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Taxation—Federal Estate Taxation—Retention of Power to Terminate Trusts

Since the decision in *Commissioner v. Estate of Holmes*[1] the law has been settled that the retention by the settlor of a trust of the power to terminate that trust is such a power as contemplated by Section 811(d) of the Internal Revenue Code,[2] if there are contingent beneficiaries under the trust. Therefore, where the power to terminate is retained it will be subject to the estate tax. The Court in *Holmes* stated:

> It seems obvious that one who has the power to terminate contingencies upon which the right of enjoyment is staked, so as to make certain that a beneficiary will have it who may never come into it if the power is not exercised, has power which affects not only the time of enjoyment but also the person or persons who may enjoy the donation. More therefore is involved than mere acceleration.[3]

To the taxpayer's contention that the interests were vested, the Court said, ". . . 'enjoyment' and 'enjoy,' as used in these and similar statutes, are not terms of art but connote substantial present economic benefit rather than technical vesting of title or estates."[4]

The question then arose, what effect does Section 811(d) have on a power to terminate where there is a beneficiary or are beneficiaries who have the equitable fee in trust, and where there are no contingent interests involved? The Court of Appeals for the Fifth Circuit in *Hay's*

[1] Commissioner v. Estate of Holmes, 326 U. S. 480 (1936). In this case the decedent had created trusts for the benefit of his sons. They were to continue for fifteen years, unless sooner terminated by the decedent. The decedent, as trustee, was authorized in his discretion either to distribute or to accumulate the income. On the death of any beneficiary his share was to go to his surviving issue, or if none, to his surviving brothers or their issue, or if deceased, to the decedent's wife. The Supreme Court held the value of the trust to be includible in the decedent's gross estate as an interest whereof the "enjoyment" was subject at the date of his death to change through the exercise of a power to "alter, amend, or revoke."

[2] INT. REV. CODE 811(d) provides in substance that "the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property . . . to the extent of any interest therein of which the decedent has at any time made a transfer . . . where the enjoyment thereof was subject at the date of his death to change through the exercise of a power . . . by the decedent alone or by the decedent in conjunction with any other person . . . to alter, amend, revoke, or terminate. . . ." Section 811(d) is composed of two paragraphs, the first of which is applicable to transfers after June 22, 1936. The second paragraph is applicable to transfers on or prior to that date and is the same with a few minor differences, the most notable being that the word "terminate" is not included. However, the Supreme Court in *Holmes* declared that the addition of the word "terminate" was declaratory of existing law prior to 1936.

It should be noted that the power to terminate is different from the power to revoke in that by terminating a trust the principal and accumulated income go to the beneficiary then entitled to the income from the trust, while by revoking, the principal and accumulated income return to the settlor. Therefore, when a settlor retains the power to terminate he is not reserving a power to subsequently bring the trust back to himself; he is reserving the power to shorten the life of the trust.

[3] Commissioner v. Estate of Holmes, 326 U. S. 480, 487 (1936).

[4] *Id.* at 486.

Estate v. Commissioner[5] held that such a trust would not be includible in the decedent's estate. In that case the decedent had transferred land to herself as trustee for the benefit of her four children and the heirs at law of any of the children who died during the continuance of the trust. The trustee was to pay to the beneficiaries in her discretion the income, and the trust was to continue until the death of the settlor unless the settlor, as trustee, terminated it prior thereto. On termination the principal and accumulated income were to be distributed to the beneficiaries, or to their heirs by the law of descent. The Commissioner of Internal Revenue relied on the *Holmes* case and contended that the decedent could change the enjoyment of the trust property by exercising the power to terminate. The court rejected this contention, holding that, since the beneficiaries had a vested equitable fee in the trust,[6] the decedent had no power over who should enjoy the property.[7]

A contrary result was reached by the Court of Claims in *Lober v. United States.*[8] There, the settlor created trusts providing that the principal should be paid over to the beneficiaries on their reaching the age of twenty-five. The settlor, as trustee, held the power to accumulate the income until the beneficiaries became of age. The trustee could also pay over a part or all of the principal to the beneficiaries, so that he had in effect a power to terminate. The trust instrument made no provision for a gift over in the event of the death of a beneficiary, but the court decided the case on the assumption that, under New York law where the trust was created, it would go to the beneficiaries' heirs and not back to the settlor. The Government urged that *Holmes* was controlling. The plaintiffs contended that *Holmes* was distinguishable. The Court of Claims agreed with the Government's position, however, and held that the reasoning in the *Holmes* case was conclusive upon it. They said: "A father who has the power to decide that his son should have certain assets to use, enjoy, spend, waste or invest, or to decide that he shall

[5] Hay's Estate v. Commissioner, 181 F. 2d 169 (5th Cir. 1950).

[6] The court said that under the applicable state law (Mississippi) the words "heirs" was not necessary to create an estate of inheritance, as every estate in land is deemed a fee simple if a less estate be not clearly intended. *Id.*, at 173.

[7] *Cf.*, Estate of Barney v. Kelm, 53-2 U. S. T. C. ¶ 10,915, where the court in a very similar case pointed out that if the trustees did accumulate the income and not pay it over to the principal beneficiary, nevertheless, upon the death of the beneficiary the entire trust would pass to his estate out of which the creditors would be able to obtain satisfaction. The court said that while the trust fund would be immune from the claims of creditors during the life of the beneficiary, upon his death the limitation of the trust indenture in that regard would not apply. Consequently, the beneficiary during his life time would enjoy the benefits of the fund and the credit standing it would afford him even though the fund was not paid to him until the termination of the trust or to his estate upon his death.

But see Zirjacks v. Scoffield, 197 F. 2d 688 (1952). There the Fifth Circuit held that a similar case was covered by Section 811(d)(1). They said the law of Texas governed this trust and it was different from Mississippi's.

[8] Lober v. United States, 108 F. Supp. 731 (Ct. Cl. 1952).

not have them at all for any of these purposes, but that his creditors, his children, wife or collateral relatives should have them, has a significant control over assets. We think it is substantially the kind of control which the Supreme Court was dealing with in *Commissioner v. Holmes*."[9]

Because of this conflict in the lower courts, the Supreme Court granted certiorari in the *Lober* case.[10] In that Court the taxpayer again urged that *Holmes* was distinguishable on the grounds that there the decedent had selected contingent beneficiaries who should take on the death of the principal beneficiaries, while in the *Lober* trusts the decedent had no control over who would take in the event of the death of a beneficiary. The Court, in a brief opinion, rejected this contention, and relying on the *Holmes* case, said that they were "more concerned with 'present economic benefit' than with 'technical vesting of title or estates.' And the *Lober* beneficiaries were granted no 'present right to immediate enjoyment of either income or principal.'"[11] Thus, the Court concluded that, if a settlor retains the power to terminate a trust, even where the beneficiary has a vested interest, it will be includible in his gross estate for estate tax purposes.

The question arises as to whether the whole value of the trust property should be held subject to the estate tax. It would appear that at most only accumulated income should be taxed. For it has been said that:

> Where by the terms of the trust a restraint on the alienation of the right to receive the income but no restraint on the alienation of the right to receive the principal is imposed, the creditors of the beneficiary are entitled to a decree that the beneficiary's interest in the principal should be sold.[12]

This would seem to give the beneficiary in a state which recognizes that the beneficiary has the equitable fee in the trust the power to assign the remainder interest held during the continuance of the trust. Having the right to do this, he would have at least the present right of enjoyment in the remainder. Further, if the beneficiary's interest were not subject to spendthrift provisions, the beneficiary could assign the entire fee during the continuance of the trust.[13] Thus, it would seem that he would have the present enjoyment of the whole fee of the trust under such circumstances.

The decision of the Supreme Court in *Helvering v. Helmholz*[14] should

[9] *Id.* at 733.
[10] Lober v. United States, 74 S. Ct. 98 (1953); certiorari granted in 345 U. S. 969 (1953).
[11] Lober v. United States, 74 S. Ct. 98, 99 (1953).
[12] I Scott, Trusts § 152.5, p. 761 (1939). See also 65 C. J., *Trusts* § 303, p. 550 (1933).
[13] I Scott, Trusts § 132, p. 699 (1939).
[14] Helvering v. Helmholz, 296 U. S. 93 (1935).

be noted at this point. It was held there that the retention of the power to terminate by the decedent would not subject the trust to the estate tax, if the trust indenture specified that the trust could be terminated only with the consent of all the beneficiaries. Justice Roberts speaking for the majority said: "The general rule is that all parties in interest may terminate the trust.[15] The clause in question added nothing to the rights which the law conferred. Congress cannot tax as a transfer intended to take effect in possession or enjoyment at the death of the settlor a trust created in a state whose law permits all the beneficiaries to terminate the trust."[16] The Treasury Regulations are now in accord with this holding.[17] Thus, if Lober had not included the power to terminate the trust it would not have been subjected to the estate tax, as under the applicable state law the settlor of a trust can terminate the trust if he obtains the consent of all parties in interest.[18] And, practically speaking, he would still have the same control, as it can be fairly assumed that the consent of the sole beneficiary would be easily obtainable.

The *Lober* decision, thus, seems to be penalizing the less tax conscious settlor. While the fact that the consent of the beneficiaries would be a substantial power where there are contingent beneficiaries who would hesitate in giving away their possibility in the trust, the same would not be true where there was only a single beneficiary who held the whole fee in the trust property. It would therefore seem that the Supreme Court should be concerned with "technical vesting of titles and estates," despite what was said in the principal case.

JOHN G. HUTCHENS

Torts—Libel and Slander—Liability of Law Enforcement Officers for Defamation Contained in Official Communications

One of the many problems arising to confront those engaged in the enforcement of the criminal law is that of the liability of law enforcing officers for libel and slander contained in their reports to superiors and in their communications with other officers.

For example, an investigating officer can often put into his reports not only statements of fact, but also much in the nature of inference, conclusions, surmise, etc., which he is able to draw from his observations, evaluated in the light of his own training and experience. Such things might be characterized as "policeman's hunches." It goes without say-

[15] In so holding the Court cited the RESTATEMENT, TRUSTS §§ 337, 338 (1935).
[16] Helvering v. Helmholz, 296 U. S. 93, 97 (1935).
[17] U. S. TREAS. REG. 105, § 81.20(b)(3) (1939).
[18] N. Y. PERS PROP. LAW § 23; N. Y. REAL PROP. Law § 118; McEvoy v. Central Hanover Bank & Trust Co., 274 N. Y. 27, 8 N. E. 2d 265 (1937).
See also N. C. GEN. STAT. §§ 39-6, 39-6.1 (1950) for the comparable North Carolina law on this point. It is provided there that the grantor in a voluntary conveyance may revoke the interest of any person not *in esse*.