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Contingencies and the Estate Tax

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I. INTRODUCTION

> Contingencies . . . may assume an infinite variety of shapes and forms to suit the needs of the transferor. A stated contingency may represent a strong probability, and perhaps even a practical certainty, that the property will shortly return to the transferor. On the other hand, the possibility of regaining the property may be so remote as to be essentially nonexistent.[1]
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> As one federal court reiterated, "the basic purpose of the estate tax 'is to bring within the gross estate of the transferor that which he gave upon a contingency terminable at his death.'"[2]

Contingencies[3] indicate probabilities. If a decedent dies owning a lottery ticket, the value of that ticket is included in his gross estate. In this instance, the decedent owns the property and it is just the nature of the property itself that involves a contingency related to its value. Because the lottery has not yet occurred, the value of that ticket would be its cost, reflecting the unlikelihood that decedent, like any other lottery ticket owner, is holding a "winning" ticket.[4] If decedent can possess other types of property that depend on the happening of an event that has not occurred at his death, should that unvested property be included in his gross estate, although similarly discounted to reflect that probability? On the other hand, what if decedent's death extinguishes the possibility that he will ever own the property? In that instance, should the testamentary nature of the transfer and abuse potential require an artificial rule of inclusion at full value? In that context, to what extent should the fact that the contingency is donor created affect inclusion and valuation

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1. U.S. Treas. Dept., Federal Estate and Gift Taxes: A Proposal for Integration and for Correlation with the Income Tax 31 (1947) [1947 Treas. Proposal].

2. Looney v. United States, 569 F.Supp. 1569, 1571 (M.D.Ga. 1983), citing Broderick v. Keefe, 112 F.2d 293, 296 (1st Cir. 1940).

3. As used in this article, contingent interests include all types of property interests that are subject to the risk of non-possession. They, therefore, include vested interests subject to defeasance. The Restatement of Property has noted the confusion of terminology in this context. See Restatement of Property § 157 (1937) ("the term 'contingent remainder' has been used too frequently in a loose manner to designate any remainder involving an uncertainty."). I apologize if I am inappropriately adding to this ignorance.

4. This treatment may be contrasted to a lottery winner's winnings that are included in his estate, although not necessarily at the payments' actuarial value as the right to future payments may be subject to restrictions. See Estate of Shackleford v. United States, 98-2 U.S. Tax Case (CCH) ¶ 60.320, at 86, 531-32, 82 A.F.T.R. 2d (P-H) 98-5538, 98-5543-44 (E.D. Cal. 1998) (holding on motion for summary judgment that if the decedent's estate could demonstrate that the value of decedents right to future lottery installment payments would be almost forty percent lower than the regulations' approach by taking into account restrictions on marketability, then a departure from the regulations' annuity tables would be warranted.) cf. Estate of Gribauskas v. Commissioner, 116 T.C. No. 12 (2001).

rules? Overall, should there be any *de minimis* rule to deal with remote contingencies?

Currently, the treatment of contingent interests for estate tax purposes[5] varies depending on what Code section is applicable. Consequently, there are instances when contingent interests are included in decedent's gross estate at different values. That is, some are included at the full fair market value of the property;[6] some are included at a value discounted to reflect probabilities;[7] and some are excluded altogether.[8]

Inclusion with valuation adjustments, i.e., a purely mathematical rule, provides the most even treatment of contingencies. With such a rule, the remoteness or minimal value of a contingency is reflected in the general rule of discounting for unlikely contingencies so that there is no need for a *de minimis* exception to avoid what might be considered the harsh result of alternative full date-of-death value inclusion rule. Essentially, all valuation inherently involves approximation; contingencies complicate the mathematics of valuation and possibly increase reliance on expert appraisals[9] but do not change any of the fundamental rules of valuation. Even that added difficulty is alleviated or eliminated by focusing on burden of proof.

Part of the difficulty inherent in formulating a consistent treatment of contingent property interests is a feeling that a too attenuated or too unlikely contingency should be disregarded. At common law, contingencies were indeed "disregarded" or "destroyed" because they resembled "mere 'possibilities'"[10] or expectancies. They were considered potential interests and were not

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5. In the gift tax area, a transfer of a contingent interest in property is taxable. See Dickman v. Commissioner, 465 U.S. 330, 335 (1984), ("The Court has also noted that the language of the gift tax statute 'is broad enough to include property, however conceptual or contingent'. . . .") citing Smith v. Shaughnessy, 318, U.S. 176, 180 (1943). Yet, courts have held that gifts of contingent interests that are difficult to value either will not be taxable transfers or will be theoretically taxed but given a zero value. This article is concerned only with the estate tax inclusion sections; however, contingencies related to the gift tax or to estate tax deductions will likely be the subject of another article.

6. See infra Parts II. C, II. G. and accompanying discussion.

7. See infra Part II. A. and accompanying discussion.

8. See infra Part II. D. and accompanying discussion.

9. Expert appraisal is already required, under the regulations, for certain property. See, Regs. § 20.2031-6(b) (requiring professional appraisals with respect to household and personal effects, such as "jewelry, furs, silverware, paintings, etchings, engravings, antiques, books, statuary, vases, oriental rugs, coin or stamp collections" valued at more than $3,000).

10. Restatement of Property, § 162 (1936). "Contingent remainders and executory interests are clearly no longer thought of as mere possibilities of receiving an interest in the future. Rather, they are thought of as present interests in which the right to possession is postponed and uncertain." Lawrence W. Waggoner, et al., Family Property Law: Cases and Materials on Wills, Trusts, and Future Interests 957 (2d ed. 1997). The doctrine of destructability of contingent remainders, although originating from the need for continuous seisin, also encouraged the alienability of land. See Jesse Dukeminier & James E. Krier, Property 295 (3d ed. 1993).

alienable during the decedent's lifetime; they were descendible and devisable only if they survived the decedent's death.[11] In a sense, *de minimis* contingent interests are only notches a little further along that continuum, greater than mere expectancies, but not much more so. Extending this perspective, a rule involving more likely probabilities, such as a "more-likely-than-not" rule,[12] could also be imposed to subject to estate taxation only those property transfers that will probably vest and to ignore contingencies with a probability of 50% or less.[13]

Alternatively, creating a uniform rule might well require an examination of how the issue of control, which is central to transfer taxes, applies to contingencies. Where contingencies are the product of the donor, or essentially the donor,[14] perhaps contingencies should be ignored or interpreted against the interests of the donor.[15] After all, the donor initially controls whether or not to insert a contingency and, even at that time, can decide whether or not to impose it after evaluating the probabilities of the interest returning to him. In a way, contingencies within decedent's control are not real contingencies. Since the donor controls whether or not to qualify an interest with a contingency, the risk factor is, to a great extent, undermined. An argument can be made that contingencies created by decedent have a potential for abuse that warrants no discounting to reflect risk. Thus, in constructing a rule about contingencies, one may want to distinguish between those contingencies within the decedent's control and those not within his control. More specifically, a rule might need to distinguish between those contingencies *initially* within the decedent's control (regardless of whether he creates a

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11. Thus, interests extinguished by the condition of decedent's death are not descendible or devisable. Id. at 296. Dukeminier & Krier, supra note 10, at 296.

12. The Treasury Department proposed the adoption of a more-likely-than-not rule to determine the taxability of reversions as either completed gifts or as testamentary transfers. U.S. Dept. of the Treasury, 2 Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President, reprinted in 52 Fed. Tax. (P-H) § 3, ¶ 59,476 (1984) [hereinafter 1984 Treasury Reform]. Where it was more probable that the property would revert to the transferor, the transfer was an incomplete gift and subject to estate taxation; by contrast, where it was more probable that the property would not revert to the donor, there would be a gift taxed at the property's full value (without reduction for the reversion). Id. at 378-80. The likelihood of a reversion would be determined by reference to actuarial determinations of estimates of the donor's (and other relevant individuals') life expectancy. Id. at 380. Subsequent transfers of any reverted property would reflect and be offset by applicable previous transfer tax. Id.

13. A greater than 50% (a more-likely-than-not) rule has the appeal of simplicity; however, such a rule might create additional complexity by encouraging the creation of and combination of such contingencies in trust instruments. Moreover, such a rule creates too great an exception to the general rules of inclusion without supplying a cogent rationale to except them.

14. The prohibition may be extended to certain related individuals and entities.

15. This may be characterized as "the rule in Robinette" despite some courts' misreading of that case. See infra note 137.

contingency that he cannot control) and those over which he has never had any control. Indeed, in the instance of donor-created contingencies, an artificial rule of full inclusion more successfully prevents tax avoidance. Thus, where there exists a great potential for donor manipulation, an artificially constructed rule, with its simplicity and clarity, could apply to ignore all uncertainty and to include the full value of the property in decedent's gross estate.

II. A REVIEW OF CONTINGENCIES AND ESTATE TAX CODE SECTIONS[16]

A. *Section 2033: The Mathematical Rule*

Section 2033 of the Internal Revenue Code,[17] a section that remains essentially the same as its predecessor sections,[18] includes all property interests that decedent owned at death. Property included in decedent's estate under section 2033 is valued according to the rules in section 2031.[19] In determining fair market value, "[a]ll relevant facts and elements of value as of the applicable valuation date shall be considered in every case."[20] Where a contingent interest

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16. This article contains a discussion of the estate tax inclusion under §§ 2033-2034, 2036-2042 and omits any discussion of estate tax § 2035 that includes certain completed gifts in decedent's estate as testamentary transfers. Because of § 2035(a)(2), releases within three years of death of interests that had they been retained at decedent's death would have caused inclusion in decedent's estate under §§ 2036-2038 and 2042 are included in the estate. IRC § 2035(a). In this way, deathbed transfers of a "taxable string" or retained interest or power will not avoid estate taxation, and the property will be valued as of decedent's death. Likewise, insurance proceeds, that greatly exceed the lifetime value of an insurance policy, are taxed in decedent's estate at that higher value. IRC § 2042. Section 2035(b) includes the value of the gift tax paid with respect to all taxable gifts made within three years of decedent's death, but § 2035(a) excludes most completed gifts made after 1976. IRC § 2035. Since § 2035 relates to other estate tax sections, the article addresses them individually, under their specific Code sections, rendering an additional review unnecessary. Id.

17. Section 2033 provides: "The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death." IRC § 2033.

18. This statute was originally enacted in the Revenue Act of 1916. Pub. L. No. 64-271, § 200, 39 Stat. 756, 777. Initially, § 2033 was codified as § 811(a), in the 1939 Code. See Internal Revenue Act of 1954, Pub. L. No. 83-591, 68A Stat. 1 app. at 931 [hereinafter 1954 Code] (comparing provisions in the 1939 Code with complimentary provisions in the 1954 Code); S. Rep.1622, 83d Cong., 2d sess. 468 [hereinafter 1954 S.Rep.] (noting that § 2033 in the 1954 Code corresponded to § 811(a) in the 1939 Code). For a brief period, the statute excluded real property outside the United States. 1954 Code, supra, § 2033, 68A Stat. at 381. The exception was deleted effective for decedents dying after October 16, 1962. See Revenue Act of 1962, Pub. L. No. 87-834, § 18, 76 Stat. 960, 1052.

19. The regulations under § 2031 indicate that valuation under each estate tax code section (from §§ 2031-2044) should reflect the property's fair market value. "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Regs. § 20.2031-1(b).

20. Id.

terminates at decedent's death, like with vested terminating interests, nothing is included under section 2033.[21]

As the regulations explain, section 2033's inclusion of all of decedent's surviving property interests means "all property, whether real or personal, tangible or intangible, and wherever situated, beneficially owned by the decedent at the time of his death."[22] The IRS has maintained that the phrase includes any beneficial interests in a trust that decedent owns at death even though created under another's revocable trust as long as that interest is "descendible, devisable, and alienable" under local law.[23] Therefore, while the value of an interest that is subject to alteration and complete divestment would reflect those contingencies, the IRS has ruled that:

> [t]he mere presence of these possibilities does not warrant the assignment of a merely nominal value to such a defeasible interest in any case where there is still a reasonable probability that the estate will actually acquire possession of at least some substantial portion of the property in question.[24]

Similarly, the court in *Hill's Estate* held includable a decedent's reversionary interest that was contingent on the trustee's determination that some part of the trust corpus was not needed for trust administration on the death of either the decedent's wife or the decedent's daughter.[25] Although the court explained that "[t]he amount of corpus returnable to the decedent's estate under these provisions of the trust is somewhat speculative and admits of no accurate determination, . . . we cannot doubt that the right had value at the date of the settlor's death."[26]

Whether contingent or vested, inclusion of an interest under section 2033 depends on whether the interest is transferable under local law. Although most states allow for the alienation of contingent interests,[27] in a minority of states, only vested interests are includable in the decedent's estate. For example, in a case involving the grandchild exception to the 1986 generation-skipping transfer tax legislation, the court needed to determine whether the

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21. See, e.g., Rev. Rul. 75-145, 1975-1 C.B. 298. While interests extinguished at death are not included in decedent's estate, those extinguished by will are includable. See, e.g., Regs. § 20.2033-1(b). ("Notes or other claims held by the decedent are likewise included even though they are cancelled by the decedent's will."). Promissory notes extinguished by decedent's death will be included in decedent's estate unless they were calculated as part of the bargained for consideration given for the notes. Estate of Moss v. Commissioner, 74 T.C. 1239 (1980), acq. in result in part, 1981-2 C.B. 2.

22. Regs. § 20.2033-1(a).

23. See Rev. Rul. 67-370, 1967-2 C.B. 324.

24. Id.

25. In re Hill's Estate v. Commissioner, 193 F.2d 724 (2d Cir. 1952), acq., 1951-1 C.B. 1.

26. *Hill's Estate*, 193 F.2d at 728.

27. See, Restatement of Property, § 162 (1936).

assets of the trust would be in the grandchild's estate should he die before the trust's termination. In focusing its examination on section 2033, the court stated: "Generally, if interests are contingent, they are not includable in the decedent's gross estate, whereas, if the interests are vested, then they are includable in the gross estate under section 2033."[28] Because of Michigan's preference for early vesting, the court found that the interest in question would have vested in the grandchild and thus fell within the statutory language.[29]

Sometimes, under state law a contingent interest does not make the owner a beneficial owner. Since the statute and regulations require that decedent "beneficially" own the property for section 2033 to apply,[30] in those instances, property over which decedent has a contingent interest will not be included under that section. For example, although the court in *Arrington V. United States*[31] held for the government, the issue was still whether the interest was vested or contingent, the answer to which question determined beneficial ownership and, consequently, estate taxation.[32]

Specifically enumerated in the regulations under section 2033 are claims decedent held at his death, whether or not cancelled by his will.[33] Likewise, the IRS has maintained that possible claims from potential wrongful death actions that relate to the decedent's pain and suffering are includable in decedent's gross estate.[34] Property subject to section 2033 includes the right to future property and as such includes contingent fees[35]

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28. Comerica Bank v. United States, 93 F.3d 225, 228 (6th Cir. 1996).

29. Id. at 229.

30. See Regs. § 20.2033-1(a).

31. 34 Fed. Cl. 144 (1995), aff'd, 108 F.3d 1393 (Fed. Cir. 1997).

32. *Arrington,* 34 Fed. Cl. at 147-48.

33. Regs. § 20.2033-1(b).

34. Rev. Rul. 75-127, 1975-1 C.B. 296 (finding that damages under any state with a "survival" type wrongful death statute with no recovery for pain and suffering are not includable in decedent's estate but also ruling that damages for the decedent's pain and suffering were includable); Rev. Rul. 69-8, 1969-1 C.B. 219 (ruling damages for pain and suffering under the Federal Death on the High Seas Act are includable in decedent's estate). Rights that emerge after decedent's death are not includable in decedent's estate under § 2033. See Connecticut Bank & Trust Co. v. United States, 465 F. 2d 760, 763 (2d Cir. 1972).

35. See Estate of Curry v. Commissioner, 74 T.C. 540, 545-47 (1980) acq., 1981-2 C.B. 1; Rev. Rul. 55-123, 1955-1 C.B. 443. But see Estate of Nemerov v. Commissioner, 15 T.C. Memo. (CCH) 855, T.C. Memo. (P-H) ¶ 56,164, at 56-696 (1956) (holding that where attorney's fees were undeterminable at decedent's death and where no quantum meruit claim could have been sustained at that time, nothing was includable in decedent's estate although the decedent had performed some work on the cases, because no right of recovery had accrued at decedent's death).

and the like.[36] In *Estate of Curry,*[37] the court held that decedent's interest in contingent fees associated with thirteen pending cases before the Indian Claims Commission was includable, rejecting the taxpayer's argument that "contingent fees are not includable in the gross estate because there is no compensable interest as of the date of death."[38] Moreover, the court "reject[ed] petitioner's contention that because the claims here involved had not been reduced to judgment, they were too remote and speculative to be valued."[39]

Along those same lines, the Board of Tax Appeals held that executor's fees earned by decedent before his death, although not at the time reviewed by the probate court and thus not accrued for income tax purposes, were nonetheless includable in decedent's estate as choses in action.[40] Similarly, in *Simmons*[41] the court rejected the estate's argument that the decedent's income tax refund claim had a zero value at decedent's death. Indeed, even if, as the estate claimed, decedent did not know about the claim,[42] the court reversed and remanded the district court's decision "because there was no rational basis for the jury's finding that the claim for an income tax refund was valueless on the date of the decedent's death."[43]

Recently, in *Estate of Smith,*[44] the court held that the decedent's right to section 1341 relief was an asset of her estate and rejected the estate's argument that because repayment to Exxon pursuant to a settlement agreement achieved over a year after the decedent's death was a pre-condition to section 1341 relief, decedent's right to that benefit did not exist at her death.[45] While

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36. A promise to return property to the estate where the estate had insufficient assets to satisfy its tax liability was held to be property includable under § 2033. Welch v. Hall, 134 F.2d 366 (1st Cir. 1943); First Victoria Nat'l Bank v. United States, 620 F.2d 1096, 1107 (5th Cir. 1980).

37. 74 T.C. 540 (1980).

38. *Estate of Curry,* 74 T.C. at 545. In valuing these interests, the court considered the extent to which the claims had been pursued, decedent's success at similar actions, and the probability of success in these cases as determined at decedent's date of death. The court rejected the government's argument that the claims be valued at the amount ultimately recovered by the estate.

39. Id. at 547.

40. Estate of McGlue v. Commissioner, 41 B.T.A. 1199 (1940). The court included these fees at the value equal to one-half (he was co-executor) of the amount claimed as a deduction for executor's fees on that decedent's estate tax return.

41. United States v. Simmons, 346 F.2d 213 (5th Cir. 1965), rev'g and remanding 12 A.F.T.R.2d (RIA) 6291, 63-2 U.S.T.C (CCH) ¶ 12176 (S.D. Ga. 1963).

42. See also Bank of California v. Commissioner, 133 F.2d 428, 432 (9th Cir. 1943) (holding that an income tax refund claim, not yet made at decedent's death, was nevertheless an includable property interest in decedent's estate).

43. *Simmons,* 346 F.2d at 215.

44. Estate of Smith v. Commissioner, 108 T.C. 412 (1997), rev'd and remanded (on the issue of valuation of that interest), 198 F.3d 515 (5th Cir. 1999), nonacq., 2000-19 I.R.B. 962.

45. *Estate of Smith,* 108 T.C. at 426.

the Fifth Circuit reversed the Tax Court on a different issue,[46] both courts agreed that the section 1341 claim was an asset of decedent's estate includable under section 2033.[47]

In addition, *Estate of Smith* held that fair market value includes potential tax benefits.

> In the instant case, the tax event that was looming on the horizon at the date of death is the converse of the one in Eisenberg: Rather than a potential future tax detriment, as was the case in Eisenberg, here there was a potential future tax benefit to the Estate, which would ripen in the event that it were to repay to Exxon, in whole or in part.[48]

Thus, the court cited to[49] and analogized its decision to the recent trend of some courts to allow a discount for built-in capital gains.[50] If a contingent liability can affect valuation, the court reasoned, a contingent benefit must also be included in decedent's estate.

According to the regulations, valuation of present and future interests in property, such as life estates of third parties or remainder interests owned by the decedent, is made by reference to the actuarial tables.[51] Those tables calculate the present value of partial interests in property by estimating the relevant individual's life expectancy as well as by assuming a constant interest

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46. The Circuit Court reversed the Tax Court's adoption of post-death facts to value an uncertain claim that ultimately gave rise to an amount refundable under § 1341 in a claim filed subsequent to decedent's death. *Estate of Smith,* 198 F.3d at 527-28.

47. Id. at 527 ("We agree with the Commissioner and the Tax Court that the contingent right to future income tax relief under section 1341, based on pre-death events, is a factor that must be taken into account in connection with the Estate and that the contingent nature of the benefit merely affects its date-of-death value.").

48. Id. at 528-529.

49. Id. (citing to the Second Circuit's decision in Eisenberg v. Commissioner, 155 F.3d 50 (2d Cir. 1998)).

50. See, e.g., Davis v. Commissioner, 110 T.C. 530 (1998) (The court allowed the reduction for built-in capital gains in valuing stock, although no sale was anticipated, because since 1986, if there were such a sale, the tax could not be avoided); Eisenberg v. Commissioner, 155 F.3d 50 (2d Cir. 1998), rev'g, 74 T.C. Memo. (CCH) 1046, T.C. Memo. (RIA) ¶ 97,483 (1997) (In a gift tax case involving the value of stock, the Second Circuit allowed a discount for the amount of taxable gain that could have resulted had there been a sale of the building that was the main asset of the company. This discount was allowed despite the fact that there was no intention to sell the building or liquidate the company. The Tax Court had denied the reduction "where the evidence failed to establish a liquidation or sale of the corporation or its assets is likely to occur, reasoning the tax liability is purely speculative." T.C.M. at 1048.); Estate of Jameson v. Commissioner, 77 T.C. Memo. (CCH) 1383, T.C. Memo. (RIA) 99,043 (In valuing stock, the court took into account the company's built-in capital gains and a small marketability discount.). Cf. Armstrong v. United States, 85 A.F.T.R.2d (RIA) 1320 (W.D. Va. 2000), wherein, in the gift tax area, the court refused to reduce the value of stock by an illusory assumption of gift tax liability by the donee.

51. See Regs. § 20.2031-7.

rate equal to the current market rate. Deviation from the tables may only occur in very limited circumstances, such as when the taxpayer is suffering from a terminal disease.[52] Thus, these types of interests are dependent on the probability that the individual's actual life duration will match the average person's. They also incorporate a continuous interest rate over that duration that is not likely to reflect actual rates since that rate is not likely to remain the same over that period. Further, the government has acknowledged the difficulty posed by valuing contingent interests that are not subject to ordinary rules of actuarial valuation and has stated that the general rules of valuation as expressed in the regulations should apply.[53] Thus, for example, to value a remainder interest that is subject to being reduced by additional children either born or adopted by his fifty-three year old mother,

> ... the actuarial value of the decedent's remainder interest ascertained by the formula set forth in section 20.2031-[7T(d)] of the regulations, should be the starting point. Consideration should then be given to all known facts and circumstances that might tend to decrease such value, with due regard for (1) the certainty that a woman who has reached the age of 53 years will not bear children is far greater than that which attends most other human affairs and (2) the unlikelihood that a woman of that age will adopt a child.[54]

Section 2033 includes property that inherently involves risks and difficulty in valuation. In *First Victoria National Bank v. United States*,[55] the court held the transfer of a rice production history was includable under section 2033 since it was comparable to goodwill that "has value only because it carries the expectancy of receiving future assets of more concrete value."[56] Likewise, an author's name that could be devised was includable and valued with respect to contracts decedent had entered into before her death, subject to discounting to reflect the uncertainty of the value of the name continued on ghostwritten novels of the same genre subsequent to her death.[57] In *Estate of Andrews*,[58] while the estate had omitted the decedent's name as an asset of the estate on the estate tax return,[59] the court underlined the importance of her name as contributing to the success of the first post-death, ghostwritten, novel.[60] Thus,

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52. See Regs. § 20.7520-3(b).

53. See Regs. § 20.2031-1(a); Rev. Rul. 76-472, 1976-2 C.B. 264.

54. Rev. Rul. 76-472, 1976-2 C.B. 264.

55. 620 F.2d 1096 (5th Cir. 1980).

56. *First Victoria Nat'l Bank*, 620 F.2d at 1106.

57. The court substantially discounted the contract amount by the risk associated with an inability to produce a novel agreeable to the publisher. See Estate of Andrews v. Commissioner, 850 F.Supp. 1279, 1291 (E.D. Va. 1994).

58. Id. at 1279.

59. Id. A decedent's name is an unusual property interest. See State ex re Elvis Presley International Memorial Foundation v. Crowell, 733 S.W.2d 89 (1987).

60. *Estate of Andrews*, at 1286.

while valuation was subject to contingencies, the asset, although unusual, was clearly includable under section 2033, but discounted to reflect uncertainty of the success of the novels written by others under decedent's name after her death.

Essentially, all "property," as used in the section 2033 includes contingent interests, including all choses in action,[61] although valuation may reflect substantial discounts due to the property's contingent nature and although valuation may be problematic and inexact.[62] That is, except where contingent interests are excluded because they are not beneficially owned by the decedent under state law, property interests subject to section 2033 are included at a value that reflects the uncertainty of the contingency attached to or inherent in the property interest.

B. *Section 2034 and the Inclusion of Marital Expectancies*

Section 2034 requires that the value of the surviving spouse's dower, curtesy, or statutory share interest be included in the decedent's estate.[63] These interests that belong to another only belong to them, contingently, at decedent's death or, potentially earlier, in the case of divorce. From 1918,[64] they were specifically included in decedent's estate as long as, under local law, decedent was not prohibited from ever acquiring an interest in such property. Most of the cases brought under section 2034 involve issues of adequacy of consideration for a spouse's relinquishing these interests[65] and the corresponding deductibility of a claim under section 2053.[66] Marital property interests that are included in decedent's estate under section 2034 are included in basically the same way that property is included under section 2033.

C. *Section 2036 and the Dominant Role of Abuse Prevention*

61. *Estate of Curry,* at 545.

62. Id. at 546-547 ("However, the contingent nature of the contract right must bear on the factual question of valuation. It cannot, as a matter of law, preclude the inclusion of the interest in the decedent's gross estate or command that the value be fixed at zero . . . . Valuation for estate tax purposes frequently involves difficult and somewhat imprecise calculations.").

63. IRC § 2034.

64. Revenue Act of 1918, Pub. L. No. 65-254, § 402(b), 40 Stat. 1057, 1097 (1918).

65. See, e.g., Empire Trust Co. v. Commissioner, 94 F.2d 307 (1938); Estate of Byram v. Commissioner, 9 T.C. 1 (1947). Most involve adequacy of consideration under § 2043. Section 2043(b) specifically denies that relinquishment of these rights are "consideration 'in money or money's worth,'" except for the purposes of a § 2053 debt of the estate to the extent that the transfer satisfies § 2516(1). IRC § 2043(b).

66. See, e.g., Estate of Herrmann v. Commissioner, 85 F.3d 1032 (2d Cir. 1996).

1. *An overview.*—Under section 2036,[67] if a decedent makes an inter vivos transfer of property but retains for himself during his lifetime either a life interest in that property or a power to control the lifetime "possession or enjoyment" of that property, the full date of death value of that property will be included in his estate.[68] Historically, state inheritance taxes incorporatedthephrase "possession or enjoyment" of property[69] and most understood that such transfers were essentially testamentary dispositions.[70] These arrangements have often been described as "will substitutes."[71]

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67. Section 2036(a) provides:

> 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.

The relevant regulations define the phrase "right . . . to designate the person or persons who shall possess or enjoy the transferred property or the income therefrom" to include,

> a reserved power to designate the person or persons to receive the income from the transferred property, or to possess or enjoy non-income-producing property, during the decedent's life or during any other period described in paragraph (a) of this section. With respect to such a power it is immaterial . . . (iii) whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death (e.g. the death of another person during the decedent's lifetime)."

Regs. § 20.236-1(b)(3)(iii).

68. IRC § 2036.

69. See Commissioner v. Estate of Church, 335 U.S. 632, 637-638 (1949) ("The 'possession or enjoyment' provision appearing in section 811(c) seems to have originated in a Pennsylvania inheritance tax law in 1826 . . . . Most of the states have included the Pennsylvania-originated 'possession or enjoyment' clause in death tax statutes, and with what appears to be complete unanimity, they have up to this day . . . substantially agreed with this 1884 Pennsylvania Supreme Court interpretation.")

70. See United States v. Estate of Grace, 395 U.S. 316, 320 (1969) ("The general purpose of the statute was to include in a decedent's gross estate transfers that are essentially testamentary i.e., transfers which leave the transferor a significant interest in or a control over the property transferred during his lifetime."); Commissioner v. Estate of Church, 335 U.S. at 639, 646 (1949) (citing their decision in Helvering v. Hallock, 309 U.S. 106 (1940), the court stated: "Testamentary dispositions of an inter vivos nature cannot escape the force of this section by hiding behind legal niceties contained in devices and forms created by conveyancers."); Estate of Gilman v. Commissioner, 65 T.C. 296, aff'd, 547 F. 2d 32 (2d Cir. 1976); Estate of Deobald v. U.S., 444 F.Supp. 374, 382 (E.D. La.1978).

71. See, e.g., *Hallock,* 308 U.S. 106, 114 (1940).

Congress has repeatedly reacted to the potential for abuse inherent in section 2036.[72] In enacting its predecessor, Congress quickly reacted to three Supreme Court cases[73] allowing a decedent to avoid estate taxes where he retained a lifelong right to enjoy property.[74] That statute, with substantially the same language as the current one, was enacted to prevent tax avoidance.[75] In 1976, Congress reacted to the decision in *United States v. Byrum,*[76] and enacted

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72. In its repudiation of its earlier decision in May v. Heiner, 281 U.S. 238 (1930), that emphasized a rule based on legal title, the court, in *Estate of Church,* 335 U.S. at 641-642, stated: "The effect of the Court's interpretation of this estate tax section was to permit a person to relieve his estate from the tax by conveying its legal title to trustees whom he selected, with an agreement that they manage the estate during his life, pay to him all income and profits from the property during his life, and deliver it to his chosen beneficiaries at death. Preparation of papers to defeat an estate tax thus became an easy chore .... And by this simple method one could, despite the 'possession or enjoyment' clause, retain and enjoy all the fruits of his property during life and direct its distribution at death, free from taxes that others less skilled in tax technique would have to pay." Some commentators, however, have minimized the potential for abuse, particularly when compared to the complexities inherent in retaining Code §§ 2036-2038. See, e.g., Joseph Isenbergh, Simplifying Retained Life Interests, Revocable Transfers, and the Marital Deduction, 51 U. Chi. L. Rev. 1, 13-15 (1984).

73. The three per curiam decisions are Burnet v. Northern Trust Co., 283 U.S. 782 (1931); Morsman v. Burnet, 283 U.S. 783 (1931); McCormick v. Burnet, 283 U.S. 784 (1931).

74. See, *Estate of Church,* 335 U.S. at 639-640 ("Both houses of Congress unanimously passed and the President signed the requested resolution that same day." 335 U.S. at 640); United States v. Byrum, 408 U.S. 125, 160, 165 (1972) (J. White, dissenting).

75. See Commissioner v. Estate of Church, 335 U.S. at 639-640 (Acting Secretary of the Treasury Ogden Mills stated that without Congressional action to reverse the three Supreme Court opinions the resulting loss to the Treasury would be "in excess of one-third of the revenue derived from the Federal estate tax, with anticipated refunds in excess of $25,000,000."); United States v. Byrum, 408 U.S. at 159-160 (J. White, dissenting).

> The dialogue between the following Congressmen underscores this intent:
> "Mr. Hawley. Mr. Speaker and gentlemen, the Supreme Court yesterday handed down a decision to the effect that if a person creates a trust of his property and provides that, during his lifetime, he shall enjoy the benefits of it, and when it is distributed after his death it goes to his heirs—the Supreme Court held that it goes to his heirs free of any estate tax ....
> Mr. Schafer of Wisconsin. This is a bill to tax the rich man. I shall not object ....
> Mr. Sabath. Reserving the right to object, all the resolution purports to do is to place a tax on these trusts that have been in vogue for the last few years for the purpose of evading the inheritance tax on the part of some of these rich estates?
> Mr. Hawley. It provides that hereafter no such method shall be used to evade the tax.
> Mr. Sabath. That is good legislation.

74 Cong. Rec. 7198, cited in United States v. Byrum, 408 U.S. at 160 (J. White, dissenting).

76. 408 U.S. 125 (1972).

section 2036(b)[77] for the same policy of preventing abuse.[78] Because of the increased use of valuation freezes in estate planning,[79] Congress enacted section

77. The Tax Reform Act of 1976, Pub. L. No. 95-600, § 702(i)(1), adding § 2036(b), effective for transfers after June 22, 1976, states:

(b) Voting Rights—

(1) In General—For purposes of subsection (a)(1), the retention of the right to vote (directly or indirectly) shares of stock of a controlled corporation shall be considered to be a retention of the enjoyment of the 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 f 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.

(3) Coordination with section 2035—For purposes of applying section 2035 with respect to paragraph (1), the relinquishment or cessation of voting rights shall be treated as a transfer of property made by the decedent.

78. Cited in the House Committee Report as the "Reasons for chang[ing]" the law subsequent to the *Byrum* decision, was the belief "that voting rights are so significant with respect to corporate stock that the retention of voting rights by a donor should be treated as the retention of the enjoyment of the stock for estate tax purposes. Your committee believes that this treatment is necessary to prevent the avoidance of the estate and gift taxes." H. Rep. No. 94-1380, 94th Cong., 2d Sess. 64 (1976); Joint Comm. on Taxation, General Explanation of the Tax Reform Act of 1976, 589 (1976). The committee report cited to an article that suggested that the value of their retained voting control would not be subject to any transfer tax under Byrum. Id. at 64, n.3.

79. An estate freeze in the context of a grantor retained income interest trust or equivalent is a technique by which the donor freezes the value of the transferred remainder interest, which generally has a greater appreciation potential, while reducing the value of the gift by the retained interest that is actuarially calculated at the date of the gift but in fact has a much lower value. See Staff of Joint Comm. on Taxation, 101st Cong., 2d Sess., Federal Transfer Tax Consequences of Estate Freezes (JCS-13-90) 16-19 (Comm. Print 1990). ("Estate freezes raise three basic transfer tax concerns. First, because frozen interests are inherently difficult to value, they can be used as a means of undervaluing gifts. Second, such interests entail the creation of rights that, if not exercised in an arm's-length manner, may subsequently be used to transfer wealth free of transfer tax. Third, 'frozen' interests may be used to retain substantial ownership of the entire property while nominally transferring an interest in the property to another person." Id. at 16. "Further, undervaluation may result from the use of Treasury tables valuing annuities, life estates, terms for years, remainders and reversions. Those tables are based on assumptions regarding rates of return and life expectancy that are seldom accurate in a particular case, and therefore, may be the subject of adverse selection. Because the taxpayer decides what property to give and when to give it, use of tables, in the aggregate, more often results in undervaluation than in overvaluation." Id. at 18.). The Treasury has defined circumstances under which the tables may not be used. See Regs. § 25.2702-3(b)(2) and (3). (Excluding high payout annuities which exhaust the fund before the term expires; a grantor retained income trust (GRIT) wherein the transferor's retained interest is comprised of unproductive or underproductive assets; transfers with retained interests based on persons with a terminal illness, which is defined as an incurable illness or deteriorating condition expected result in their death within a year (although a contrary presumption arises if the person actually survives at least 18 months)).

2036(c).[80] Although this subsection of the statute was subsequently repealed,[81] its repeal was simultaneous with the enactment of Chapter 14[82] which contains the gift tax special valuation rules.[83] Thus, with respect to transfers with a life time retained income or enjoyment, section 2702 not only emphasizes that, without a "qualified interest," such a transfer with a retained income interest will be subject to the gift tax at the full value of the property, ignoring the retained interest,[84] but also by retaining section 2036(a)(1), Congress also

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80. See Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10402(a) (amending IRC § 2036), applicable to decedents dying after 1987, but only with respect to transfers subsequent to December 17, 1987. Section 2036(c) applied to GRITs (Grantor Retained Income Trusts) with the exception of trusts where the retained term was ten years or less, where the donor did not serve as a trustee, and where the income interest was determined solely by reference to the trust's income. IRC § 2036(c)(6). See H.R. No. 100-1104 (vol.2), at 74, n.1. This exception did not apply where the grantor had a contingent reversion or certain powers of appointment. See Notice 89-99, 1989-2 C.B. 422.

81. See Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11601, 104 Stat. 1388. The Omnibus Budget Reconciliation Act of 1990, added Code §§ 2701-2704 as part of the amendment to subtitle B which added Chapter 14, with Code § 2702 effective for transfers after Oct. 8, 1990, except as provided in § 11602(e)(1)(B); § 11601 repealed IRC § 2036(c). Some retained income transfers are not subject to these rules such as incomplete gifts and transfers to a personal residence trust. See IRC § 2702(a)(3).

82. Chapter 14 was added by the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11602(a). Technical Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (codified in relevant part at IRC § 7520), further increased the accuracy of the tables' use.

83. See IRC §§ 2701-2704. Section 2702 expressly deals with gifts with retained life interests, the subject of § 2036, so that without a "qualified interest" as defined in § 2702(b), the transferor is seen as making a gift of the full value of the underlying property, unreduced by the value of the donor's retained life interest. The provision applies where either the transferor or any "applicable family member" retains an interest in the trust. An "applicable family member" is defined as the transferor, his spouse, either of their lineal descendants or their spouses. See IRC §§ 2702(a)(1), 2701(e)(2); Regs. § 25.2701-1(d)(2). These family members include the transferor's spouse, either his or his wife's ancestors or lineal descendants or their spouses, and any of the transferor's siblings or their spouse. IRC §§ 2704(c)(2) & 2702(e); Regs. § 25.2702-2(a)(1). Section 2702 gives a zero value to interests retained by the transferor or applicable family member that are not "qualified interests." IRC § 2702(a)(2)(A). However, § 2702(a)(2)(B) allows a reduction of any retained interest that is a qualified interest as defined by § 2702(b), i.e., an interest which is in the form of a qualified annuity, a qualified unitrust interest, or a qualified remainder interest. That interest is then valued under the rules of § 7520. See Regs. §§ 25.2702-3(b),(c), & (d). Note that § 2702(c)(3)(A) defines a "term interest" as including "a life interest in property" so that retained, non-qualified, income interests for life are taxed in full at the transfer of the remainder interest and the full fair market value of the property is subject to estate tax at the transferor's death. The regulations provide a reduction in "aggregate taxable gifts" for gift tax purposes, or "adjusted taxable gifts" for estate tax purposes, where a term interest that was valued at zero under § 2702 was subsequently transferred. See Regs. § 25.2702-6.

84. The legislative history states:

> . . . the committee [was] concerned about the undervaluation of gifts valued pursuant to Treasury tables. Based on average rates of return and life expectancy, those tables are seldom accurate in a particular case, and

subjects the transfer to estate tax at the property's full date-of-death value, with appropriate offsets.[85]

2. *Contingent retained life estates and section 2036: Overkill or justified policy decision?*—Under section 2036, where the decedent has at any time transferred property and has retained a contingent life interest in that property, the full date of death value of the property, less the value of any remaining life interest currently enjoyed by another at decedent's death,[86] is included in decedent's gross estate.[87] Moreover, where decedent transferred

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> therefore, may be the subject of adverse selection. Because the taxpayer decides what property to give, when to give it, and often controls the return on the property, use of Treasury tables undervalues the transferred interests in the aggregate, more often than not. Therefore, the committee determines that the valuation problems inherent in trusts and term interests in property are best addressed by valuing retained interests at zero unless they take an easily valued form--as an annuity or unitrust interest. By doing so, the bill draws upon . . . rules valuing split interests in property for purposes of the charitable deduction.

Report on Omnibus Budget Reconciliation Act of 1990, S. 3209, 101st Cong. (1990), 136 Cong. Rec. S15,629, S15,681.

85. Because of § 2001(b) and the regulations under § 2702, the property is not subject to transfer tax twice; rather, the effect of this provision is to include any post-gift appreciation in the decedent's estate. See Regs. § 25.2702-6.

Particularly after the enactment of § 2702, courts and commentators have urged that the issue of what constitutes "adequate and full consideration" under § 2036 in the sale of a remainder interest in property wherein the decedent has retained a life estate is no longer an area with abuse potential and that this language in the statute should be interpreted without regard to the value of what would have been included in decedent's estate had there been a gift of the remainder interest. See Estate of D'Ambrosio v. Commissioner, 101 F.3d 309 (3d Cir. 1996) cert. denied, 520 U.S. 1230 (1997); Wheeler v. United States, 116 F.3d 749 (5th Cir. 1997); Estate of Magnin v. Commissioner, 184 F.3d 1074 (9th Cir. 1999); Ronald H. Jensen, Estate and Gift Tax Effects of Selling a Remainder: Have D'Ambrosio, Wheeler and Magnin Changed the Rules? 4 Fla. Tax Rev. 537 (1999) (Prof. Jensen urges that the decisions in these cases be applied to non-spousal election situations). These cases and commentators have rejected the decision in *Gradow v. United States,* 11 Cl. Ct. 808 (1987), aff'd, 897 F.2d 516 (Fed. Cir. 1990). This author, however, believes that *Gradow* was correctly decided. See Wendy C. Gerzog, Why Gradow Is Still Correct, 89 Tax Notes 551 (Oct. 23, 2000).

86. What is subtracted from the fair market value of the property is the actuarially determined value of the remaining life interest not dependent upon surviving the decedent and currently enjoyed by another at decedent's death. Regs. § 20.2036-1(a). Some have questioned the fairness of this valuation rule's disregard of multiple contingent life estates since the regulation allows a reduction only for the one life estate currently enjoyed at the decedent's death regardless of the existence of more than one contingent life interest that precedes decedent's and therefore not dependent on surviving him. See Regis W. Campfield, Martin B. Dickinson, William J. Turnier, Taxation of Estates, Gifts and Trusts 343-344 (1999).

87. IRC § 2036(a)(1). With respect to property transferred after 1987, unless decedent specifically directs otherwise, his estate may recover the tax attributable to inclusion of property under § 2036 from the transferees of the property. See Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 3031(f)(1), 102 Stat. 3342 (codified at IRC § 2207B). See also

property but retained, during his life, a contingent power to designate who shall enjoy the income or current use of the property, the entire date of death value of the property is included in his estate.[88] The regulations specifically state that "it is immaterial . . . whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death (e.g. the death of another person during the decedent's lifetime)."[89]

Originally, when a decedent transferred property during his life and retained a life estate subsequent to another's life estate (a contingent life estate), where the decedent did not survive the life tenant, the property was not included in decedent's gross estate.[90] It was only in 1932, when Congress amended the predecessor to section 2036 to include the phrase "for any period not ascertainable without reference to his death,"[91] that this language was

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Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1302(b), 111 Stat. 788 (amending IRC § 2207(A) to require a specific contrary direction of decedent to nullify application of the estate's right to recovery).

88. IRC § 2036(a)(2). See Estate of Field v. United States, 143 F.Supp 520, 525 (S.D.N.Y. 1956), rev'd, on other grounds, sub nom, Hollander v. United States, 248 F.2d 247 (2d Cir. 1957) ("Thus, though the donor, according to the letter of the trust instrument, had the power to alter or revoke the interests of his children, the exercise of that power was ineffective unless and until the birth of issue. That might be thought to sterilize it as a generating source of taxation but it fell precisely into the words of Article 20(b)(3) of the Regulations which provided that a power would be considered to have existed on the date of a decedent's death although its exercise 'was restricted to a particular time or the happening of a particular event which had not arrived or occurred at decedent's death.'") *Estate of Field*, 143 F.Supp. at 525. On appeal, the Second Circuit found that a 1951 amendment to the 1939 Code provided retroactive relief for decedent's dying between March 18, 1937 and February 11, 1939. *Hollander*, 248 F.2d at 250.

89. Regs. § 20.2036-1(b)(3)(iii).

90. See May v. Heiner, 281 U.S. 238 (1930) (Interpreting § 302(c) of the 1926 Act to find that the decedent's reservation of a contingent life estate after one she had given her husband did not cause the trust to be includable in her estate). While retained life estates would subject the property to estate tax inclusion, a retained contingent life estate could not do so because the decedent's "death did not effect the transfer of the possession and enjoyment of the property and income to the daughters from and after that time, but, having occurred during the lifetime of the daughters, it foreclosed the possibility of her acquiring a reversionary interest in this half of the property." Nichols v. Bradley, 27 F.2d 47, 48 (1st Cir. 1928). That is, since she did not survive her daughters, "no reversionary interest ever arose in her favor." Id.

91. In the 71 Pub. Res. 131, 46 Stat. 1516 (1931), Congress amended § 302(c) to include the time frame for "any period not ending before his death." This section was again amended the next year to include the phrase "for any period which does not in fact end before his death" as well as the phrase "for any period not ascertainable without reference to his death." See Revenue Act of 1932, § 803(a), Pub. L. No. 72-154, 47 Stat. 279. This language was interpreted as specifically including contingent life estates. See Commissioner v. Nathan's Estate, 159 F.2d 546 (7th Cir. 1947); Marks v. Higgins, 213 F.2d 884 (2d Cir. 1954); Estate of Hohensee v. Commissioner, 25 T.C. 1258 (1956). The legislative history re-enacting this phrase is clear: "The expression 'not ascertainable without reference to his death' as used in section 811(c)(1)(B). . . includes the right to receive the income from transferred property after the death of another person who in fact survived the transferor. . . ." H. Rep. (Conf.) No. 1412, 81st Cong., 1st Sess. (1949) (affirming § 811(c)'s applicability to transfers subsequent to June 7, 1932), reprinted in

intended to change the scope of the Code section to include such contingent retained interests.[92] Because this Code section examines facts as they exist at the time of the transfer and not at the time of the donor's death,[93] "[i]t is irrelevant that the grantor in fact died before her husband [the primary life tenant], since, under the statute, the tax status of the transferred property is determined by the character of the transfer, and not by subsequent events."[94] For a brief time after the 1932 legislation, however, even the government took the position that retaining a contingent life estate that never vested at decedent's death would not cause the property to be included in decedent's

1949-2 C.B. 295-301.

92. According to the current regulations, both this type of factual situation and a contingent retained life estate are examples of the meaning of the phrase "not ascertainable without reference to his death" as used in § 2036. See Regs. §§ 20.2036-1(b)(1)(i) and (ii). The Tax Court, in *Estate of Hohensee*, explained the effect of the 1932 Act amendment: "As of the date of the transfer it was impossible to tell how much decedent would get without knowing when he would die—in other words, a time not ascertainable without reference to his death. This retained interest, in fact, yielded him less than it might have because of the circumstance that he predeceased his wife. But in prospect, when the trust was created, any contingency merely contributed to the question of valuation. The value of the transfer for estate tax purposes is determined by reducing the value of the transferred property by the amount of the outstanding income interest in the wife. [citations omitted]." *Estate of Hohensee*, 25 T.C. 1258, 1261. [citation omitted]. See Estate of Hubbard v. Commissioner, 250 F.2d 492, 496 (5th Cir. 1957) (Because the transfer was made before the effective date of the 1932 amendment, the donor's right to income after the death of the current life beneficiary who survived the donor did not require the property to be included in the donor/decedent's gross estate.) But see Estate of Curie v. Commissioner 4 T.C. 1175 (1945), nonacq., 1945 C.B. 8 (holding that the transfer of additional stock to the trust, which was created in 1928, after the passage of the Revenue Act of 1932 was subject to that Act. The Tax Court also held that a right to income in excess of $12,000 during his wife's life as well as a contingent right to all of the income if the decedent had survived his wife, did not subject the trust to inclusion in decedent's estate. The court considered the phrase " for a period not ascertainable without reference to his death" inapplicable since this phrase was only intended to apply where "decedent actually came into enjoyment of the income, not for his life, but for a period, in the determination of which the date of his death was a necessary element, for example, where the grantor is to receive the income annually but with the provision that none of the income between the last annual payment and his death is to be received by him or his estate." 4 T.C. at 1184).

93. See Estate of Farrel v. United States, 213 Ct. Cl. 622, 627, 553 F.2d 637, 640 (1977) (explaining the difference between §§ 2036 and 2038: "But under the language of 2036(a) there is no compelling reason why the moment of death has to be exclusively important. Unlike section 2038, this provision seems to look forward from the time of transfer to the date of the transfer's death, and can be said to concentrate on the significant rights with respect to the transferred property the transferor retains, not at every moment during that period, but whenever the specified contingency happens to arise during that period so long as the contingency can still occur at the end of the period.").

94. Commissioner v. Estate of Arents, 297 F.2d 894, 896 (2d Cir. 1962).

estate[95] and there was much confusion in the courts and Congress about what to do with cases that involved issues concerning that legislation.[96]

Indeed, there have been occasional instances where courts have been uncomfortable with the lack of a *de minimis* baseline of inclusion with respect to retained contingent interests and they have engrafted their own exceptions to section 2036. Specifically, there is an example of ignoring remote contingencies under section 2036(a)(1) in the Tax Court's decision in *Pardee v. Commissioner*[97] when the court was calculating the amount includable in the decedent's gross estate. In determining the amount of the trust needed to satisfy decedent's obligation to support his two minor children, the court looked only to the fixed monthly amount of decedent's legal obligation. Although the court acknowledged that decedent might have the legal obligation to pay a greater monthly amount while a child was at school or camp, it stated that "this contingency never occurred, and we do not believe the remote possibility should affect the computation."[98] Likewise, the court characterized the decedent's power to use additional trust funds should a court modify the support award as being "dependent upon a contingency beyond the decedent's control which did not in fact occur . . . ."[99] This decision to ignore the value of contingent rights made the calculations easier, but reflects some willingness to apply a *de minimis* exception to what is generally seen as a broadly applied and inclusive Code section.

In *United States v. Byrum*,[100] likewise, the majority of the Supreme Court rejected the government's argument that by retaining voting control of the stock that decedent had transferred to his children, decedent had retained the power to liquidate or merge. Instead, the court held that such a power was "a speculative and contingent benefit which may or may not be realized."[101] In this instance, the broader right (voting) was vested, but a potential beneficial result of exercising decedent's right was cast as "speculative and contingent."

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95. See E.T. 5, 1934-2 C.B. 369, rev'd in T.D. 4729, 1937-1 C.B. 284. See Rev. Rul 67-97, 1967-1 C.B. 380, declaring the 1934 ruling obsolete. In 1937 and in 1938, the Secretary of the Treasury issued two regulations to clarify its change in position. See T.D. 4729, 1937-1 C.B. 284; T.D. 4868, 1938-2 C.B. 356.

96. See supra notes 88, 91-92. In Rev. Rul. 72-611, 1972-2 C.B. 526, the IRS ruled that the transfer of a contingent interest with a retained right to receive income from that property was a transfer within section 2036 where that contingent interest became vested before his death. That is, the contingent remainder interest vested indefeasibly before the donor's death because he did in fact survive "A," the pre-condition to vesting.

97. 49 T.C. 140 (1967), acq., 1973-2 C.B. 3.

98. Id. at 150, n.12.

99. Id. at 150. Actually, one child did attend summer camp for one season for twice the amount of monthly child support (i.e., the $500 payment to the camp exceeded decedent's $250 monthly support for that child). See id. at 142.

100. United States v. Byrum, 408 U.S. at 125 (1972).

101. Id. at 150.

However, the characterization as "speculative or contingent" suggests that, unlike the right to appoint oneself a trustee as in *Estate of Farrel,*[102] a vote for liquidation or merger is "too unlikely to occur." Alternatively, this characterization implies that liquidation (or merger) is too extraordinary or "too great a price to pay" to exercise that right as in *Estate of Smead.*[103] Essentially, in *Byrum*, the Court held that voting control meant control over many corporate decisions, and that decedent's exercise of that control was not discretionary but subject to fiduciary constraints.[104]

Similarly, some courts have held that, with respect to any retained income rights accompanying a transfer of community property from one spouse to another as her separate property, the donor spouse has not retained sufficient rights over the income from that property under state law to include the property in his gross estate.[105] Specifically, one court described the essence of the community property interest in income that the donor spouse possesses in the other spouse's separate property as "an inchoate standing to complain that the other spouse made an excessive or capricious gift to a third party, or to demand an accounting on dissolution of the marriage or partition, alleging the income was used to improve the other spouse's separate property"[106] that does not rise to the level of a right to income under section 2036. Rather, the donor spouse's interest was "a mere expectanc[y]"[107] since the other spouse could have disposed of the property or converted it to non-income producing property, destroying the interest.[108] Thus, while the lower court[109] determined that the right to the income in such a circumstance "was not illusory, but an enforceable right sufficient to require inclusion"[110] of the property under

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102. See infra notes 120-125 and accompanying discussion.

103. Estate of Smead v. Commissioner, 78 T.C. 43 (1982). See infra notes 274-281 and accompanying text.

104. Indeed, it is this latter reasoning (limitation of right because of fiduciary duty) that is the basis for the Tax Court's decision in Estate of Wall v. Commissioner, 101 T.C. 300 (1993), wherein the decedent had retained the power to remove the sole corporate trustee and replace it with another corporate trustee independent from the grantor. See also Rev. Rul. 95-58, 1995-2 C.B. 191 (The IRS ruled that it would accept the decision in *Wall* as well as in Estate of Vak v. Commissioner, 973 F.2d 1409 (8th Cir. 1992) as long as the substitute trustee was neither the grantor nor a trustee "related or subordinate to the decedent (within the meaning of section 672(c))." Rev. Rul. 95-58, 1995-2 C.B. at 191.

105. See, e.g., Estate of Wyly v. Commissioner, 610 F.2d 1282 (5th Cir. 1980) (construing Texas community property law); Estate of Deobald v. United States, 444 F.Supp. 374 (E.D. La. 1978).

106. *Wyly,* 610 F.2d at 1290.

107. Id. at 1291.

108. Id. at 1292.

109. Estate of Castleberry v. Commissioner, 68 T.C. 682 (1977), nonacq., 1978-2 C.B. 3, rev'd sub nom Estate of Wyly v. Commissioner, 610 F.2d 1282 (5th Cir. 1980).

110. *Estate of Castleberry,* 68 T.C. at 690.

section 2036, the Fifth Circuit, in *Estate of Wyly v. Commissioner*,[111] reversed and held that community property interest in the income from separate property "is so limited, contingent, and expectant"[112] that it is not encompassed within the phrase "right to income" as used in that statute.

However, it was the fear of abuse[113] and loss of revenue that motivated Congress quickly to overturn case law and enact the predecessor statute to section 2036.[114] It is that fear of abuse that has resulted in the inclusion of the full value of the property, less the value of the currently held term or life estate, to be included in decedent's estate even when it is very unlikely that decedent will ever receive his contingent retained life interest. In this vein, courts have explained that a threshold, minimal value of that interest is unnecessary so long as the interest is not "illusory." In *Commissioner v. Estate of Church*,[115] the estate had argued that it was extremely improbable that the decedent would have survived all of his siblings and their ten children; "the happening of such a contingency was so remote, the money value of such a reversionary interest was so infinitesimal" to subject the property to estate taxes.[116] Yet, the Supreme Court in *Church* held that subjecting such a retained interest to estate tax was necessary to prevent tax avoidance.[117]

In *Commissioner v. Nathan's Estate*,[118] the decedent's retained contingent interest depended on his surviving his sister, which he did not in fact do. However, the court did not consider that the contingent aspect of that interest was significant: "We cannot lessen the effect or the meaning of the words because the settlor's interest was less certain or the enjoyment of the estate reserved more remote. We feel we must give the words used their fair,

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111. *Wyly*, 610 F.2d 1282 (5th Cir.1980).

112. Id. at 1294.

113. Id. at 1290, ("The purpose of this provision is to prevent circumvention of federal estate tax by use of inter vivos schemes which do not significantly alter lifetime beneficial enjoyment of property supposedly transferred by a decedent."); Estate of Shafer v. Commissioner, 749 F.2d 1216 (6th Cir. 1984) ("[This] Section was enacted to prevent the circumvention of the federal estate law by various inter vivos schemes.").

114. Revenue Act of 1939 § 811(c), Pub. L. No. 76-1, 53 Stat. 121 (Codified at IRC § 811), read:

> 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 (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) 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 . . . .

Section 2036 "corresponds to section 811(c)(1)(B) of the 1939 Code, as amended. No substantive change has been made." 1954 S. Rep., supra note 18, at 469.

115. 335 U.S. 632 (1949).

116. Id. at 636.

117. Id. at 645, 650.

118. 159 F. 2d 546 (7th Cir. 1947).

rightful meaning and we can not make them depend on the size or nature of the settlor's reservation appearing in his transfer."[119]

Likewise, with respect to retained contingent powers, in *Estate of Farrel v. United States,*[120] the taxpayer had argued that the language in the regulations should only apply "where the contingency relates to the 'exercise' of an already existing power, and conversely, to be inapplicable where the power only springs into existence when a trustee vacancy occurs."[121] The court refused, however, to give a narrow reading to the regulation and found that decedent's legally enforceable right to make herself trustee if a vacancy occurred was a "significant, though contingent, power to choose those who shall have possession or enjoyment."[122] The court emphasized that this right was "foreseeable when the trust was created—that it was a real right, neither insignificant nor illusory . . ."[123] The right was exercised twice over "eight years and, if she had lived, may well have had more."[124] Thus, the likelihood of its being used was borne out and the probability of its future use, if calculated at her death but without regard to that fact, was great.[125]

The regulations under section 2036 allow the estate to subtract the value of the remaining outstanding life estate currently being enjoyed by another at decedent's estate because the interest is not dependent upon surviving the decedent and, hence, is not testamentary.[126] Some commentators have argued that all interests, whether currently enjoyed or not, that are not dependent upon surviving the decedent should reduce the value of the property included under section 2036.[127] Yet, to the extent that the decedent has assured himself that should he outlive the life tenant(s), he will continue to enjoy the property or the income from income-producing property for the rest of his life, he is intending to make a testamentary transfer of the entire property. Although he does not actually transfer the entire property at his death, that result is merely fortuitous because he had the bad luck to die before his primary life beneficiary.

From the time of its enactment to the present day, the fear of abuse has been a major motivating factor for this Code section. Because a transfer with even a contingent retained income interest or power is essentially a testamentary transfer, the full value of the property that is really being transferred at the decedent's death should be included in his gross estate.

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119. Id. at 549.
120. 553 F.2d 637 (Cl. Ct. 1977).
121. Id. at 641.
122. Id. at 642.
123. 213 Ct. Cl. at 631; 553 F.2d at 642-643. Id. at 642-43.
124. Id. at 643.
125. *Estate of Farell*, 553 F.2d at 643.
126. See supra note 86 and accompanying text.
127. Id.

Moreover, while this section may apparently dictate a harsh result, the contingency is donor-created so that its remoteness or unlikelihood is controlled entirely by the decedent. By not retaining any kind of life interest in the transferred property, the transfer would have been truly an inter vivos one, not subject to estate tax.

D. *Section 2037: An Express* De Minimis *Rule*

1. *Background of section 2037.*—Section 2037 includes the value of property in decedent's estate[128] where decedent had made an inter vivos transfer[129] in which he has retained a statutorily defined "not insignificant" reversionary interest[130] and wherein the beneficiary cannot enjoy the property except by surviving the decedent.[131]

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128. Only the interest(s) dependent upon surviving the decedent are includable in decedent's estate. See Reg. §§ 20.2037-1(d) & (e), Ex. (3). Estate of Tarver v. Commissioner, 255 F.2d 913, 918 (4th Cir. 1958).

129. A transfer for the purposes of § 2037 may exist with respect to a death benefit paid to an employee's spouse by the act of decedent/employee's employment contract. See, e.g., Estate of Fried v. Commissioner, 445 F.2d 979, 983-984 (2d Cir. 1971); Rev. Rul. 78-15, 1978-1 C.B. 289.

130. A reversionary interest is "not insignificant" where its value exceeds 5% of the value of the property. The reversionary interest is valued by comparing the value of that interest with the value of the property itself, undiminished by any interest(s) not dependent on surviving the decedent. See Regs. § 20.2037-1(c)(4).

131. Section 2037(a) provides:

> (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 after September 7, 1916, 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, if—
>
> (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and
>
> (2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Id. See also Regs. § 20.2037-1(a).

Thus, section 2037 has a survivorship test,[132] requires a retained reversion,[133]

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132. The survivorship test requires that obtaining the enjoyment and ownership of the property could only have been achieved through surviving the decedent. See, e.g., Estate of Thacher v. Commissioner, 20 T.C. 474 (1953)(wherein decedent's wife whose interest was defeasible on her divorce or separation only acquired her interest "absolute and unconditional" on decedent's death). If there is another way by which the beneficiary could have acquired and enjoyed the property, the survivorship requirement will not be met and the property will not be included in decedent's estate under this Code section. To qualify as an alternative means of acquiring the property, i.e. to be an "other event" under the regulations, the means must be real and not illusory. See Regs. §§ 20.2037-1(b), 20.2037-1(e), Ex. (1), (5) & (6). See also Commissioner v. Marshall's Estate, 203 F.2d 534, 539-40 (3d Cir. 1953) (wherein the court held that the possibilities of the beneficiaries' enjoying the property through either a change in Pennsylvania's intestate laws, divorce, or willful neglect, non-provision, or desertion within one year of her death, "taken together" were not "so remote as to be 'unreal.'"), Smith v. United States, 158 F.Supp. 344, 349 (D. Colo. 1957) (where the beneficiary could have obtained enjoyment of the property not only by surviving the decedent, but also by decedent's wife's exercise of a withdrawal power.).

With the Technical Changes Act of 1949, Pub. L. No. 81-378, § 7, 63 Stat. 891 (1949), the predecessor to § 2037 applied to alternative contingencies. See § 811(c)(3)(B), 1939 IRC. This "alternative contingencies" provision was eliminated from § 2037, as enacted in the 1954 Code.

133. IRC § 2037(a)(1). See Regs. § 20.2037-1(c), -1(e) Ex. (2).

While § 2037 requires a retained reversionary interest, the predecessor § 811(c)(1)(C), of the 1939 Code for transfers after October 7, 1949, but before the new provision enacted in the 1954 Code, had no such requirement. During those years, § 811(c) read:

> (3) Transfers taking effect at death—transfers after October 7, 1949—An interest in property transferred by the decedent after October 7, 1949, shall be included in his gross estate under paragraph (1)(c)(whether or not the decedent retained any right or interest in the property transferred) if and only if—
>
> (A) Possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent; or
>
> (B) Under alternative contingencies provided by the terms of the transfer, possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the earlier to occur of (i) the decedent's death or (ii) some other event; and such other event did not in fact occur during the decedent's life. . . .[emphasis added]

See Technical Changes Act of 1949, supra note 132, at § 7(a). When the current version of this section was adopted in the 1954 Code, the pre-October 8, 1949, version requiring that decedent retained a reversionary interest in the transferred property was re-instituted in order to provide relief from the application of Estate of Spiegel v. Commissioner, 335 U.S. 701 (1949). Congress later viewed taxing property when decedent had relinquished all interest in the property as "unduly harsh to subject the property to estate tax merely because the ultimate taker of the property is determined at the time of the decedent's death." 1954 S. Rep., supra note 18, at 123; 1954 H. Rep., supra note 18, at 90.

The reversionary interest requirement of the statute is broadly construed and does not depend on strict property law definitions. The St. Louis Union Trust cases (Helvering v. St. Louis Union Trust Co., 296 U.S. 39 (1935); Becker v. St. Louis Union Trust Co., 296 U.S. 48 (1935) were overturned by Helvering v. Hallock, 309 U.S. 106 (1940), which repudiated formal property law distinctions. For transfers made between the dates of these decisions, Regs. § 20.2037-1(g), (providing relief for taxpayers who relied on the earlier case law).

and excepts those reversionary interests with a minimal value as determined just before decedent's death.[134] The requirement of a reversionary interest includes a possibility either that the transferred property be returned to him or his estate, or that it be subject to his power of disposition.[135] Valuation of the reversionary interest is determined by recognized actuarial principles, including use of the annuity tables.[136] Where reversionary interests are difficult to value,[137] the general rules under section 2031 apply.[138] In determining the five

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134. The 1954 Code revision of the predecessor of § 2037 adopted the 5% rule: "In the future property previously transferred by a decedent will be includable in his estate only if he still had (either expressly or by operation of law) immediately before his death a reversionary interest in the property exceeding 5 percent of its value, that is, if he, prior to his death, had 1 chance in 20 that the property would be returned to him." 1954 S. Rep., supra note 18, at 123; 1954 H. Rep., supra note 18, at 90.

135. IRC § 2037(b)(1) & (2). Prior to the enactment of § 2037 in the 1954 Code, the Supreme Court had held that its predecessor section applied to contingent retained powers as well as interests. See Fidelity-Philadelphia Trust Co. v. Rothensies, 324 U.S. 108 (1945).

136. "The value of a reversionary interest immediately before the death of the decedent shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, under regulations prescribed by the Secretary." IRC § 2036(b). See § 20.2037-1(c)(3). Estate of Bogley v. United States, 514 F.2d 1027, 1039-40 (1975). See generally, Rev. Rul. 76-178, 1976-1 C.B. 273 (The probability of a male 88-years old surviving his female counterpart was calculated by using a special factor supplied by the IRS. Because the reversionary interest exceeded the 5% threshold, the property was included in decedent's estate. The value of the property reduced by the value of the life estate not dependent on surviving the decedent is the value included in decedent's gross estate.) Estate of Roy v. Commissioner, 54 T.C. 1317, 1322-1323 (1970). Stating that:

> decedent's actual health immediately before death is not to be considered in determining the value of his reversionary interest for the purposes of the 5% rule; otherwise, only in cases of accident or unexpected death would section 2037 apply.

137. Where the reversion is dependent upon more unusual situations, such as several measuring lives, the executor may request a factor from the IRS; in addition, the IRS Publication 1457, "Actuarial Values, Book Aleph" may also provide assistance in valuing "more unusual situations." Regs. § 20.2031-7T(d)(4).

While the actuarial tables may be used to compute successive life estates, it is difficult to value reversionary interests dependent on events, particularly where the event involves a voluntary act. See Robinette v. Helvering, 318 U.S. 184 (1943) (wherein a gift was valued without reduction for the donor's retained reversionary interest because that interest, dependent not only on the donor's survivorship but also on the death of his daughter without issue attaining age 21, was unascertainable. "Actuarial science may have made great strides in appraising the value of that which seems to be unappraisable, but we have no reason to believe from this record that even the actuarial art could do more than guess at the value here in question." Id. at 189.) The effect of the holding in *Robinette* was to deny the donor the benefit of a smaller gift, i.e. reduced by the value of the donor's retained interest which could not be valued due to the contingencies imposed by the donor. Unfortunately, however, the holding of this case has sometimes been applied summarily to § 2037 cases with the result that reversions that cannot be valued have been assigned a value of zero and thus allowed to escape taxation under the 5% rule. See, e.g., Commissioner v. Cardeza's Estate, 173 F.2d 19 (3d Cir. 1949) (holding that, the death of decedent's son without issue was considered too speculative to value); Estate of Cardeza v.

percent rule, the courts will not aggregate interests or powers to satisfy this requirement.[139] Also, where the reversionary interest applies to only a portion of the corpus, only that part will be subject to estate tax.[140] Congress wanted to

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United States, 52 A.F.T.R. 1911 (E.D. Pa. 1957), aff'd, 261 F.2d 423 (3d Cir. 1958) (relating to the same estate as the 1949 case). In this case, the court stated that the issue was "whether it can be established that a woman 85 years old has a less than 5% chance of surviving a man of 64 married to a woman of 59 and also any child or children whom he may have in the future." Id. The court found that the value was unascertainable and thus had a zero value. Estate of Graham v. Commissioner, 46 T.C. 415, 426-427 (1966), The court observed, "Decedent's power to dispose of the trust assets immediately before his death was contingent upon survival of the decedent and his wife for 6 years by the decedent's daughters, and the voluntary act of those daughters, or the survivor of them, of terminating the trust." Id. at 426. While the contingency of survival may be calculated, the court said it would be a "mere guess" to quantify such a voluntary act. Id.). But see In re Hill's Estate v. Commissioner, 193 F.2d 724 (2d Cir. 1952) (wherein the court refused to attempt to value a complicated set of factors). "The amount . . . is somewhat speculative and admits of no accurate determination, but we cannot doubt that the right had value at the date of the settlor's death." Id. at 728. The court found the contingency too remote.

> This was conditional upon the complete failure of the daughter's issue. Actuarially it is most unlikely that the estate will receive anything under this provision. At the settlor's death there was alive an infant granddaughter who might marry and have children before the trust terminated. Also, the daughter aged 35 survived; she was married and the prospect that she might have additional children was not improbable.

Id. Although the court cited to both *Cardeza's Estate* and to *Robinette*, and stated that it had no ascertainable value, the court actually attempted to "guess" at its value. If a donor-created contingency cannot be calculated, however, perhaps a more reasonable approach would be to ignore this donor-created contingency and to rely on the survivorship contingency to determine whether or not the de minimis requirement of § 2037 would be met.

With respect to interests that are difficult to value, the IRS has followed the 1954 Committee Reports: "Where it is apparent from the facts that property could have reverted to the decedent under contingencies that were not remote, the reversionary interest is not to be necessarily regarded as having no value merely because the value thereof cannot be measured precisely." 1954 S. Rep., supra note 18, at 469; 1954 H. Rep., supra note 18, at A314. Moreover, with respect to the contingency of a failure of issue, the regulations state that the general rules under § 20.2031-1, are applicable where it cannot be shown that a woman is incapable of having issue. See Regs. § 20.2037-1(c)(3). See also Rev. Rul. 61-88, 1961-1 C.B. 417. But see H. Rep. No. 1412, supra note 91, at 297 (stating that "the rule of Robinette v. Helvering, under which a reversionary interest not having an ascertainable value under recognized valuation principles is considered to have a value of zero, is to apply.").

138. See Regs. § 20.2037-1(c)(3).

139. See, e.g., Estate of Klauber v. Commissioner, 34 T.C. 968 (1960) "Respondent would have us regard each of these elements as 'strings' attached to corpus and somehow add them (in spite of basic differences) in order to determine that the requisite 5 per centum of section 811(c)(2) had been exceeded." Id. at 976. This refusal to aggregate reversionary interests to determine whether they meet the 5% rule contrasts with the Third Circuit's approach to defining an "unreal" alternative contingency. But see Commissioner v. Marshall's Estate, 203 F.2d 534, 540 (3d Cir. 1953).

140. *Estate of Klauber*, 34 T.C. at 975-6.

tax these transfers because, like under section 2036, transfers under section 2037 are considered will substitutes.[141]

Section 2037 applies only to contingent reversions that never vest. If they did vest, section 2033 or 2038[142] would include the value of the property in decedent's gross estate.[143] Section 2037 applies only to retained reversionary interests in the property, but not to retained reversionary interests that only comprise rights to the property's income.[144]

Essentially, section 2037 is instructive as a testing ground for different theories regarding contingencies. The section only covers contingent interests that are destroyed by decedent's death and thus never vest; moreover, it is a section that Congress has, historically, both broadened and then restricted in its application. It parallels section 2036 in that the testamentary nature of the transfer is emphasized; moreover, because it is property once owned by decedent and it is decedent who creates the contingencies and thus determines the conditions under which the property will return to him, in defining its reach, Congress has considered the inherent possibility of abuse.

The *Spiegel* decision, and the initial Congressional approval of that decision, focused on the possibility of tax avoidance, and established the statute's breadth. In the wake of that decision, no actual reversion was required to characterize a transfer taking effect at decedent's death as a testamentary transfer that would cause inclusion of that property in decedent's estate.[145] In *Spiegel,* the court stated:

> The question is not how much is the value of a reservation, but whether after a trust transfer, considered by Congress to be a potentially dangerous tax evasion transaction, some present or contingent right or interest in the property still remains in the settlor so that full and complete title, possession or enjoyment does not absolutely pass to the beneficiaries until at or after the settlor's death.[146]

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141. Estate of Allen v. United States, 558 F.2d 14, 19 (Ct.Cl. 1977) ("The background of § 2037 demonstrates that one of the purposes of the statute is to tax transfers with a reversionary interest contingent on survivorship when they are used as testamentary substitutes.").

142. Section 2038 would apply to retained powers decedent actually held at his death. See discussion infra Part II. E and accompanying notes.

143. It is possible for both §§ 2033 and 2037 to apply, but it would require an unlikely scenario. It would require a secondary life estate in a third person following the life of the decedent with a vested reversion in the decedent.

144. See Regs. § 20.2037-1(c)(2).

145. See supra note 133.

146. Estate of Spiegel v. Commissioner, 335 U.S. 701, 707 (1949). Congress restricted the retroactive application of Spiegel by imposing a 5% de minimis requirement for transfers before October 8, 1949 (as well as by requiring that the reversion be expressed in the transfer instrument). See The Technical Changes Act of 1949, § 7, supra note 132. In 1954, Congress extended the de minimis rule to all transfers when it enacted § 2037. Between October 8, 1949

Indeed, the definition of a "reversionary interest" under section 2037 adopts, like sections 2036[147] and 2038,[148] a broad interpretation of the powers decedent needs to retain in order to cause inclusion under that statute. That is, even the power to withdraw principal for the benefit of another is encompassed within that definition.[149] Where the taxpayer had argued that the powers were too meager for inclusion, the court distinguished the limited inclusion of remote reversions from limited powers over the property.[150] "The clear rationale of these cases is that the decedent is taxable wherever his death is the only event which will guarantee the ultimate beneficiaries that they will take and that the remainder will not be vested in the decedent or someone to be designated by him."[151]

By contrast, the 1954 repudiation of much of an expanded application of section 2037 re-focused on a solution that differentiated between likely and very unlikely returns of the transferred property. In the 1954 version of this statute, a reversion was required for inclusion in decedent's estate and very unlikely reversions, that is, those with less than a five percent chance of returning to the decedent, were exempt from estate tax.[152]

Even the survivorship test, in some sense, appears to have a "remote contingency" or similar threshold. The survivorship test is intended to underline the testamentary nature of the transfer that is subject to inclusion under section 2037. That test is not met if a beneficiary can enjoy the property by an alternate means than by surviving the decedent;[153] however, if that alternative contingency is "unreal," that alternative condition will be ignored so that the beneficiary will be deemed only able to enjoy the property through survivorship.[154]

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and 1954, there was no requirement that decedent retain a reversionary interest for the application of the predecessor to § 2037.

147. See Struthers v. Kelm, 218 F.2d 810 (8th Cir. 1955) (power to control the timing of the beneficiaries enjoyment was a retained power under § 2036.).

148. See Lober v. United States, 346 U.S. 335 (1953) (power to accelerate enjoyment of the trust property was caused inclusion under § 2038).

149. See Estate of Klauber v. Commissioner, 34 T.C. 968 (1960) (trustee's power to pay $4,000 a year to decedent's wife for decedent's life was held includable under the predecessor to § 2037. The trustee's powers were attributable to decedent because the court held that the decedent could control the removal and appointment of any trustee). But see United States v. Byrum, 408 U.S. 125 (1972); Estate of Wall v. Commissioner, 101 T.C. 300 (1993) discussing the attribution of powers of a trustee where decedent retained the power to remove the trustee and appoint one amenable to his wishes with respect to § 2036).

150. See *Estate of Klauber*, 34 T.C. at 974.

151. Id.

152. See supra note 134 and accompanying text.

153. See § 20.2037-1(b). See also supra note 132.

154. In Commissioner v. Marshall's Estate, 203 F.2d 534 (3d Cir. 1953), the court aggregated the alternative contingencies and found that, "The possible contingencies taken together under which beneficiaries could have taken the interest without surviving Marshall

2. *The five percent rule.*—Congress established the five percent rule of section 2037 in the 1954 Code, because it considered it "unduly harsh" to include property in decedent's gross estate where he had relinquished practically all of his rights in the property.[155] On the other hand, Congress considered reversions "under contingencies that were not remote" sufficient interests for inclusions.[156] The five percent rule requires that before his death, decedent "had 1 chance in 20 that the property would return to him."[157]

The main argument for adopting a *de minimis* rule is that the decedent has barely retained any likelihood that the interest will return to him and that his beneficiaries will need to survive him to receive the property so that the transfer is only minimally testamentary in character. That argument is a seductive one, easily understood and apparently objective by its use of numbers.

> The remoteness of it is obvious from the fact that. . . the possible reverter to the settlor was conceivable only if all three of the children of the settlor were to die before he did and were to die without descendants of their own. Disregarding the possibility of descendants of his children, the record shows an actuarial computation of the likelihood that the settlor would survive all three of his children of only about 1 ½ chances out

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cannot be regarded as so remote as to be unreal." Id. at 540. In that case, the beneficiaries could have taken their one-third interests:

(1) by a change in the intestate laws of Pennsylvania, mitigating or eliminating the surviving spouse's share;

(2) under the present intestate laws if Marshall had divorced his wife or she had divorced him;

(3) if Marshall either willfully neglected or refused to provide for Mrs. Marshall for one year previous to her death, or if he willfully and maliciously had deserted her for that period.

See id. at 539. The Tax Court opinion emphasized the lack of the decedent's intention to create a reversionary interest dependent on survivorship, stating that "The language relied upon by the Commissioner is the usual provision inserted by lawyers as a catch-all." 16 T.C. 918, 922 (1951). The transfer at issue was a pre-October 8, 1949, transfer so that to fall within the predecessor statute of § 2037, the reversion had to exist by the express terms of the instrument and not, as § 2037 allows alternatively, by operation of law. See IRC § 2037(a)(2).

The regulation itself provides an example of an "unreal" event, i.e., substituting survivorship with a stated term of years requirement that equals or exceeds the decedent's life expectancy. That is, if the alternative contingency is a 70-year old decedent's surviving a 20-year term, that alternative contingency will be denominated "unreal." Regs. § 20.2037-1(e), Ex. (5).

155. See supra note 133.

156. See supra note 136. (Congress wanted the reversionary interest in § 2037 to be "valued by recognized valuation principles and without regard to the fact of the decedent's death. Where it is apparent from the facts that property could have reverted to the decedent under contingencies that were not remote, the reversionary interest is not to be necessarily regarded as having no value merely because the value thereof cannot be measured precisely." Id.)

157. See supra note 134.

> of 100. On the basis of such a chance of realization, the computation gave a value of about $4,000 to a trust corpus of $1,000,000. To tax the settlor's estate more than $450,000, as is here proposed, because of the existence of this $4,000 worth of a possible reverter is not the kind of taxation that a court can readily imagine that Congress meant to impose.[158]

Indeed, in *Spiegel*, the value of the right to receive $1, for someone the settlor's age, at the time the trust was executed, at the death of the last of the three primary beneficiaries was $0.00390. That figure could be adjusted to reflect the birth of the settlor's three grandchildren who also qualified as trust beneficiaries so as to reduce the value of the reverter from $4,000 to $70.[159]

Congress enacted the five percent *de minimis* rule as a reaction to the numbers in *Spiegel*[160] although another rationale given for the five percent rule was "to bring certainty to the law."[161] Perhaps another rationale for the *de minimis* rule was that it softened the contemporaneous expansion of section 2037 to include unintentional reversions.[162] That is, at the same time the *de minimis rule* was enacted, section 2037 began to apply to implied reversions, created by operation of law, and often due to drafting errors.[163] Thus, the *de minimis* rule may be said to correct those "mistakes" and, in this respect, it could also be viewed as reflecting the transferor's intent that the transfer was not intended to be testamentary.[164] To the extent that section 2037 includes reversions implied by operation of law, it differs from section 2036 and may justify the exception; yet, the *de minimis* exception applies to intentional reversions as well wherein the transfers are, indeed, testamentary in character.

Moreover, if one quantified the powers encompassed by the definition of a reversionary interest within section 2037, limited powers such as those restricted to altering *when* the beneficiaries' would enjoy their vested interests might be considered "remote." Yet, here, no numbers were submitted to Congress to create such a sympathetic exception. In the same manner, valuing the decedent's reversion based on his actual life expectancy rather than on the

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158. *Estate of Spiegel,* 335 U.S. at 727 (J.Burton, dissenting) (applying the computations of the Tax Court).

159. See id. at 733-734 (J. Burton, dissenting).

160. S. Rep. 831, 81st Cong., 1st Sess. 8-9 (1949).

161. Estate of Roy v. Commissioner, 54 T.C. 1317, 1322 (1970).

162. See The Technical Changes Act of 1949, Pub. L. No. 378, § 7, 63 Stat. 891 (1949); IRC § 2037(a)(2).

163. See Boris I.Bittker, Elias Clark, and Grayson M.P. McCouch, Federal Estate and Gift Taxation 345 (7th ed. 1996).

164. Indeed, that was the actual suggestion of J. Burton in his dissent in *Spiegel.* "On the other hand, this element of remoteness provides a thoroughly reasonable consideration which may be combined with other evidence to determine the presence or absence of the factual intent on the part of the settlor which is discussed in the fifth and final proposal." *Estate of Spiegel,* 335 U.S. at 727.

mortality tables has an appeal similar to the argument using numbers to show how little the reversion is worth, but that argument is one that the courts and Congress have uniformly rejected. "Admittedly such a position has appeal and ignites a sympathetic reaction under the facts here present [footnote omitted]. However, we must be mindful of the old adage that 'hard cases make bad law.'"[165] Likewise, by subjectively quantifying these contingent powers and by identifying those donors who are most likely to exercise their limited powers, one might eliminate some property from estate taxation by extending the *de minimis* rule in this way.[166] Yet, again, no such facts and circumstances exception appears in the statute.

By contrast, remoteness created by the transferor makes the focus on numbers less relevant and the apparent harshness or unfairness, less real. By redirecting the focus to the transferor, i.e., the one who created the reversionary interest with those remote contingencies, since he's writing the rules, the likelihood of the event's occurring is not necessarily the best test to determine the application of the estate tax to these transfers. Retention of a remote reversionary interest may be likened to an insurance policy that doesn't cost the donor anything under the current *de minimis* rule; without subjecting any property to estate tax if he should die as expected before the primary life beneficiary, he is assured that in the unlikely event that he does survive the life beneficiary, he will retain the ability to re-assess who will ultimately receive the property.

E. *Section 2038: Powers Vested at Decedent's Death*

Section 2038 includes property that decedent transferred but with respect to which he has retained at his death a power to affect its enjoyment.[167]

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165. Estate of Roy v. Commissioner, 54 T.C. 1317, 1322 (1970).

166. No one would seriously argue that focusing on the subjective intent of the donor/decedent is a workable test, particularly in the estate tax area. Thus, it is good that courts have consistently ignored this factor. See, e.g., Estate of Graham v. Commissioner, 46 T.C. 415 (1966). "For the purposes of section 2037, the fact that decedent expressly declined to exercise the power is irrelevant." Id. at 426.

167. IRC § 2038(a)(1) provides:

> The value of the gross estate shall include the value of all property.—
>
> (1) Transfers after June 22, 1936—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, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death."

When the statute applies, only the value of the interest subject to decedent's retained power is

As the regulations specify, where decedent's power is subject to a contingency beyond his control, section 2038 does not apply.[168] According to the court in *Estate of Farrel*,[169] "Section 2038 looks at the problem from the decedent's death – what he can and cannot do at that specific moment"[170] and contingencies, not within decedent's control, compromise the decedent's ability to exercise a power at death.[171] Thus, because section 2038 only looks at powers held by decedent at his death, this section applies only to powers vested, actually or effectively, at that time. Contingent retained powers are, for the most part, covered by sections 2036 or 2037, including the value of such property in decedent's estate.

Section 2038 provides, however, that a power will be deemed to exist at the decedent's death

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included in decedent's estate. Regs. § 20.2038-1(a).

168. See Regs. § 20.2038-1(b). "However, section 2038 is not applicable to a power the exercise of which was subject to a contingency beyond the decedent's control which did not occur before his death (e.g., the death of another person during the decedent's life). See IRC § 2036(a)(2) for the inclusion of property in the decedent's gross estate on account of such a power."; see also, Jennings v. Smith, 161 F.2d 74 (2d Cir. 1947) (wherein since the contingencies of illness or financial distress had not occurred before decedent's death, the court held that decedent did not have the power at his death to change the enjoyment of the beneficiaries' property and so the predecessor to § 2038, i.e. IRC § 811(d) of the 1939 Code, did not cause the value of that property to be included in decedent's estate; see, e.g., Estate of Yawkey v. Commissioner, 12 T.C. 1164 (1949) (where at decedent's death, none of the beneficiaries was 30 years old, the pre-condition to decedent's having the power to transfer principal to them after age 30 had not occurred so that the property was not included in decedent's estate under the predecessor to § 2038). Where the condition precedent to donor's power to revoke is an act within his control, he has made an incomplete gift. See Rev. Rul. 54-537, 1954-2 C.B. 316.

169. 553 F.2d 637 (1977).

170. See id.

171. Indeed, the essence of § 2038 is that decedent's power "to alter, amend, revoke, or terminate" makes the beneficiaries' interests at least in some way contingent interests until decedent's death. That is, it may be more accurately described as a vested interest subject to defeasance, but such property law distinctions do not control Federal estate taxation. See, e.g., Helvering v. Hallock, 309 U.S. 106 (1940), repudiating such formalities in the context of the predecessor of § 2037. See generally, supra note 133. Even where decedent has retained a power limited to determining the timing of the beneficiaries' receipt of property and where he cannot benefit himself directly from the exercise of his power, their interest is to that extent uncertain and under decedent's control. See Estate of Lober v. United States, 346 U.S. 335 (1953); Regs. § 20.2038-1(a).

Since a § 2038 power can be held by decedent "in whatever capacity exercisable," where decedent has the legal power to replace a trustee, the trustee's powers are attributable to him. See Regs. § 20.2038-1(a)(3). Therefore, decedent may possess at his death a power over the property's enjoyment by virtue of broad discretion given to a trustee. Moreover, incompetence that does not permanently disqualify a decedent from being trustee may nonetheless cause inclusion under § 2038. See Round v. Commissioner, 332 F.2d 590 (1st Cir. 1964). Certain transfers wherein, during a continuous period beginning on or before September 30, 1947, through August 16, 1954, decedent was mentally disabled are exempt from § 2038. See Regs. § 20.2038-1(f).

> even though the exercise of the power is subject to a precedent giving of notice or even though the alteration, amendment, revocation, or termination takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.[172]

Congress engrafted this exception, or clarification, because it considered decedent to have "to all intents and purposes practical, if not technical, ownership . . . although notice may be required as a condition precedent . . . ."[173] Perhaps, however, this addition was unnecessary. That is, the contingency of notice-giving is an act within the decedent's control. Moreover, the effective date after the exercise is not really a pre-condition to decedent's possessing a power at his death unless the statute is interpreted as requiring decedent to have a presently effective as well as presently exercisable power at his death.

A veto power, if contingent,[174] will avoid inclusion under section 2038, but courts have interpreted a non-contingent veto power as another articulation of a joint power[175] so as to cause inclusion of the property subject to decedent's veto power in his estate. In this regard, "... it is irrelevant whether the decedent's participation initiates the termination, or, as here, is in the nature of a consent after others have set the machinery in motion, it being sufficient under the statute merely that she act 'in conjunction with' the others."[176] Thus, to distinguish a veto power as a power that is formally effective after a pre-condition (i.e. the agreement of the other trustees to exercise the power) from any joint decision in which the order of concurrence is unknown and irrelevant, is either to say that Congress intended this particular type of contingency to be within a natural reading of the statutory language "by the decedent in conjunction with any other person" or to allow an exception for a contingent power that is analogous to the exemption of powers with delayed effective dates found in section 2038(b). Any such contingency, however, must be distinguished from a truly contingent veto power, such as the one found in

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172. IRC § 2038(b). The value of decedent's interest, however, is discounted to reflect this delayed effective date. See Regs. § 20.2038-1(b).

173. H. Rep. No. 704, 73d Cong., 2d Sess. (1934), reprinted in 1939-1 C.B. (Part 2), at 581.

174. See, e.g., Estate of Kasch v. Commissioner, 30 T.C. 102 (1958), acq., 1958-2 C.B. 6.

175. See, e.g., Estate of Grossman v. Commissioner, 27 T.C. 707 (1957). For transfers after the Revenue Act of 1924 (June 2, 1924, 4:01p.m EST), joint powers fall within § 2038; for transfers before that time, a decedent's joint power held in conjunction with someone with an adverse interest to its exercise would not fall under the predecessor to § 2038. See §§ 20.2038-1(a) & (d). Section 2038 does not, however, apply where his power requires the consent of all the beneficiaries if his power doesn't increase their rights under local law. See Regs. § 20.2038-1(a)(2).

176. Grossman v. Commissioner, 27 T.C. at 709.

Estate of Kasch, wherein the court rejected the government's emphasis on the form of the decedent's retained power and stated that "[h]is only power was a contingent one to give his written consent to an invasion of the corpus in case his wife or any child or grandchild suffered a period of illness or other incapacity for which other funds were insufficient."[177] In that case, decedent's joint power was itself subject to a contingency beyond his control and thus the property was not includable under section 2038. That is, if a power is subject to an ascertainable standard, there is insufficient control to subject the transfer to estate tax.[178]

Moreover, where the decedent has a presently exercisable power to affect contingent interests of the beneficiaries, the courts have distinguished between a contingent power and a power over a contingent interest, resulting in the value of the contingent interest's being included in his estate.[179] Interestingly, the court in *Estate of Want,*[180] rejected the taxpayer's argument that the value of the contingent remainder was unascertainable or *de minimis,* so that nothing should be included in his estate.[181]

Even if a power is subject to a contingency *within* the decedent's control, however, section 2038 might not apply where the pre-condition is one that has other significant ramifications.[182] For example, where a trust provides

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177. Estate of Kasch v. Commissioner, 30 T.C. at 102, 107 (1958).

178. See, e.g., United States v. Powell, 307 F.2d 21 (10th Cir. 1962) (wherein a power to withdraw funds for the beneficiary's "happiness" was construed as an ascertainable standard similar to "welfare" and "comfort," exempting it from decedent's estate; the court distinguished Merchants National Bank of Boston v. Commissioner, 320 U.S. 256 (1943), interpreting "happiness" as a broader term than these other standards); Estate of Frew v. Commissioner, 8 T.C. 1240 (1947) (wherein a power to withdraw principal for the beneficiaries support and maintenance was held subject to a contingency and not includable under the predecessor to § 2038. Moreover, the contingent "spendthrift" powers depended solely on the beneficiary's voluntary act and therefore were not includable under this section. See id. at 1244-1245.).

179. See, e.g., Estate of Want v. Commissioner, 29 T.C. 1223 (1958) (the contingent beneficiaries interests were dependent upon the death of decedent's only child without issue prior to age 30 and upon the death of decedent's wife); Estate of Graham v. Commissioner, 46 T.C. 415 (1966) while the court held that the decedent had retained a power to alter, amend or revoke a contingent remainder interest the court also found that the value of that interest was unascertainable and, therefore, zero. Id. at 431. Although the court framed the issue in this manner, the question of who becomes ones heirs is perhaps a question more collateral to that decision and, in this case, subject to a pre-condition and thus really a contingent power.

180. Estate of Want v. Commissioner, 29 T.C. 1223 (1958).

181. See id. at 1242-1243. In *Want,* the court stated that "valuation should consider only the simplest of the contingencies, i.e., that Jacqueline should die during decedent's life before attaining age 30 years, the value of the contingent interest, if any, would be considerably less than the full value of the trust corpus." Id. However, the court asked the parties to file computations under the Tax Court's Rule 50 to determine the value of that interest.

182. See Estate of Tully v. United States, 528 F.2d at 1401, 1405-1406 (1976) ("... to conclude that a motive for such action would be the death benefit plan itself is not only speculative but ridiculous.... In reality, a man might divorce his wife, but to assume that he would fight through an entire divorce process merely to alter employee death benefits approaches the

that after-born or adopted children will become additional beneficiaries, ". . . the act of bearing or adopting children is an act of independent significance, the incidental and collateral consequence of which is to add the child as beneficiary to the trust."[183]

Similarly, the Claims Court in *Estate of Tully*[184] rejected the government's argument that decedent had a power of revocation or termination because he could have changed his compensation contract, terminated his employment, or divorced his wife. "The possibility of divorce in the instant situation is so *de minimis* and so speculative rather than *demonstrative, real, apparent* and *evident* that it cannot rise to the level of a section 2038(a)(1) 'power.'"[185] In so doing, the court was adding a type of *de minimis* test for a power's inclusion under section 2038. If, mathematically, one were to concretize this analysis, one might say that where "X" percent of the volitional pre-condition is attributable to voluntary acts unconnected with a reasonable person's decision to activate his retained power, the power will be exempt from section 2038.

It is clear that section 2038 was not intended to apply to contingent powers. The rationale given for this limitation is that the focus is on what decedent owns at his death. If pre-conditions exist to his actually having such powers, the power is said not to exist at his death. Yet, another way of interpreting the statute and the phrase what the decedent holds "at his death" is to say that he actually holds a contingent power at his death, one that has value. Admittedly, this interpretation of the statute is contrary to current regulations and case law precedent, but it is also another way of looking at the asset decedent owns at his death. That is, during his lifetime, decedent transferred property with respect to which, at his death, he has retained something of value. The only difference between this interpretation and the conventional one is a difference in the value of that retained power; it is not really a distinction between a power in existence at his death and one that is not. By means of traditional analysis, moreover, the regulations and case law engraft a *de minimis* exception to section 2038.

F. *Section 2039 and its Relationship to Sections 2036 and 2037*

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absurd."); see also Rev. Rul. 80-255, 1980-2 C.B. 272.

183. Rev. Rul. 80-255, 1980-2 C.B. 272.

184. See supra note 182 and accompanying text.

185. *Estate of Tully*, 528 F.2d at 1406. (Stating that "[w]hile it may be argued that *Tully* kept a certain de minimis association with the death benefit plan, such association never rose to the dignity of a power to 'alter, amend, revoke or terminate' the transfer." Id.).

Section 2039, enacted in the 1954 Code as a clarification of the treatment of joint and survivorship annuities in an employment context,[186] includes in decedent's estate the value of "an annuity or other payment" issued under some kind of employment agreement[187] that a beneficiary is entitled to receive if he survives the decedent and that the decedent had a right to enjoy during his lifetime or before his death.[188] The statute combines a kind of survivorship requirement somewhat similar to section 2037[189] with the time

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186. See 1954 H. Rep., supra note 18, at 90-91and at A314-A315. The report stated that "[i]t is not clear under existing law whether an annuity of that type purchased by the decedent's employer, or an annuity to which both the decedent and his employer made contributions is includable in the decedent's gross estate" and that "[t]his section is new and does not correspond to any specific provisions of existing law." Id. at 90. The report also gave examples of contracts to which section 2039 is applicable. See id. at A314-A315; H. Rep. No. 2543, 83d Cong., 2d Sess. 74 (1954). The statute was intended to tax employee death benefits. See e.g., Estate of Barr v. Commissioner, 40 T.C. 227, 234-235 (1063); Estate of Schelberg v. Commissioner, 70 T.C. 690, 698 (1978), rev'd, 612 F.2d 25 (2d Cir. 1979); Bahen's Estate v. United States, 305 F.2d 827, 835 (1962) (Congress wanted to tax "a large share of employer-contributed payments to an employee's survivors."). Id.

187. Decedent's rights under different employee plans will be considered together to determine the applicability of § 2039. "The scope of section 2039(a) and (b) cannot be limited by indirection." Regs. § 20.2039-1(b)(ii) Ex. (6). See also Looney v. United States, 569 F.Supp. 1569 (M.D. Ga. 1983) (combining the company's Disability Plan with its Survivor Benefits Plan).

188. Section 2039 provides:

> (a) General.—The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another 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.

Congress had created exceptions for benefits relating to qualified plans (originally designated as IRC § 2039(c)) and IRA's (§ 2036(e)), which were enacted by the Tax Reform Act of 1976. See H. Rep. No. 94-1380, 94th Cong., 2d Sess. 68-70), and for annuities resulting from community property laws (replacing the above as § 2039(c)), but the exceptions have been repealed. See 100 Cong. Rec. 3436 (March 17, 1954) (Statement of Mr. Byrnes); 1954 S. Rep., supra note 18, at 123-124 (the exception for certain qualified plans to the House Bill). Pub. L. No. 98-369, § 525(a) (i.e., The Deficit Reduction Act of 1984), repealed the special provisions of §§ 2039(c)-(g) for qualified plans) and Pub. L. No. 99-514, § 1852(e)(1)(A) (i.e., The Tax Reform Act of 1986), repealed the special provision relating to annuities created by community property laws.

Section 2039 is not an exclusive section and other statutes may apply; however, § 2039 does not include insurance on decedent's life. 1954 S. Rep., supra note 18, at 470 ("This section does not, however, apply to insurance under policies on the life of the decedent to which § 2042 is applicable.").

189. See Regs. § 20.2039.1(b)(2) Ex. (5), (wherein, according to the company's plan, the employee would receive ½ at age 60, his retirement, and his named beneficiary would receive the other ½ at his death; but if the employee died before age 60, the beneficiary would receive all of the annuity. According to the example, if the employee died before age 60, all would be included under § 2039).

frames and lifetime rights parallel to section 2036.[190] The amount includable is proportionate to the amount of the decedent's (or employer's) contributions.[191] However, when the beneficiary's benefits are forfeitable on the happening of certain events, those contingencies affect the value of the payments received and thus reduce what is included in decedent's estate.[192]

The regulations define the terms "other payment" and "agreement"[193] very broadly[194] and the survivorship requirement allows for alternative contingencies.[195] Under the regulations, "[t]he payments may be equal or unequal, conditional or unconditional, periodic or sporadic."[196] Further,

> [t]he decedent 'possessed the right to receive' an annuity or other payment if, immediately before his death, the decedent had an enforceable right to receive payments at some time in the future, whether or not, at the time of his death, he had a present right to receive payments. In connection with the preceding sentence, the decedent will be regarded as having had 'an enforceable right to receive payments at some time in the future' so long as he had complied with his obligations under the contract or agreement up to the time of his death.[197]

Although the beneficiary must survive the decedent for section 2039 to apply, if, for example, the decedent must also die before a certain age for the beneficiary to receive payments under the employer's plan, the additional required contingency will not take the transfer out of section 2039; by contrast, under similar facts, the survivorship requirement of section 2037 would not apply.

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190. The time frames in § 2039 copy verbatim the time frames in § 2036. "For the meaning of the phrase 'or 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', see section 2036 and 20.2036-1." Regs. § 20.2039-1(b)(ii). Significantly, the application of § 2039 relates to an agreement or contract entered into after March 3, 1931, the date of the Joint Resolution enacting the predecessor to § 2036. See supra notes 73-75.

191. IRC § 2039(b). See also Regs. § 20.2039-1(c).

192. See Regs. § 20.2039-1(b)(2) Ex.(2).

193. "The term 'contract or agreement' includes any arrangement, understanding or plan, or any combination of arrangements, understandings, or plans arising by reason of the decedent's employment." Id. § 20.2039-1(b)(1)(ii). Even where the employer is under no legal obligation to pay benefits, "[i]f, however, it can be established that the employer has consistently paid an annuity under such circumstances, the annuity will be considered as having been paid under a 'contract or agreement.'" Regs. § 20.2039-1(b)(2), Ex. (4).

194. However, the contract or agreement must arise from decedent's employment and not from benefits receivable by statute. See, e.g., Rev. Rul. 81-182, 1981-2 C.B. 179 ("The value of monthly benefits payable to decedent's spouse under section 402(e) of title 42 of the United States Code (the Social Security Act) is not includable in the decedent's gross estate.")

195. See supra note 189.

196. Regs. § 20.2039-1(b)(1)(ii).

197. Id.

Courts have held two, divergent, interpretations of the definition of "other payment." On the one hand, the Claims Court[198] and Tax Court[199] have held that this term includes decedent's right to disability payments despite the fact that he died without ever having received any payments. Those courts determined that because his rights were nonforfeitable, decedent had, at his death, the right to receive disability payments that were includable in his estate under section 2039. According to the court in *Estate of Bahen*, a "decedent's interest in future benefits, even if contingent, is sufficient."[200] Moreover, the court cited to legislative history of the statute that indicated that Congress wanted this statute interpreted along the lines of section 2036[201] and considered the remoteness of the contingency irrelevant.[202]

On the other hand, the Second Circuit in *Estate of Schelberg v. Commissioner*[203] agreed with the estate's argument that the decedent's rights were "too contingent to meet the condition of section 2039(a)"[204] and interpreted the term "other payment" as excepting certain remote contingencies:

> Even more plainly Congress was not thinking of disability payments that an employee would have had only a remote chance of ever collecting had he lived. Not only are the disability payments in this case extremely hypothetical, they are also far from the 'annuity or other payment' contemplated by Congress. Courts have, consistent with basic principles of statutory construction, recognized that 'annuity or other payment' does not mean 'annuity or other payment,' but that

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198. Estate of Bahen v. United States, 305 F.2d 827 (1962). See also Looney v. United States, 569 F.Supp. 1569 (M.D. Ga. 1983).

199. Estate of Schelberg v Commissioner, 70 T.C. 690 (1978), rev'd, 612 F.2d 25 (2d Cir. 1978). ("Upon the happening of a contingency over which neither he nor IBM had any control – namely his becoming permanently and totally disabled at least 52 weeks before reaching the normal retirement age of 65 – decedent would have become entitled to the payments under the Disability Plan.")

200. Estate of Bahen v. United States, 305 F.2d 827, 831 (1962). According to the court, "The right they possessed may have been contingent but it was not at the whim of the employer." Id. at 831.

201. See 1954 H. Rep., supra note 18, at A314-316; 1954 S. Rep., supra note 18, at 470 ("The rules applicable under section 2036 in determining whether the annuity or similar payment was payable to the decedent, or whether he possessed the right thereto, for his life or such periods shall be applicable under this section."); *Estate of Bahen*, 305 F.2d at 832.

202. "We are not inclined to believe that, with potential disability payments of the type involved here, it makes any difference under Section 2039 how probable it is that the decedent would, if he had lived, have obtained the benefits. But we point out that, if Mr. Bahen had survived his heart attack on November 11, 1955, it is not far-fetched to believe that he might have become totally disabled before reaching retirement age." Id. at 832, n.11.

203. 612 F.2d 25 (2d Cir. 1979). See also Estate of Van Wye v. United States, 686 F.2d 425 (6th Cir. 1982).

204. *Estate of Schelberg*, 612 F.2d at 29.

the phrase is qualitatively limited by the context in which it appears.[205]

The court proceeded to distinguish *Estate of Bahen* as being on that side of the line, as more like post-retirement benefits; it stated that the facts in *Estate of Schelberg* showed benefits more like sick pay, a substitute for wages that had been held not to constitute "other payment."[206] While the court outlined this issue in terms of whether the disability payments were more like wages than a retirement survivor annuity, the court also framed the issue around whether remote contingencies are covered by section 2039 and, in this context, the Second Circuit held that they are not.

By contrast, based on *Estate of Bahen*, the Seventh Circuit in *Estate of Wadewitz v. Commissioner*[207] held that section 2039 "includes a right to possess in the future even if such right is contingent upon the happening of an event as long as the contingency is not within the control or discretion of another."[208] The court emphasized that the decedent's rights to contract payments were solely within his control. That is, the company had no discretion about paying decedent or his named beneficiaries; only the decedent had control over his decision to retire and to avoid certain competitive acts specified in the contract.[209] If the company had had that discretion, the court noted, then the decedent would not have possessed a right, "but a mere expectancy."[210]

While the legislative history of section 2039 would suggest otherwise,[211] this statute is read differently from section 2036 with respect to

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205. Id. at 32-33.

206. See, e.g., Estate of Fusz v. Commissioner, 46 T.C. 214, 217 (1966) acq. in result, 1967-2 C.B. 2 ("Obviously, current compensation 'payable to the decedent' cannot also be 'receivable by any beneficiary.'"); Looney v. United States, 569 F.Supp. 1569, 1574 (M.D. Ga. 1983) (characterizing payments under IBM's Disability Plan as "post-employment" benefits, the court distinguished those from the company's Sickness and Accident Plan, wherein "it is assumed that at some point in the near future he will be able to return to active employment.")

207. 339 F.2d 980 (7th Cir. 1964).

208. Id. at 983. The Tax Court had held only that § 2039 requires the right to receive future payments and not that decedent began to enjoy his interest during his lifetime. Estate of Wadewitz v. Commissioner, 39 T.C. 925, 939 (1963), aff'd, 339 F.2d 980.

209. See also Silberman v. United States, 333 F.Supp. 1120, 1127 (W.D. Pa. 1971) (citing both *Wadewitz* and *Bahen* and holding that where the contract did not require significant services, but only advice and consultation, for decedent to qualify for payments, they contemplated retirement and, thus, § 2039 applied.). But see Kramer v. United States, 406 F.2d 1363 (1969) (wherein the court held that because the facts had been fully stipulated and because the court could not read into the facts whether or not decedent's agreement to serve as an advisor and counselor was an employment or a retirement agreement. This was despite the fact that the decedent would be paid the same amount even if he became incapacitated and that his widow would receive a continuation of these benefits after decedent's death).

210. *Estate of Wadewitz,* 339 F.2d at 983.

211. See supra notes 190, 201.

contingent payments. While the government has stopped litigating this issue[212] and has acceded to the Second Circuit's decision in *Estate of Schelberg*,[213] it has done so without any formal ruling. With the government's acceptance of *Schelberg*, however, decedent's right to receive an "annuity or other payment" means decedent's right to an annuity or other payment, except one that the decedent is unlikely to receive, engrafting a *de facto, de minimis* exception to this statute.

G. *Section 2040: A Statute with Artificial Rules of Inclusion*

For non-spousal property, section 2040 enunciates two rules:[214]

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212. Although the government's official position, as stated in A.O.D. 1981-14, indicated that they would "continue to litigate this issue in other circuits," they have apparently changed their minds. See Richard Holz, Properly Structured Death Benefit Plans Can Avoid Estate and Gift Tax Consequences, 15 Est. Planning 100, 101 (1988) ("Despite its victory in *Looney*, the Service decided not to contest the results reached by the Sixth Circuit in *Van Wye* and the Second Circuit in *Schelberg*. Accordingly, in an unreported development, a consent judgment was subsequently entered in favor of *Looney's* estate. The Service's concession appears to resolve in favor of the taxpayer the issue of whether contingent, future benefits under a disability plan must be combined with death benefits in applying section 2039."); John R. Cummins, Turney P. Berry and Martin S. Weinberg, Using the Service's New Handbook for Estate Tax Examiners, 68 J. Tax'n 276, 282, n.28 (1988). In Looney v. United States, 569 F.Supp. 1569, 1574-1575 (M.D. Ga. 1983), the court found that the decedent, after five years in service with IBM, had an enforceable right to receive the disability benefits; the court rejected the taxpayer's reliance on *Schelberg* despite the same facts and agreed with *Bahen*.

213. 612 F.2d 25 (2d Cir. 1978).

214. Section 2040(a) provides:

> (a) General Rule.—The value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants with right of survivorship by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth: Provided, That where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such other person from the decedent for less than an adequate and full consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: Provided further, That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy by the entirety by the decedent and spouse, then to the extent of one-half of the value thereof, or, where so acquired by the decedent and any other person as joint tenants with right of survivorship and their interests are not otherwise specified or fixed by law, then to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants with right of survivorship.

For examples of the percentage of consideration rule, see Regs. § 20.2040-1(c), Ex. (1)-(6). For examples of the fractional interest rule, see Regs. § 20.2040-1(c), Ex. (7) and (8).

(1) for purchased property, the full value of the property is included in the decedent's estate minus amounts shown to be provided by the contributions[215] of the other joint tenant(s); and (2) for gifts or inherited jointly-owned property, the decedent's fractional share is included in his estate.

The essential feature of a joint tenancy is the condition or contingency of survivorship;[216] a joint tenant only owns the entire property outright if he survives the other joint tenant(s). In other words, a joint tenancy may be viewed as the equivalent of a life estate with a contingent remainder, contingent on surviving the other joint tenant.[217] However, section 2040 covers only that contingency inherent in the property law concept of a joint tenancy with the right of survivorship or a tenancy by the entireties; because of the nature of the property interest, no other contingency can be explicitly imposed on the creation of a joint tenancy. Decedent's interest disappears at his death and, immediately, the other joint tenant owns the property outright. If, however, there were conditions imposed in order for the joint tenant to take, the contingencies would effect a severance of the joint tenancy, and thereby create a tenancy in common.[218]

If, for example, the right to possess jointly held property is subject not only to the contingency of survivorship, but also to the condition that the surviving joint tenant did not murder the decedent,[219] the joint tenancy is

215. With respect to appreciated property given as a gift by one of the joint tenants to another, the entire value of the property will be seen as the donor's, assuming he had purchased it, despite that the value of the property appreciated while in the hands of the donee; however, if the donee sold the appreciated property, the amount of gain, but not the original cost, will constitute consideration from that donee/joint tenant. See Estate of Goldsborough v. Commissioner, 70 T.C. 1077 (1978), Rev. Rul. 79-372, 1979-2 C.B. 330; Regs, § 20.2040-1(c), Ex. (4). Likewise, income from income-producing property under the above set of facts is treated like gain from the property. See Regs. § 20.2040-1(c), Ex. (5). For contribution adjustments due to subsequent unequal contributions towards improvements, see Estate of Peters v. Commissioner, 386 F.2d 404 (4th Cir. 1967).

216. See United States v. Jacobs, 306 U.S. 363, 370 (1939).

217. See Estate of Sullivan v. Commissioner, 175 F.2d 657 (9th Cir. 1949).

218. In jurisdictions that recognize a tenancy by the entirety, state law does not allow creditors to reach this type of property interest. See, e.g., Sawada v. Endo, 561 P.2d 1291 (Hawaii 1977); Central Nat'l Bank of Cleveland v. Fitzwilliam, 465 N.E.2d 408 (1984).

219. According to the Restatement, if a donee criminally causes the donor's death, he is precluded from benefiting under a will or will substitute. See Restatement (Second) Property; Donative Transfers § 34.8, statutory note 11 (1992) (citing state statutes providing that the murderer cannot receive the victim's one-half interest; the death severs the interest and the surviving joint tenant becomes a tenant in common with decedent's heirs). Moreover, most states have enacted laws that reflect the public policy of prohibiting a murderer from materially benefiting from homicide. See, e.g., Ga. Code Ann. § 53-4-6 (2000); D.C. Code Ann. § 19-320 (2000); Cal. Prob. Code § 250 (Deering Ann. 2000); Ala. Code § 43-8-253 (2000). See also Estate of Grund v. Grund, 648 N.E.2d 1182 (Ind. Ct. App. 1995). Likewise, the Federal government may seize property used or acquired from trafficking in illegal drugs; however, where property is held in a tenancy by the entireties, the criminal spouse's survivorship right may be

severed and decedent receives only his one-half interest as a tenant in common with the other half passing to the victim's estate.[220] Under such a situation, the IRS has ruled that section 2040 is inapplicable and section 2033 would apply to the decedent's interest that did not terminate at death.[221] Likewise, in the instance of simultaneous death, the joint tenancy is treated as a tenancy in common.[222]

For property owned solely by husband and wife jointly with the right of survivorship, the rule is that one-half of the fair market value of the property is included in the decedent's estate.[223] Congress created, and changed, the rule under section 2040(b) to simplify the administration of the general rule of this section where, as between married individuals, there were particular problems with tracing issues.[224] Moreover, within a spousal context, because of the

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forfeited. See 21 U.S.C. § 881. Some courts impose a constructive trust even where there is a conflicting statute. See *Estate of Karas*, 485 A.2d 1083 (N.J. App. Div. 1984). See also Restatement (Second) Property; (Donative Transfers) § 34.8, statutory note 6 (1992)(citing caselaw wherein courts have imposed a constructive trust.)

220. See Unif. Probate Code § 2-803(c)(2).

221. Rev. Rul. 78-166, 1978-1 C.B. 283.

222. See Unif. Simultaneous Death Act § 3.

223. IRC § 2040 provides:

(b) Certain Joint Interests of husband and Wife—

(1) Interests of spouse excluded from gross estate—Notwithstanding subsection (a), in the case of any qualified joint interest, the value included in the gross estate with respect to such interest by reason of this section is one-half of the value of such qualified joint interest.

(2) Qualified Joint Interest Defined—For purposes of paragraph (1), the term "qualified joint interest" means any interest in property held by the decedent and the decedent's spouse as—

(A) tenants by the entirety, or

(B) joint tenants with right of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants.

Section 2040(b), to deal with spousal joint tenancies, was originally added by the Tax Reform Act of 1976, effective for joint tenancies created after December 31, 1976. See Pub. L. No. 94-455, §§ 2002(c)(1), 2002(d)(3). The Revenue Act of 1978 added §§ 2040(d) and 2040(e) to allow pre-1977 joint tenancies to qualify under the new 50% inclusion rule and § 2040(c) to make spousal services qualify as consideration for jointly held farm or trade or business property in which both spouses materially participate. See Pub. L. No. 95-600, §§ 511(a), 702(k)(2). Congress enacted the current version of § 2040(b) in the Economic Recovery Tax Act of 1981, when Congress at the same time repealed subsections (c) through (e). See Pub. L. No. 97-34, §§ 403(c)(1), 403(c)(3)(A).

224. See S. Rep. No. 97-144, 97th Cong., 1st Sess. 127 (1981) [hereinafter 1981 S. Rep.] ("[T]he committee believes that the taxation of jointly held property between spouses is complicated unnecessarily. Often such assets are purchased with joint funds making it difficult to trace individual contributions. . . . Accordingly, the committee believes it appropriate to adopt an easily administered rule under which each spouse would be considered to own one-half of jointly held property regardless of which spouse furnished the consideration for the property."). The rule also acknowledged the services furnished by the widow as contributions to the acquisition of jointly held property. See H. Rep. No. 94-1380, 94th Cong., 2d Sess. 20 (1976).

unlimited marital deduction, such a rule would not affect the estate's tax liability although it could have an impact on the surviving spouse's income tax liability when she sold the property.[225]

Section 2040 provides artificial constructs as rules of inclusion for jointly held property.[226] Because they are artificial, typical valuation rules such as minority discounts or control premiums that are reflective of real market phenomena do not apply.[227] In this way, this section parallels sections 2036 and 2037 that do not follow a mathematical rule of inclusion.

H. *Section 2041: Parallels to Sections 2033 and 2036-2038*

1. *Background and introduction to section 2041.*—Section 2041[228] is most comparable to section 2033,[229] the section that includes in decedent's gross estate property owned by decedent at his death. But, because the Supreme Court in *Helvering v. Safe Deposit & Trust Co. of Baltimore*[230] declined to

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225. "In light of the unlimited marital deduction adopted by the committee bill, the taxation of jointly held property between spouses is only relevant for determining the basis of property to the survivor (under sec. 1014) and the qualification for certain provisions (such as current use valuation under sec. 2032A, deferred payment of estate taxes [under sec. 6166] and for income taxation of redemptions to pay death taxes and administration expenses under sec. 303)." 1981 S. Rep., supra note 224, at 127.

226. These rules do not apply to community property or to property held as tenants in common. See 1981 S. Rep., supra note 224, at 126.

227. Estate of Young v. Commissioner, 110 T.C. 297, 316 (1998) ("As a result of this artificial inclusion, we conclude that section 2040 is not concerned with quantifying the value of the fractional interest held by the decedent (as would be the case under section 2033." The court thus denied the application of a fractional interest discount and a lack of marketability discount to the property included under section 2040.").

228. Section 2514 is the gift tax equivalent to § 2041 and concerns the inter vivos transfers resulting from an exercise of a general power of appointment. For example, if a holder of a general power of appointment that allows him to withdraw $20,000 from a trust releases that power this year, that declaration that he will not take the money results in the remainderman's being $20,000 richer. Thus, he is making a gift of that amount and is thereby subject to gift taxes.

229. "General powers of appointment should continue to be subjected to gift or estate tax. Such powers are too much like outright ownership to be treated differently." K. Jay Holdsworth, et. al., Report on Transfer Tax Restructuring, 41 Tax Law. 395, 412 (1988) [hereinafter Report on Transfer Tax Restructuring].

230. 316 U.S. 56 (1942). In Safe Deposit & Trust Co. of Baltimore, the decedent was the income beneficiary and held a testamentary power of appointment in three trusts created by others. In addition, in one of the three trusts, he was to have received the corpus at age 28. See id. at 58). The government had argued that his ownership rights in these trusts were essentially fee simple ownership interests, but the estate argued that they were not equivalents as the restrictions on alienation and income use were significant; further, because the decedent died before he reached 21, he could not make a will to transfer the property at his death. See id. While agreeing "that the realities of the taxpayer's economic interest, rather than the niceties of the conveyancer's art, should determine the power to tax," the Court did not reach its decision based on an analysis of the equivalence of decedent's rights and ownership, but on Congressional intent. Id. at 59, n.1. "We find it unnecessary to decide between these conflicting contentions on the

extend the purview of section 2033 to include unexercised testamentary powers of appointment, section 2041 deals specifically with powers of appointment in situations where decedent never first owned the property outright.[231] Section 2041 basically views a donee general power of appointment, which is defined as a power to appoint the property either to decedent, decedent's creditors, decedent's estate, or the creditors of decedent's estate,[232] as an equivalent of decedent's ownership of that property.[233]

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economic equivalence of the decedent's rights and complete ownership. For even if we assume with the Government that the restrictions upon the decedent's use and enjoyment of the trust properties may be dismissed as negligible and that he had the capacity to exercise a testamentary power of appointment, the question still remains: Did the decedent have 'at the time of his death' such an 'interest' as Congress intended to be included in a decedent's gross estate under §302 (a) of the Revenue Act of 1926? It is not contended that the benefits during life which the trusts provided for the decedent, terminating as they did at his death, made the trust properties part of his gross estate under the statute. And viewing §302 (a) in its background of legislative, judicial, and administrative history, we cannot reach the conclusion that the words 'interest . . . of the decedent at the time of his death' were intended by Congress to include property subject to a general testamentary power of appointment unexercised by the decedent." Id. at 58-59 (Footnote omitted.) The Court proceeded to review case law under the predecessor section contained in the Revenue Act of 1916, wherein the Court had held that exercised and, by logical extension, that unexercised general powers of appointment were outside decedent's interests contained in that statute. Likewise, the same provision was reenacted in the Revenue Acts of 1921 and 1924 and so the Court considered that when the then current provision was enacted, the same language should be interpreted the same way so as not to include unexercised powers of appointment. Further, the regulations subsequent to the 1926 legislation did not indicate a new treatment for these interests. Id. at 59.

231. Other sections deal with property once owned by decedent but transferred to another while retaining powers over the property. See, e.g., §§ 2036 and 2038.

232. See IRC § 2041(b)(1).

233. In part to reconcile the Code sections dealing with transfers of property owned outright with retained powers and/or interests, as well as what Congress considered the differences between outright ownership and owning a general power of appointment under § 2041 or at least concessions Congress made to certain perceived differences employed as typical estate planning modes of the time, Congress made some exceptions to the definition of a general power of appointment. See 1984 Treasury Reform, supra note 12, at 384 ("the purpose of this [term 'general power of appointment'] is to include in a decedent's estate property with respect to which the decedent possessed virtually the same control as if the property were owned outright. Thus, a power will not be classified as a general power of appointment if it can be exercised only in conjunction with the creator of the power or in conjunction with a person having a 'substantial interest' in the property that would be adversely affected by the exercise of the power of appointment. Moreover, a power will not be classified as a general power of appointment if the ability to exercise the power is limited by an 'ascertainable standard' relating to the support, health, education, or maintenance of the holder.") See also IRC §§ 2036-2038. The Treasury Department, however, argued that the exceptions have actually contributed to the disparity in treatment between ownership and powers of appointment and should therefore be eliminated. See id. at 384-385.

If the power to withdraw the $20,000 is held jointly with the creator of the power, for example, Congress didn't want the property that would be includable in the creator's estate under §§ 2036 and/or 2038 also to be included in the donee's, holder of the power of appointment's, When a general power of appointment is a power to appoint property

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estate in the event that the donee predeceased the creator. See § 2041(b)(1)(C)(i); see also Sen. Rep. No. 382, 82d Cong., 1st Sess. 5 (1951), reprinted in 1951 U.S.C. Cong. & Ad. Serv. 1530, 1533 [hereinafter 1951 S. Rep.] ("since in this case the property would be includable in the gross estate of the creator of the power.") [hereinafter 1951 S. Rep.]. Note that for a power created on or before October 21, 1942, no joint powers are considered as owned by the decedent, since they are excepted from the general power of appointment definition. See § 2041(b)(1)(B).

If the property had been jointly owned in fee simple, § 2040 would have produced that same result as this exception since the creator, having provided all of the consideration, would have had the full value included in his gross estate while the donee joint owner, under that same rule, would have had none of the property included. See supra note 214.

In addition, Congress imposed an exception to § 2041 wherein the donee holder of the power held the power together with someone having a substantial interest in the property that is similar to the exception present in the gift tax regulations as well as those in the grantor trust rules. See §§ 672(a), 674(a), 677(a), 2041(b)(1)(C)(ii). See also Regs. § 25.2511-2(e). ("A donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom.") Thus, the donor does not have the power if it is held in conjunction with someone having a substantial adverse interest. Likewise, a power of appointment is not taxable in decedent's estate where the holder of the power may only exercise that power with someone holding such substantial adverse interest in the exercise of the power. See id. § 672(a) defines an "adverse party." Distinctions focusing on whether the grantor holds a joint power with an adverse or nonadverse party are central to determining the incidence of taxation under §§ 674-677. "Principles developed under the income and gift taxes will be applicable in determining whether an interest is substantial and the amount of property in which the adversity exists." 1951 S. Rep., supra, at 1534.

In these instances, the theory is that an adverse party's own interests would produce a natural conflict with the decedent's exercise of his power; that is, the holder of the power is going to have so much inherent difficulty from his lack of freedom in these situations, that it's hard to say that he really owns the property. Section 2040 does not have such a parallel provision; however, the ability to exercise the rights and powers of ownership cannot be blocked by a joint tenant in the same way as a joint power can function. If decedent jointly owned property outright with anyone who had a substantial adverse interest to the exercise of any power, independent of that joint tenant, he would have a unilateral right to partition, resulting in his owning his proportionate share of the property as a tenant in common. By contrast, where a donee held a power of appointment jointly with someone with an adverse interest to his exercising that power, the decedent would not have free access to even one-half of the property.

Finally, if the holder of a power of appointment has a power limited by an "ascertainable standard relating to the health, education, support, or maintenance of the decedent," § 2041 exempts that power from inclusion in the holder's estate. Here, like in the judge-made exceptions found in §§ 2036 and 2038, decedent's control is seen as limited by the courts and thus is not an equivalent to ownership. See § 2041(b)(1)(A). "If the holder of a power is legally accountable for its exercise or nonexercise, the power is not deemed to be a general power." 1951 S. Rep., supra, at 1534; Leopold v. United States, 510 F.2d 617 (9th Cir. 1975); Old Colony Trust Co. v. United States, 423 F.2d 601 (1st Cir. 1970). Critics have suggested that where decedent's power is limited to those four, he is not very limited at all, and indeed "owns" the property, but the statute retains that exception. See, e.g., Erwin N. Griswold, Powers of Appointment and the Federal Estate Tax, 52 Harv. L. Rev. 929 (1939); Richard W. Harris, Ascertainable Standard Restrictions on Trust Powers under the Estate, Gift, and Income Tax, 50 Tax Law. 489, n.118 (1997) ("[I]t is difficult to understand why property subject to such a power of invasion should not be included in the powerholder's gross estate.").

to the decedent, a donee power of appointment is essentially the equivalent of a fee simple interest. After all, if decedent can withdraw $20,000 from a trust, he owns the $20,000. The act of withdrawal is the only condition required for him to own the property outright and that condition is one wholly within his control. It may be considered a contingency as it is a condition precedent to possession, but it is not a condition precedent to ownership whose essential feature is control.

Likewise, a power to appoint property to one's creditors is essentially like ownership of a fee interest. That is, if the trustee can withdraw the $20,000 to pay for debts incurred by decedent, decedent owns the property. Although decedent must first incur a debt before such a power of appointment may be exercised, this type of general power of appointment mostly just adds indirection to the transfer. The conditions precedent or contingencies are, like with the power to appoint property to oneself, within the control of the holder of the power.

A testamentary power of appointment is less of an equivalent to a fee interest since the property cannot be withdrawn from the trust during the decedent's lifetime. However, one of the primary indicia of ownership is the ability to transfer property at one's death. While decedent's death may be seen as a condition precedent for such a power, since death is one of the two inescapables, it is not as much a contingency as a timing factor.

A testamentary power to appoint property to one's creditors is a combination of indirection and delayed payments, but despite any discount accorded for the time value of money, the holder's control indicates ownership roughly equivalent to a fee interest. One could spend money fairly freely during one's lifetime and then appoint one's trust property to one's creditors at death.

Because section 2041 is an equivalent to ownership, there is another aspect of the statute that parallels sections 2035 through 2038. In those latter sections, decedent initially owned the property outright, but then transferred some aspects of the property while retaining others.[234] Section 2041 includes property[235] in decedent's gross estate where decedent exercised or released[236] his power of appointment during his lifetime but retained some aspects of the property that would parallel sections 2035 through 2038. For example, if decedent released his power to withdraw $20,000 so that he made a gift to the

234. See discussion infra Parts II. C-E for an explanation of those Code sections in more detail.

235. See Regs. § 20.2041-3(d)(3)-(5) (illustrating the rules and calculations for computing the proportion of the value of the property includable in decedent's estate.)

236. For powers created on or before October 21, 1942, there are separate rules requiring that decedent had exercised his power either by will or during his lifetime in such a way that would parallel §§ 2035-2038 in order for § 2041 to require inclusion of the property in decedent's gross estate. That is, merely holding that power at death or a total release of a power will not constitute a prohibitive exercise for these grandfathered powers.

remainderman of that amount, but if he also continued to collect the income from that amount as income beneficiary of the trust, he is seen as owning \$20,000 and then transferring \$20,000 while retaining the income from \$20,000. If he had indeed initially owned the \$20,000 rather than having had a general power of appointment over the \$20,000, he would have had the \$20,000 (or the date of death value of that property) included in his gross estate under section 2036(a)(1).

However, having stated the parallel between 2041 transfers with retained interests or powers to sections 2035 through 2038, there is also a *de minimis*, freebie, aspect to the lifetime transfer with retained interest/power part of section 2041 which distinguishes section 2041 general powers of appointment from these other sections. Section 2514(e) excepts from gift taxation, and correspondingly 2041(b)(2) provides with respect to estate taxation, that a lapse (not exercising or releasing the power, i.e. doing nothing) will not be considered a release such as to cause the property to be included in decedent's gross estate to the extent that the value of the property subject to the general power of appointment did not exceed the greater of \$5,000 or five percent of the aggregate value of the property subject to the power. That is, in each year that the decedent, during his lifetime, allowed his power over the statutorily *de minimis* amount of property to lapse, he could continue to receive the income from that amount and not have any property included in his estate under the part of section 2041 that parallels sections 2035-2038.[237] At the time of this rule's enactment, it was unclear how popular this device would become.

> It is too early to know just what use will be made of the provisions which exempt the first \$5,000 or 5% of a trust fund over which a power lapses during the lifetime of the donee. Prior to the 1942 Act it was quite common for a testator in his will to give a noncumulative power of invasion of principal in a small amount each year to his widow or children, and it is quite likely that this practice will be revived. In other cases, testators will be content to give a power to a disinterested trustee to pay principal to income beneficiaries, since a power in which trustee alone would not involve liability for tax.[238]

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237. Note, however, that in the year of decedent's death, since there is no "lapse," the de minimis rule does not come into play and whatever value of the property over which decedent held that \$5,000 or 5% power is included in decedent's estate under the part of § 2041 that states that inclusion is required for general donee powers that decedent holds at his death.

238. George Craven, Powers of Appointment Act of 1951, 65 Harv. L. Rev. 55, 78 (1951) [hereinafter Craven].

Today, few trusts lack this "benefit,"[239] particularly since the *Crummey*[240] case and, indeed, an estate planner might be deemed incompetent for ignoring its use in minimizing a wealthy taxpayer's transfer taxes.[241]

The *de minimis* section relating to lapses was added in 1951[242] when sections 2514 and 2041 retroactively replaced[243] the powers of appointment statute amended in 1942.[244] Apparently, Congress decided to codify the common practice of allowing the beneficiary the availability of small sums of money from a trust as long as he didn't actually withdraw the funds at the end of each year on the grounds that some income beneficiaries were "unsophisticated" and needed such a fallback provision.[245] Whether this was a policy choice or a political expediency, historically, there has been ambivalence

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239. Estate planners often limit the time for exercising the $5,000 or 5% power to ensure that it is likely to "lapse" and not be exercised. If the power is exercised under this situation, inclusion in decedent's gross estate is determined under Regs. § 20.2041-3(d)(3)-(5).

240. See Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968).

241. The popularity of the combination was and is rampant. See, e.g., Report on Transfer Tax Restructuring, supra note 229, at 412 ("This 'five-and-five' exception and the resulting *Crummey* problem discussed above may be routinely exploited by some sophisticated taxpayers.").

242. Powers of Appointment Act of 1951, Pub. L. No. 82-58, 65 Stat. 91 (1951), reprinted in 1951-2 C. B. 343.

243. The Powers of Appointment Act of 1951 retroactively applied to powers of appointment created since 1942 as well as retaining the pre-1942 Act provision with respect to powers created before October 21, 1942. See 1951 S. Rep., supra note 233, at 1530, 1532.

244. The Revenue Act of 1942, Pub. L. No. 77-753, 56 Stat. 798 (1942). The Revenue Act of 1942 was enacted in response to the Supreme Court's decision in *Safe Deposit and Trust Co. of Baltimore*, wherein the Court refused to expand the purview of § 2033 to include unexercised general powers of appointment. See Helvering v. Safe Deposit & Trust Co. of Baltimore, 316 U.S. 56 (1942). With respect to a general power of appointment created pre-October 21, 1942, only exercised powers were included in the holder's gross estate. That is, lapsed or released powers were not subject to transfer tax. Indeed, when Congress enacted the Powers of Appointment Act of 1951, there were advocates of extending this pre-1942 rule so that the only powers that would be subject to estate taxation would be those connected with property that had previously been allowed the marital deduction. See Preliminary Digest of Suggestions for Internal Revenue Revision Submitted to the Joint Committee on Internal Revenue Taxation, prepared by the Staff of the Joint Comm. on Internal Revenue Taxation, April 21, 1953, p.108.

245. See 1951 S. Rep., supra note 233, at 1535 ("Since the problem of the termination or lapse of powers of appointment during life arises primarily in the case of dispositions of moderate-sized properties where the donor is afraid the income will be insufficient for the income beneficiary and therefore gives the income beneficiary a noncumulative invasion power, it is believed that the exemption provided in the committee amendment ($5,000 or 5 percent of the principal) will be adequate to cover the usual cases without being subject to possible abuse.") See also Craven, supra note 238 at 77. In addition, "the Bar Association representatives, on the other hand, pointed out . . . donees in small communities or with general powers over small funds, who did not have access to competent legal advice, either might not learn of the existence or nature of their powers or might not be properly advised of steps which could be taken to reduce their estate tax liability." Craven, supra note 238, at 63.

about its retention.[246] Indeed, it is hard to find a cogent policy reason for its retention; section 2033, the section's clearest parallel, does not contain such a similar exception. Rather, the unified credit exempts small estates from transfer taxation[247] and protecting wealthy beneficiaries from their own lack of financial sophistication is either no longer necessary[248] or too paternalistic. Moreover, ironically, while the main purpose of the 1951 Act was "to make the law simple and definite enough to be understood and applied by the average lawyer,"[249] the $5,000 or five percent power exception has produced some of the more complex calculations for estate tax inclusions where the decedent's lapsed powers exceed that threshold.[250]

2. *Contingencies and section 2041.*—What if decedent holds at his death a power to appoint property only if certain conditions are first met? Does he have a general power of appointment? Is the property subject to such a power valued to take into account the contingency? Under the law in effect prior to the Powers of Appointment Act of 1951, the answer to this question was unclear.[251] Under the current regulations, while notice giving or a delayed effect will not prevent property subject to a general power of appointment from

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246. It appears to have been a compromise between the position of the House and the Treasury Department. See 1951 S. Rep., supra note 233, at 1535 ("The House Bill provided that the failure to exercise a future power which lapses during the life of the holder of the power shall not be deemed an exercise or release of the power. An amendment by your committee modifies this latter provision so as to exempt from estate and gift tax only limited amounts of property subject to lapsed powers."). In 1951, the Treasury Department did not want to have this exception as it considered it an area of potential tax abuse and so it opposed the House Bill to consider a lapse as not an exercise or release. See Craven, supra note 238, at 76-77. In its 1984 Proposals, the Treasury Department changed its position. It proposed that § 2041 "be replaced by a rule treating an individual as the owner of property for transfer tax purposes where the individual possesses a nonlapsing right or power to vest the property or trust corpus in himself or herself. For purposes of this rule, a power or right would be treated as nonlapsing if it did not, by its terms, expire prior to the death of the powerholder. See 1984 Treasury Reform, supra note 12, at 385. By contrast, the ABA in 1951 urged its enactment and then in 1988 began to seek its repeal. See Report on Transfer Tax Restructuring, supra note 229, at 412 ("There is no conceptual justification for that exception."). One commentator has suggested that the $5,000 or 5% power exception is "simply an obvious example of the propensity of Congress to draft transfer tax statutes that exclude from taxation the most common forms of wealth transmission and tax only the unusual ones." See Amy Morris Hess, The Federal Taxation of Nongeneral Powers of Appointment, 52 Tenn. L. Rev. 395, 429 (1985).

247. See IRC § 2010.

248. Many people, both the sophisticated and unsophisticated, use financial planners, have mutual investments, and receive investment advice today. Ironically, the exception has been criticized as exacerbating a trap for the unwary. "The treatment of the power-holder as the grantor of the affected portions of the trust for income tax purposes creates an area of noncompliance for unsophisticated taxpayers." Report on Transfer Tax Restructuring, supra note 229, at 413.

249. See 1951 S. Rep., supra note 233, at 1531.

250. See id. at 1536; see also Regs. § 20.2041-3(d)(3)-(5).

251. See Craven, supra note 238, at 67-68.

inclusion in decedent's gross estate, a power whose exercise is dependent on an event or contingency "which did not in fact take place or occur during [decedent's lifetime] is not a power in existence" at decedent's death.[252] Thus, contingencies such as surviving to a specific age or surviving certain persons prevent property subject to powers of appointment from being treated as property owned by decedent.[253]

Under section 2041, the court looks to what power decedent had available to him at his death whether or not the exercise of the power could take place at that moment. The Seventh Circuit in *Estate of Kurz v. Commissioner*[254] underlined that position when it held that a sequence of withdrawal rights would not prevent a power under section 2041 from being "exercisable."[255] In that case, the decedent had a donee power of appointment wherein she could consume five percent of the family trust if the marital trust was exhausted. The taxpayer argued that there was no general power of appointment because, in order for the decedent to have such a power under section 2041, the event must have occurred by the time of decedent's death; otherwise, the decedent's interest had not ripened and was merely a type of expectancy. The government, on the other hand, adopted the position that unless the contingency attached to decedent's power of appointment was one beyond his control, the property subject to the power was includable in decedent's gross estate. The court found little of a real contingency in this case and held that "Section 2041 is designed to include in the taxable estate all assets that the decedent possessed or effectively controlled. If only a lever must be pulled to dispense money, then the power is exercisable."[256] According to the court, "the regulation does not permit the beneficiary of multiple trusts to exclude all but the first from the estate by the expedient of arranging the trusts in a sequence. No matter how long the sequence, the beneficiary exercises economic dominion over all funds that can be withdrawn at any given moment."[257]

The Tax Court in *Estate of Kurz v. Commissioner*[258] did not look at the contingency as a timing or sequence issue but as a substantive pre-condition to the decedent's exercise of her power.[259] When the court approached the

252. Regs. § 20.2041-3(b).
253. See id.
254. 68 F.3d 1027 (7th Cir. 1995).
255. See id. at 1028.
256. Id. at 1029.
257. Id. at 1030.
258. 101 T.C. 44 (1993), aff'd, 68 F.3d 1027 (7th Cir. 1995).
259. The Tax Court in *Kurz* refused to apply the regulations under § 2041 that parallel § 2038 and are more limited in application with regard to contingent powers than § 2036. Explaining their inapplicability, the court described how the government failed to amend its regulation under § 2041 at the time it amended the regulation under § 2038 and stated that "[t]here is no indication that the omission was inadvertent." Id. at 57. The court emphasized the difference between the two sections in that, with respect to § 2038, decedent once owned the

contingency this way, it engrafted an additional requirement for a contingency to except decedent's power of appointment from inclusion in his estate under section 2041. The court stated that the contingency or event had to have some significant non-tax consequences independent of the decedent's ability to exercise the power and could not be "illusory."[260] Where that type of precondition was absent, the contingency would not prevent the decedent from having "practical ownership."[261] The court gave some examples of such non-tax purpose as having children or obtaining a divorce.[262]

The treatment of contingent powers of appointment under section 2041 is, like other aspects of section 2041, replete with favored treatment. That is, although this section generally parallels sections wherein decedent had owned the property that he literally only had a power to appoint to himself, his creditors, his estate or his estate's creditors, section 2041, like its concomitant gift tax section 2514, grants tax benefits to lapsed powers. Similarly, section 2041, through the regulations, excepts contingent powers of appointment from taxation while property contingently owned by the decedent is subject to estate tax under section 2033. Moreover, the Tax Court has indicated that it is willing to further exempt powers of appointment subject to a contingency within the decedent's control, as long as that contingency is not illusionary and not tax-motivated.

I. *Section 2042: A* De Minimis *Rule for Certain Remote Contingencies*

Section 2042 includes property in decedent's gross estate where either the estate is the recipient of the proceeds[263] or the decedent owned at his death, or within three years of his death,[264] any of the "incidents of ownership," exercisable alone or with anyone else, in an insurance policy on his life.[265]

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property outright and, while transferring some of the property to another, decided to retain a power to regain ownership or a prohibitive indicia of ownership, but that with respect to § 2041, the decedent never owned the property and was only the recipient of a general power of appointment. See id. at 57-58.

260. See id. at 60. Indeed, the court defined as illusory those conditions lacking a non-tax independent consequence. Perhaps, the court adopted the language of the regulations under § 2037. Regs. § 20.2037-1(b) explains that the condition of survivorship necessary for inclusion of decedent's reversion under § 2037 would not be found where a beneficiary could obtain the property "either by surviving the decedent or through the occurrence of some other event. . . . However, if a consideration of the terms and circumstances of the transfer as a whole indicates that the 'other event' is unreal and if the death of the decedent does, in fact, occur before the 'other event', the beneficiary will be considered able to possess or enjoy the property only by surviving the decedent." Regs. § 20.2037-1(b).

261. Kurz v. Commissioner 101 T.C. at 60.

262. See id.

263. See IRC § 2042(1).

264. See IRC § 2035(a)(2).

265. See IRC § 2042(2).

Incidents of ownership are defined broadly in the regulations to include the economic benefits of the policy[266] and include such powers as the ability to change the policy's beneficiary or to obtain a loan against its cash surrender value.[267] When decedent is found to hold any of the incidents of ownership in insurance on his own life, the entire proceeds are includable in his gross estate.[268]

Except with respect to reversionary interests, there is nothing in section 2042 that indicates whether or not contingent rights are incidents of ownership.[269] Added by the 1954 Code, which attached a similar limitation to the application of section 2037,[270] a reversionary interest which is valued at more than five percent of the policy's value just before decedent's death is an incident of ownership and that interest is defined as "a possibility that the policy, or the proceeds of the policy, may return to the decedent or his estate, or may be subject to a power of disposition by him." Unlike section 2033 that discounts all contingent interests to reflect their uncertainty, because section 2042 includes the full value of the insurance proceeds in decedent's estate, the only discounting of contingencies under section 2042 operates with the *de minimis* rule regarding reversionary interests. Thus, if it is very unlikely that decedent will regain any incidents of ownership, the statute excepts such ownership from inclusion. However, if it is fairly probable that decedent will re-possess the incidents of ownership, the full, undiscounted, value of the proceeds is includable in his estate.

In *Estate of Smith v. Commissioner*,[271] the Tax Court held that the decedent's right to prevent the cancellation of a life insurance policy on his life by purchasing the policy for its cash surrender value if his employer, whom he did not control, chose to stop paying premiums was not an incident of ownership under section 2042 since it was contingent upon an event that never occurred and over which the decedent had no control.[272] Likewise, in *Estate of*

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266. Regs. § 20.2042-1(c)(2).

267. Id.

268. Regs. § 20.2042-1(a)(3).

269. IRC § 2042 includes reversionary interests that the decedent may have retained and treats them like § 2037, imposing a de minimis requirement before requiring inclusion. That is, "... the term "incident of ownership" includes a reversionary interest (whether arising by the express terms of the policy or other instrument or by operation of law) only if the value of such reversionary interest exceeded 5 percent of the value of the policy immediately before the death of the decedent." The statute states that the value of a reversionary interest shall be determined by applying the traditional methods of valuation. IRC § 2042(2).

270. H.R. Rep. No. 83-1337, at A316-A317 (1954) ("To place life insurance policies in an analogous position to other property, however, it is necessary to make the 5-percent reversionary interest rule, applicable to other property, also applicable to life insurance."). Section 2042 replaced § 811(g) of the 1939 Code.

271. 73 T.C. 307 (1979), acq. in result in part, 1981-2 C.B. 2.

272. Id. at 309.

Beauregard v. Commissioner,[273] the Tax Court held that decedent lacked incidents of ownership under section 2042 because, under a settlement agreement and local court order, decedent had no right to change the beneficiaries of an insurance policy on his life even though had he survived the children's age of majority or on the happening of certain events, he might repossess that right. Finally, in *Estate of Smead v. Commissioner*,[274] the Tax Court held that a decedent's right to convert a group policy into an individual one on the termination of his employment was not an incident of ownership since it was an event which, although literally within the taxpayer's control, would be unlikely to occur in order to exercise that right.

Essentially in each of these three cases, decedent held a contingent right to the incidents of ownership in the policy on his life. If these interests were covered by section 2033, they would be included in decedent's estate, although discounted to reflect the unlikelihood of these events occurring. Under section 2042, however, the threshold question is whether decedent held any of the incidents of ownership at his death and, if so, the entire proceeds are includable as long as, if it is a reversionary interest, its value exceeds the five percent minimum value. The statute does not suggest that other contingencies should follow a similar *de minimis* rule and courts have not explicitly fashioned their holdings to parallel that principle. Thus, in theory, the statute could be read to say that if decedent held any contingent right in a life insurance policy on his life, the full value of the proceeds of that policy should be included in his estate. However, perhaps because there is no discounting or *de minimis* rule, courts have been reluctant to hold that attenuated contingencies not within the control of decedent cause inclusion of the entire proceeds in his estate.[275]

Respectively in *Smith*, *Beauregard*, and *Smead*, the Tax Court was loath to include as an incident of ownership the right to purchase a policy if decedent's employer, whom he did not control, decided to stop paying premiums; the right to change beneficiaries if the decedent survived his

273. 74 T.C. 603 (1980), acq., 1981-2 C.B. 1.

274. 78 T.C. 43 (1982), acq,. Rev.Rul. 84-130, 1984-2 C.B. 194.

275. Likewise, courts were hesitant to hold that a decedent's power to choose a settlement option was an incident of ownership. See Estate of Connelly v. United States, 551 F.2d 545 (3d Cir. 1977); Hunter v. United States, 624 F.2d 833 (8th Cir. 1980). But see Estate of Lumpkin v. Commissioner, 474 F.2d 1092 (5th Cir. 1973). One commentator has suggested that the plain language of the statute requires inclusion of "even a fractional interest held by decedent." Sharon L.R. Miller, 'Incidents of Ownership' as Applied to a Right Held by a Decedent to Select an Optional Mode of Settlement, 33 Case W. Res. 51, 52 (1982). However, with respect to contingent rights or powers, it is not clear whether there is even that "minimal degree of power associated with an 'incident' of ownership" requiring inclusion in decedent's gross estate. See id. at 70.

children's majority;[276] and the right to convert to an individual policy on termination of employment. One way of viewing these decisions is to say that the court was informally or implicitly applying the probabilities inherent in the five percent rule; that is, there was less than a one in twenty chance that the contingency would occur. Because the contingency was an event unlikely to occur, requiring inclusion of the full value of the proceeds, perhaps, seemed "unduly harsh."[277]

Another way of viewing these decisions is that the court considered the property interests subject to contingencies over which decedent lacked control as insufficiently owned by decedent. In *Smith*, the court stated, "At his death, Smith could neither have initiated changes in the two policies nor consented to them; the company alone maintained full control over the policies."[278] In *Smead*, the court reviewed the earlier decisions and stated that "In both *Smith* and *Beauregard*, the insured's purported rights in the policy were entirely too contingent or remote to constitute incidents of ownership possessed by the decedent at the time of his death."[279] Here, the court stated that while the decedent had more control since he could voluntarily quit his employment, "where the only way the insured can surrender or cancel a policy is by quitting his job, that is not considered to be an incident of ownership."[280] The court then extended this logic to a conversion privilege that arose only at the termination of decedent's employment. "We conclude that the conversion privilege that decedent could exercise or control only by quitting his job was entirely too contingent and too remote to be considered an incident of ownership possessed by the decedent at the time of his death."[281] In *Beauregard*, the court looked at what decedent owned at his death, chose to ignore rights the decedent could have regained if he had outlived his children's majority, and thus implicitly rejected that contingent rights can be owned at decedent's death. "On this basis, whatever Beauregard could have done with the policy had he lived until his two children had attained age 21, became self-supporting, or left the custody of their mother is of no significance; the relevant inquiry is, what incidents of ownership, if any, did Beauregard possess at the time of death?"[282]

In each of these insurance cases, decedent owned a valuable economic right. In *Smith* and in *Smead*, decedent would never have to pass a test of his insurability; even if he developed a terminal illness at the time the contingency

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276. In *Beauregard*, the court analogized the right to change beneficiaries after the court order and settlement agreement were no longer valid to a reversionary interest under § 2037 and said that in this case the value was below that de minimis threshold. 74 T.C. at 611-13.

277. See supra notes 155-166 and accompanying text.

278. Estate of Smith v. Commissioner, 73 T.C. at 311.

279. Estate of Smead v. Commissioner, 78 T.C. at 49.

280. See id. at 51.

281. See id. at 52.

282. Beauregard v. Commissioner, 74 T.C. at 610.

occurred, he had a right to have his insurance continue. In *Beauregard*, the decedent would regain the policy once his children were 21 years old, married, became self-supporting, or left the custody of their mother when all restrictions imposed by the court order and settlement agreement would have been removed. However, in each of these cases, decedent's contingent rights were imposed by others (i.e., either his employer whom he did not control or a court) and were never under his control. In this respect, there is no real potential for abuse in such circumstances. Therefore, the most appropriate estate tax treatment for these contingent interests that decedent holds at his death is to include their value, properly discounted to reflect their contingent nature. Rather than have a *de minimis* rule, Congress should treat remote contingencies in this circumstance like remote contingencies in section 2033.

III. PROPOSED SOLUTION

A. *Contingencies and Decedent's Control*

Two rules should be established to deal with contingent interests and contingent powers. These rules should underline the decedent's initial control in imposing the contingency. The first rule should be applied to non-decedent created contingencies: contingencies should be taken into account so that the value included in decedent's estate approximates the property's economic value, properly discounted to reflect the uncertainty of the contingency. The second rule should be applied to decedent-created contingencies; it should be a harsher, artificial rule of valuation and inclusion, designed to discourage more complex contrivances and avoidance techniques. Thus, if section 2033 applies, the estate will continue to include contingent interests at their value as of decedent's date of death, with approximations based on probabilities at that time. By contrast, where sections 2036[283] or 2037 apply, the estate should include the full date of death value of the property over which decedent has retained any interest or power.[284] Including the full date of death value of the

283. Unlike under current law, there should be no reduction for any outstanding life estate, even one currently being enjoyed at the decedent's death. While, on the one hand, that life estate is not dependent upon surviving the decedent, full inclusion would promote simplicity. In addition such treatment would be consistent with the grantor trust provisions that treat a grantor who has retained a reversionary interest as the owner of the income for income tax purposes.

284. Where an interest is subject to a contingency that was created by another and not under decedent's control, only the value of that contingent interest should be included in decedent's estate. Thus, where § 2041 applies to donee general powers of appointment held by decedent at his death, since that part of the statute parallels § 2033, property included under that aspect of § 2041 should be valued like property included under § 2033, reflecting the actual economic value of the property over which the taxpayer has such a power. By contrast, with respect to the part of § 2041 that parallels transfers with retained interests or powers, these § 2041 interests should be artificially valued, as under §§ 2036 and 2037. Likewise, with respect to

property in decedent's estate in these instances will encourage simpler lifetime transfers.

With respect to decedent-inserted non-tax motivated contingencies such as reversions at the decedent's divorce or failure of issue, currently, the reversion would not satisfy the "survivorship test" of section 2037,[285] and the property would not be included under that statute. Likewise, under section 2036, the focus is on what income interest decedent retains for his life, for a period not ascertainable without reference to his death, or for a period that does not end before his death so that non-testamentary contingencies are generally irrelevant to that analysis.[286] Yet, decedent has controlled the initial imposition of the contingency and the contingent reversion that he holds at his death has value. Because this interest does not expire until decedent's death, moreover, it is in a very real sense testamentary. To the extent that he has not, until his death, "let go" of the property he once owned outright, a full date of death inclusion would discourage such partial transfers.[287]

On the other hand, with respect to non-decedent created or controlled non-tax contingencies, all interests should be valued to approximate the risk. For example, a remainder interest subject to inclusion under 2033 would be valued as it currently is, discounted to reflect the probability of the contingency's occurring.[288] Where an employee insurance policy may be converted to an individual policy if and when he leaves his employment,[289] the contingency was not decedent created and should reduce the value of what is

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property included under §§ 2039 and 2042, where the contingency is decedent created and/or controlled, the full date of death value of the property should be included in decedent's estate. With respect to contingencies that were not imposed or controlled by the decedent, a mathematical rule should be applied to include value of these interests discounted to reflect their unlikelihood. With respect to property included under §§ 2034 and 2040, sections that otherwise resemble § 2033, but whose property interests are inherently contingent, the current rules of inclusion should continue to apply.

285. See supra note 132 and accompanying text.

286. Where a court could alter decedent's support obligation so that it was unclear what part of the trust could produce the income "retained" by the decedent, because decedent had created a trust wherein income would satisfy his support obligation, even under current law, the court should have included the full value of the trust in decedent's estate rather than approximate what additional amounts of income could be applied because of the possibility of a court's increasing decedent's support obligation that could be satisfied from trust income. See supra notes 97-99, and accompanying discussion.

287. Concededly, the imposition of the contingency is not a consequence of an attempt for tax avoidance. Thus, with these non-tax motivated contingencies, it would be preferable to the current tax treatment to at least adopt a mathematical rule that would include the value of decedent's contingent reversion immediately before his death.

288. See supra notes 24, 54, and 62, and accompanying discussion.

289. See supra notes 272, 278-281, and accompanying discussion.

included in decedent's estate.[290] That is, the value of that contingent conversion right should be viewed as an asset of the estate and valued under the mathematical rule.[291]

B. *Problems with* De Minimis *Rules*

While *de minimis* rules have appeal in that remote retained powers or interests are ignored, the element of decedent control over these contingencies is also ignored. Moreover, they create inequitable treatment with other property interests included in decedent's estate. That is, estate assets with relatively small value that are owned outright are included in decedent's estate under section 2033 and various other estate tax provisions. Therefore, it is unclear why, when a decedent owns property with a large value and chooses to transfer most but not all of it, he is rewarded by the application of a *de minimis* rule that exempts the value of his retained interest from inclusion in his estate.

If the reason for the *de minimis* rule is that otherwise the full value of the property is included in decedent's estate, the issue may be whether the rule itself is unduly harsh. Thus, either the rule itself should be changed for every transfer, or the decedent should not be allowed to retain any power or interest and escape its application. Since an attorney drafts the trust or advises the transfer, an unduly harsh result can be avoided by a professional's advice; if the decedent insists on including a retained interest or power, the rule is not "unduly harsh." If the potential for abuse has effected a rule that requires inclusion of the full value of the property at decedent's death, where decedent has imposed a contingency on a retained interest or power, there is no reason for a *de minimis* rule. Indeed, in the instance of decedent created contingencies, *de minimis* exceptions should be rejected as they undermine the rationale for, and create more complexity with respect to, a policy driven, artificial rule of inclusion.

C. *Why Categorizing Transfers as Essentially Testamentary or Inter Vivos Does Not Solve the Problems of Decedent-Created Contingencies*

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290. Theoretically, decedent's employment choice was affected by the existence of this employer-created benefit, so that one might assert that the decedent had ultimate control of the decision to possess this benefit at his death. But, that argument is too tenuous and far-fetched, even for this author. On the other hand, one might argue that at least until all non-vested employer created benefits are included in decedent's gross estate, this contingent life insurance benefit should also be excluded. See, e.g., Estate of Barr v. Commissioner, 40 T.C. 227 (1963); Estate of Tully v. United States, 528 F.2d 1401 (Ct. Cl. 1976). However, this author believes all such benefits should be included in decedent's gross estate and supports such general change as has been proposed by the A.B.A. Tax Section. See Report on Transfer Tax Restructuring, supra note 229, at 411.

291. This contingent reversion right was created by a third party unlike the donor-created non-tax contingent interest that was property originally owned outright by the decedent.

An early attempt to deal with contingent reversionary interests and powers focused on whether or not the transfer is essentially testamentary.[292] The government proposed that where any beneficiary could possess or enjoy the property during the transferor's lifetime, the transfer should be treated as a completed gift and not taxed in decedent's estate. If no one could enjoy the property during the transferor's lifetime, the full date of death value of the property would be included in the decedent's estate without considering the value of the reversionary interest or a reduction for another's outstanding life estate.[293] This test, and this distinction, is similar to the one embodied in the survivorship test of section 2037.[294] Unlike section 2037, however, there was no *de minimis* exception and no adjustment for the currently enjoyed life estate not dependent upon surviving the decedent. "In this manner there is but one taxable event and difficult problems of valuing 'slippery and elusive' interests are avoided."[295]

According to the 1947 Treasury proposal, where an essentially inter vivos transfer reverts to the transferor, it will cause the property potentially to be subject to a second transfer tax that "will tend to discourage such devices."[296] With respect to contingent reversionary powers, as opposed to contingent reversionary interests, over the property, however, where the transferor has a contingent power to appoint the property if he survives the life beneficiary, because this transfer does not have the same potential for the imposition of a second transfer tax, the proposal treats as testamentary all

292. Applying some of these ideas to create an artificial rule of inclusion for contingent retained interests and powers, the rule first characterizes a transfer as essentially testamentary or not; if denominated testamentary, the full date of death value would be included in decedent's estate. "Essentially testamentary" might constitute all but minimally valued or remote reversions of both income or principal, expanding the de minimis exception of § 2037 that currently applies only to remote reversions of the property itself. Alternatively, such a proposal might broaden the current 5% requirement of § 2037 to exclude any reversion that is not "mostly" testamentary in character, enlarging the current § 2037 exception to any reversionary interest valued at more than one-half of the property. On the other hand, instead of a survivorship test, like in § 2037, that requires that a beneficiary can receive the property only by surviving the decedent, the survivorship requirement could be met by a lower threshold, where survivorship is a predominant or likely (as opposed to the only) contingency for the reversion.

293. 1947 Treas. Proposal, supra note 1, at 23-24. In describing the gift tax consequences of such a transfer, the government proposal suggested that these were obvious and settled by Supreme Court case law: either the value of the property less the value of the contingent reversionary interest was subject to gift tax or the full value of the property would be taxed where "the reversionary interest cannot be valued according to recognized actuarial methods of computation (Robinette v. Helvering, 318 U.S. 184 (1943))." 1947 Treas. Proposal, supra note 1, at 22-23.

294. See supra note 132. An example of an essentially inter vivos transfer is a reversionary interest contingent upon absence of the transferor's issue. See 1947 Treas. Proposal, supra note 1, at 23.

295. Id.

296. Id. at 24.

contingent reversionary powers to change the beneficial enjoyment of the property.[297]

Subsequent reform attempts, moreover, have expanded the *de minimis* exception to section 2037 and have urged an "easy to complete" rule (a completed gift) where it is "more likely than not" that the reversionary interest will not return to the donor so that it is taxed as a completed gift at its full value; by contrast, where it is more probable that the reversionary interest will indeed vest in the donor, a "hard to complete rule" (an incomplete gift subject to estate tax at the decedent's death) will be applied and it will be an incomplete transfer.[298]

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297. Id. at 24-25. Retained powers to alter the timing of the beneficial enjoyment of property were not to be subject to estate taxation. This proposal contrasts to § 2036(a)(2) that includes such retained powers in decedent's estate. See Struthers v. Kelm, 218 F.2d 810 (8th Cir. 1955).

298. See 1984 Treasury Reform, supra note 12, at 380.

Some reform measures have advocated easy-to-complete rules and have emphasized simplicity. For example, Professor Isenbergh proposed that the complicated estate tax sections, such as §§ 2036-2038, be repealed as long as the gift taxes paid on these inter vivos transfers are themselves subjected to transfer tax. That is, the rule of § 2035(b) would be extended to apply to all gifts, rather than merely those gifts made within three years of decedent's death. (Section 2035(c) was re-numbered, without substantive changes, § 2035(b) by the Tax Reform Act of 1997, Pub. L. No. 105-34, § 1310(a), applicable to decedent's dying after August 5, 1997.) Isenbergh, supra note 72, at 8-9. With respect to his proposal to eliminate § 2036, Professor Isenbergh noted the problem of taxpayer abuse: "This potential abuse is simply an aspect of the ubiquitous and largely irreducible problem of valuation of lifetime transfers, an area where taxpayers often have the upper hand." Id. at 16. With respect to these problems, he suggested an estate tax reporting requirement of gifts of remainder interests with the IRS making proper adjustments "entail[ing] no greater administrative difficulties than the present system. . . ." Id. Professor Isenbergh proposed the repeal of § 2038 by requiring that revocable transfers be treated as irrevocable and taxed on their creation. Id. at 17-18. Since the grantor controls valuation, any uncertainties should be interpreted against his interest.

Other commentators have advocated the adoption of "hard-to-complete" rules in the instance of retained interest transfers to avoid double taxation and on the basis that these transfers are essentially testamentary. Currently, these transfers are often subject to both gift tax and estate tax; a "hard-to-complete" rule would subject them only to estate tax. See, e.g. A.L.I., Federal Estate and Gift Taxation 43 (1969); 1984 Treasury Reform, supra note 12, at 378-79 (compare proposed rule regarding retained beneficial interests to § 25.2511-1(e), IRC § 2702); Charles L.B. Lowndes, Common Sense Correlation of the Estate and Gift Taxes, 17 U. Fla. L. Rev. 507, 518 (1965); Harry L. Gutman, A Comment on the ABA Tax Section Task Force Report on Transfer Tax Restructuring, 41 Tax Law. 653, 676 (1988) (advocating a hard-to-complete rule where the estate and gift tax bases are uniform and where the donor can no longer affect the enjoyment of the property); See generally, Joseph M. Dodge, Redoing the Estate and Gift Taxes Along Easy-to-Value Lines, 43 Tax L. Rev. 241 (1988) (Professor Dodge emphasized the appropriateness of "hard-to-complete" rules to tax, at the decedent's death, inter vivos transfers that are essentially testamentary. He proposed that gifts not be valued based "on estimates of, or speculation about, future events and by analyzing relevant events as they actually occur. Hindsight, in other words, should be used whenever possible. For example, the ultimate transfer tax effect of inter vivos transfers with retained interests should be suspended until the retained interest expires or the transferor dies, whichever occurs first. Similarly, certain inter vivos transactions that attempt to

However, categorizing a transfer as essentially testamentary or as essentially inter vivos depending upon the contingency itself ignores the issue of control and its concomitant potential for abuse. Thus, fashioning rules for determining where on a continuum of lifetime or testamentary transfers a particular decedent-created contingency falls may increase complexity without substantial equitable gains. Additionally, analyzing the transfer *after* the imposition of a decedent-created contingency misdirects the focus from control to the result of the decedent's exercise of his control. The primary emphasis should be placed on the imposition of the contingency in the first place and on who controls that decision. With rules of full inclusion for partial transfers of property, moreover, Congress would be underlining its policy of encouraging simple, completed transfers of property.

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fix low transfer tax values should be held open until death. Id. at 244).