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RELEASING POWERS OF APPOINTMENT IN PENNSYLVANIA

by

Thomas L. Wentling*

In 1943, the Pennsylvania legislature passed an Act expressly authorizing the release of powers of appointment.¹ Half the states in the Union were passing similar statutes.² The Acts were an effort to make clear that powers of appointment could be released whether they were general or special and whether they were exercisable by deed or by will. There was a compelling reason why, suddenly, the legislature should feel concern over the question of the extent to which powers of appointment were releasable in Pennsylvania. That reason was the passage of the Federal Revenue Act of 1942 which substantially increased the taxability of an estate of a donee of a power.

BACKGROUND OF THE 1942 REVENUE ACT

The first federal estate tax in 1916 did not mention powers of appointment, nor did the first Regulations³ promulgated under the Act. The following year the Treasury corrected the omission with a Regulation⁴ which made taxable, property passing under a general power. This Regulation provided further that as to property passing under a special power, the question of taxability would depend on "the terms of the instrument by which the donee of the power" was appointed. The Revenue Act of 1918 filled the statutory void with its express provision⁵ that a decedent's gross estate should include property passing under a general power exercised by will. This provision was several times reenacted with little change, and the Treasury contented itself with asserting taxability of property subject to general powers only. In 1939, Section 811 of the Internal Revenue Code described what property was includable in the gross estate of a decedent and sub-section (f) included the value of any property:

"To the extent of any property passing under a general power by appointment exercised by the decedent (1) by will * * * or * * *".

Three prerequisites had to be present before a power fell within the terms of the statute: the property must pass, the power must be general, and it must be exercised.

¹Act of May 28, 1943, P.L. 797, No. 334.
²Ohio passed a release law as "an emergency measure necessary for the immediate preservation of the public peace, health and safety." (L. 1943, S. 271, effective June 3).
⁴T.D. 2477 (1917).
⁵Section 402 (e).

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The determination of whether these conditions existed in a particular case was ad-
mittedly a matter of local property law to be passed upon by the individual state
courts.6

The Pennsylvania courts as well as other state courts were usually helpful to
the taxpayers. They were quick to call a power special rather than general.7 On the
other hand, the Pennsylvania courts were liberal in finding that a power had been
exercised. An intent to exercise was presumed in the absence of clear contrary
evidence.8 But it was in the interpretation of what property passed under a gen-
eral power that the Pennsylvania courts sidetracked short of taxation most prop-
erty subject to a power. If the appointees were also remaindermen and if they got
the same or less than they would have in default of an appointment, there was no
tax.9 If they got more, the estate of the donee of the power was taxable, but only
on the amount of the excess.10 Under these interpretations there were few Penn-
sylvania powers which subjected property to the federal estate tax.

THE PRESENT FEDERAL LAW

The Revenue Act of 1942 extensively revised the estate11 and gift12 tax sec-
tions of the Internal Revenue Code. All property over which a donee decedent
had at the time of his death a power of appointment became taxable as part of his
estate, with two exceptions. First, if the appointive classes were limited to certain
relatives of the donor and the donee or to charities; secondly, if the power was in
the hands of a disinterested fiduciary and was exercisable only in favor of a re-
stricted class; in either case the power was not included in the statutory definition
of a power of appointment and the property was not taxable to the donee's estate.
The gift tax amendments meanwhile provided that an exercise or release of a
power inter vivos should be deemed a taxable transfer by gift. These joint
amendments surrounded the donee with a tax web. He couldn't keep the power
and he couldn't give it away without becoming taxable. Overnight the possession
of a power became a burden. If the donee released the power, the takers in de-
fault got an indefeasible remainder, but the gift tax was payable from the donee's
pocket. And, if the donee did nothing and died, the remaindermen got the prop-
erty but its value was taxable to the estate of the donee. True, section 826(d)
of the Code was amended13 to permit recovery by the donee's executor of a propor-
tionate share of the tax from the appointee or remainderman. Nevertheless, the

6 Paul, Federal Estate & Gift Taxation (1942), Section 9, 14.
7 Fidelity Trust Co. v. McCaughrn, 1 F. 2d 987 (E.D. Pa. 1924).
8 Provident Trust Co. of Philadelphia v. Scott, 335 Pa. 231, (1939); Biddle's Estate, 333 Pa.
316, (1939).
9 Legg's Estate v. Commissioner of Internal Revenue, 114 F. 2d 760 (1940); Rothensies v.
Fidelity Philadelphia Trust Co., 112 F. 2d 758 (1940).
11 Section 811 (f).
12 Section 1000 (c).
13 Section 403 (c) of Revenue Act of 1942.
14 Section 403 (d) 3 of Revenue Act of 1942.
donee's estate might still suffer loss. For the addition of the appointive property to the donee's property might place his estate in a higher tax bracket and thereby increase its taxability even after apportionment.

Conscious of this harsh dilemma, Congress provided\textsuperscript{14} that the 1942 amendments should not apply to powers of appointment which were created on or before October 21, 1942\textsuperscript{18} if released before January 1, 1943. But this did not adequately ease the problem. The question of the release of powers was admittedly a matter of local property law.\textsuperscript{16} It was small solace to Pennsylvania taxpayers to have the federal lawmakers deliberately leave a loophole if the local law did not permit or recognize such a release. The Treasury regulations went as far as they could in providing:\textsuperscript{17}

"It is presumed that all general powers of appointment are releasable, unless the local law on the subject is to the contrary; and it is presumed that the method employed to release the power is effective, unless it is not in accord with the local law on the subject.* * *."

The Regulations referred only to general powers; no mention was made of the releasability of special powers. The omission was deliberate. For in only a few states had the question been decided. Congress was aware of the necessity for making "allowance for the inability to release various non-general powers under applicable local law."\textsuperscript{18} Because of the uncertainty over local releasability, especially of special powers, Congress did two things. First, it provided that the donee of a special power which was created before October 21, 1942, would not be taxable unless he exercised the power.\textsuperscript{19} If he exercised the power inter vivos he would incur a gift tax. If he exercised it by will his estate would be taxed. But if he just held on to the power and died with it, he would escape the tax. This exception applied only to those donees whose power was created prior to October 21, 1942. A special power created in a donee after that date would be taxable whether exercised or not.\textsuperscript{20} The second important relief granted by Congress to donees caught with powers in 1942 was to extend the tax free release date of January 1, 1943. Six times so far\textsuperscript{21} the crucial release date has been changed, until now it is July 1, 1947.\textsuperscript{22} Congress realized that under the various state interpretations of local property law, many donees, in fairness, needed an additional opportunity to effect a release.\textsuperscript{23} The federal presumption was in favor of releasability but leeway was granted in recognition of the doubtful situation in many states.

\begin{itemize}
\item \textsuperscript{14}The enactment date of the amendments.
\item \textsuperscript{16}Local law in Federal Taxation, 32 Yale Law Journal 799 (1943).
\item \textsuperscript{17}U.S. Treasury Regulation 105, Section 81.24 (b) (3).
\item \textsuperscript{18}Report of the Committee of Conference, Revenue Act of 1942. Amendment No. 399.
\item \textsuperscript{19}Revenue Act of 1942, Section 403 (d) (1).
\item \textsuperscript{20}Section 811 (f) and Section 1000 (c), Internal Revenue Code.
\item \textsuperscript{21}Originally Jan. 1, 1943, but successively extended to July 1, 1943, March 1, 1944, Jan. 1, 1945, July 1, 1945, July 1, 1946, and July 1, 1947.
\item \textsuperscript{22}House Joint Resolution 353, approved May 29, 1946.
\end{itemize}
THE PENNSYLVANIA LAW

With the question expressly referred to the individual states by the Regulations, lawyers and lawmakers in Pennsylvania showed an awakened interest in Pennsylvania law on the subject of releases. The leading case was Lyon v. Alexander. There, Justice Drew was besieged in the arguments with fine lines distinguishing common law powers and their historic releasability or non-releasability. Curtly, he threw the old law out the window:

"We think it profitless to review the cases defining the various kinds of powers or to enter upon even a summary of the distinctions which have been drawn. For all practical purposes there may be said to be two marked differences in powers of appointment; they can be summarized as general and special powers."

The donee, in Lyon v. Alexander, had a general testamentary power over the property only if she should outlive all her brothers. She and her remaindemen brothers joined in a conveyance and the question arose in the form of a case stated to determine the marketability of the real estate. The court held that the power was released:

"...where the power is a general one under which the donee may appoint to any one, the testator has completely relinquished all dead hand dominion over the property and has placed it for all practical purposes as completely within the control of the donee of the power as though a fee had been created in him. There is neither a trust nor an obligation in the nature of a trust because the power is not coupled with a duty... If the donee of a general power may appoint to his own estate or to anyone in the world, no individual is wronged by what he may do, and therefore no individual can complain... The release or extinguishment of the power may take any form. It may be by a contract or by deed and may be implied from a conveyance of general warranty."

Naturally, if a general power exercisable by will was releasable inter vivos, a fortiori, a general power exercisable at any time could be released. It was immaterial that the power was not given to a donee but was merely reserved by the donor for his own exercise—it was releasable. The Restatement agreed with these Pennsylvania views on releasing general powers.

The Pennsylvania high court has not been called upon to determine whether a special power was releasable. But there is little doubt as to what its decision...

\[24304\text{ Pa. 288, (1931).}\
\[25304\text{ Pa. at 291.}\
\[26304\text{ Pa. at 292.}\
\[27\text{Mogridge's Estate, 342 Pa. 308, (1941).}\
\[28\text{Jackson Trust, 351 Pa. 89, (1945). But a donor-reserved power is not releasable tax free prior to July 1, 1947. Henry F. Du Pont 2 TC 246 (1943); U.S. Treas. Regulation 108, Sec. 86.3.}\
\[29\text{Restatement of Property, Ch. 25, Section 334 (1940).}\
\[30\text{See Petition of McCawley, 35 Luz. L.R. Rep. 180.}\]
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would have been before the 1943 Act. Justice Drew distinguished between releasability of general and special powers, pointing out that:

"In the latter case, there is sound reason why the repository of the power should not be permitted to extinguish it, because the testator has indicated the persons to whom the property shall go and there is reposed in the appointee of the power a confidence, something partaking of the nature of a trust."

The Restatement in general agreed with this dictum. It declared that special powers were not ordinarily releasable.

To broaden the Pennsylvania rules on releases and to make them clear, the legislature passed the 1943 Act. Under it, any power of appointment could be released whether general or special, whether exercisable inter vivos or only by will, whether the property subject to the power was real or personal, and whether or not consideration was given. The release could be conditional, and it could be partial both as to the property subject to, and the objects of, the power.

The purpose of the law was to give certain Pennsylvania donees a real opportunity to take advantage of the 1942 amendments to the federal estate and gift taxes. Local donees could take effective action to sidestep the federal taxgatherers, but only if their power was created prior to October 21, 1942. Congress had felt no inclination to protect donees who received their powers after that date. The donor could have changed the instrument creating the power or the donee could have refused to accept the power, if either wished to avoid the tax results brought on by the 1942 amendments. Only the hapless donee who already had his power when the federal changes were made was being offered a way out.

For this latter group of donees, the Pennsylvania law brightened the picture. They could wholly or partially release any power prior to July 1, 1947, without paying a gift tax. If the release was total, there would obviously be no estate tax. If the release was partial and if it restricted the appointees to one or more of the exempt classes in the federal estate tax law, there would be no estate tax. And, of course, if the power was a special one and was created before October 21, 1942, it need not be released at all, so long as it was not exercised.

There was one exception to the broad release provisions in the 1943 Act. "A power in trust which is imperative" was not releasable. This use of legal shorthand to describe the exception to releasability invited criticism because the phrase "power in trust" was already subject to loose usage and was the source of

31304 Pa. at 292.
32Restatement of Property, Ch. 25, Section 335 (1940).
33Act of May 28, 1943, P.L. 797.
34Remarks by Chairman of the Committee on Judiciary General, Pa. Senate Journal, April 27 1943.
35Letter of General Counsel of the Treasury, dated November 6, 1942, CCH Inheritance Tax Service, paragraph 6003.
some confusion.\textsuperscript{36} The addition of the word imperative shed little light since it had been defined as a power in trust or in the nature of a trust.\textsuperscript{37} What powers are non-releasable as a result of this exception has not been judicially determined. Justice Drew's language in Lyon \textit{v. Alexander}, supra, indicated that all special powers could be considered powers in trust. Such an interpretation was, however, foreclosed by the express direction of the Act that special powers were releasable.

In the similar statutes of several other states,\textsuperscript{38} the only exception to releasability was where "the instrument creating the power specifically provides to the contrary." Pennsylvania did not adopt this clear language. It, along with Alabama, California, Kentucky and New York, preferred the language of imperative power in trust. It is fair to assume from this deliberate disregard of simple for more obscure language that the Pennsylvania exception is not coextensive with the other. In Pennsylvania the intent of the donor that the power not be released is not solely determinative.

If the power is a special one, exercisable in favor of a reasonably limited class,\textsuperscript{39} and the donor expressly declares that the power shall not be released, then there is an imperative power in trust which is not releasable. If, however, the power is general or is exercisable in favor of an unreasonably large group, the result is different. The expressed intent of the donor creates an imperative power but cannot establish a power in trust. No trust, actual or constructive, can exist where the beneficiaries are not sufficiently made known.\textsuperscript{40} Such an attempted trust is void ab initio.\textsuperscript{41} Therefore a general power cannot be brought within the Pennsylvania exception and is always releasable, without regard to the donor's intent.\textsuperscript{42}

Imperative powers in trust may also be implied. The classical argument over powers in trust arose in the situation where there was a power created with no gift over in default of an appointment. The courts have felt that property subject to such an unexercised power should be divided equally among the possible appointees wherever possible.\textsuperscript{43} The courts arrived at this result ostensibly on the theory that the donee was under a duty to exercise the power, and that a failure to do so would entitle the court to enforce the entrusted power after his death. The commentators have been left to determine whether the power is subject to a real trust or a constructive trust, or whether the transaction is in reality merely an im-

\textsuperscript{36}Restatement Property Ch. 25 Sec. 320, Special Note p. 1830 (1940).
\textsuperscript{37}Bogert, Trusts and Trustees, Sec. 116 (1935).
\textsuperscript{38}Maryland, Colorado, Connecticut, Massachusetts, New Jersey, Rhode Island, Mississippi and Virginia.
\textsuperscript{39}See Restatement Property, Ch. 25, Sec. 320 (2) (a) (1940).
\textsuperscript{40}Bogert, Trusts and Trustees, Sec. 161.
\textsuperscript{41}Bogert, supra, Sec. 162.
\textsuperscript{42}Cf. Restatement, Property Ch. 25, Sec. 334, Comment b (1940).
\textsuperscript{43}See Hays Estate, 286 Pa, 520, 527 (1926) Bogert, supra, Sec. 116; 80 ALR 503 (1932).
plied gift. Implied powers in trust are subject to the same limitation as express ones. If the power is exercisable in favor of anyone, or an unreasonably large class, then no power in trust can be established since there are no designated cestuis who can take the property. The property not appointed must revert to the donor or his estate for lack of a determinable group in whose favor the court can enforce the trust. When, however, the power is special so that a power in trust can be implied, the "imperative" aspect of the power can also usually be implied. If the appointive class consists of children or close relatives, it is fair to assume that the donor intended them to be beneficiaries in any event. If the appointees are in any other limited class, the power should be held imperative unless there is distinct evidence of a contrary intent in the donor. Such implied powers in trust should not be releasable under the Pennsylvania Act.

There is another situation where an imperative power in trust might be implied. The donor of the power might make the donee a trustee of the property subject to the power. In Scott's Estate the donee-trustee was not permitted to exercise inter vivos a testamentary power in her own favor. The Supreme Court laid heavy emphasis on the fact that the donee was a trustee. Would a similar result be reached where a donee-trustee attempted to release a testamentary power? It is submitted that the answer should be, no. A donor by making one a trustee as well as a donee of a power shows increased confidence in the judgment of the donee. If a donee can release, a donee-trustee should be able to. The donee could in any event resign as trustee and then release the power. Making the donee a trustee is not alone sufficient evidence of a mandate by the donor that the power should come within the Pennsylvania exception to releasability.

THE 1945 AMENDMENTS

The Pennsylvania Act was amended in 1945 to incorporate three principal changes as to powers of appointment. First, the term power of appointment was expressly made to include a power of consumption. Secondly, a provision was added permitting the disclaimer as well as the release of powers. Thirdly, the
1945 amendment attempted to make it clear that the existence of a spendthrift trust should not preclude the release of a power, so long as the release was in favor of a remainderman.58

The reference to spendthrift trusts is ambiguously worded. No power "subject" to a spendthrift trust provision is to be released except to a remainderman. Such a power, if conceivable, would be an imperative power in trust and therefore not releasable at all. What must be meant is when a donee of a power has an antecedent life estate subject to a spendthrift trust. Ordinarily, the effect of a release of power is to give the remainderman an indefeasible interest. But a release, if partial, could exclude the remainderman from the field of possible appointees; or the release might take the form of a contract not to appoint to the remainderman. Under the Pennsylvania Act, the release, where a spendthrift trust is involved, must not operate to the disadvantage of the remainderman.

The recognition of the right to disclaim as well as release a power will become increasingly important after June 30, 1947, the tax-free release date. By rejecting a power, either entirely or in part, the donee may avoid a tax. The temptation to assert a disclaimer will be strong. The executor of a donee who has died without exercising a power would find it convenient to argue that the donee had disclaimed. The Pennsylvania Act provides for certain formalities in connection with a disclaimer of a power. Nevertheless, in view of the permissive wording of the Act, it is doubtful if the legislature meant to force a compliance with the formalities set out. Adherence would be excellent evidence to present to the federal tax authorities. But such adherence should not be mandatory in order to make a disclaimer effective if other proof of its validity is available. The most important factor would be the lapse of time between the creation of the power, or the donee's knowledge of it, and the alleged rejection. Once accepted, there could not be a later disclaimer. But the presumption that a gift is accepted would not necessarily apply since a power may be a burden even though it gives the donee an important right because of his control over the wealth of others.

**Summary**

The Pennsylvania Act is broad enough to meet the challenge of the 1942 Federal Revenue Act. Local residents have been provided with the necessary tool to affect releases and consequent tax savings on powers which were created prior to October 21, 1942. The federal time limit for tax releases has been extended to June 30, 1947. The release Act should be widely taken advantage of until that time, to bring powers of appointment into the tax exempt classifications and to release powers of consumption given life tenants who will not in all probability require any or all of the principal.

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58 Schoonmaker v. Commissioner of Internal Revenue, 6 T. C. No. 53, Promulgated March 8, 1946.
The importance of the Pennsylvania statute will inevitably decline rapidly after June 30, 1947, (or a later extended date.) Future powers will be drawn to come within the federal exempt classes so that no release will be necessary. After June 30, 1947, an attempted release to bring a power within the exempt classes, will subject the property to a gift tax, and then to a later estate tax, as part of the donee's estate. The Regulations are explicit that "if a decedent who has a general power of appointment reduces such power after June 30, 1947, . . . the value of the property subject to the power is includable in his gross estate under Section 811 (f) (1) (B) or (C)."

Pennsylvania donee-taxpayers are confronted with these possibilities:

1. If the donee died before October 21, 1942—the property subject to the power is taxable to the donee's estate only if the power was general and if it was exercised by will or in contemplation of death, or to take effect only after death, and if the property "passed" by reason of such exercise.

2. If the donee did not die before October 21, 1942—the important thing then is the date that the power was created by the donor. If created before October 21, 1942, tax may be avoided in a number of ways. For example, if the power is special, the donee's estate will not be taxed if the power is never exercised. Whether the power is general or special, it can be exercised or released prior to June 30, 1947, without tax. And until June 30, 1947, it can be partially released without a gift tax and thereby brought within the federal exempt classes which will render the power non-taxable to the donee's estate. If the power is created by the donor after October 21, 1942, or if created before that time and the donee has done nothing to render it non-taxable before June 30, 1947, then escape avenues from a gift or estate tax are strictly limited. Always open to the donee is the use of the $30,000.00 specific exemption and the $3,000.00 annual exclusion in the federal gift tax. And as to recently created powers, there is the possibility of a partial or complete disclaimer by the donee. If the donee rejects the gift of the power, the takers in default will become assured of receiving the property in equal shares and the donee will escape tax. The fact that the Pennsylvania Act permits partial disclaimers raises an interesting possibility. Perhaps with a general power recently created a donee could disclaim so much of the power as permitted general discretion in appointing, and accept only so much of the power as would bring it within the federal exempt classes.

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54 The amount paid as gift tax will be credited on the later estate tax. I.R.C. Ch. 3, Section 813.
55 U.S. Treas. Regulations 105, Section 81.24 (b) (3).
56 These sections deal with transfers in contemplation of death and transfers in which the transferor has retained power at death to designate the ultimate beneficiary.