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Taxation -- Effect of Renunciation on the Taxability of Property Subject to Power of Appointment

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lina's obsolete view of "delivery," that in addition to intention there must be a manual transfer of the instrument itself. If such is not the case, certainly there is the possibility that the court in future cases may use this well-considered statement as a springboard toward the modern and majority view that delivery is merely a question of intention to give the deed legal effect evidenced by some word or act indicating such an intention.30

GEORGE J. RABIL.

Taxation—Effect of Renunciation on the Taxability of Property Subject to Power of Appointment

In order to minimize the estate tax on the passing of property many a testator devises his property to his wife or child for life, giving the devisee the power to appoint by will the ultimate taker of the property. Usually he also provides that in the event of the failure of the donee of the power of appointment to exercise this power, the property, at the death of the donee, will go to a specified beneficiary. Whether or not the property subject to the power is taxable in the donee's estate where the appointee is also a taker in default has been the subject of much litigation and of endless legal writings.4

Early in the line of cases, New York declared that where the appointee took a one-fourth interest in an estate under the exercise of a power of appointment instead of the one-seventh interest which would have been his had the power not been exercised, the entire amount was taxable in the estate of the donee.5 Then, in 1905, where the appointee had renounced all rights under the exercise of the power, the same court declared that an interest given in default of appointment vested at the death of the donor of the power, and that since the appointee would take the same interest under the power as was already vested in her in default, the interest was not taxable in the donee's estate.6 Much later

30 Tiffany, Real Property, §1033 (3rd ed. 1939).


2 In re Potter's Estate, 51 App. Div. 212, 64 N. Y. Supp. 1013 (1900); In re Chauncey's Estate, 102 Misc. 378, 168 N. Y. Supp. 1019 (1918) (the appointee filed a conditional election whereby she desired to take under the instrument which gave her the larger amount); In re Taylor's Estate, 209 App. Div. 299, 204 N. Y. Supp. 367 (1922) (the appointee could not claim part under the donor's will and the excess under that of the donee); see In re Delano's Estate, 176 N. Y. 486, 68 N. E. 871 (1903). Contra: 3 Restatement, Property §369(c) (1940) ("if the total property passing to such appointee differs from his interest in default of appointment only in that it is a larger fractional interest in the . . . thing covered by the power, the property passes . . . in default of appointment so far as the appointed interest is identical to the interest in default.").

3 In re Lansing's Estate, 182 N. Y. 238, 74 N. E. 882 (1905). But cf. In re Cooksey's Estate, 182 N. Y. 92, 74 N. E. 880 (1905) where the court held the interests taxable because the donor's will did not allow any default interest to vest unless and until the donee died without exercising the power.
the U. S. Supreme Court in *Helvering v. Grinnell* adopted the view of the New York court and held that where the appointee renounced his interest under the appointment and took the same interest under the will of the donor, the property passing to him was not taxable in the estate of the donee.\(^5\)

Emphasis was placed on the “passing” requirement of the tax statute,\(^6\) the court finding that no property interest passed by virtue of the admitted exercise of the general power of appointment.

Since the *Grinnell* decision, the major problem has been to determine whether that decision was based primarily on the renunciation by the appointees or on the fact that the interests in default and under the power were exactly the same. Both views have received support.\(^7\) Where the appointee received the exact equivalent, or a lesser amount, the majority of the cases, prior to 1943, favored non-taxability.\(^8\)

Although now overruled by statute\(^9\) as to donees dying after Octo-


\(^5\) The same result was reached in *In re Chauncey’s Estate*, *supra* note 2, where the appointee took the exact amount under the will of the donor that he would have under the will of the donee, he having previously filed an election to take under whichever will left him the greater amount.

\(^6\) Revenue Act of 1926, §302, 44 Stat. 9 (1926). The value of the gross estate of a decedent shall include the value of property “(f) To the extent of any property passing under a general power of appointment exercised by the decedent . . . .” The three conditions precedent to taxation of the interests were: “(1) The existence of a general power of appointment; (2) an exercise of that power by the decedent by will; and (3) the passing of the property in virtue of such exercise,” *Helvering v. Grinnell*, 294 U.S. 153, 155 (1935).

\(^7\) Renunciation or election is immaterial, *Lewis v. Rothensies*, 138 F. 2d 129, 132 (3rd Cir. 1943); *Rothensies v. Fidelity-Philadelphia Trust Co.*, 112 F. 2d 758 (3rd Cir. 1940); *Morris v. Commissioner*, 39 B.T.A. 570 (1939); James C. Webster, 38 B. T. A. 273 (1938). Renunciation or election is inseparable from the *Grinnell* case, Estate of Rogers v. Commissioner, 320 U.S. 410 (1943); *Helvering v. Safe Deposit and Trust Co.*, 316 U.S. 56 (1942); *see* Estate of Guggenheim, 1 T. C. 845, 852 (1943); Estate of Morris, 38 B. T. A. 408 (1938).

\(^8\) *Lewis v. Rothensies, supra* note 7; Legg’s Estate v. Commissioner, 114 F. 2d 760 (4th Cir. 1940); *Rothensies v. Fidelity-Philadelphia Trust Co., supra* note 7; *In re Duryea’s Estate*, 277 N. Y. 310, 14 N. E. 2d 369 (1938); James C. Webster, 38 B. T. A. 273 (1938); Eisenstein, *Powers of Appointment and Estate Taxes*: 1, 52 YALE L. J. 296, 327 (1943). But Estate of Rogers v. Commissioner, 320 U.S. 410 (1943) held taxable interests which were appointed to the taker in default in a lesser amount than would have passed in default, declaring that the estate tax is aimed at the “exercise of the privilege of directing the course of property after a man’s death.” This case controlled the decision in *Estate of Kerr v. Commissioner*, 9 T. C. 359 (1947) (the appointing will was the instrument through which the beneficiary received his interest which was smaller than that given him in default). Prior to *Helvering v. Grinnell* the theory of “confirmation of a theretofore defeasible title” had allowed taxation. *Lee v. Commissioner*, 57 F. 2d 399 (D. C. Cir. 1932), *cert. denied* *Lee v. Burnet*, 286 U.S. 563 (1931) (the appointee took a vested remainder instead of an absolute fee in default); *Wear v. Commissioner*, 65 F. 2d 665 (3rd Cir. 1933) (“The generating source of the change was the death of the donee without action adverse to them.”).

\(^9\) *Int. Rev. Code §811.* “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, real or personal . . . (f) To the extent of any property (A) with respect to which the decedent has at the time of his death a power of appointment . . . or has exercised or released a power in contemplation of death or by a disposition in-
ber 21, 1942, the Grinnell rule still affects litigation over taxes on estates of decedents dying before that date. Such was the situation in Commissioner v. Cardeza's Estate10 where A died leaving two-thirds of his estate to his daughter for life, and giving her a general testamentary power of appointment. He also provided that in default of appointment the income was to go to his grandchildren, living at her death, for the life of C, a grandson living at the time of his death, and that the principal was then to be divided among his grandchildren or their issue. The daughter died in 1939 and appointed all the property subject to the power to her son, C, in fee, who, fourteen months after her death, renounced all benefits under his mother’s testamentary exercise of the power, he being the sole surviving lineal descendant. Held: The property is not taxable in the donee’s estate.

The contentions of the commissioner in this case are worth noting, the second being a novel attempt to open another avenue of attack on powers exercised before 1942. The commissioner contended first, that the Grinnell rule should be limited to the situation where the interests, appointed and in default, were equal, but this was rejected. The entire court declared it would be “purely fictional” to assert that the property passed by virtue of the appointment as the appointee had rejected all benefits under the power.11 He also argued that this was not the ordinary default gift and that the word “executed,” in the will of A, applied only to those acts of the donee necessary to a valid execution in form of the power; that the power was validly executed by the donee in that she performed all acts contemplated by the donor, and even if the property has not passed because of the renunciation, still the execution itself cut off the gift in default of appointment, and the property passed by intestacy.12 Leaving this contention unanswered except as the final decision affects it, the two majority judges, in ruling for the taxpayer, based their decision on the theory that since no property passed by virtue of the execution of the power, the default interests, which according to Pennsylvania law vested at the death of the donor subject
to be divested by the exercise of the power, were never divested, and thus not taxable in the estate of the donee.

In reality, although the court contends that it is merely applying Pennsylvania law, it is also determining the intention of the donor at the time he used the word "executed," for it was necessary that this intention be determined prior to the application of any local law. There are three steps which the writer believes the court used in arriving at its decision. It decided first, that "execute" means "exercise," second, that "exercise" means "effective exercise to transfer to the appointee the property," and third, that under the Pennsylvania law a gift in default of appointment vests immediately upon the death of the donor, subject to be divested by the "exercise" of the power. Thus, the donor's intention, according to the court, was to vest the gifts, subject to divestment by the effective transfer of the property interest to the appointee, which never happened.

North Carolina probably agrees with the divestment theory of Pennsylvania, having declared that where there is no gift in default, the interest passes by act of law on the death of the donor to the distributees, subject to be divested by the exercise of the power. It is generally conceded that reference must be made to local law to find out whether or not the decedent had an interest in the property. Where the facts do not show clearly that the power was exercised, many states supply the exercise by statute or by interpretation of the acts of the donee. The court here expressly applied the Pennsylvania law. North Carolina has by statute and court decision declared that, unless a

13 Holt v. Hogan, 58 N. C. 82 (1859). This theory of the interest vesting subject to be divested by the exercise of the power is an old one, Cunningham v. Moody, 1 Ves. Sr. 174, 27 Eng. Rep. 965 (1748); Doe v. Martin, 4 T. R. 39, 65, 100 Eng. Rep. 862, 896 (1790); 2 Sugden, A Practical Treatise of Powers 5, 33, 119 (1837), which is still accepted, Legg's Estate v. Commissioner, 114 F. 2d 760 (4th Cir. 1940); James C. Webster, 38 B. T. A. 273 (1938); In re Freeman's Estate, 35 Pa. Super, 185, 189 (1908) approved in 280 Pa. 273, 124 Atl. 435 (1924) and in 281 Pa. 190, 126 Atl. 270 (1924); Farwell, A concise Treatise on powers 310 (3rd ed. 1916); 4 Kent, Commentaries on American Law 369 (10th ed. 1840); 3 Walsh, Commentaries on the Law of Real Property §323 (1947); see Estate of Day v. Commissioner, 44 B. T. A. 524, 529 (1941).

14 Rothensies v. Fidelity-Philadelphia Trust Co., 112 F. 2d 758 (3rd Cir. 1940); Morris v. Commissioner, 39 B. T. A. 570 (1939); Estate of F. R. Shepherd, 39 B. T. A. 38 (1939) ("The Board, like the Federal courts, is bound by decisions of the state courts in regard to property rights and the effect of conveyances executed within the state relating to property situated therein."); James C. Webster, 38 B. T. A. 273 (1938); Cone v. Commissioner, 31 B. T. A. 515 (1934); 1 Paul, FED. ESTATE AND GIFT TAXATION §9.14 (1942). Where the state court has spoken, the application is simple. Where it has not, the federal court must apply its own interpretation of the state law. 1 Paul, supra at 441; Eisenstein, supra note 8, at 304.

15 N. C. GEN. STAT., §31-43 (1943) ("A general devise of the real estate of the testator . . . shall be construed to include any real estate . . . which he may have power to appoint . . . ." This section also applies to personality.); N. C. GEN. STAT., §105-2(5) (1943) (This provision taxes the exercise of powers of appointment at the rates based on the relationship between the appointee and the
contrary intent is shown in the will, a power of appointment will be
demed exercised by a general bequest or devise or by a general re-
siduary clause.

The Cardeza decision still seems to be limited by Estate of Kerr v.Commissioners\(^1\) in which the Tax Court held the entire amount of the
interests taxable in the donee's estate even though the new interests,
remainders, were merely a smaller part of the default interests, estates
in fee. However, the court distinguished its decision in the Cardeza
case on the ground that there were in that case no new interests created
under the power, the appointee taking exactly what he had before the
attempted exercise of the power.

ROBERT L. HINES.

Taxation—Income—Family Partnerships

Great difficulty has been encountered in determining the status of
family partnerships as a means of effecting tax savings through a divi-
sion of income among the family members. Culbertson v. Commis-
sioner,\(^1\) although more favorable to the taxpayer than prior decisions
in the Tax Court, has admittedly produced greater subjectivity and con-
sequently increased uncertainty in an area already extensively litigated.
Although provision under the Revenue Act of 1948 for joint returns
of husband and wife virtually renders consideration of this type of
partnership unnecessary, the problem is still much alive in the formation
of parent-child arrangements.

An understanding of the well recognized principles governing tax
liability in these family arrangements is essential as a background to
Culbertson. Lucas v. Earl ruled that the tax burden may not be shifted
by an assignment of future income from services rendered by the assign-
or; income is taxable to the tree which actually bore the fruit.\(^2\) As a
corollary, income from property may be taxable to the donor if he re-

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\(^1\) Johnston v. Knight, 117 N. C. 122, 23 S. E. 92 (1895) (the intention of the
donee to execute the power, however manifested, will make the execution valid
and effective, and unless the contrary is shown by the testator's will a general
residuary clause will operate as an execution of the power); Taylor v. Eatman,
92 N. C. 601 (1885) ("It is not necessary to refer to the power if the act shows
that the donee had in view the subject of the power at the time."); see Cone v.
Commissioner, 31 B. T. A. 515, 518 (1934) (the Board says the intent to exercise
the power must come from reference to the power, direct reference to the subject
matter, or it may appear from the facts that the instrument would be inoperative
without the exercise of the power).

\(^2\) 69 Sup. Ct. 1210 (1949), reversing 168 F. 2d 979 (5th Cir. 1948).

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