van Doren goes on to demonstrate that the power of "voting stock" may be a "voting stock." *Id.*

Lasswell-McDougal system. Shockingly enough, the "reforms" in future interests (upholding the dead hand) are, as Professor Bordwell observed, reforms "in the wrong direction."[138] One sees equally that the tax reform amendments are too meager to come anywhere close to eliminating serious tax avoidance, and in the tax field, the mistakes and wrong policy turns that can be carefully studied in perpetuities law could now be avoided as these problems arise in tax contexts.[139]

In summary, we need a statutory change to signal the courts towards the creative shaping and sharing of democratic values through the use of the tax power, with a skill and sensitivity expected from a corps of judicial specialists that have operated successfully upon doctrine flowing from the Commerce Clause,[140] the Bill of Rights and the Fourteenth Amendment.

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138. Bordwell, *Perpetuities from the Point of View of the Draughtsman*, 11 RUTGERS L. REV. 429 (1956).

139. SIMES, PUBLIC POLICY AND THE DEAD HAND (1955); Smith, *Perpetuities in New Jersey, A Plea for Judicial Supremacy*, 24 RUTGERS L. REV. 80 (1969), and materials cited therein; Dukeminier, *Kentucky Perpetuities Law Restated and Reformed*, 49 KY L.J. 3 (1960).

140. Compare the legislation of the Court, interpreting the Commerce Clause in Houston E. & W. Texas Ry. Co. v. United States, the Shreveport Rate Case, 234 U.S. 342 (1914) and Wickard v. Filburn, 317 U.S. 111 (1942) with *Byrum*.