Estate Tax and the Closely Held Corporation -- A Nearly Fatal Blow to Section 2036

William L. Tankersley III
to which the government may put its easement may change accordingly. If what the government wishes to do with its easement is to restrict use of public trust property altogether, that is, to preserve the property in its natural state, riparian owners cannot complain that something has been taken from them. Whatever rights they had, whatever the nature of their ownership in the soil under the water, they took their property subject to the public easement. 53

There is room for much abuse if the government carries the public trust rationale too far. On one hand, there must be limits to the type of use the government wishes to make of its easement. If the legislature were to find, for example, that the most pressing public need with respect to tidal waters was to derive revenue from their sale, other aspects of public trust law must intervene to prohibit the destruction of the trust. 54 On the other hand, the legal theory of public trust easement whereby the government can prohibit development of wetlands areas by owners in fee of the subsoil will leave many persons who have made substantial investments in coastal property with very little to show for their expenditure and probably very little in the way of remedy. For these reasons, fairness dictates that the avenue opened by Marks v. Whitney be taken as merely a stopgap approach to the prevention of wetlands destruction.

MARIANNE K. SMYTHE

Estate Tax and the Closely Held Corporation—A Nearly Fatal Blow to Section 2036

Many a tax consultant who has a client with a majority interest in a closely held corporation has been looking for a way for his client to avoid estate taxes on such stock without having to give up control of his corporation in the process. In United States v. Byrum 1 the Supreme Court has provided such an opportunity. According to the Court’s interpretation of section 2036 of the Internal Revenue Code, 2 the majority

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1 In Zabel v. Pinellas County Water & Navig. Control Authority, 171 So. 2d 376, 388 (Fla. 1965), the dissenting opinion found “the retained inalienable trust doctrine” to be sufficient grounds to deny compensation to an owner of the tidelands denied a permit to dredge and fill.

2 Professor Sax devotes much of his article, supra note 33, to the problem of preserving the public-trust servitude in spite of legislative indifference and hostility.

192 S. Ct. 2382 (1972).

2 INT. REV. CODE OF 1954, § 2036 provides:
stockholders of closely held corporations will be able to have their cake and eat it, too. The majority stockholder may now put his stock in trust, retain the voting rights, and retain control over disposition of any assets in the trust, which enables him to maintain control over his corporation without fear that the stock will be included in his gross estate for federal estate tax purposes.

The decedent in Byrum created an irrevocable trust to which he transferred a portion of his shares of stock in three closely held corporations. The trusts were created for the benefit of his children or, in the event of their death before the termination of the trust, his grandchildren. An independent corporation was designated as the sole trustee with broad and detailed powers to administer and control the trust property in its sole discretion, subject to the rights reserved by the decedent to vote all shares of stock in the trust, to disapprove the sale or transfer of any trust assets, to approve investments and reinvestments, and to remove the trustee and designate another corporate trustee to serve as successor. The Commissioner of Internal Revenue included the value of the transferred shares in the decedent's gross estate on the grounds that the retained control of the corporations gave the decedent continued employment, remuneration, and the right to determine whether the corporations would be liquidated or merged. These retained benefits gave the decedent the "possession and enjoyment" required under section 2036(a)(1). In addition, the Commissioner included the stock under section 2036(a)(2), concluding that the retained

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(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 which does not in fact end before his death—

1. the possession or enjoyment of, or the right to the income from, the property,

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.

3The percentage ownership after transfer was as follows:

<table>
<thead>
<tr>
<th>Corporation</th>
<th>Percentage owned by Decedent</th>
<th>Percentage owned by the Trust</th>
<th>Total by Both</th>
</tr>
</thead>
<tbody>
<tr>
<td>Byrum Lithographing Co., Inc.</td>
<td>59%</td>
<td>12%</td>
<td>71%</td>
</tr>
<tr>
<td>Graphic Realty, Inc.</td>
<td>35%</td>
<td>48%</td>
<td>83%</td>
</tr>
<tr>
<td>Bychrome Co.</td>
<td>42%</td>
<td>46%</td>
<td>88%</td>
</tr>
</tbody>
</table>

92 S. Ct. at 2387 n.2.
4Id. at 2395.
5See note 2 supra.
right to vote the stock and to veto any stock transfer by the trustee enabled the decedent to maintain control over corporate dividend policy, thus enabling the decedent to shift or defer the beneficial enjoyment of the trust income between present income beneficiaries and remainder-men. The Court rejected the Commissioner’s arguments for inclusion under both subsections in a six-to-three decision. The Court’s opinion on the application of each sub-section will be examined in turn.

First, the Court held that reserving management powers over the trust without more was not enough to qualify under the “possession and enjoyment” provision of section 2036(a)(1). The Byrum Court distinguished “possession and enjoyment” of the “property” from “control” of the corporation. The government conceded that the mere retention of the right to vote shares did not constitute the type of “possession and enjoyment” contemplated by the statute. However, they argued that control was covered by the statute. The Court’s response was that Byrum transferred only stock, not “control,” because the trust never owned as much as fifty percent of the stock of any one corporation. The Court said that he retained not “income from or the use of the property,” but control of the corporation by retaining the right to vote the shares he owned and those he placed in trust. Because control was not an attribute of property that was given up, the stock was not includible. The Court said, “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.” However, even if “control” had been considered “property” and thereby had been covered by section 2036(a)(1), the necessary criteria for inclusion would still not have been met. “Enjoyment” has been defined as connoting a “substantial present economic benefit.” The Court could find no “substantial present

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692 S. Ct. at 2395.
7See note 3 supra.
892 S. Ct. at 2396-97.
9Id. at 2396. Only when the decedent retains the income from or the use of the property is it included. United States v. Estate of Grace, 395 U.S. 316 (1969); Commissioner v. Estate of Church, 335 U.S. 632 (1949); Estate of McNichol v. Commissioner, 265 F.2d 667 (3d Cir.), cert. denied, 361 U.S. 829 (1959). But see Estate of Pamela D. Holland, 1 T.C. 564 (1943).
10"Indeed, at the time of his death he still owned a majority of the shares in the largest of the corporations and probably would have exercised control of the other two by virtue of being a large stockholder in each." 92 S. Ct. at 2397.
11Id. at 2397.
12Id.
13Commissioner v. Estate of Holmes, 326 U.S. 480, 486 (1946); see, e.g., Estate of McNichol
economic benefit" retained by Byrum in his power to liquidate or merge the corporation, since this right was not a "present" benefit. In addition, the Court said that the restrictions imposed on Byrum by the Internal Revenue Service\(^4\) and his "fiduciary duty" to minority stockholders\(^5\) were sufficient to prevent any substantial benefit from his continued employment and compensation.\(^6\)

The government's primary contention was that the decedent's control of the dividend policy of the corporations and control over the disposition of the stock itself enabled him to distribute the "possession and enjoyment" of the property between the income beneficiaries and the remaindermen. The *Byrum* Court disagreed, relying on two cases in which the decedent retained powers over the trust, *Estate of Willard V. King*\(^7\) and *Reinecke v. Northern Trust Co.*\(^8\), which the Court stated involved retained powers essentially the same as Byrum's retained powers. Although neither of these cases was controlling,\(^9\) the Court appeared to say that if a taxpayer had relied on the case law as he saw it, the courts would not overturn such a "principle of taxation."\(^10\) In both of the cases there was no power to designate who should enjoy the

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\(^{4}\) INT. REV. CODE OF 1954, § 162(a)(1) will not allow a tax deduction for a salary payment which is not an ordinary and necessary business expense.

\(^{5}\) See, e.g., Estate of William F. Hofford, 4 T.C. 790, modifying 4 T.C. 542 (1945). (even though the settlor retained control of the corporation through an employment contract, if he rendered services for the corporation and the compensation was reasonable then there would be no inclusion).

\(^{6}\) 37 T.C. 973 (1962). King created three trusts and transferred securities to a third party trustee. The income was to be paid to certain designated beneficiaries for life with remainders over to designated remaindermen. The trustee could exercise the rights of management and investment only in accordance with the directions of the settlor. The trust holdings of securities were at no time significant from the point of view of control of the particular companies involved. The trust assets were held non-includable in his gross estate.

\(^{7}\) 1737 T.C. 973 (1962). In *Reinecke* the decedent created five trusts with life interests to the income designated in certain beneficiaries. He reserved the "power to supervise the reinvestment of trust funds, to require the trustee to execute proxies to his nominee, to vote" the shares held by the trust, and to control leases executed by the trustee. *Id.* at 344. The trust assets were held not includable in the decedent's gross estate since the mere retention of management powers will not render the trust includable in his gross estate.

\(^{8}\) 278 U.S. 339 (1929). In *Reinecke* the decedent created five trusts with life interests to the income designated in certain beneficiaries. He reserved the "power to supervise the reinvestment of trust funds, to require the trustee to execute proxies to his nominee, to vote" the shares held by the trust, and to control leases executed by the trustee. *Id.* at 344. The trust assets were held not includable in the decedent's gross estate since the mere retention of management powers will not render the trust includable in his gross estate.

\(^{9}\) The Court recognized that neither of these cases was controlling since one was an unappealed Tax Court decision and the other was decided before the present § 2036 was enacted. However, they did carry weight as a reliance factor. 92 S. Ct. at 2389.

\(^{10}\) *Id.* "Courts properly have been reluctant to depart from an interpretation of tax law which has been generally accepted when the departure could have potentially far-reaching consequences."
income from the transferred property.\textsuperscript{21}

The majority also rejected the argument that \textit{United States v. O'Malley}\textsuperscript{22} compelled the inclusion of the trust. Byrum did not retain a right "to designate the person who shall possess or enjoy the property" as required by section 2036(a)(2).\textsuperscript{23} The Court interpreted "right" as used in the statute as an "ascertainable and legally enforceable power."\textsuperscript{24} O'Malley's legal right to accumulate or distribute the income in his discretion put him squarely within the net of section 2036.\textsuperscript{25} According to the majority, Byrum reserved no right to tell the trustee how to distribute the income of the trust. Byrum's power to elect the directors of the corporations conferred no legal right to command the payment or nonpayment of dividends. In the view of the majority, the power to declare dividends is vested solely in the corporate board of directors, not with the majority stockholder. The dividend policy of the corporation is subject to business and economic considerations, the threat of derivative suits,\textsuperscript{26} the sufficiency of retained earnings,\textsuperscript{27} and the accumulated earnings tax.\textsuperscript{28} The majority stockholder is also restricted by a fiduciary duty to the minority stockholders not to misuse his powers.\textsuperscript{29} The government sought to equate this \textit{de facto} position of a controlling stockholder with the "legally enforceable right" specified in the statute and applied in \textit{O'Malley}. The majority, however, felt that the decedent was sufficiently restricted in his \textit{de facto} power to eliminate any substantial benefit he might receive by his position; therefore, there was no

\textsuperscript{21}The two settlers in \textit{King} and \textit{Reinecke} did not have power to distinguish between the income beneficiaries or the remaindermen. The powers retained were management over the trust assets. The settlers did have control over any of the corporations whose stock was transferred to the trusts. The management powers alone did not permit the settlers to designate who shall enjoy the property. \textit{Reinecke v. Northern Trust Co.}, 278 U.S. 339, 344, 346 (1929); Estate of Willard V. King, 37 T.C. 973, 974, 980 (1962).

\textsuperscript{22}383 U.S. 627 (1966). O'Malley created five irrevocable trusts in which he reserved the "right" in the trust agreement along with two other persons to accumulate the income in their sole discretion and thus was able to "designate" between the income beneficiaries and the remaindermen. The trust corpus and the accumulated income were held to be includible in his gross estate. \textit{Id.} at 629, 634.

\textsuperscript{23}92 S. Ct. at 2394.

\textsuperscript{24}Id. at 2390.

\textsuperscript{25}See note 22 supra.

\textsuperscript{26}See note 15 supra.

\textsuperscript{27}See, e.g., \textit{CAL. CORP. CODE ANN.} § 1500 (West Supp. 1971). For liability of directors see \textit{id.} § 825 (West 1955).

\textsuperscript{28}\textit{INT. REV. CODE} of 1954, § 531 (an accumulated earnings tax penalty is imposed on the improper accumulation of surplus).

\textsuperscript{29}\textit{H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES} § 240 (2d ed. 1970).
It is clear that an inter vivos transfer of stock in a closely held corporation which is qualified only by the settlor's implied retention of control of the stock through his management of the corporation, without more, does not qualify as a taxable testamentary disposition. The retention of management powers or voting rights of the stock in trust does not put the transfer within section 2036(a)(1) because these powers do not convey any direct benefit to the settlor. The trustee may still use the assets of the trust, including the stock, to benefit the income beneficiaries because the settlor has not retained control over the use or disposition of the stock. The majority relied heavily on Reinecke v. Northern Trust Co. to support its holding; however, the dissent very clearly distinguished Reinecke from Byrum on its facts. The Reinecke settlor, through his shares of stock and those he could vote in trust, could not control any of the corporations whose stock was placed in trust. The Court failed to recognize that Byrum's control and powers over the trust were more extensive than any of the fact situations in the cases cited by the majority.

2972 S. Ct. at 2394.
30Soled, Estate Tax Consequences of Inter Vivos Transfers of Stock in a Closely-Held Corporation, 31 Md. L. Rev. 191, 221-25 (1971), gives a good discussion of the implied retention theory and how the government has attempted to utilize it.
31Section 2036 taxes inter vivos transfers when the objective intent or operation of the transfer is a testamentary disposition. The government has consistently argued for inclusion based on the management powers retained by a decedent over the corporation even though no direct control of the stock in trust was provided for. The courts have been uniform in rejecting this "implied" retention theory based solely on powers of management. See, e.g., Gardner v. Delaney, 103 F. Supp. 610 (D. Mass. 1952).
33Id. The Beckwith trustee could still dispose of the stock and take back the voting rights of the stock in trust. These powers of the trustee prevented the settlor from effectively exercising any control over the disposition or accumulation of the income. They also prevented any benefit from accruing to the settlor.
34278 U.S. 339 (1929). It should be noted that this case was decided before the current § 2036 or its predecessor § 811(c) (Int. Rev. Code of 1939, ch. 3, § 811(c), 53 Stat. 121). See note 18 supra.
3592 S. Ct. at 2399 (White, J., dissenting).
36Id. at 2389 n.6; see, e.g., Estate of Edward E. Ford, 53 T.C. 114 (1969), aff'd, 450 F.2d 878 (2d Cir. 1971) (settlor was named trustee with power to invade corpus; however, the trust assets were held not includable because there were sufficient "external standards" in the trust agreement); Estate of C. Dudley Wilson, 13 T.C. 869 (1949) (en banc), aff'd per curiam, 187 F.2d 145 (3d Cir. 1951) (settlor had the power as trustee to accumulate or distribute the income, but this power was clearly defined by the trust agreement).
The Court would have done well to follow the example of *State Street Trust Co. v. United States*, which held that even if the retained powers taken separately would not require inclusion, the powers considered as a whole might be so all-inclusive as to mandate inclusion in the decedent's gross estate. The broad powers retained by Byrum would not allow a court of equity to effectively supervise the affairs of the trust so as to protect the income beneficiaries and the remaindermen. Since courts are hesitant to interfere with corporate management decisions and the hands of the trustees were tied as to investment policies, there was no real power or standard that could have prevented Byrum from achieving a substantial benefit from the voting rights and control of the corporation. The *Byrum* Court, however, failed to recognize this distinction. When applied to the facts in *Byrum*, the *State Street* analysis would require a conclusion that the powers retained by Byrum were too broad to avoid inclusion under section 2036. Consequently, the *Byrum* decision had gone further than any other in narrowing the inclusionary powers of the "possession and enjoyment" clause of section 2036(a)(1).

The Court appears to have made a complete reversal of its position in *Commissioner v. Estate of Church*. According to *Church*, the settlor must "absolutely, unequivocally, irrevocably, and without possible reservations part with all of his title and all of his possession and all of his enjoyment of the transferred property." Byrum, for all practical purposes, had given up almost nothing by placing his corporate stock in trust. The stock in a closely held corporation conveys three principal benefits: control of the corporation, income from the stock as dividends, and a capital investment. The terms of the trust agreement and the application of those terms effectively shielded all of these benefits from

2363 F.2d 635 (1st Cir. 1959).

*State Street* could be considered overruled by Old Colony Trust Co. v. United States, 423 F.2d 601 (1st Cir. 1970); however, the principle expounded in *State Street* is still used in the area of charitable estate tax deductions under the Int. Rev. Code of 1954, § 2055(a)(2). See, e.g., Estate of Stewart v. Commissioner, 436 F.2d 1281 (3d Cir. 1971). There is no reason why the same standard cannot also apply to § 2036.

See, e.g., Estate of Harry H. Beckwith, 55 T.C. 242 (1970) (trustee gave decedent the power to vote the stock in trust; trust stock held not includable since decedent could not restrict the trustee's freedom to vote or dispose of the stock); Estate of C. Dudley Wilson, 13 T.C. 869 (1949), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951); Estate of George H. Burr, 14 P-H Tax Ct. Mem. 1189 (1945).

335 U.S. 632 (1949).

*Id.* at 645.
the income beneficiaries. Control of the corporation was retained by the decedent in the form of the voting rights. The capital investment could not be enjoyed by the income beneficiaries through the sale or use of the stock as collateral because the decedent had power over any disposition of the trust assets. Income beneficiaries can only benefit from the increase in capital growth if the growth yields a higher rate of income. Since the stock in trust had a very low income yield, the only way the income beneficiaries could benefit would be for the trustee to sell the stock and reinvest the corpus and the capital gain in other income-producing property. The trustee was prevented from doing this by the restrictions imposed by Byrum. The only benefit Byrum gave up was the income which, for all practical purposes, was nonexistent.45

The majority failed to find a “substantial economic benefit” in the powers retained by the decedent. Certainly it could not be said that the income beneficiaries received a benefit as a result of their almost nonexistent dividend income.46 The failure to find a “substantial present economic benefit” in Byrum’s control over the trust property did not give a true picture of corporate affairs,47 nor is it supported by Byrum’s own conduct in retaining control of the stock. The decedent must have considered control of the corporation valuable in that he not only guaranteed his voting control, but also restricted any possible disposition of the stock that would affect that control.48 The essence of the problem is aptly summarized by the dissent: “[T]he majority’s discourse on § 2036(a)(1) is an unconvincing rationalization for allowing Byrum the tax free ‘enjoyment’ of the control privilege he retained through the voting power of the shares he supposedly ‘absolutely’ and ‘unequivocally’ gave up.”49

The majority’s narrow construction of section 2036(a)(2) in construing “right” to mean a “legally enforceable power”50 to avoid the reach of section 2036(a)(2) is erroneous in two major respects. When the

45The trust received $339 in dividends in the five years of its existence before the death of the decedent. In the sixth year, the year of the decedent’s death, $1,498 in dividends were paid to the trust. 92 S. Ct. at 2398.
46Id.
47See N. LATTIN, THE LAW OF CORPORATIONS § 87, at 343 (2d ed. 1971). A stockholder does in fact receive substantial benefits through his control of the corporation. The power inherent in his position allows him the enjoyment of a great deal of influence over the corporation and the minority stockholders.
4892 S. Ct. at 2400 (White, J., dissenting).
49Id.
50Id. at 2390 states: “The term ‘right,’ certainly when used in a tax statute, must be given its normal and customary meaning. It connotes an ascertainable and legally enforceable power...."
majority interprets "right" as a legally enforceable right, it is using the statute to tax the decedent based on rigid, formal control rather than on the realities of the situation. This is contrary to legislative intent as evidenced by the passage of the Joint Resolution of March 3, 1931.\(^5\)

The Byrum decision is an unfortunate return to the May v. Heiner\(^5\) rationale. Contrary to the opinion of the majority, United States v. O'Malley\(^5\) cannot be used to reach this interpretation of right as connoting a "legally enforceable right" because the O'Malley decision was more concerned with realities than with legal technicalities.\(^5\) The O'Malley Court never was concerned with the problem since the power was enforceable. In addition, the Byrum Court in its interpretation of section 2036(a)(2) ignores the interpretation given "right" in section 2036(a)(1) by other courts which have refused to narrow the meaning of the statute.\(^5\) One court faced with a "right" to receive the income from a trust that was barred by the Statute of Frauds held the trust includible despite the unenforceable nature of the right.\(^5\) Clearly the interpretation of the word "right" by the Court is not the normal and customary meaning as used by other courts.

Once the restriction imposed by "legally enforceable right" is removed, the issue should become whether the decedent could have desig-

\(^5\)The current § 2036 was enacted in part by the Joint Resolution of March 3, 1931, Pub. L. No. 131, ch. 454, 46 Stat. 1516, which passed through both houses in one day due to the emergency situation created by the decision in May v. Heiner, 281 U.S. 238 (1930), and two per curiam decisions that followed shortly thereafter. May allowed a decedent to create a life estate in his property without inclusion in his gross estate on the grounds that the property had already been given to the remainderman prior to the death of the decedent. If allowed to stand, the May loophole would have effectively crippled the federal estate tax. Congress clearly indicated its rejection of such a result and attempted to revise the statute to include transactions which the objective intention or result was in fact a testamentary disposition. The action by the Byrum Court is clearly a step away from this objective.

\(^5\)281 U.S. 238 (1930). The May decedent created a trust under which the income was payable to the decedent's husband for his life and upon his death payable to the decedent. The remainder was to be distributed equally among her children upon her death. The assets of the trust were held not includible since the transfer did not take effect in possession or enjoyment at or after her death. The May Court relied on property law and looked at the form of the transaction as a present transfer of future rights, an approach clearly rejected by Congress as evidenced by the immediate passage of the Joint Resolution of March 3, 1931, Pub. L. No. 131, ch. 454, 46 Stat. 1516.


\(^5\)92 S. Ct. at 2403 (White, J., dissenting).

\(^5\)See, e.g., Skinner v. United States, 316 F.2d 517 (3d Cir. 1963). The Skinner settlor retained no "legally enforceable right" under the trust instrument as did O'Malley, but the trust was held includible nonetheless.

\(^5\)McNichol v. Commissioner, 265 F.2d 667 (3d Cir.), cert. denied, 361 U.S. 829 (1959) (an oral agreement to receive the income from the property transferred).
nated between the income beneficiary and the remainderman. The majority felt that he had such a right, but its use was sufficiently restricted by an “external standard” which, under the teachings of Jennings v. Smith, would keep the trust assets out of his gross estate. The Court compared the powers of the trustee and the powers of the majority stockholder and then applied the “external standard” concept to the latter. There is grave doubt, however, whether any “external standards” exist that can be applied to the conduct of the corporate board. Courts have been hesitant to interfere with the management and business decisions of the directors of a corporation; therefore the threat of a derivative suit may not in fact supply the necessary “external standard” as supposed by the majority. Additionally, this “external standard” on which the Court heavily relies to justify non-inclusion is not a standard created by the trust instrument. One court, although referring to a trustee situation, stated that an external standard cannot be implied from extrinsic circumstances not contained in the trust agreement. In addition, a settlor who arranges his affairs properly can not only avoid suit by the minority shareholders, but also can avoid the imposition of the accumulated earnings tax on his corporations. The duty owed to minority shareholders by the majority shareholders as alleged by the majority appears to have some support. However, even if such a duty could be found it could only be exercised through Byrum’s power to vote for the board of directors, but in the opinion of the Byrum Court a majority stockholder can exercise no control over the corporate board since the board is subject to other “external controls.” It would appear that the Court’s extension of the “external standard” concept of

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See note 2 supra.

Jennings v. Smith, 161 F.2d 74 (2d Cir. 1947). “External standard” is a term of art used to describe conditions set out in the trust agreement or in the case law of the state which a court of equity can rely on in deciding if the trustee has gone beyond the scope of his powers or has abused his discretion. If an “external standard” exists then a trustee’s actions are subject to review and the income beneficiary and the remainderman are protected from the mistakes or wrongful acts of the trustee.

Id. Section 2036(a)(2) does not cover “powers to designate” which are non-discretionary in nature. If the powers retained by the settlor are controlled by a determinable “external standard” enforceable by a court having equity jurisdiction, then they are non-discretionary. See, e.g., Industrial Trust Co. v. Commissioner, 165 F.2d 142 (1st Cir. 1947).

Murray, supra note 40, at 17; Soled, supra note 31, at 217.

See, e.g., Murray, supra note 40, at 17.


92 S. Ct. at 2402 (White, J., dissenting).

H. HENN, supra note 29, § 240.

92 S. Ct. at 2391-93.
the trust to include the fiduciary duty of majority stockholders and directors of the corporation to minority stockholders is not justified by the realities of corporate life.65

The majority of the Court used the principle of "reliance" as another justification for allowing Byrum to escape taxation on the trust assets. The "principle of legitimate reliance" on clearly established case law may be sound elsewhere, but not in this area of the law. The amount of power which could be retained safely without invoking section 2036 was far from established.67 By allowing the decedent or his counsel to interpret the case law as they see it and to use it as a defense to inclusion is wholly irrational. This application will result in havoc for the courts in attempting to apply the tax statutes.

The Byrum dissent very aptly showed that the majority's opinion does not withstand close analysis. The Court appears to be reverting to the pre-May v. Heiner68 era of a narrow and formal interpretation of the statute. The court hints at its motivation for such a step in a footnote to their opinion:

The interpretation given § 2036(a) by the Government and by Mr. Justice WHITE'S dissenting opinion would seriously disadvantage settlors in a control posture. If the settlor remained a controlling stockholder, any transfer of stock would be taxable to the estate. . . . The typical closely held corporation is small, has a checkered earning record and has no market for its shares. Yet its shares often have substantial asset value. To prevent the crippling liquidity problem that would result from the imposition of estate taxes on such shares, the controlling shareholder’s estate planning often includes an irrevocable trust. The Government and the dissenting opinion would deny to controlling shareholders the privilege of using this generally acceptable method of estate planning without adverse tax consequences. Yet a settlor whose wealth consisted of listed securities of Corporations he did not control would be permitted the tax advantage of the irrevocable trust even though his more marketable assets present a far less serious liquidity problem. The language of the statute does not support such

65See R. Baker & W. Cary, Cases and Materials on Corporations 403-617 (3d ed. 1959); N. Lattin, supra note 47, § 78; Murray, supra note 40; Soled, supra note 31.
6792 S. Ct. at 2403-04 (White, J., dissenting); Gray & Covey, State Street—A Case Study of Sections 2036(a)(2) and 2038, 15 Tax L. Rev. 75 (1959).
68281 U.S. 238 (1930). May v. Heiner was the last major case under § 2036 to use the principles of property law in defining testamentary dispositions. Congress intervened with the Joint Resolution of March 3, 1931, indicating that Congress did not intend for property law to control the estate tax law. See, e.g., United States v. Estate of Church, 335 U.S. 632 (1949).
a result and we cannot believe Congress intended it to have such dis-

The Court appears to fear the possibility of inequality in the application of the statute to stockholders in a control posture. This fear is ill-

founded, as shown by the recent decision of Estate of Harry H. Beckwith, which allowed the decedent to maintain control of voting

rights in stock he held at his death without inclusion in his gross estate because he had no other power as to disposition and investment. This

result certainly does not put the settlor at a disadvantage. In addition, a settlor should not be allowed to keep substantial control on property he transfers by gift. If he is not willing to transfer the property without strings attached, then he should not be entitled to the benefit of escaping estate taxation on such property. A settlor is not allowed to maintain strings on other types of property; why then should an exception be made in the case of a closely held corporation?

The full impact of Byrum is not clear. The scope of Byrum appears to include settlors with one hundred percent stock ownership as well as majority stockholders. By transferring all or a part of his stock into trust with a third party as trustee, a settlor apparently may retain the Byrum powers without fear of estate taxation. The transfer to a third party trustee would create the necessary minority stockholder to whom the board of directors would owe a fiduciary duty. The settlor could accomplish this result with very little, if any, loss of control of the stock. In addition, the interpretation of the statute to include only a "legally enforceable power" opens up another door to the tax planner. Conceivably, a settlor might now be able to place property in trust and retain a life estate through an oral agreement, which would be void under the Statute of Frauds. Since the oral agreement would not be "legally enforceable," the trust assets would not be included in the gross estate. Members of the settlor's family might be willing to honor the agreement despite its unenforceability. As can be seen, Byrum opens up a whole new area in which the prudent tax planner may avoid substantial estate taxes for his client of which the above examples are just a couple of

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69 S. Ct. at 2397 n.34.
70 55 T.C. 242 (1970). Beckwith transferred stock of a closely held corporation to a trust. He retained voting control over that stock through the annual execution of proxies by the trustee. The court could find no expressed or implied agreement with respect to the trust that would restrict the trustee from either voting the stock himself or of disposing of it. It held the stock was not includible in the decedent's gross estate.
71 See note 50 supra.
many possible avoidance schemes. The full impact may not be perfectly clear until the lower courts begin to apply Byrum, but apparently Byrum has created a substantial loophole in the estate tax field.

The Byrum decision creates a gross inequity in favor of a settlor with substantial stock interest. It gives him control benefits that a settlor with land or other types of property interests would not dream of retaining without fear of estate taxation. The Court has also gutted a major portion of section 2036 with its interpretation of "right," which has severely limited the scope of this section. However, the tax loophole created gives Congress a compelling opportunity finally to clarify its intention as to the scope of section 2036 after so many years of court indecision and confusion. If Congress accepts this opportunity, the tax planner might finally be able to advise his client with some assurance as to the effect of his transfer.

WILLIAM L. TANKERSLEY III

Labor Law—The Obligations of a Successor Employer.

"In taking over a going concern or labor force, the labor title is to be searched as diligently as the title to real property." A number of labor disputes have arisen from uncertainty as to the obligations owed by the acquiring company to the predecessor's union following the merger with or acquisition of a unionized business. The recent Supreme Court decision in NLRB v. Burns International Security Services, Inc. should dispel some of the confusion stemming from prior court and National Labor Relations Board attempts to interpret the mandates of the Labor Management Relations Act (the Act) in regard to the labor obligations of the successor employer. Imposition of successorship status upon the acquiring corporation

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Sangerman, The Labor Obligations of the Successor to a Unionized Business, 19 Lab. L.J. 160 (1968), quoting City Packing Corp. (1948) (no further citation given; probably an unpublished arbitration decision).

92 S. Ct. 1571 (1972).


John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543 (1964), in which the Court reserved decision on the question of survival of the previously negotiated collective bargaining agreement, was used as the rationale for the Board's mistaken conclusion that the entire collective bargaining agreement survived the change in ownership. The Board's order in the Burns case was a result of its interpretation of the meaning of Wiley.