10-1-1951

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THE 1951 POWERS OF APPOINTMENT ACT—ITS FEDERAL ESTATE TAX AND GIFT TAX IMPLICATIONS

By

EDWARD N. POLISHER *

1. Introduction

One of the salient attributes of tax law is its susceptibility to change. This characteristic is ascribable to several causes and is nurtured from different sources. Among the factors is the newness of the entire body of Federal tax law as compared with other systems of jurisprudence, such as the common law and the civil law. For example, the Federal income tax statute dates only from 1913, the estate tax from 1916 and the present gift tax from 1932. The common law and the civil law have behind them centuries of history and precedent. Because of its developing experience, the law of Federal taxation is in its formative stage and is fluid, responding to changing conditions as the needs for revenue and the demonstrated equities of the situation demand.

Another cause for the frequency of change is traceable to the fact that in building the system of Federal taxation, legal terms having well known definitions under local law have been employed. Sometimes the commonly accepted definitions of these familiar legal terms must be disregarded, for to so construe them would result in negating the intention of the Congress in enacting the tax statute. Frequently, a conflict exists between the local law concepts of these terms in the different states themselves which must be resolved. Therefore, to protect the Federal revenues and to bring to the tax statutes an interpretation which will make them effective, it becomes imperative for the courts to establish a uniform construction which will prevail throughout all of the several states, without regard to geographic location. Moreover, the well springs of change in the law of Federal taxation are fed by the contributions of the Congress, the Courts and the Treasury through its regulations and rulings, whose combined force and frequent mutations are responsible for the accelerated pace of change in tax law.

The treatment of powers of appointment for Federal estate and gift tax is the current example of this tendency for change. Early in the history of the Federal estate tax law, in 1918, the realism which attends tax law already was manifest. The concept of the ownership of property, as that term was used in the common law, was too narrow a basis upon which to determine the incidence of estate tax. A more realistic rationale, necessary to an effective tax system, recognized that ownership of property consisted of more than the mere legal title and was represented by the total of the bundle of rights which, taken together, make possible the full enjoyment and control of property. Thus, a power of appointment, which has been defined as the power given to another to deal with the property of the owner as though it were his own, vests in the donee of the power certain of the attributes
of ownership of property relating to its enjoyment, control and disposition, which were so closely akin to ownership, that under certain circumstances such powers become proper instances for the imposition of estate tax and gift tax.

II. Historical Background

The first provision for the taxation of powers of appointment appeared in the Revenue Act of 1918.¹ An attempt to tax such powers under the general provisions of the original Federal estate tax statute of 1916 proved abortive, the Supreme Court holding that appointed property was not subject to distribution as part of the donee's estate and, therefore, not taxable under the 1916 statute.²

The Revenue Act of 1932 added a provision dealing with the exercise of powers of appointment to take effect at death. Otherwise, the provision of the 1918 Act remained substantially unchanged until 1942.

The Revenue Act of 1942³ completely revised this section, substituting new criteria for the taxability of property subject to powers of appointment. In order to mitigate the impact of these changes on those who, in relying on the status of the law as it existed prior to the changes effected by the 1942 Act, had created powers of appointment which would now result in tax incidence, Congress provided that the 1942 amendments should not apply to certain types of pre-existing powers under specified circumstances.

The 1951 Powers of Appointment Act, approved by the President on June 28, 1951,⁴ is the most recent modification of the subject.

III. Taxability of Powers of Appointment before 1942 Revenue Act

A. ESTATE TAX

Under Section 811 (f) of the Internal Revenue Code, as it read prior to the 1942 amendments, property subject to a power of appointment was includible in the estate of the donee of the power:

(a). Where it was subject to a general power;

(b). If exercised by will, in contemplation of death or by a transfer, which was either revocable or irrevocable, but intended to take effect in possession or enjoyment at or after death; and

(c). If the property actually passed to the appointees by virtue of the exercise of the power of appointment.

Thus, there were three requirements, all of which had to be satisfied before tax incidence would result:

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¹ Section 402 (e).
³ Section 403 (a).
⁴ P. L. 58, 82d Congress, 1st session.
(1). The power must have been general;
(2). It must have been exercised; and
(3). The property must have passed to the appointee as a result of the exercise of the power.

The technical nature of these three conditions was such that it was comparatively simple, through skillful draftsmanship, to escape the applicability of the Federal estate tax law.

B. GIFT TAX

There was no gift tax on the exercise or release of a power of appointment created on or before October 21, 1942.6

IV. Taxability of Powers of Appointment Under 1942 Revenue Act

A. ESTATE TAX

Under the Revenue Act of 1942, all these prior requirements were scrapped. The test was the existence of the power of appointment, either in the decedent alone or in conjunction with another person, irrespective of whether it was exercised. Nor was it required that the property "pass" by virtue of the exercise of the power.6 The presence of the power was itself sufficient. The distinction between general and special powers was also eliminated. Thus, property subject to a "special" power was includible unless the class of possible appointees was limited to the decedent's spouse, the spouse of the creator of the power, descendants of the decedent or his spouse, descendants (other than the decedent) of the creator of the power or his spouse, spouses of such descendants, charitable, etc. institutions; or unless it was a power to appoint within a restricted class, if the decedent did not receive from the creator of the power, or thereafter acquire, any beneficial interest in the property, and if the power was not exercisable to any extent, for the benefit of the decedent, his estate, his creditors or the creditors of his estate.7

Except where the power was limited, the effect of the changes made by the 1942 Revenue Act was to treat property subject to a power of appointment in all respects as if it were the property of the decedent.

Section 811 (f) (2) specifically excluded four types of powers from the operation of the statute. One was a power to appoint within a specified class based upon relationship as described above; second, a power to appoint to charities; third, a pure fiduciary power to appoint within a restricted class; and fourth, a power founded upon adequate consideration.8

6 Commissioner v. F. E. Walston, 168 F.2d 211 (CCA-4, 1948).
6 Regulations 105, Section 81.24.
7 Section 811 (f) as amended by Sec. 403 (a) of 1942 Revenue Act.
The tax was imposed whether the power to appoint was exercisable by the decedent, either alone or in conjunction with any person. Moreover, where the power to appoint was exercised by creating another power to appoint, the first power was taxable to the extent of the value of the property subject to the second power.\textsuperscript{9}

The Revenue Act of 1942 provided an opportunity for the tax-free release of powers created before October 22, 1942, which exceeded the restricted class defined under its provisions. The provisions governing such releases concerned only powers created by one other than the holder of the power. The release of a power of appointment did not have to be express or formal in character. If a power of appointment was partially released before July 1, 1948, (later extended by successive Joint Resolutions of Congress to July 1, 1951),\textsuperscript{10} so that there remained nothing but a limited power, the exercise of which was exempt under Section 811 (f) (2) of the Internal Revenue Code, as amended by Section 403 (a) of the Revenue Act of 1942, no part of the property was includible in the decedent's estate.

\textbf{B. GIFT TAX}

The opportunity to release certain powers of appointment, gift-tax-free, was provided by Section 452 of the 1942 Revenue Act and was originally made operative as of January 1, 1943. By successive Joint Resolutions of Congress, this tax-free release period was also extended to July 1, 1951.\textsuperscript{11}

For persons under legal disability or in the military service, the benefit of this provision was advanced to the expiration of six months after the removal of the disability or the release from military service.\textsuperscript{12}

The 1942 Act provided that an exercise or release of a power of appointment should be deemed a transfer of property by the individual possessing such power. There were excepted from the tax powers of appointment which fell within the same restricted pattern as those set forth under sub-section (a) of this discussion dealing with estate tax.\textsuperscript{13}

\textbf{V. The 1951 Powers of Appointment Act}

The need for a change in the estate and gift taxation of powers of appointment became apparent soon after the enactment of the 1942 Revenue Act. The latter was artificial and complicated to apply and tended to force the disposition of property into narrow and rigid patterns. Its treatment and definition of powers of appointment represented a complete departure from their concept under local law. The Regulations implementing the law broadened the definition of powers

\textsuperscript{9} Section 811 (f) (2), Regulations 105, Section 81.24 (b) (2).
\textsuperscript{10} P. L. 578, 81st Cong., June 27, 1950.
\textsuperscript{11} Ibid.
\textsuperscript{12} Section 452 (b) (2) of Revenue Act of 1942.
\textsuperscript{13} Section 1000 (c) Internal Revenue Code as amended by Sec. 452 (a) of the 1942 Revenue Act.
of appointment to include powers to invade or consume principal and powers to alter, amend, revoke or terminate.\textsuperscript{14} The attempts to exempt fiduciary powers proved inadequate because of the fear that any remote interest of a fiduciary might subject the property over which the fiduciary power existed to taxation in the fiduciary’s estate. Frequently, such fiduciaries, who were the normal beneficiaries of the creator of the power, might enjoy some contingent interest in the property subject to the power. As a result, wills were drawn to exclude participation, as fiduciary, of the testator’s kin who were best suited to exercise such powers and the power was vested in persons unrelated to the testator who were less satisfactory.

\textbf{VI. Scope of 1951 Powers of Appointment Act}

The 1951 Act amends Sections 881 (f) and 1000 (c) of the Internal Revenue Code, relating to powers of appointment, by repealing the provisions inserted by the 1942 Revenue Act. The general scope of its amendments are:

(a). As to general powers of appointment created on or before October 21, 1942, liability for Federal estate and gift taxes is imposed on the exercise of such powers.

(b). As to general powers of appointment created after October 21, 1942, Federal estate and gift taxes are levied on property over which the donee possessed, exercised or released such powers under certain circumstances.

(c). New definitions of a general power of appointment and exceptions thereto.

(d). Provision for tax-free periods within which existing powers of appointment, which would result in the imposition of estate and gift taxation, may be released, tax-free.

\textbf{VII. Provisions of the 1951 Powers of Appointment Act}

A. Powers Created on or before October 21, 1942—“Pre-existing Powers”

For the purposes of the subsequent discussion in this article, powers created on or before October 21, 1942, will be referred to as “pre-existing powers”; while those created after that date will be designated as “future powers”. However, a power of appointment created by will, executed on or before October 21, 1942, will be considered a pre-existing power only if the decedent died before July 1, 1949, without having republished such will, by codicil or otherwise, after October 21, 1942.\textsuperscript{15}

1. \textbf{ESTATE TAX}

The incidence of estate taxation on pre-existing powers under the new act is made to depend on the exercise of general powers only, as that term is newly

\textsuperscript{14} Regulations 105 Sec. 81.241 (b) (1), for estate tax; Regulations 108, Sec. 86.2 (b) for gift tax.

\textsuperscript{15} Section 811 (f) (5) (b), 1951 Act; this definition continues in effect the provisions of P. L. 693, 80th Congress, approved June 12, 1948.
defined. The exercise can be accomplished, either by will, or by a disposition of such a nature that, if the transfer were of the decedent's own property, it would be includible in his gross estate under Sections 811 (c) or (d) of the Code.16

Section 811 (c) of the Code deals generally with transfers made by a decedent in contemplation of death, transfers intended to take effect in possession or enjoyment at or after his death, as amended by the Technical Changes Act of 1949 and the Revenue Act of 1950. Section 811 (d) of the Code is concerned with transfers in which the decedent reserved the right to alter, amend, revoke or terminate. The rules of Section 811 (c) and (d) which are to applied are those in effect on the date of the decedent's death which are applicable to transfers made on the date on which the inter-vivos exercise occurred. For instance, an inter-vivos exercise of a power by a decedent, dying after the date of the enactment of the 1950 Revenue Act, could not be construed to have been made in contemplation of death unless it was effected within three years prior to his death.17

The new amendments are intended to take effect as to the estates of decedents dying after October 21, 1942, as though the 1942 Revenue Act had never been enacted.18 The result is to restore the tax consequences as they existed prior to October 21, 1942, so that only the exercise of a general power of appointment would be taxable, except for one modification. It is no longer necessary that the property subject to the power pass, under the exercise of the power, to the designated beneficiary in whose favor it is exercised. The mere exercise of the power is sufficient.19

As to what constitutes an exercise of the power, two recent cases are significant. The power must be validly exercised under law. Thus, a power whose exercise violated the rule against perpetuities is not deemed an exercise.20 However, where the power was validly exercised, the fact that the appointees renounced their right to take under the power, but relied upon their interests as takers in default of the appointment, will not avoid the tax consequences resulting from the actual exercise of the power.21

2. GIFT TAX
   a. Exercise of Power

The exercise of a general power of appointment created on or before October 21, 1942, is deemed a transfer of property by the holder of the power.22

16 Section 811 (f) (1), 1951 Act.
17 Report, Senate Committee on Finance No. 382, 82nd Congress, 1st Session page 4 (this Report will be identified in subsequent footnotes as S. C. F. Report). For full discussion of Code Sections 811 (c) and (d) see Polisher, Estate Planning and Estate Tax Saving (2d ed., 1948), Chapter VII, pps. 65-89, Chapter VIII pps. 90-123, and Chapter IX, pps. 124-138.
18 Sec. 811 (f) (5) (c), 1951 Act.
19 Sec. 811 (f) (1), 1951 Act.
21 Estate of Sarah V. Moran, 16 T. C.—No. 100 (1951).
22 Section 1000 (c) (1), 1951 Act.
3. COMPLETE AND PARTIAL RELEASES AND LAPSED POWERS

a. A complete release or failure to exercise a pre-existing general power of appointment at any time will not result in the imposition of Federal estate or gift taxes. Hence, such powers may be retained without incurring tax liability, if they are not exercised. It will apply to powers over property, which if exercised, would have been taxed under Sections 811 (c) and (d) of the Code.\(^{28}\)

b. Where a pre-existing general power of appointment is partially released before November 1, 1951, so that it is no longer a general power of appointment, its subsequent exercise will not be deemed an exercise of such power for Federal estate and gift taxation.\(^{24}\) Nor will the partial release of a pre-existing, general power of appointment which takes place on or after November 1, 1951, result in gift tax at that time. However, a subsequent exercise of the modified power during life, which leaves in the holder no power to change the disposition of the property will be a taxable gift;\(^{26}\) or an exercise of the modified power by will, will cause the property to be included in the decedent's gross estate.\(^{28}\)

It will be noted that the time limit within which the partial release must be accomplished, in order to escape Federal estate taxation, is November 1, 1951, or within the time fixed by paragraph "2" of Section 403 (d) of the 1942 Revenue Act;\(^{27}\) and for gift tax, on or before November 1, 1951, or within the time limit set forth in paragraph "2" of Section 452 (b) of the 1942 Revenue Act.\(^{28}\) The sections of the 1942 Revenue Act referred to above grant to persons under legal disability, and those in the armed services, a period of six months after the removal of the disability or the discharge from the armed forces, whichever is applicable, within which a tax-free partial release may be made.

B. Powers Created After October 21, 1942—"Future Powers"

1. ESTATE TAX

a. Possession of Power

The estate tax is imposed upon property over which the decedent possessed a general power of appointment at the time of his death.\(^{29}\) Here, the existence of the general power in the decedent at the time of his death is sufficient to create the estate tax liability. Its exercise is not necessary. Thus:

(1). If the decedent had a general power of appointment exercisable only by will in favor of his estate, the property subject to the power is taxable; or

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\(^{23}\) Secs. 811 (f) (1) and 1000 (c) (1), 1951 Act.
\(^{24}\) Ibid.
\(^{25}\) See S. C. F. Report, p. 4.
\(^{26}\) See, S. C. F. Report, p. 4.
\(^{27}\) Sec. 811 (f) (1), 1951 Act.
\(^{28}\) Sec. 1000 (c) (1), 1951 Act.
\(^{29}\) Sec. 811 (f) (2), 1951 Act.
(2). If, at the time of his death, the decedent has a general power of appointment exercisable in his own favor only during lifetime, the property subject to the power would also be taxable.\textsuperscript{30}

b. Exercise or Release of Power

The exercise or release of a general power of appointment by the holder at any time through a disposition of such nature that, if it were the transfer of the decedent's own property, it would be includible in his gross estate under Sections 811 (c) or (d) of the Code, would cause such property to be taxable in the estate of the holder of the power.\textsuperscript{31}

c. Exercise by Creation of Another Power

Section 811 (f) (4) is added by the 1951 Act to deal with successive powers of appointment which, under the law of any state, could be created and exercised so that the property would be handed down from generation to generation without ever being subject to estate tax. The Committee report points out that in at least one state, (Delaware) a succession of powers of appointment, general or limited, may be created and exercised over an indefinite period without violating the rule against perpetuities. Hence, the need for this provision. Section 811 (f) (4) provides that the exercise of any future power of appointment will be taxable, where it is accomplished by creating another power of appointment which, under applicable local law can be validly exercised so as to postpone the vesting of the property, or suspend the absolute ownership, or power of alienation of such property, for a period which is ascertainable without regard to the date of the creation of the first power. This result will obtain whether or not the first power is exercisable in favor of the holder of the power or his estate.\textsuperscript{32}

d. Existence of Power at Decedent's Death

The power of appointment in the holder is considered to exist at his death, if its exercise takes effect only:

(1). Subject to giving notice before exercise or death; or

(2). On the expiration of a stated period after its exercise, whether or not such notice was given before the decedent's death or before the power has been exercised.\textsuperscript{33}

2. GIFT TAX

(a). The exercise of a future general power of appointment or its release on or after June 1, 1951, is deemed a transfer of property by the person possessing the power.\textsuperscript{34}

\textsuperscript{30} S. C. F. Report, p. 4.
\textsuperscript{31} Sec. 811 (f) (2), 1951 Act.
\textsuperscript{32} S. C. F. Report, p. 6.
\textsuperscript{33} Section 811 (f) (2), 1951 Act.
\textsuperscript{34} Section 1000 (c) (2), 1951 Act.
(b). Similarly, as in B (1) (c) above, the exercise of a future power, by creating another power of appointment, which under local law could postpone the vesting or suspend the ownership or power of alienation of the property indefinitely, will subject to the gift tax the property as to which the second power exists.85

3. COMPLETE AND PARTIAL RELEASES

a. Complete release of a future general power of appointment in contemplation of death, or to take effect in possession or enjoyment at or after death, or in which the holder reserved the right to alter, amend, revoke or terminate is taxable, if of such a nature that, were it the decedent's own property, it would be includible in his gross estate under sections 811 (c) or (d) of the Code.86

b. Partial release of future power

(1). The partial release of a future power prior to June 1, 1951, which reduced it to a special power of appointment, will not be taxable on its subsequent inter-vivos exercise.

(2). A partial release of a future power, on or after June 1, 1951, will result in:

(a). Gift tax, where the modified power is subsequently released during life under circumstances which leave in the holder no power to change the disposition of the property; and

(b). Estate tax on the property subject to the power, where the possession of the modified power at death, or its inter-vivos exercise or release, was accomplished by a disposition which, if it were a transfer of the decedent's own property, would be taxable under section 811 (c) or (d).87

4. LAPSED OR TERMINATED POWERS

(a). In many situations, dispositions are made of moderate sized properties where the donor feels that the income therefrom will be insufficient to provide for the income beneficiary. To meet this, the income beneficiary is given a non-cumulative power to invade the principal. The Regulations, defining a power of appointment under the 1942 Revenue Act,88 stated that a power of appointment included one in which the property is transferred in trust for the life of the beneficiary, with power in the beneficiary to appropriate or consume the principal of the trust. In many instances, this power to consume principal was not exercised. Since reasonable invasions of principal to meet the needs of the income beneficiary seemed entirely justifiable and socially desirable,

85 Section 1000 (c) (4), 1951 Act.
86 Section 811 (f) (2), 1951 Act.
87 S. C. F. Report, p. 4.
88 Regulations 105, Section 81.24 (b) (1) for estate tax; Regulations 108, Section 86.2 (b) for gift tax.
the 1951 Act provides for an exemption from estate and gift taxes in limited amounts, where the power to invade is not exercised during the lifetime of the holder and therefore lapses; otherwise, it is treated as a release of the power which may be taxable.

(b). Therefore, the failure to exercise a future power, which lapses during the life of the holder, may result in the imposition of estate and gift taxes. Section 811 (f) (5) allows an annual exemption for lapsed powers in an amount equal to the greater of $5,000.00 or 5% of the trust or fund over which the lapsed power existed. The Report of the Senate Committee on Finance furnishes the following example:

If a person has a non-cumulative right to withdraw $10,000.00 a year from the principal of a $200,000.00 trust fund, failure to exercise this right will not result in either estate or gift tax with respect to the power over $10,000.00 which lapses each year prior to the year of death. At his death there will be included in his gross estate the $10,000.00 which he was entitled to draw for the year in which his death occurs, less any sums which he may have taken on account thereof while he was alive during the year.

However, if, in the above example, the person had had a right to withdraw $15,000.00 annually, failure to exercise this right in any year prior to the year of death will be considered a release of a power to the extent of the excess over 5% of the trust fund. Thus, all over $10,000.00 which the decedent failed to withdraw in any calendar year would be includible in his estate.

(c). The above formula determines the proportion of property over which the power lapsed, which is not considered a taxable disposition for estate tax purposes, and the proportion which would be taxable, if other requirements of 811 (c) and (d), as amended, are satisfied.

(d). Once the proportion is fixed, the valuation of that portion, as of date of death of the decedent (or one year later, under the optional valuation allowed by Section 811 (j) of the Code, if elected by executor) is determined according to principles applicable to valuation of transfers of property under corresponding provisions of 811 (c) or (d). Thus, for example, assume that a person who is life tenant of a trust has the right, exercisable only in the calendar year 1952, to appropriate $50,000.00 of trust principal and that the principal of the trust at the end of 1952 is worth $1,000,000.00. Under Section 811 (f) (5), no part of the disposition by reason of the lapse of the power will be treated as a taxable disposition since it does not exceed 5%. It is, therefore, immaterial whether the trust corpus later declines or increases in value. However, if in this example, the value of the trust has been $800,000.00 at the end of 1952, the tax-free limit of 5% thereof or $40,000.00 would be exceeded by $10,000.00;

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89 Section 811 (f) (5), 1951 Act.
and then the lapse of the power over the $10,000.00 (or one-fifth of the amount which could have been appropriated) will be treated under Section 811 (f) (5) as a taxable disposition. Accordingly, under valuation principles applicable in determining the amount includible in the gross estate in case of a transfer intended to take effect in possession or enjoyment at or after death, if the trust corpus had declined in value to $600,000.00 at the date of death, then $7,500.00 would be includible in the decedent’s gross estate by reason of the lapse. Conversely, if the value of the trust had risen to $1,200,000.00 at the date of death, then $15,000.00 would be includible in the decedent’s gross estate by reason of the lapse.

This formula follows the pattern now incorporated in Section 811 (c) (2) and (3) of the Code, as amended by the Technical Changes Act of 1949.41

Should the entire fund over which the lapsed power existed be includible in the decedent’s gross estate under an applicable sub-section of Section 811 of the Code, no additional amount will be added to the gross estate for the lapsed power in prior years. The whole necessarily includes the sum of all its parts.

5. RENUNCIATION AND DISCLAIMER OF POWER

Experience has shown that in inter-vivos trusts, a power of appointment is given to persons who often do not learn of the existence of the power until long after the trust was created. Moreover, such trusts and often wills create powers of appointment in favor of persons not yet born or unascertainable at the time the instrument is executed. Sections 811 (f) (2) and 1000 (c) (2) of the 1951 Act specifically provide that a disclaimer or renunciation of such a future power of appointment shall not be deemed a release of such power. The disclaimer or renunciation must be unequivocable and must be made within a reasonable time after learning of the existence of the power. Moreover, the power may be disclaimed or renounced, without disclaiming or renouncing any other interest which the donee may have in the property, providing such disclaimer or renunciation is effective under local law.42

6. SCOPE AND EFFECT OF 1951 ACT ON OTHER CODE SECTIONS

The report of the Senate Committee on Finance43 makes the following enigmatic statement:

"The provisions relating specifically to powers of appointment, which are proposed to be inserted in the Internal Revenue Code by this bill, are not intended to limit the scope of other subdivisions of the Code (such as sub-secs. (a), (c), and (d) of Section 811 and sub-

41 For explanation, see 1950 Supplement (pps. 19-22) Polisher, EST. PLANNING AND ESTATE TAX SAVING (2d ed. 1948).
43 Ibid.
section (a) of Section 1000) which apply to the transfer at death
or during life of any interest in property possessed by the taxpayer.”

This riddle is answered by a reference to the decision in Commissioner v.
F. E. Walston, which held the exercise of a power of appointment prior to
the 1942 Revenue Act not subject to gift tax. However, under the above
statement of the Committee, where the donee, by the exercise of his non-taxable
power of appointment, transfers an interest which he had in the property before
he exercised the power, the incidence of tax, with respect to the transfer of his
own interest, must be determined in accordance with the rules applicable to other
transfers of property. Thus, if the donee were the life income beneficiary of
the trust with power, during his lifetime, to appoint the corpus to his children only
and exercised this power, it would not be taxable as to the trust corpus. How-
ever, by his action he has transferred to his children the right which he had to
the income from the corpus during the remainder of his life. As to this, there will
be a gift tax.

VIII. Definition—General Power of Appointment

Section 811 (f) (3) defines a general power of appointment and is applicable
to both pre-existing and future powers.

A. A power exercisable in favor of decedent, his estate, his creditors
or creditors of his estate is deemed a general power of appointment. The parties
in whose favor the exercise of the power would create a general power of ap-
pointment are stated in the disjunctive. Hence, a power exercisable in favor of any
of these, but not others, would still be a general power of appointment. Where
the power exists over part, but not all of the property, that part only is includible
in his gross estate.

B. Where the power described in (a) above is subject to certain limita-
tions or restrictions, it will no longer be considered a general power of appoint-
ment, despite the fact that it is exercisable by the decedent in his own favor.
Section 811 (f) (3) sets forth certain exceptions:

(1). A power to consume, invade or appropriate property in favor
of the holder of the power which is limited by an ascertainable standard related
to his health, education, support or maintenance is not a general power of appoint-
ment. A corollary of this is that the holder of a power, who is legally accountable
for its exercise or non-exercise, is not deemed to have a general power. However,
a power exercisable in favor of the holder, his estate, his creditors or the creditors
of his estate is not regarded as a power for which the holder is legally accountable.
The guiding principles for the application of this doctrine of an "ascertainable standard" are to be found in the decisions dealing with the estate tax implications of revocable trusts with powers of invasion of corpus retained; charitable remainders, after life interests with power to invade corpus for life-tenant's benefit; and the income tax implications of trusts with power retained by grantor to deal with corpus.

(2). A pre-existing joint power which can only be exercised with the consent or joinder of another person or persons, is not a general power of appointment.

(3) a. A future joint power, exercisable only with consent of the creator of power, is not a general power of appointment. The property subject to the power would be taxed in the estate of the creator.

b. A future joint power, exercisable only with consent or joinder of a person having a substantial interest in the property subject to the power, and adverse to the exercise of the power in favor of the decedent his estate, his creditors or creditors of his estate is not a general power of appointment.

c. Powers which, after the application of the tests applied in "(a)" and "(b)" above remain general powers of appointment, will be treated as though those holders, in whose favor it could be exercised, were joint owners of the property subject to the power. The portion of the property taxable in the decedent's estate will be the fractional share of the property over which the power exists, determined by dividing value of the property by the number of persons in favor of whom such power is exercisable. Thus, if there were three such holders, one-third of the property would be includible in the decedent's gross estate.

d. What is a substantial adverse interest for the purposes of (b) above? The concept of substantial adverse interest, as developed under the Federal income and gift tax, will be applicable now to powers of appointment for estate tax purposes. This is departure from the existing provisions of the estate tax statute and introduces, for the first time, the principle that a power over property, held by the decedent with another person having a substantial adverse interest, will not result in the imposition of the estate tax.

Section (f) (3) (C) (ii) of the 1951 Powers of Appointment Act sets forth only one type of substantial adverse interest—a person who, after the decedent's death, is possessed of a power over the same property, as was the decedent's power, exercisable in his own favor, his estate, his creditors or the creditors of his estate.

The report of the Senate Committee on Finance on the 1951 Act supplies others:

48 Polisher, ESTATE PLANNING AND ESTATE TAX SAVING (2d ed. 1948) pps. 131-134.
49 Ibid., pps. 277-279.
50 Ibid., pps. 393-396.
(a). A taker in default has an adverse interest. Whether it is substantial, depends on the facts in each case.

(b). A co-holder has no adverse interest merely because:
   (1). Of his joint possession of the power; and
   (2). He is a permissible appointee under the power.

These exceptions are in accord with the prevailing rules of state property law which regard neither the power, nor the expectancy as appointee, as an "interest" in property.

The principles which obtain under the income tax and gift tax defining a substantial adverse interest will also control for estate tax.\(^5\)

IX. Effective Date of 1951 Act

The amendments made by this Act take effect as though they had been contained originally in the 1942 Revenue Act, all of whose provisions dealing with powers of appointment are specifically repealed. It follows that the provisions of the new law will apply to estates of all decedents dying after October 21, 1942 and will affect gifts made on or after January 1, 1943. These were the effective dates of the 1942 Revenue Act. Moreover, a special provision is included to prevent the retroactive imposition of gift tax upon releases of powers of appointment made prior to June 1, 1951, of powers of appointments created after October 21, 1942. This treatment is necessary because, since 1942, there have been repeated extensions (the last until July 1, 1951) of the period for gift tax-free releases of powers of appointment, irrespective of the date of their creation, whether before or after October 21, 1942.

X. Features Of 1951 Act—New and Retained From Prior Law

A. NEW FEATURES

The 1951 Act introduces new concepts into the estate tax. Among them are:

(1). The substantial adverse interest in the co-holder of a future joint power of appointment eliminates the estate tax on the property subject to the power. This principle, while present in Federal income tax and gift tax, is new to estate tax.

(2). A future joint power exercisable only with creator of power, is not subject to estate tax in the estate of co-holder but is taxable only in the estate of the creator. Until now, the possession by the decedent of such a power over property, either alone or in conjunction with another person, was taxable.

(3). A pre-existing power, exercisable with the joinder of any other person, is not subject to estate or gift tax. Under the 1951 Act, the nature and extent of the interest of the co-holder of a pre-existing power is not important.\(^5\)

\(^5\) Ibid., pps. 368-373, 434; Gilbert Pleet, 17 T. C.—No. 11 (1951).
(4). The limitation of a power to consume principal by an ascertainable standard related to the health, education, support and maintenance of the holder of power prevents it from being considered a general power of appointment and would not be taxable.

(5). The treatment of co-holders of powers of appointment, making them taxable on aliquot portions of value of property subject to the power, depending on number of co-holders, is new.

The changes expressed in "1", "2" and "3" above are steps in direction of the correlation of the Federal income, estate and gift tax concepts which has been advocated by many tax authorities and the Treasury advisory committee.\(^62\)

B. FEATURES RETAINED FROM PRIOR LAW

Certain principles have been carried over from the prior law governing the taxation of powers of appointment.

(1). The possession and exercise of a pre-existing power imposes estate and gift taxes. However, the passing of property under the exercise of power is no longer necessary.

(2). The possession, alone, of a future power is sufficient to create estate and gift tax liability.

(3). The exercise of a general power of appointment by the creation of another power results in estate tax and gift tax liability under certain circumstances. The antecedent of this provision is to be found in Section 811 (f) (2) of the Code, as amended by the 1942 Revenue Act.

XI. An Inconsistency Which Will Result

A. Some tax-free powers created after October 21, 1942, which were exercisable only in favor of the restricted statutory class set up in the 1942 Revenue Act, will now be taxable. Thus, where a donor gave his spouse a power of appointment exercisable in her own favor and others, who fall within the restricted class defined in the 1942 Revenue Act, it would now be taxable unless it were limited to an ascertainable standard relating to her own health, education, support and maintenance.

Other situations may arise which would also produce this result.

XII. Refunds

The 1951 Powers of Appointment Act is significantly silent in respect of refunds. No extension of the right to file and prosecute claims for refunds is included in the new Act to cover those situations where powers, which were taxable under the law prior to the date of its enactment, now become non-taxable under its provisions. This is an omission which is difficult to explain in view of the

\(^{62}\) Ibid. Chapter XXV, pps. 589-604.
usual "refund saving" provision of prior acts, including the 1942 Revenue Act which made the change in the first instance.

As a result, the provisions of Section 910 of the Code, as implemented by Regulations 105, Section 81.96, will control. Under these, claims for refunds for estate taxes, erroneously or illegally assessed or collected, must be filed within three years next after payment of the amount sought to be refunded.

Since the amendments made by the 1951 Powers of Appointment Act are intended to take effect, retroactively, as though they had been contained originally in the 1942 Revenue Act, the situation calls for some remedial action by the Treasury or the Congress, to make possible claims for refund of estate taxes in those cases where taxes, properly assessed and collected under the provisions of the prior law, would not have been payable under the new provisions.

XIII. Marital Deduction Trusts with Powers of Appointment

Section 811 (e) of the Code, added by the 1948 Revenue Act, created a marital deduction applicable to any interest in property passing from the decedent to the surviving spouse. The amount of the deduction was limited so that it could not exceed fifty per cent of the adjusted gross estate, as that term was defined. In order for the interest passing to the surviving spouse to qualify for the marital deduction, the transfer must meet certain requirements stated in the statute. One of the approved methods of transferring property, which would qualify for the marital deduction, was through a trust under which the surviving spouse was entitled to receive all of the income therefrom during her lifetime, or so long as the trust remained in effect, and was given the power, exercisable by her alone and in all events, either during life or at death, to appoint the entire corpus to herself or to her estate; and with no power in any other person to appoint any part of the corpus other than to the surviving spouse. To satisfy these requirements, it is obvious that the surviving spouse must be given a general power of appointment, as that term is now defined under the provisions of the 1951 Powers of Appointment Act. With such a power of appointment over the trust corpus granted to the surviving spouse, the intention of the Congress to allow the property passing by means of the marital deduction trust to escape taxation at the death of the decedent-spouse, but to tax it at the death of the surviving spouse, will be effectuated.

It follows that the provisions of the 1951 Powers of Appointment Act do not legally encumber or conflict with the provisions creating the marital deduction under the 1948 statute.

XIV. Problems in The Wake of the New Act

A. Following the enactment of the amendments to Section 811 (f) by the 1942 Revenue Act, many existing powers of appointment, which were not taxable when created, were threatened with liability for estate and gift taxes. A tax-free
opportunity to avoid such taxes was provided in the Act by, either releasing such vulnerable powers of appointment, or reducing their scope, so that they would conform to one of the restricted types of powers of appointment, which, by the provisions of the 1942 Revenue Act, would not cause the property over which the power existed to be subject to Federal estate and gift taxes. Now, with the passage of the 1951 Act, many of these original powers, if they had been permitted to remain unchanged, would not be taxable. For instance, under the 1951 Act, a pre-existing power of appointment, exercisable in conjunction with another person, is not deemed a general power of appointment as to which the tax would apply. Similarly, a future power of appointment, exercisable by the decedent in conjunction with the creator of the power, would not now be deemed a general power of appointment but would have been a taxable power prior to the 1951 Act, if it were not limited to the restricted classes set up in the 1942 Revenue Act. Where such powers were released and restricted in scope after the passage of the 1942 Act, the holder of the power relinquished valuable rights of control and disposition in order to avoid the imposition of Federal estate and gift taxes. Would it now be possible to restore these rights? It will be recalled that in order to enable holders of such powers to partially release them, many of the states enacted legislation, specifically authorizing such procedure, after the 1942 Revenue Act became law. Will the Legislatures now enact enabling legislation to restore these released rights to the holders of powers, or must resort be had the courts to set aside such releases, as having been induced by an attempt to comply with the Federal tax law which has now been changed? Recent experiences in such proceedings have been inconclusive.

B. Pre-existing Powers

In view of the fact that the incidence of tax on pre-existing powers depends upon the exercise of the power, care must be taken that the execution of the holder's will, under local law, does not result in the exercise of the power, where this result is not intended. Since an unexercised, pre-existing general power of appointment is not taxable for Federal estate and gift taxes, the holder must decide, before November 1, 1951, whether he wishes the power to remain dormant and unexercised, or whether it is to his best interests to reduce the power, so that it becomes a non-general power of appointment which could be exercised later without incurring any liability for tax.

63 For list of such states, see Ibid., pps. 179-180.
64 See, Stone vs. Stone, 29 N. W. (2d) 271 (Mich., 1947) and Lowry vs. Kavanagh Mich., 34 N. W. 2d 60 (Mich., 1948) involving attempts to set aside family partnerships which failed to realize anticipated tax savings because of a change in the law relating to income taxation of family partnerships.
C. Pre-existing Joint Powers

Since a pre-existing joint power, exercisable in conjunction with any person, is not deemed a general power of appointment, it can be exercised at any time in the future without incurring Federal estate and gift taxes. In these situations, care must be taken that the holder of the power does not by his exercise transfer an interest in the property which he holds independent of the power. If so, the transfer of his independent interest would be subject to tax.

D. A power to consume or invade property for the benefit of the decedent, which is limited by an ascertainable standard relating to his health, education, support and maintenance, must be carefully analyzed to determine whether, under the existing decisions, the standard is ascertainable.

E. Where a non-cumulative power of appointment to consume or invade property for the benefit of the holder is created and it is desired to take advantage of the exemption granted by Section 811 (f) (5), which is a tax-free right to withdraw, annually, the greater of the sum of $5,000.00 or 5% of the principal over which the power exists, care should be taken that the phraseology used follows as closely as possible the wording in the statute.

XV. Conclusion

From the foregoing discussion of the provisions of the 1951 Revenue Act, it would seem that the sincere attempt on the part of the Treasury and the Congress to clarify the artificial and muddled treatment of powers of appointment for Federal estate and gift taxes has resulted in compounding the confusion. Sometimes, in legislation, the cure becomes worse than the disease. The various stages in the development of the law governing the taxation of powers of appointment created situations and inequities which demanded specific treatment in order to avoid injustices. The 1951 Powers of Appointment Act represents the most recent effort of the Congress to meet the problem. It remains to be seen whether this Act is the best solution available.