FEDERAL ESTATE TAXATION: SECTION 2036 (a) (1)
TRANSFER REQUIRES AFFIRMATIVE ACTION

The Sixth Circuit, in National City Bank v. United States, held that the possession by the decedent of the power to alter the ultimate disposition of property, in the absence of any exercise of that power, was not sufficient in itself to constitute a transfer under section 2036(a)(1) of the Internal Revenue Code.

In order to preserve an effective taxing system, the federal estate tax includes within a decedent's estate not only property he possessed at death but also certain property which he transferred prior to death. The taxable inter vivos transfers are of two general types. First, transfers in contemplation of death are taxed because the transferor's state of mind and primary motivations in making them are basically testamentary in character. Second, transfers by which the transferor does not divest himself of his total interest in the property are taxed since the transferor thereby postpones the final disposition of the property until his death. Thus, a taxable transfer will occur when a life interest in the property is retained, or when the transfer does not become operative until the transferor's death, or, finally, when the power to alter, amend, revoke, or terminate an otherwise complete transfer is reserved for the transferor's life.

When the inter vivos transfer provisions, sections 2035-38 of the Internal Revenue Code, are applied, the primary concern is usually the nature of the interest which is retained after a particular transfer.

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1 INT. REV. CODE OF 1954, § 2033.
4 INT. REV. CODE OF 1954, § 2037. See generally LOWNDES & KRAMER §§ 7.1-10; 3 MERTENS §§ 23.01-.39; Foosener, How to Meet the Issue of Transfers Intended to Take Effect at Death, 2 J. K. LASSER'S ESTATE TAX TECHNIQUES 1201 (1966); Moore, Transfers Intended to Take Effect in Possession or Enjoyment at or After Death, 40 TAXES 876 (1962).
5 INT. REV. CODE OF 1954, §§ 2036 (a) (2), 2038. See generally LOWNDES & KRAMER §§ 8.16-.20; 5 MERTENS §§ 25.01-.30; Leiter, Estate Tax Consequences of Inter Vivos Transfers, 38 TAXES 399 (1960); Note, 13 W. RES. L. REV. 737 (1962).
On relatively infrequent occasions, however, the existence of a transfer sufficient to support the imposition of an estate tax has been questioned. Controversy has particularly arisen in the context of the application of section 2036 (a) (1) when there has been an undisputed transfer of a limited property interest to a donee in a manner such that the donee has the ability to alter the ultimate disposition of the property but dies without doing so. The issue in this circumstance is whether the mere possession of the power to direct the enjoyment and possession of the economic benefits of the property constitutes an inter vivos transfer by the donee. In the broader context, whether the transfer concept does or should necessitate affirmative conduct on the part of the alleged transferor raises significant issues concerning the effectuation of a coherent estate taxation scheme.

A delineation of the scope of the transfer concept requires in the first instance an examination of the case law, for the Internal Revenue Code contains no relevant definition of the term. The decisions have

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6 Int. Rev. Code of 1954, § 2036 (a) (1). All of the inter vivos transfer sections expressly require a transfer and all share a common legislative origin. Section 202 (b) of the original estate tax code in the 1916 Revenue Act provided that the value of the decedent's gross estate would include the value of all property "to the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for a fair consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title." Revenue Act of 1916, ch. 463, § 202 (b), 39 Stat. 777-78. Subsections were gradually added to this section to clarify the taxation of specific situations, but not until the 1954 Code were the various provisions actually separated into individual sections. See Lowndes & Kramer §§ 6.1-9; 2 Mertens § 20.01.

Because the inter vivos transfer sections share this common legislative history, and because in the development of the specific sections the requirement of a transfer remained unchanged, it follows that a "transfer" has the same meaning under all the sections. See Libbey v. United States, 147 F. Supp. 383, 384 n.1 (N.D. Cal. 1956); Lowndes & Kramer § 9.1, at 163. Therefore, even though this note will focus on § 2036 (a) (1), the discussion is equally applicable to the other inter vivos transfer sections.

7 United States v. O'Malley, 383 U.S. 627 (1966), examined the transfer concept in a distinguishable context. In that case the decedent had established an irrevocable trust but had retained the power to distribute the income to the beneficiaries or to accumulate it in the corpus. The issue was whether the increments added to the corpus by his exercise of the power to accumulate constituted a transfer under the predecessors of § 2036 (a) (2) or § 2038. See notes 56-58 infra and accompanying text. Although the Court phrased the issue in terms of whether there had been a transfer by the decedent, the scope of the problem was how much the decedent transferred, not whether he had initially made a transfer. 383 U.S. at 632-33. See Lowndes & Stephens, Identification of Property Subject to the Federal Estate Tax, 65 Mich. L. Rev. 105, 109-13 (1966).
generally dealt with difficulties arising in three specific areas, namely, retirement annuities purchased by an employer, vested property rights, and life insurance contracts. With respect to the first category, retirement annuity contracts purchased by an employer for his employees usually provide the employee with an option to convert the mode of payment provided in the policy to one of several alternative arrangements. Prior to the addition of section 2039 in the 1954 Code, the question of whether these annuities were taxable to a decedent-employee's estate frequently arose. In Adeline S. Davis, the decedent exercised such an option and converted the policy from an annuity for life to a joint annuity. The court held that the decedent had made a taxable transfer under either the predecessor of section 2036 (a) (2) or of section 2038.

In comparison, the decedent in Libbey v. United States did not exercise his option to convert the policy. Arguing that nevertheless there had been a transfer, the Government contended that since Libbey had the option to convert the ten-year annuity to a life annuity, by refraining from doing so he assured that his wife would receive any unpaid annuity at his death and thereby he in-

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8 Among typical pay-out arrangements and conversion options are the following: (1) an annuity for a term of years; (2) an annuity for life; (3) a cash refund annuity which provides for monthly payments with a lump sum payment to the decedent employee's estate or his beneficiary in the amount, if any, by which the proceeds when applied toward the purchase of the annuity exceed the total of the payments received; (4) a joint and last survivor annuity, which provides lifetime payments to the employee and then to such beneficiary as he designates if the beneficiary survives; (5) a joint and one-half survivor annuity, which provides a larger monthly payment to the annuitant for life than the regular joint and last survivor annuity but pays the survivor only one-half that amount. Libbey v. United States, 147 F. Supp. 383, 384 (N.D. Cal. 1956).

9 INT. REV. CODE OF 1954, § 2039. Section 2039, enacted in 1954, expressly provides for the taxation of retirement annuity contracts. Therefore, while the cases discussed in this section are still valid as they relate to the transfer concept, the precise practical problem which they present will no longer arise with respect to INT. REV. CODE OF 1954, §§ 2035-38. See Note 67 infra and accompanying text.

10 27 T.C. 378 (1956).

11 Id. at 379.

12 Id. at 381; accord, Mearkle's Estate v. Commissioner, 129 F.2d 986 (3d Cir. 1942); Commissioner v. Clise, 122 F.2d 996 (9th Cir. 1941), cert. denied, 315 U.S. 821 (1942); Commissioner v. Wilder's Estate, 118 F.2d 281 (5th Cir.), cert. denied, 314 U.S. 634 (1941).


14 Id. at 384. See also Estate of King, 28 Wis. 2d 451, 137 N.W.2d 122 (1965) (annuitant did not have any option to convert the policy to another pay-out arrangement); Estate of Sweet, 270 Wis. 256, 70 N.W.2d 645 (1955) (same).
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directly effected a transfer intended to take effect in possession or enjoyment at his death.15

The court, however, held that no transfer within the "plain language"16 of the section had occurred. The distinction between the factual circumstances in the two cases which led to disparate results is simply that in Davis there was overt action by the donee while in Libbey there was none.

A similar explanation applies where a property interest is vested in an individual by the operation of local law. While the determination of the respective property interests is controlled by state law, the tax effect of that determination is a matter of federal law:17 if local law prescribes that a property interest is vested in an individual, a renunciation of that right will constitute an overt act which will satisfy the requirement of a transfer under the estate tax.18 In Anna H. Kinney19 the decedent was the sole surviving trustee and life beneficiary of a testamentary trust established by her deceased husband. Stock dividends were paid to the trust, and as a matter of New York property law the right to those dividends became vested in the life beneficiary.20 Although the decedent, in her role as trustee, took no action to distribute the dividends, she was found, in her role as beneficiary, to have consciously renounced her right to the dividends. The court held that a transfer within the meaning of section 2036 (a) (1) had occurred because the decedent, as beneficiary, had been

15 147 F. Supp. at 384.
16 Id. at 385. The language of the Libbey court is typical of that used by the courts in determining the issue of transfer. It is conclusory and does not indicate why a particular result was reached.
18 Compare Brown v. Routzahn, 63 F.2d 914 (6th Cir.), cert. denied, 290 U.S. 641 (1933), with Commissioner v. Vease's Estate, 314 F.2d 79 (9th Cir. 1963) and Hardenberg v. Commissioner, 198 F.2d 63 (8th Cir.), cert. denied, 344 U.S. 836 (1952).

In Hardenberg the taxpayers were heirs of an intestate decedent. Local law provided that title to the intestate's property vested in his heirs at the moment of death. The heirs, however, renounced their gift, and it was held that they had made a taxable transfer to the other takers. On the other hand, in Brown the taxpayer was a legatee under a will, and local law there provided that title to the legacy did not vest in the legatee until distribution of the estate was made. Therefore, when this gift was renounced by the taxpayer, no taxable transfer occurred because the taxpayer was vested with no title which he could transfer; rather, he possessed merely the right to accept or reject the gift.
19 59 T.C. 728 (1968).
vested with the right to the dividends and by her inaction, as trustee, had permitted them to become part of the trust corpus; thus, as a result of the respective positions which she had assumed in her dual capacity, the decedent had transferred the economic benefit of the dividends to the remaindermen.\textsuperscript{21}

In contrast, the decedent in *Estate of Eleanor H. Beggs*\textsuperscript{22} possessed a valid claim against her husband's estate. Although the estate had sufficient assets, the decedent-executrix made no effort to collect the debt. Pursuant to the husband's will, the wife was given a life interest in the income from the residuary estate, and the remainder was to have been distributed to the decedent's daughter. Accordingly, it was argued that since the decedent would have depleted the residue if she had collected the debt, her failure to demand payment bestowed an economic benefit on her daughter. While recognizing and conceding the economic effect of the arrangement, the court, nevertheless, held that the inaction on the part of the decedent was not a transfer by the decedent under the predecessor of

\textsuperscript{21}Because the dividends were in the trust and no action to remove them was ever taken, it might seem that no transfer could be present in *Kinney*. This conclusion results from a failure to appreciate the separation of title inherent in a trust. The legal title, and the tangible evidence of that title in the form of the stock dividend were, it is true, paid to the trust. However, the beneficial title to those dividends was vested in the income beneficiary by the operation of the New York property law. The overt transfer resulted when Mrs. Kinney "consciously waived and renounced" her beneficial right to the dividends which she thereby transferred to the trust. The conceptual difficulty develops from the fact that there was no tangible object involved in the transfer; rather, all that was transferred was the intangible beneficial title to the dividends. The analogy to the renunciation by an heir is readily apparent. The *Kinney* court explained that the lack of necessity for an affirmative declaration of renunciation was the result of Mrs. Kinney's dual capacity as trustee and beneficiary: "that she, as trustee, elected not to engage in the empty ritual of transferring legal title to her name in her individual capacity so that she might merely transfer legal title back to the trust does not change the essential nature of her intention." \textsuperscript{39} T.C. at 731.

An alternative explanation of the affirmative action in *Kinney* is possible by comparison to *Davis v. United States*, 27 F. Supp. 698 (S.D.N.Y. 1939). In *Davis*, the overt action constituting a transfer resulted when the specific pay-out scheme expressly provided in the annuity contract was affirmatively altered by the election of the decedent. In *Kinney*, while the trust instrument was silent as to a pay-out arrangement for stock dividends, the New York property law supplemented the instrument by providing that stock dividends should be paid to the life beneficiary. That scheme was substantively changed by Mrs. Kinney when she, as trustee, elected not to distribute the dividends to herself as beneficiary, but rather accumulated them to corpus. Therefore, notwithstanding her lack of "physical" transfer, she affirmatively altered the pay-out scheme by an action sufficiently overt for classification as a transfer.

\textsuperscript{22}13 T.C. 131 (1949).
2036 (a).\textsuperscript{28} In \textit{Beggs}, unlike \textit{Kinney}, the decedent had possessed only an enforceable claim.\textsuperscript{24} While an economic benefit had been conferred on a third person, it did not result from the renunciation of an interest vested in the decedent by the operation of law. Thus, the \textit{Beggs} case highlights an element which is implicit in the concept of transfer, namely, the existence of a property interest with respect to which the decedent must have taken affirmative action.

The exercise of the incidents of ownership of a revocable life insurance policy, notably when those incidents include the right to change beneficiaries, the power to alter the mode of settlement, and the right to surrender the policy for its cash surrender value,\textsuperscript{25} similarly brings the applicability of section 2036 (a) (1) into question. In \textit{In re Pyle's Estate}\textsuperscript{26} the decedent purchased an insurance policy on the life of her husband. Later she exercised the power to select the mode of settlement by which she retained a life interest in the proceeds with distribution to her children at her death. The court easily found the necessary action for a transfer in the settlement election\textsuperscript{27} and thus taxed the decedent's estate under section 2036 (a) (1).\textsuperscript{28}

However, \textit{National City Bank v. United States},\textsuperscript{29} a recent case of the Court of Appeals for the Sixth Circuit, provides a contrast to \textit{In re Pyle's Estate}. In \textit{National City Bank} the decedent's husband purchased life insurance on his own life and some years later selected a mode of settlement by which, if his wife survived, the proceeds of

\textsuperscript{28} Id. at 137-38. It appears from the factual context of the case that the court was referring particularly to Int. Rev. Code of 1939, § 811 (c) (1) (B), 53 Stat. 121, predecessor of Int. Rev. Code of 1954, § 2036 (a) (1).

\textsuperscript{29} Mrs. Beggs' claim had been extinguished at the time of her death by the running of the statute of limitations. 13 T.C. at 134.

\textsuperscript{30} Some of the other common incidents of ownership include the following: (1) the power to assign the policy; (2) the power to revoke an assignment in some situations; (3) the power to pledge the policy as collateral for a loan; (4) the power to obtain a loan from the insurer against the surrender value of the policy. See Keeton, \textit{Basic Insurance Law} 168 (1960); Lowndes & Kramer, § 13.7, at 279-81; 2 Mertens § 17.10, at 350-54; Vance, \textit{Insurance} § 108 (3d ed. 1951).

\textsuperscript{28} The tax court stated that "it was her act [in electing the mode of settlement] and not the insured's death that directed the manner in which the funds were to be handled." 36 T.C. 1017, 1020 (1961). (Emphasis added.) In affirming, the Third Circuit noted that "transfer could be accomplished only through the exercise of ownership rights created by the terms of the policy . . . ." 313 F.2d at 330. (Emphasis added.)

\textsuperscript{29} 371 F.2d 13 (6th Cir. 1966). See Goodnow v. United States, 302 F.2d 516 (Ct. Cl. 1962).
the policies were to be held at interest for her life and at her death distributed to the children. Thereafter he assigned the policies to his wife. However, none of the rights or options possessed by the decedent-wife as a result of the assignment was ever exercised,\(^{30}\) thus leaving the mode of distribution as provided prior to the assignment. Nonetheless the decedent did possess the power to control the ultimate disposition of the policy proceeds. Therefore, the Commissioner assessed a deficiency against the estate, claiming that the value of the proceeds should have been included in the estate under section 2036 (a) (1).

In the refund suit, the district court held that the decedent had adopted the mode of settlement selected by her husband since the failure to revoke or to alter it could only be construed as a "silent acceptance of the transfer of the proceeds to her daughters with a retention of a life interest in herself."\(^{31}\) The Sixth Circuit, in reversing the trial court, reasoned that "giving the word 'transfer' its ordinary meaning, we are not willing to hold that mere inaction, acquiescence or 'silent acceptance,' without more on the part of Mrs. Dauby, constituted a 'transfer.'"\(^{32}\) The court distinguished Pyle and similar cases\(^{33}\) by noting that in each of them "some positive action which constituted a 'transfer' was taken by the decedent . . . ."\(^{34}\) While the court recognized that the decedent could have taken affirmative action which would have constituted a transfer, it noted that she did not in fact do so. Rather, the court found that the property

\(^{30}\) Because the assignment was an absolute assignment of a revocable insurance policy, Mrs. Dauby possessed all the incidents of ownership mentioned in note 25 supra and accompanying text.

\(^{31}\) The district court argued: "It must be presumed that a person ordinarily intends the natural and probable consequences of acts knowingly done or knowingly omitted. As possessor and owner of all the incidents of ownership in the three insurance policies under the facts and circumstances shown, it must be presumed that Pearl Dauby intended and did accept that disposition of the insurance proceeds made at the time of Jerome Dauby's death in accord with his election. The fact that Pearl Dauby did not revoke the mode of settlement can be construed only as a silent acceptance of the transfer of the proceeds to her daughters with a retention of a life interest to herself." National City Bank v. United States, Civil No. C-62-370, N.D. Ohio, March 31, 1965.

\(^{32}\) 371 F.2d at 16.

\(^{33}\) Id. at 17. Also distinguished were Savage v. United States, 331 F.2d 678 (2d Cir. 1964); Rundle v. Welch, 184 F. Supp. 777 (S.D. Ohio 1960); Estate of Mable E. Morton, 12 T.C. 380 (1949). In addition, O'Malley v. United States, 383 U.S. 627 (1966), was cursorily dismissed, the court stating that "O'Malley presents a factual situation that differs from the present case . . . ." 371 F.2d at 17. See note 7 supra.

\(^{34}\) 371 F.2d at 17.
passed to the children under the mode of settlement selected by the decedent's husband.\textsuperscript{35}

Reconciliation of the cases which found no transfer by the decedent\textsuperscript{36} with those where a transfer was recognized\textsuperscript{37} is possible only if positive action by the decedent is seen as the determinative factor. But for that element the cases are virtually indistinguishable: each decedent held a life interest in the property concerned, retained the power to control the final disposition of that property, and conferred a benefit upon a third person by the exercise or nonexercise of that power. However, to make the consequence of taxation depend on the presence of overt action would conceivably frustrate the taxing scheme. Arguably, therefore, as urged by the Government in \textit{Libbey},\textsuperscript{38} \textit{Beggs},\textsuperscript{39} and \textit{National City Bank},\textsuperscript{40} the decedents in those cases should have been taxed in the same manner as the decedents to whom affirmative conduct was ascribed\textsuperscript{41} because, as a practical

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\item \textsuperscript{35} See also \textit{Estate of Idamay S. Minotto}, 19 P-H Tax Ct. Mem. 514 (1950), where the court framed the issue in terms of who made the transfer in determining if the decedent was taxable under §2036(a)(1). The factual similarities between \textit{Minotto} and \textit{National City Bank} are significant. In both cases the decedent's interest resulted from an election of the insured prior to the assignment to the decedent. In both cases the decedent became the owner of the policy with the power to defeat the election made by the insured, but in neither case did the decedent exercise the power. Finally, in both cases, since the proceeds were distributed according to the mode of settlement chosen by the insured, the courts held that the decedent had not made the transfer. The only distinction between the cases is the means available to defeat the insured's mode of settlement. In \textit{National City Bank} the decedent could have changed beneficiaries, altered the mode of settlement, or relinquished the policy for its cash surrender value. In \textit{Minotto}, since the beneficiaries and the mode of settlement were irrevocable, the decedent only had the alternative of surrendering the policy. Nevertheless, to the extent that both had the power to defeat the election of the insured, the cases are indistinguishable.

To approach the issue, as in \textit{Minotto}, by asking who made the transfer rather than, as in \textit{National City Bank}, by inquiring whether a transfer had been made by the decedent will not result in a different resolution as to the ultimate taxation of the decedent's estate. However, the \textit{Minotto} approach may easily confuse the issue. If emphasis is placed upon who made a transfer, attention may be shifted to the wrong transaction, since the event sought to be taxed is not the transfer between the original transferor and the original donee, the taxability of which has never been questioned, but rather the transaction between the donee and the secondary beneficiaries of the first transfer.

\item \textsuperscript{36} \textit{National City Bank v. United States}, 371 F.2d 13 (5th Cir. 1966); \textit{Libbey v. United States}, 147 F. Supp. 383 (N.D. Cal. 1956); \textit{Estate of Eleanor H. Beggs}, 13 T.C. 131 (1949).

\item \textsuperscript{37} In re Pyle's Estate, 313 F.2d 328 (3d Cir. 1963); \textit{Estate of Eleanor H. Beggs}, 13 T.C. 131 (1949).

\item \textsuperscript{38} \textit{Libbey v. United States}, 147 F. Supp. 383, 384 (N.D. Cal. 1956).

\item \textsuperscript{39} \textit{Estate of Eleanor H. Beggs}, 13 T.C. 131, 137 (1949).

\item \textsuperscript{40} 371 F.2d at 16-17.

\item \textsuperscript{41} See cases cited note 37 supra.
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matter, they all achieved the same end: the effective shifting of an economic benefit to a third person. However, while the requirement of positive action for a transfer may appear to be an undue interpretive restriction in light of the substantive economic effect of the transactions, it would seem to be fully warranted by the language and purpose of section 2036 (a) (1), and by the interrelationship of the various sections of the estate tax.

While a transfer is an express prerequisite to taxation under section 2036 (a) (1), no definition of the term is provided in the Code. The conventional definition of a transfer in property law is an “act by which the owner of a thing delivers it to another person with the intent of passing the rights he had in it to the latter.” For tax purposes, however, the focus is not on the formalities of delivery and intent but rather on the substance of the transaction. Accordingly, the courts have adopted the position that “the essence of a transfer [as respects taxation] is the passage of control over the economic benefits of property rather than any technical changes in its title.” Admittedly, this definition does not conclusively evince that positive action is required for a transfer, but, when reference is made to the factual situations of the cases which submit a definition, arguably such an understanding is imparted.

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42 The regulations pertaining to the inter vivos transfer sections also fail to afford a satisfactory definition of transfer. The only definition is contained in Treas. Reg. § 20.2013-5 (b) (1958): “The term 'transfer' of property by or from a transferor means any passing of property or an interest in property . . . .” This regulation, however, was promulgated with reference to Int. Rev. Code of 1954, § 2013, which allows an estate tax credit for the federal estate tax previously paid on certain transfers of property made to the decedent and has no direct connection with the inter vivos transfer sections.

43 See LOWNDES & KRAMER § 8.7, at 133-34; 2 MERTENS § 20.06, at 630-34. The assertion that the estate tax will focus on substance rather than form means only that the tax law will not be restricted by the formalities and technicalities of traditional property concepts. It should not be inferred, however, that the tax law ignores the means by which a transaction is consummated; for if that were the case, such requirements as transfer would be rendered completely meaningless.


45 In United States v. Manufacturers Nat'l Bank, supra note 45, the transaction sought to be taxed was an absolute assignment by the decedent to his wife of insurance policies on the life of decedent. In Estate of Sanford v. Commissioner, supra
The purpose of section 2036 (a) (1) lends additional support to the contention that overt action by the decedent is necessary to constitute a transfer. Its legislative history discloses that Congress' purpose in adding the section to the code was to repudiate May v. Heiner and its progeny. Those cases involved situations in which the decedent had made a transfer while retaining a life interest in the property. While there was definitely an affirmative action on the part of the decedent, the Supreme Court decided that the property transferred could not be taxed to the decedent's estate under section 402 (c) of the 1918 Revenue Act, the predecessor of section 2036 (a) (1), since the transfer was not in contemplation of or intended to "take effect ... at or after his death." In light of the limited purpose of the 1931 Amendment to render the May v. Heiner situation taxable, it arguably follows that only that specific situation was intended to be reached by the new provision. Therefore, since that circumstance involved affirmative action by the decedent, it is arguable, again by implication, that Congress intended reserved life interests to be taxed only in connection with an active transfer.

The proposition that Congress intended that affirmative action constitute an element of a transfer is buttressed by a consideration of section 2041, formerly section 302 (f) of the 1926 Revenue Act.

note 45, the decedent made a gift of property in trust, reserving the power to alter the terms of the trust. In Chase Nat'l Bank v. United States, supra note 45, the decedent took out insurance policies on his life and named his wife as beneficiary but reserved the power to change the beneficiaries.

47 281 U.S. 238 (1930).


The proposition that Congress intended that affirmative action constitute an element of a transfer is buttressed by a consideration of section 2041, formerly section 302 (f) of the 1926 Revenue Act.

The present language of § 2036 (a) (1) is traceable to the Joint Resolution of March 3, 1931, 46 Stat. 1516, and to the amendments made to the resolution in the Revenue Act 1932, ch. 206, § 803 (a), 47 Stat. 279. See 74 CONG. REC. 7078-79 (1931) (remarks of Senator Smoot); id. at 7198 (remarks of Representative Hawley); H.R. REP. No. 708, 72d Cong., 1st Sess. (1932), reprinted in 1939-1 (pt. 2) CUM. BULL. 457, 490; S. REP. No. 665, 72d Cong., 1st Sess. (1932), reprinted in 1939-1 (pt. 2) CUM. BULL. 496, 532. The committee reports to the 1932 Revenue Act summarize the purpose of the amendments: "The purpose of this amendment to section 302 (c) of the Revenue Act of 1926 is to clarify in certain respects the amendments made to that section by the joint resolution of March 3, 1931, which were adopted to render taxable a transfer under which the decedent reserved income for his life." H.R. REP. No. 708, supra at 490; S. REP. No. 665, supra at 532. (Emphasis added.)

49 Revenue Act of 1918, ch. 18, § 402 (c), 40 Stat. 1097 (1919). This section was substantially re-enacted by Revenue Act of 1926, ch. 27, § 302 (c), 44 Stat. (pt. 2) 70, amended by Joint Resolution of March 3, 1931, ch. 454, 46 Stat. 1516 [now INT. REV. CODE OF 1954, § 2036].

50 INT. REV. CODE OF 1954, § 2041. See generally LOWNDES & KRAMER §§ 12.1-14;
Prior to 1942, section 302(f) provided that only exercised powers of appointment were taxable. In that year, however, the section was amended to include unexercised general powers created after October 21, 1942. Therefore, both sections 302(c) and 302(f), prior to the amendments in 1951 and 1942, taxed only overt action. The amendment to section 302(c) did not change the requirement of an affirmative act for a transfer, but merely provided that if the transferor retained a life interest in the property conveyed, the property would be included in his estate. The amendment to section 302(f), on the other hand, expressly altered the necessity for an affirmative act by providing that henceforth even the property subject to an unexercised general power of appointment would be included in the decedent's taxable estate. This amendment to the predecessor of section 2041 indicates, therefore, that Congress is aware of the distinction between action and inaction and will explicitly tax inaction if it so intends.


51 See, e.g., Helvering v. Safe Deposit & Trust Co., 316 U.S. 56 (1942); United States v. Turner, 287 F.2d 821 (8th Cir. 1961); Estate of Isabella C. Hoffman, 3 B.T.A. 1361 (1926).

Section 302(f) of the Revenue Act of 1926, ch. 27, 44 Stat. 70-71 (1927), the predecessor of §2041, provided: "The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property .... To the extent of any property passing under a general power of appointment exercised by the decedent ...."

52 Revenue Act of 1942, ch. 619, §403, 56 Stat. 942. This amendment created a drastic change in the taxation of powers. Previously, to be taxable to a decedent's estate, a power had to be a general power of appointment which had been exercised over property passing to the appointee by virtue of the exercise. The 1942 amendment eliminated all three requirements so that with two exceptions all powers, whether exercised or not, caused the property subject to the power to be taxed to a donee-decedent's estate. Dissatisfaction with the 1942 Act resulted in the 1951 Powers of Appointment Act, now §2041 of the 1954 Code, which taxes general powers whether exercised or not. Special powers are taxed only in the limited situation where they are exercised in a testamentary manner as to create a second power which is not subject to the rule against perpetuities. Traditional property law defines a general power of appointment as the unrestricted power of the donee to appoint to anyone including himself and his estate, while a special power is the power of the donee to appoint to only members of a limited class excluding himself. RESTATEMENT, PROPERTY §320 (1940); SIMES & SMITH, FUTURE INTERESTS, §875 (2d ed. 1956).

Section 2041, however, modifies the traditional definitions by providing that a power is a general power for purposes of the estate tax, only if it "is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate ...." INT. REV. CODE OF 1954, §2041(b)(1). Accord, INT. REV. CODE OF 1954, §2514(c) (power of appointment for purposes of the gift tax).

53 See notes 47-49 supra and accompanying text.

54 See notes 50-52 supra and accompanying text.
While the language and purpose of section 2036 (a) (1) may suggest that a transfer requires affirmative action, such an interpretation is dictated by the estate taxing scheme, which contains separate provisions for the taxation of transfers of interests in property and powers of control over property. When the Service has attempted to invoke section 2036 (a) (1) to include in the taxable estate property in which the decedent retained a life interest and the power to effect the ultimate disposition of the property, it has argued that the requisite transfer is inherent in the mere existence of that power. Such an approach, however, overlooks the fact that powers possessed by a decedent are expressly taxed to his estate by three specific sections of the code.

For example, section 2036 (a) (2) reaches transfers with the reserved power for life to designate those who shall enjoy the income or possession of property. In addition, section 2038 (a) applies to transfers where the power to alter, amend, or revoke is retained by the decedent. These sections are usually applicable to the same transfers because the power to "designate the income or possession" will generally also constitute a power to "alter." Moreover, both sections require an independent inter vivos transfer so that under neither section will the mere existence of the power be taxable. Yet, to posit a transfer solely on the basis of the presence of a power, as the Commissioner's interpretation of section 2036 (a) (1) would do, leads to exactly that consequence. The anomaly is readily apparent: the same power could satisfy both the general requirement of a transfer and the specific requirement of a power. More important, however, the existence of these power provisions in the inter vivos transfer sections clearly indicates that they are the sections which should govern the taxation of transfers with retained powers.

See 371 F.2d at 16-17; Libbey v. United States, 147 F. Supp. 383, 384 (N.D. Cal. 1956); Estate of Eleanor H. Beggs, 13 T.C. 131, 137 (1949).

INT. REV. CODE OF 1954, §2036 (a) (2).

INT. REV. CODE OF 1954, §2038 (a).

While §§ 2036 (a) (2) and 2038 (a) will usually reach the same power, there are distinctions between the two. Section 2036 (a) (2) has two limitations not found in §2038 (a). First, §2036 (a) (2) extends only to powers retained by the decedent in connection with a transfer made by him. Second, the power must be retained for the decedent's life or an equivalent statutory period. On the other hand, §2038 (a) does not apply if the power is contingent upon some event not controlled by the decedent, whereas §2036 (a) (2) is not so restricted. Compare Treas. Reg. § 20.2038-1 (b) (1962) with Treas. Reg. § 20.2036-1 (1960). See generally LOWNDES & KRAMER § 9.14; Leiter, Estate Tax Consequences of Inter Vivos Transfers, 38 TAXES 399, 402-04 (1960).
Moreover, powers are also taxed under a third power provision, section 2041, which relates to powers of appointment. Unlike the other power sections, section 2041 does not require a transfer but taxes general powers of appointment regardless of the manner in which they are received or exercised. This section, however, differs from the other power provisions in that it applies to donated powers whereas sections 2036 (a) (2) and 2038 tax only retained powers. Furthermore, since 1942, general powers of appointment have been taxable whether or not they were exercised.

Taken together, the power sections demonstrate that Congress has given express recognition to powers of control over property and has created diverse but specialized provisions which produce a complete and comprehensive scheme for taxing them. This detailed pattern for the taxation of powers, when compared with the equally explicit treatment of transfers with retained interests in property, strongly suggests that the term transferring should not be deemed equivalent to power for purposes of sections 2035 through 2038. To do so would only create a confusion where none need exist since a power of control over property is taxed under an express power section and should not be taxed under the retained life interest section.

If powers are taxable solely as powers and not as transfers, the question remains why the Service would resort, as it did in Libbey, Beggs, and National City Bank, to section 2036 (a) (1) to tax what are essentially powers. The answer is simply that in all three cases the power sections were inapplicable. The powers were not in existence at the time of the decedent's death. Section 2041 was inapposite in Libbey and National City Bank because the

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69 INT. REV. CODE OF 1954, § 2041.
70 Treas. Reg. § 20.2041-1 (b) (1) (1961): “The term ‘power of appointment’ includes all powers which are in substance and effect powers of appointment regardless of the nomenclature used in creating the power and regardless of local property law connotations.” See LOWNDES & KRAMER § 12.5.

71 Treas. Reg. § 20.2041-1 (b) (2) (1961): “For purposes of §§ 20.2041-1 to 20.2041-3 the term ‘power of appointment’ does not include powers reserved by the decedent to himself within the concept of sections 2036 to 2038.” But see Johnstone v. Commissioner, 76 F.2d 55 (9th Cir. 1936), cert. denied, 296 U.S. 578 (1936); Estate of Charles M. Sheaffer, 12 T.C. 1047 (1949).

72 See note 52 supra and accompanying text.
powers in those cases were created prior to 1942 and, therefore, were not taxable because they constituted unexercised powers of appointment. Finally in Beggs, section 2041 was unavailable since the decedent's claim was not derived from a donated power as required by that section. Therefore, to the extent that the power sections prove to be inapplicable, a departure from the conclusion that affirmative action is required for a transfer may arguably be justified in order to preserve the integrity of the estate tax.

In light of the present provisions of the Code, however, such a suggestion would seem to be unwarranted. In recognition of the inability of the estate tax to reach the retirement annuity situation presented in Libbey, Congress, in 1954, enacted section 2039, which taxes annuities directly without reference to either a "transfer" or a "power." Therefore, the taxation of estates in such cases as Libbey would present no problem under the 1954 Code. The immunity from taxation of the power in National City Bank was expressly recognized by the court to result solely from the fact that the power fell within the section's exclusion for powers created prior to 1942. While the identical situation presented in Beggs would probably remain untaxed under the 1954 Code, this result would occur only because the claim had become barred prior to the decedent's death, for otherwise it would have been taxable under section 2033 as property possessed at death. Notwithstanding the inability of the

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See 371 F.2d at 17 (notes 29-35 supra and accompanying text); Libbey v. United States, supra note 63, at 384 (notes 13-16 supra and accompanying text).

Estate of Eleanor H. Beggs, 13 T.C. 131, 196 (1949) (see notes 22-24 supra and accompanying text).

See, e.g., Libbey v. United States, 147 F. Supp. 383 (N.D. Cal. 1956); Hanner v. Glenn, 111 F. Supp. 52, 58 (W.D. Ky. 1953), aff'd on other grounds, 212 F.2d 483 (6th Cir. 1954); Estate of Charles B. Wolf, 29 T.C. 441 (1957), modified by 264 F.2d 82 (3d Cir. 1959). In Hanner, despite the fact that the power was created after 1942, the court held that the predecessor of § 2041 did not apply because the decedent did not have a general power of appointment but rather only a "limited power" or special power to appoint to a limited class. See generally note 52 supra.


In fact, the court suggested that had the power been created after 1942, § 2041 (a) (2) would have been the appropriate section under which to tax the power. 371 F.2d at 18.

E.g., Parrott v. Commissioner, 30 F.2d 792 (9th Cir.), cert. denied, 279 U.S. 870
estate tax to reach this power, the factual situation in Beggs is so unique that the case poses no appreciable threat to the integrity of the taxing scheme.

Ultimately, therefore, it would seem that the judicially imposed requirement of overt action by the decedent to constitute a taxable transfer is sound and does not impair the effectiveness of the estate tax. Had it not been for the fortuitous circumstance of timing in Libbey and National City Bank and the bar of the statute of limitations in Beggs, the issue of whether the possession of an unexercised power of control over property constitutes a transfer under section 2036 (a) (1) would never have arisen since the tax would have been clearly sustained under other sections of the Code. However, the fact that the powers could not be reached under the power sections does not justify the tortured and distorted interpretation of section 2036 (a) (1) which would have been necessary to sustain the tax under that section.

(1929); Estate of Theodore O. Hamlin, 9 T.C. 676 (1947). In these cases the unenforced claim of the decedent was not barred by the statute of limitations at his death and was consequently taxed to his estate under a predecessor of §2033.