1949

Taxability of Irrevocable Inter Vivos Trusts

J. W. Riehm Jr.

Follow this and additional works at: https://scholar.smu.edu/smulr

Recommended Citation
J. W. Riehm Jr., Taxability of Irrevocable Inter Vivos Trusts, 3 Sw L.J. 107 (1949)
https://scholar.smu.edu/smulr/vol3/iss2/1

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit http://digitalrepository.smu.edu.
TAXABILITY OF IRREVOCABLE INTER VIVOS TRUSTS

J. W. RIEHM, JR.*

Lawyers contemplating the use of irrevocable inter vivos trusts in executing clients’ estate plans are faced with many difficult problems. One of them has been created by uncertainty as to the Federal Estate Tax consequences flowing from the use of such trusts. And in turn that uncertainty has been engendered in part by conflicting interpretations given to a particular phrase of Section 811(c) of the Internal Revenue Code. That phrase provides that property shall be included in the gross estate of a decedent “To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, . . . intended to take effect in possession or enjoyment at or after his death . . .”

The conflicting interpretations of the “intended to take effect in possession or enjoyment at or after his death” phrase (hereinafter called the “intended” phrase) raise this practical tax question today: Will the fact that a trust instrument allows a possibility of reverter to exist in the settlor make the corpus of the trust a

* Member of the faculty, Southern Methodist University Law School; formerly associated with Cravath, Swaine & Moore, New York City.

1 In order to avoid confusion, the section in question is listed throughout as § 811(c) and not under the various section numbers in which it appeared in prior revenue acts.

2 While “a possibility of reverter” is traditionally defined as the interest remaining in a grantor who has conveyed a determinable fee [and] [the definition has not been thought to have any relation to the reversionary interest of a grantor who has transferred either a vested or contingent remainder in fee” [footnote No. 6, Helvering v. Hallock, 309 U. S. 106, 118] the term as used herein can best be defined by quoting from footnote No. 1 of the Supreme Court’s opinion in Spiegels’ Estate v. C. I. R., 335 U. S. 701—, 69 S. Ct. 301, 305 (1949). “The terms ‘reverter’ and ‘the possibility of a reverter’ have been used frequently and freely in opinions and discussions of this general subject. They are used here to refer to the return or possible return to the settlor or to his estate, under conditions comparable to those here suggested, of property
part of his gross estate for estate tax purposes? Since predict-
ability of the consequences of a given act is imperative to the
estate planner inability to answer the foregoing question accu-
rately may preclude the use of *inter vivos* trusts in the plan.

In 1939 three cases involving the interpretation of the "in-
tended" phrase were submitted to the Supreme Court. Since the
decisions of the court prior to that time offered no clear cut inter-
pretation of the phrase tax practitioners hoped the decision in
those cases would clarify its scope and meaning. However, only a
short period elapsed after the decision was announced (one deci-
sion, *Helvering v. Hallock*, encompassed the three cases) before
it became clear that the court had not provided a clear-cut inter-
pretation and in fact had further confused both the lower courts
and the practitioners. Actually the confusion grew out of disputes
over the scope of the *Hallock* opinion, and though the court had
occasion in 1945 to comment on the case it was not until 1947
when *certiorari* was granted in two cases involving the same prob-
lem that tax lawyers again hoped for a decision which would an-

---

previously placed in trust by the settlor. They are not used in any strict or technical
sense peculiar to the law of property. See also, I Paul, Federal Estate and Gift Taxa-
tion § 7.21, n. 1 (1942). They may refer, for example, to a reversionary interest, or a
beneficial interest under a resulting trust, or merely some right to or control over a
beneficial interest in the trust property and, in that sense, include the 'string or
tie' to the trust property that also has been referred to frequently in discussions of
this subject. The term 'reversion' is used in its usual technical meaning in the law of
property."

* The collateral question of whether the reservation by the settlor of an interest
in or control over the corpus or the income of a trust serves
to draw the corpus into
his gross estate was answered in the affirmative by statute on March 3, 1931. Though
it is moot so far as trusts created after that date are concerned it is of importance to
us here because of its relationship to the principal question and one of the decisions
under discussion in the body of the article (Commissioner of Internal Revenue v.
Church's Estate, 335 U. S. 632, 69 S. Ct. 322 (1949)).

Squire, Superintendent of Banks of Ohio, 34 B. T. A. 575, 102 F. (2d) 1, (C. C. A.
6th 1939), cert. granted 308 U. S. 532 (1939); No. 183, Rothensis v. Huston, 103 F.
(2d) 834, (C. C. A. 3rd 1939), cert. granted 308 U. S. 538 (1939); No. 399, Bryant v.
543 (1939).

* 309 U. S. 106, 60, S. Ct. 444 (1940).

* The court relied on but did not enlarge upon the *Hallock* decision in *Fidelity-
Philaadelphia Trust Co. v. Rothensis*, 324 U. S. 108, 66 S. Ct. 508 (1945) and *Goldstone v.
swer the above question with certainty. Those two cases, Commissioner of Internal Revenue v. Church's Estate⁷ and Spiegel's Estate v. Commissioner of Internal Revenue,⁸ were decided on January 17, 1949, and a reading of the six opinions that were written indicates we are farther than ever from the goal of certainty. Therefore, any lawyer using inter vivos trusts in any estate plan today would do well to expect the worst and proceed on the assumption that the corpus of those trusts will be included in the client's gross estate by the Bureau of Internal Revenue for federal estate tax purposes.

BACKGROUND

A cursory analysis of any system of inheritance taxation will indicate that a failure to include within its ambit all inter vivos transfers which are substitutes for testamentary dispositions emasculates the system. The reason is clear. If you tax only testamentary or intestate dispositions, all one has to do to escape the tax is make an inter vivos disposition, reserving to himself the benefits of ownership until death. It is for that reason the first Federal Estate Tax law contained a section which was the forerunner of the present Section 811 (c). That was Section 202(b) of the Revenue Act of 1916, and the wording of the “intended” phrase contained therein is exactly the same as the “intended” phrase of Section 811(c).

The “intended” phrase occupied an inconspicuous place in the tax law for several years following its initial enactment. It was not until 1927 that it was subjected to judicial interpretation by the Supreme Court. In that year the Court decided Shukert v. Allen,⁹ in which it was faced with the problem of determining whether the corpus of a trust was to be included in the settlor’s estate under the “intended” phrase of the Revenue Act of 1918.¹⁰ By the trust

---

⁸ 335 U. S. 701, 69 S. Ct. 301 (1949).
¹⁰ § 402 (c), Revenue Act of 1918.
instrument dated 1921, the settlor irrevocably transferred securities to a disinterested trustee with direction that the income from the securities be accumulated until 1951 (with a proviso protecting against a violation of the rule against perpetuities) at which time the principal and undistributed income was to be divided among his three children. The Court made no statement to indicate it had looked at the record to determine what the settlor's state of mind was at the time he created the trust, i.e., whether he intended to escape the estate tax law by the creation of an inter vivos trust. Rather, the Court looked only to the legal effect of his acts, and on finding that "the interest of the children respectively was vested as soon as the instrument was executed" held the transfer in trust was not intended to take effect in possession or enjoyment after death.

In 1927 the Court also had before it the case of Nichols v. Coolidge in which parents had transferred property to their children in 1907, reserving for themselves life estates. In its opinion the Court held that the property transferred could not be included in the gross estate of the decedent under the "intended" phrase because the section, if retroactive, (meaning applicable to transfers made before enactment of the Revenue Act of 1916) would be "arbitrary, capricious and amount to confiscation." However, the Court reserved the question of "whether the challenged provision is valid in respect to transfers made subsequent to the enactment, . . ." 13

While the Coolidge case was of no use to the estate planner of 1927 because it only applied to pre-1916 trusts, the Shukert case did provide him with a foolproof tool for minimization of estate taxes. Thus, there was at least one hole in the dike protecting the government's right to tax all inter vivos transactions which might be substitutes for testamentary dispositions. And, of course, prac-

11 273 U. S. 545, 547.
12 274 U. S. 531, 47 S. Ct. 710 (1927).
13 Id. at 543.
tioners were busy probing the dike with other tools to see if it might be breached elsewhere. One of the tools used was the one mentioned in the Coolidge case, i.e., the transfer in trust with reservation of a life estate by the settlor. When cases involving trusts with reservation of a life estate began to reach the lower courts, they did not fare at all well.\(^\text{14}\) State court decisions in cases involving state inheritance tax laws which contained the same "intended" phrase as the federal law provided the federal courts with ample authority for including such trusts within the gross estate.\(^\text{15}\) In fact, in one case, *Bradley v. Nichols*,\(^\text{16}\) an executor conceded from the outset that so much of the trust involved in the litigation as was subject to the settlor's reserved life estate was includible in the settlor's gross estate. One writer seemed to express the consensus regarding the use of the life estate when he said:

"The retention by the grantor of a life interest in the property is so distinctly a characteristic of possession or enjoyment of an estate as to be convincing evidence of an intent that the grant or the deed of trust is not to take effect in enjoyment until the grantor's death; the death is the contingency upon which vesting of the beneficial interest in the transferees depends."\(^\text{17}\)

One can imagine the shock felt by the government attorneys and attorneys like counsel in the *Bradley* case\(^\text{18}\) when the Supreme Court reversed the lower courts in the famous case of *May v. Heiner*\(^\text{19}\) and held that the corpus of a trust under which the settlor had irrevocably transferred property to her four children, reserving life estates in the income for her husband and herself, could


\(^{15}\) Rottschaefer, *Taxation of Transfers Intended to Take Effect in Possession or Enjoyment at Grantor's Death*, 15 MINN. L. REV. 453, 613, 628 (1929-30); *Knouff, Death Taxes on Completed Transfers Inter Vivos*, 36 Mich. L. Rev. 1284, 1298 (1938); *Note*, 35 Yale L. J. 601 (1925-26).


\(^{17}\) *Note*, 75 U. PA. L. Rev. 168, 170 (1926-27).

\(^{18}\) *Note* 16 supra.

\(^{19}\) 281 U. S. 238, 50 S. Ct. 286 (1930); note 14 supra.
not be included in her gross estate under the "intended" phrase. The Court based its decision on the same legal test it applied in the Shukert case, viz., a determination of when the legal interests of the children vested. On finding that the children's interest vested on creation of the trust the Court concluded that no part of the corpus was to be included in the settlor's gross estate. Again the Court gave no indication to show it had looked to see what the settlor's state of mind was at the time she created the trust.

Of course, the Supreme Court decision restored to full utility the life estate tool which the lower courts had so badly mangled, and thus a great loophole was uncovered in the estate tax law. In what one might call a state of shock the Treasury Department rushed three similar cases up to the Court to find out whether the Court really meant what it had said in May v. Heiner. The Court indicated that it did by handing down per curiam opinions in all three cases, each one citing May v. Heiner.20 Something drastic had to be done to close the loophole and the Treasury Department acted the following day, March 3, 1931, by having Congress pass a Joint Resolution21 amending Section 302(c) of the Revenue Act of 1926 which contained the then applicable provision governing transfers "intended to take effect in possession or enjoyment at or after his death." The Joint Resolution provided that there would be included in the gross estate of a decedent all inter vivos transfers of property "under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property or (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom . . ."

The question of whether the amendment was intended to be retroactive in its application was soon raised and in the case of

---

Hasset v. Welch the Court held it was to apply only prospectively. Thus, those planners who had made use of the life estate tool prior to March 3, 1931, breathed a sigh of relief and concluded that they had been successful in minimizing estate taxes. Those gentlemen must have received as severe a shock when the Supreme Court reversed May v. Heiner in Commissioner of Internal Revenue v. Church's Estate as did the government counsel when May v. Heiner was decided in 1930.

At the same time the "intended" phrase was being combed for loopholes such as those uncovered in the Shukert case and May v. Heiner, a search for its outer boundaries was under way. And it is the outer boundary problem that is interfering with the utility of the inter vivos trust in estate planning today. As framed by the question set down in the opening remarks above, the problem resolves itself into one of whether a trust under which the settlor has disposed of property by such terms that he retains only a possibility of reverter falls inside or outside the boundary.

The first case of that type to reach the Supreme Court was Klein v. United States. In that case the decedent, who died intestate, had at an earlier date conveyed two parcels of land to his wife (not in contemplation of death) by a deed which provided that (1) the wife was to have a life estate, (2) if she survived him she was to receive the fee and (3) if she predeceased him he was to hold the reversion in fee. The Court held the two parcels (minus the value of the life estates) were includible in the decedent's gross estate, saying:

"It follows that only a life estate immediately was vested. The remainder was retained by the grantor; and whether that ever would become vested in the grantee depended upon the condition precedent that the death of the grantor happen before that of the grantee.... It is perfectly plain that the death of the grantor was the indispensable and intended event which brought the larger estate into being for the
grantee and effected its transmission from the dead to the living, thus satisfying the terms of the taxing act and justifying the tax imposed."²⁵

[Emphasis added]

One would expect a draftsman surveying the Supreme Court cases in the field immediately after the Klein decision to conclude that the Court was applying a test based on time of vesting of legal title in determining whether property was to be included in a decedent's gross estate. If that was the test, any good conveyancer could circumvent the statute by drafting a conveyance in a form which would presently vest title to property in the recipient subject to divestment on the occurrence of a condition subsequent.

Despite the statement of the Court in the Klein case to the effect that "nothing is to be gained by multiplying words in respect of the various niceties of the art of conveyancing or the law of contingent and vested remainders"²⁶ it appeared for a period that our draftsman had properly analyzed the Court's approach to the problem. In fact he could boast that he had two Supreme Court cases to support him, for in Helvering v. St. Louis Trust Co.²⁷ and Becker v. St. Louis Trust Co.²⁸ the court held that transfers which created vested interests subject to a possible divestment in favor of the decedent should the decedent survive the beneficiary could not be included in a decedent's gross estate. However, our draftsman was put on notice by the dissenting opinions that not all the members of the court were willing to allow circumvention of the statute by use of the vested interest subject to divestment tool.

The Hallock Case

In 1939 the now famous case of Helvering v. Hallock²⁹ reached the Supreme Court. It actually encompassed three cases: (1) Helvering v. Hallock³⁰ which involved a trust created by Hallock inci-

²⁵ Id. at 233, 234.
²⁶ Id. at 234.
²⁹ Note 5 supra.
³⁰ Note 4 supra.
dent to a separation agreement with his wife under which the wife was to receive the income for life (subject to possible termination if she remarried), on her death the corpus was to revert to Hallock if he be living and if he be dead the corpus was to go to his children; (2) *Rothensis v. Huston*\(^{31}\) which involved a trust created by one George Uber incident to an anti-nuptial agreement under which his prospective wife was to receive income for life and the corpus if she survived, but if she predeceased Uber, the corpus was to revert to him; and (3) *Bryant v. Commission of Internal Revenue*\(^{32}\) which involved a trust created by Bryant under which his wife was to receive the income from the corpus during her life, if she predeceased him the income was to go to him for his life, and after the death of both the corpus was to be paid to his executor. The Court, speaking through Mr. Justice Frankfurter, held that the trusts in each of the cases should be included in the gross estate of the decedents.

On looking through the verbal pyrotechnics of Mr. Justice Frankfurter’s opinion one sees he said three things: (1) you cannot escape the effect of the “intended” phrase by use of technical property distinctions such as those used in the *St. Louis Trust* cases\(^{33}\) in drafting trust instruments; (2) the principles enunciated in the *Klein* case controlled the decision of the cases before the court, and (3) the *St. Louis Trust* cases were overruled. In a dissenting opinion Mr. Justice Roberts argued that the decisions in the *St. Louis Trust* cases should control.

Then began the quest for the true principle of the *Klein* and *Hallock* cases. Probably the best detailed analysis of the cases decided during the period form the date of the *Hallock* decision in 1940 to 1946 is found in I Paul, *Federal Estate and Gift Taxation*, Section 7.23 and the 1946 Supplement thereto. In that section Paul traces the approaches the lower courts have taken to the

\(^{31}\) Ibid.
\(^{32}\) Ibid.
\(^{33}\) Ibid.

Notes 27 and 28 supra.
problem, along with statements of the Bureau's view and the hints the Supreme Court gave the lower courts as to the accuracy of their conclusions. Paul pointed out that the Tax Court decisions have gone through three stages: (1) where the test is whether the reverter is express or results from operation of law, if the latter, the property is not included in the settlor's estate, (2) the test of degree of remoteness, the more remote the reverter, the less chance of the property being included, and (3) a stage where it hops from one rationale to another. He summarized the Bureau's position by saying: "...as the Bureau sees it, once a reverter, whether by law or express provision, is shown to have existed at the grantor's death, the Hallock doctrine mechanically fastens on the trust property" and then pointed out that the Bureau would do well to adhere to its regulations, which he felt correctly interpreted the Hallock decision. He concluded, from his analysis of the decided cases, that the test for determining whether the corpus of a trust is to be included in the gross estate of a decedent under Section 811(c) depends on whether "...the reverter is such that the gift is contingent upon the grantor's death or that his death brings the property into greater enjoyment."

The question immediately comes to mind: Did Paul correctly state the teachings of the Hallock and Klein cases and the dissent in Helvering v. St. Louis Trust Co.? If he did, estate planners could use inter vivos trusts without fear of having them included in the gross estate of a client, unless that be the planners intention, by simply making certain that under the terms of the trust the settlor's death does not bring a larger or more definitive estate into being. The answer to the question should lie in the decisions

34 The Court ruled directly on the application of the Hallock case three times between the date it was handed down in 1940 and the date of the Church and Spiegel cases in January 1949. The three cases were: Fidelity-Philadelphia Trust Co. v. Rothensies, 324 U. S. 108, 65 S. Ct. 508 (1945); Commissioner v. Field, 324 U. S. 113, 65 S. Ct. 511 (1945); Goldstone v. United States, 325 U. S. 687, 65 S. Ct. 1323 (1945).
36 Id. at 194.
37 Id. at 197-198.
38 Id. at 195.
of Commissioner v. Church's Estate\(^{39}\) and Spiegel's Estate v. Commissioner.\(^{40}\)

**The Church and Spiegel Cases**

*The Church Case*

In 1924 Francois Church executed a trust in New York under which he transferred certain corporate stock to trustees, granting them the usual powers to hold and sell the stock and reinvest the proceeds. Church, who was then twenty-one, unmarried and childless, reserved no power to alter, amend or revoke the trust but did direct the trustees to pay him the income for life. The trust made provision for disposition of the corpus on Church's death but the provision did not cover all possible contingencies, *i.e.*, death of, or failure to take by, all named beneficiaries. Therefore, Church possessed a possibility of reverter at his death.

The trust was created at a time when the Bureau and practicing lawyer considered the reservations of a life estate grounds for including the trust corpus in a settlor's gross estate under the "intended" phrase.\(^{41}\) Thus, one must assume Church and his counsel considered the trust taxable when they created it. Yet, when Church died in 1939, the Commissioner was precluded from taxing the trust on that ground because of the decision in *May v. Heiner*. However, he was not precluded from asserting that the presence of the possibility of reverter required inclusion of the trust in Church's gross estate. In fact, he had the right to feel encouraged by the Supreme Court's decision in the *Fidelity-Philadelphia*\(^{42}\) case. In that case the Court held the corpus of a trust to be includible in the gross estate where the settlor had reserved a life estate and held a possibility of reverter, and those very same elements were present here.

When the case reached the Tax Court,\(^{43}\) it decided in favor of

---

\(^{39}\) Note 7 *supra*.

\(^{40}\) Note 8 *supra*.

\(^{41}\) Note 15 *supra*.

\(^{42}\) Note 34 *supra*.

\(^{43}\) P-H. T. C. Memo 1 43, 136.
the taxpayer; the basis of its decision being that the possibility of reverter arose by operation of law, not by an expression of the settlor, and that the *Hallock* decision applied only to express reverters. On appeal to the Third Circuit Court of Appeals\(^4^4\) that court affirmed the Tax Court on the ground that the *Dobson*\(^4^5\) case prevented it from changing the Tax Court’s decision because “[w]e cannot identify a clearcut mistake of law . . . in the Tax Court’s decision in the case of at bar.”\(^4^6\)

The first time the case was argued before the Supreme Court the Government based its contention of taxability on the combination of the reserved life estate and the possibility of reverter. It was only when reargument was ordered that the question of taxing the corpus solely on the ground that a life estate had been reserved was raised by the Court by a question to counsel.\(^4^7\)

The decision of the majority, written by Mr. Justice Black, reversed the lower courts’ decisions and held the corpus of the 1924 trust to be includible in Church’s gross estate on the ground that the reservation of a life estate by a settlor serves to bring a trust within the “intended” phrase of Section 811(c), thereby reversing *May v. Heiner*. The tax consequences of the presence of the possibility of reverter in the trust were barely mentioned, though later relied on and amplified in the *Spiegel* decision.

Incorporated in the opinion is a detailed history of the “intended” phrase of Section 811(c) from its first appearance in an 1826 Pennsylvania inheritance tax law\(^4^8\) down to date and an analysis of the applicability of the rule of *stare decisis*. In reaching his conclusion, Mr. Justice Black employed the arguments

---

\(^4^4\) 161 F. (2d) 11 (C. C. A. 3rd 1947).

\(^4^5\) 320 U. S. 489, 64 S. Ct. 239 (1943).

\(^4^6\) 161 F. (2d) 11 (C. C. A. 3rd 1947).

\(^4^7\) In ordering reargument the Court asked counsel to discuss nine questions, the third of which involved the reservation of a life estate without a possibility of reverter; see footnote 5 of Mr. Justice Burton’s dissent in *Spiegel* for a list of the questions, 69 S. Ct. 301, 308.

\(^4^8\) Pa. Acts, 1825-6, C. 72, Approved April 7, 1826.
long used by state courts as the basis for taxing trusts that contain reservations of life estates. He said:

"How is it possible to call this trust transfer 'complete' except by invoking a fiction? Church was sole owner of the stocks before the transfer. Probably their greatest property value to Church was his continuing right in the stock income. After legal title to the stocks was transferred somebody still owned a property right in the stock income. That property right did not pass to the trust beneficiaries when the trust was executed; it remained in Church until he died. He made no 'complete' gift effective before that date, unless we view the trust transfer as a 'complete' gift to the trustees. But Church gave the trustees nothing, either partially or completely. He transferred no right to them to get and spend the stock income. And under the teaching of the Hallock case, quite in contrast to that of May v. Heiner, passage of the mere technical legal title to a trustee is not necessarily crucial in determining whether and when a gift becomes 'complete' for estate tax purposes. ... Even if the interest of Church was merely 'obliterated,' in May v. Heiner language, it is beyond all doubt that simultaneously with his death, Church no longer owned the right to the income; the beneficiaries did. It had then 'passed.' It never had before. For the first time, the gift had become 'complete.'"  

Three dissenting opinions were written: one by Mr. Justice Burton, one by Mr. Justice Reed and one by Mr. Justice Frankfurter. Justices Reed and Frankfurter each wrote a single opinion dealing with both Church and Spiegel, while Mr. Justice Burton wrote a separate opinion for each case. The views of Justices Reed and Frankfurter can best be presented following the statement of the Spiegel case while Mr. Justice Burton's dissent in the Church case should be discussed here.

Mr. Justice Burton opened his dissent by saying that the Church case is similar to the Spiegel case with the added element of a reserved life estate present. Aside from his argument that the case should be affirmed because of absence of factual intent to make a substitute for a testamentary disposition (an argument that will be outlined in greater detail in discussing the Spiegel case)

he argued for affirmance on three grounds, \textit{viz}: (1) under the applicable state law there was no possibility of reverter by operation of law in the trust, (2) if there was a reverter it "should be disregarded on the doctrine of \textit{de minimis non curat lex}," (3) the Joint Resolution of March 3, 1931, and the subsequent actions of the Court in light of the resolution, coupled with the long life of \textit{May v. Heiner} preclude the reversal of \textit{May v. Heiner} and a finding that the presence of a life estate in \textit{Church} makes the trust taxable.

\textbf{The Spiegel Case}

In 1920 Sidney M. Spiegel created a trust and transferred stock to it. Under the terms of the trust the income was to go to his children and their children during his life and on his death the corpus was to be distributed in the same manner. However, no provision was made for disposition of the corpus should he survive all his children and his grandchildren. Consequently, Spiegel held a possibility of reverter, and because of its presence the Government included the corpus of the trust in his gross estate on his death in 1940. When the case reached the Tax Court it held that the trust could not be included in Spiegel's gross estate under Section 811(c),\textsuperscript{50} citing as its authority \textit{Reinecke v. Northern Trust Co.}\textsuperscript{51} The Circuit Court of Appeals for the Seventh Circuit reversed the Tax Court\textsuperscript{52} on the ground that under the applicable state law the trust instrument permitted the corpus to revert to Spiegel, thereby bringing the "intended" phrase of Section 811(c) into play.

On appeal to the Supreme Court the taxpayer argued that (1) the \textit{Hallock} rule applied only where there was an express reverter and since the reverter here was not express but arose only by operation of law, if indeed there was a reverter, the trust was not taxable, (2) the reversionary interest was so small in comparison with the value of the corpus it should not be taxed, and (3) the

\textsuperscript{50} P-H. T. C. Memo 45.075.
\textsuperscript{51} 278 U. S. 339, 49 S. Ct. 123 (1929).
\textsuperscript{52} 159 F. (2d) 257, (C. C. A. 7th 1946).
Circuit Court misinterpreted the applicable state law on reversionary interests. The Court affirmed the Circuit Court in a decision which pointed out that (1) the Hallock decision was not to be limited to cases involving express reversionary interests, (2) the value of the reversionary interest is immaterial, and (3) it would not disturb the Circuit Court's conclusions on the applicable state law. In writing the majority opinion Mr. Justice Black said:

"In the Church case we stated that a trust transaction cannot be held to alienate all of a settlor's 'possession or enjoyment' under §811 (c) unless it effects 'a bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property. After such a transfer has been made, the settlor must be left with no present legal title in the property, no possible reversionary interest in that title, and no right to possess or to enjoy the property then or thereafter. In other words such a transfer must be immediate and out and out, and must be unaffected by whether the grantor lives or dies.' We add to that statement, if it can be conceived of as an addition, that it is immaterial whether such a present or future interest, absolute or contingent, remains in the grantor because he deliberately reserves it or because, without considering the consequences, he conveys away less than all of his property ownership and attributes, present or prospective. In either event the settlor has not parted with all of his presently existing or future contingent interest in the property transferred. He has therefore not made that 'complete' kind of trust transfer that §811 (c) commands as a prerequisite to a showing that he has certainly and irrevocably parted with his 'possession or enjoyment'."

Mr. Justice Burton dissented in an opinion divided into five suggested solutions which he called alternative proposals. The first and second will not be discussed here though the first certainly has merit. The third, fourth and fifth solutions recognize that if no
possibility of reverter existed the trust could not be taxed under Section 811(c), but beyond that they hold as follows: (1) under the third, the applicable state law indicates that Spiegel did not have a possibility of reverter, (2) under the fourth the state law indicates that he did have a possibility of reverter, and (3) under the fifth the state law indicates that he did have a possibility of reverter, but that Section 811(c) "requires a finding of the settlor's actual intent in order to make the Section applicable" and that intent was not present in the instant case.

Mr. Justice Burton would accept either the third or fifth solution but he expresses a preference for the fifth. He concludes, under the third, that the applicable state law precluded Spiegel from holding a reverter by operation of law because the trust created a vested interest in the remainderman when executed and the state law holds there can be no reversion on failure to take by a remainderman whose interest is vested, unless it be expressed. The fourth proposal which he considers to have been adopted by the majority is reached, he feels, by disregarding the applicable state law. He would prefer to reverse the Circuit Court and hold the trust non-taxable under the fifth solution; one which involves a contention set forth for the first time by a member of the Court.

The contention set forth by the Justice is that taxability of transfers under the "intended" phrase of Section 811(c) hinges on the conscious intent of the settlor. A reading of the landmark cases mentioned in the BACKGROUND section of this article discloses that no mention was made of the actual intent of the settlor in any of the opinions. Furthermore, writers in the field have argued that the test of taxability was subjective and not objective and the majority opinion in the principal case appears to castigate Mr. Justice Burton for suggesting such a thing for the majority said:

"What we said demonstrates that the taxability of a trust corpus under this provision of §811 (c) does not hinge on a settlor's motives,

66 See for example: PAUL, FEDERAL ESTATE AND GIFT TAXATION, 196 (1946 Supplement).
but depends on the nature and operative effect of the trust transfer.

... Any requirement less than that which we have outlined, such as a post-death attempt to probe the settlor’s thoughts in regard to the transfer, would partially impair the effectiveness of the ‘possession or enjoyment,’ provision as an instrument to frustrate estate tax evasions. To this extent it would defeat the precise purpose for which the provision was originated and which prompted Congress to include it in §811(c).”

In fact, the view has found judicial expression in very few cases. However, the fact that the contention has not been pressed does not mean it states the incorrect approach to the problems raised by the “intended” phrase of Section 811(c). Actually it seems to present the only way out of the dilemma in which we find ourselves as a result of the majority’s opinion in this and the Church case. But first a word about the opinions of Justices Reed and Frankfurter.

Mr. Justice Reed wrote a single opinion in which he concurred in the Spiegel case and dissented in the Church case. Mr. Justice Frankfurter also wrote a single opinion in which he dissented in both cases; arguing in Spiegel that the trust was not taxable under the Hallock doctrine because the death of the settlor did not enlarge the estate of another, and in Church that the court had no right to overrule May v. Heiner because of express declarations of Congress.

**Effect of the Church and Spiegel Decisions**

The impact of the Church and Spiegel decisions is great. They clearly destroy the tests of taxability being used by many lower courts, e.g., the test of express reverter vs. reverter by operation of law and the test of remoteness. Already their presence is being felt in the lower court decisions. However, the estate planner is

---

57 335 U. S. 701, ----, 69 St. Ct. 301, 303 (1949)
not so much interested in the impact of the decisions on the lower courts as he is in knowing whether they give the clear-cut interpretation of the "intended" phrase of Section 811(c) he has been so anxiously awaiting.

It may be argued that the decisions do offer a clear-cut interpretation and in support one may quote the Court's statement in the Church case that there must be a "bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property. After such a transfer has been made, the settlor must be left with no present legal title in the property, no possible reversionary interest in that title, and no right to possess or enjoy the property then or thereafter." But in the course of setting forth that interpretation it appears the Court may have sounded the death knell to the use of inter vivos trusts in estate planning.

Following the Hallock decision in 1940, the Bureau amended its Estate Tax Regulations by Treasury Decision 5008 which purported to conform the Regulations to that decision. However, the enforcement officers of the Bureau must have ignored or misinterpreted the Treasury Decision because they began to pursue a policy of combing every trust instrument to determine whether it was possible for the corpus to find its way back into the settlor's hands or into his estate. If they concluded that such a possibility existed they held the trust taxable. In general they relied on the law of resulting trusts, i.e., when there is a failure of an express trust and no evidence to show that the settlor intended that the trustee was to receive the corpus a resulting trust springs up in favor of the settlor. However, in their zeal, they began to stretch the resulting trust concept far beyond its normal bounds. By 1943 they were arguing that inclusion of a provision for remain-

---

der over to charity on failure of all named beneficiaries and their heirs would not guarantee tax exemption for a trust because the charity might conceivably fail, with the reversion going back to the settlor by operation of the resulting trust concept. After that pronouncement, Paul suggested that the only certain escape from the dilemma was to assign any contingent reversionary interest to the United States Government, saying: "It is safe to assume that Government counsel would not argue that the grantor or his estate could regain the property because the Government might collapse or disappear."6

Nevertheless, Paul's suggestion when viewed from a purely theoretical viewpoint is no better than the remainder to charity solution because theoretically the United States might not take the remainder (the Government need not fail, its refusal to accept the interest when tendered would have the same effect) with the result that it would revert to the settlor or his estate. Thus, in pursing the possibilities of reverter concept to an absurd end one finds that theoretically a settlor may never be able to free himself of it. It is as much a part of him as his shadow.6

On May 2, 1946, the Bureau promulgated Treasury Decision 5512 containing a new interpretation of the "intended" phrase of Section 811(c) based on its experiences with the Hallock decision between 1940 and 1946. The Treasury Decision laid down a test which incorporated two elements. If,

"(1) possession or enjoyment of the transferred interest can be obtained only by beneficiaries who must survive the decedent, and

63 Estate of Bertha Low, 2 T. C. 1114, 1124 (1943).
64 Paul, Federal Estate and Gift Taxation, 194 (1946 Supplement); See also Eisenstein, The Hallock Problem, 58 Harv. L. Rev. 1141, 1179 footnote 157 (1945) for the same observation.
65 Another possible solution has just been expressed in concrete form by the Minnesota Legislature. By Laws 1949, C.201, effective March 27, 1949, the Legislature provided that no reversionary interest shall arise in a settlor, his estate or heirs at law if he shows by the trust instrument an intention to divest himself of all interest in the trust property.
the decedent or his estate possesses any right or interest in the property (whether arising by the express terms of the instrument of transfer or otherwise)" 1

the value of the property interest is includible in the decedent's gross estate.

While it may be said that after Treasury Decision 5512 was published the enforcement officers of the Bureau relaxed their search for reverters somewhat, it would seem that the wording of the majority opinions in the Church and Spiegel cases will encourage them to press forward again. Certainly, if they read those opinions literally, (and there is every reason to believe they will in light of their initial approach to the Hallock decision) they can find justification for including every inter vivos trust in the gross estate of every settlor and then letting the settlor's executor or administrator prove them wrong in court because no mention is made in either opinion of the second element required by Treasury Decision 5512. All the enforcement officers must do is adhere to the modified theory of resulting trusts which they have developed to force the trusts into the settlors' gross estate on the ground that there has been a failure to meet the requirement for exclusion set forth by the Court, q.e., "the settlor must be left with no possible reversionary interest in that title."

It may be thought absurd to say every inter vivos trust may be subjected to estate tax under the "intended" phrase of Section 811(c); that it was never the intention of Congress to premit such a situation to exist. Yet, such a result is reached if one pursues the test of taxability set forth by the majority in the Spiegel case to the conclusion heretofore urged by the enforcement officers of the Bureau. For that reason alone, if for no other, the test of actual intent proposed by Mr. Justice Burton should be considered.

It must be remembered that under the statutory pattern of Section 811 any "possibility of reverter" held by a deceased person will be valued and included in his gross estate under the language

1 Ibid.
of Section 811(a), no matter how great or small the value may be. Therefore, the question which must be answered is: Is the mere presence of a "possibility of reverter" sufficient to pull the entire corpus of a trust into the gross estate via the Section 811(c) route?

Look back at the phrase with which we are dealing. It reads, "intended to take effect in possession or enjoyment at or after his death." Now think for a moment why that phrase is a part of the estate tax law. It was pointed out above that the omission of the phrase would emasculate the law by allowing individuals to escape taxation by substituting inter vivos transfers for testamentary transfers. Therefore, the problem one faces in any particular case is that of determining whether the settlor intended to circumvent the statute by substituting an inter vivos transfer for a testamentary transfer.

At the very heart of the problem lies the question of the intent of the settlor. The word "intended" has been a part of the statute since it was first placed on the statute books by the Revenue Act of 1916. And no one, since the time the phrase first reached the Supreme Court for interpretation in *Shukert v. Allen* in 1927, has satisfactorily explained the refusal of all parties to acknowledge the presence of the word as a part of the phrase. Instead, we find the Court attempting to apply a series of objective or what one might call mechanical tests in an attempt to escape the task of determining the actual intent of the settlor.

We all know that intent is a subjective thing which can be determined only through interpretation of the objective manifestations of the individual. It is true that those manifestations are often misinterpreted by the observer; but worse than misinterpretation is the feeling of some observers that manifestations are a goal in themselves when in reality they are only sign posts or beacons pointing toward the goal. So it seems that in the cases with which we are here dealing there has been not simply a misinterpretation by the observer (the courts) of the manifestations of the

---

68 Note 9 supra.
individual (the settlor, and of course his counsel) but a failure on the part of the observer to remember that the manifestation (the trust instrument) is merely the beacon pointing the way to the thing with which the tax statute is really concerned, the "intent" of the settlor.69

Is it not absurd to argue as the Government did in the *Goodyear* case70 that a settlor "intended" to make a substitute for a testamentary disposition when he created trusts under which he would have to survive a son, the son's children and the children's issue in order to receive the corpus? The value of the reverter under one of the trusts was $0.0000000000876 on a corpus of $338,000.00. Yet, apparently if a settlor created a trust free from any possibility of reverter but in the course of creating it wrote a letter to his lawyer telling the lawyer he wanted the trust to be a substitute for a testamentary disposition, the trust would conceivably be excluded from his gross estate. For Mr. Justice Black said in the *Spiegel* case: "What we said demonstrates that the taxability of a trust corpus under the provision of Section 811(c) does not hinge on a settlor's motives, but depends on the nature and operative effect of the trust transfer."71

What prompted the foregoing statement of Mr. Justice Black? Two other statements made by him in the course of the *Church* and *Spiegel* opinions may be the basis for it. The first was made while he was developing the historical background of the "intended" phrase in the *Church* case. He spoke of its origin in Pennsylvania and the first decision by the Pennsylvania Supreme Court interpreting the phrase and said: "It was further held in that case [*Reish v. Commonwealth*, 106 Pa. 521, 527, (1884)] that

---

69 An example of such a failure is found in Surrey and Aronson, *Inter Vivos Transfers and the Federal Estate Tax*, 32 Col. L. Rev. 1332 at 1337-38 (1932) where they say, in speaking of the subjective intent test: "Further, it is to be expected that the requisite intent would usually be inferred from the nature of the interests created by the transfer [footnote omitted]. Such second-hand use of the nature of the interests might well be abandoned in favor of a test based on the interests themselves."

70 *Estate of Ellen P. C. Goodyear*, 2 T. C. 885 (1943).

the test of ‘intended’ was not a subjective one, that the question was not what the parties intended to do, but what the transaction actually effected as to title, possession and enjoyment.” The second statement appears in the Spiegel case where he said: “Any requirement less than that which we have outlined [that to escape inclusion in a gross estate divestment must be absolute, unequivocal, irrevocable and without possible reservations], such as a post-death attempt to probe the settlor’s thoughts in regard to the transfer, would partially impair the effectiveness of the ‘possession or enjoyment’ provision as an instrument to frustrate estate tax evasions.”

A careful reading of Reish v. Commonwealth may prompt many lawyers to disagree with the conclusion that the Pennsylvania Supreme Court held the test of whether a trust was to be included in a decedent’s gross estate to be an objective one. Such a conclusion seems to indicate that the observer has lost sight of the subjective thing he is looking for, the intent, and has fixed his view on the superficial objective manifestation. It is submitted that the Pennsylvania Supreme Court did not commit that error, rather it looked at the objective manifestation solely for the purpose of satisfying itself as to the subjective, i.e., the settlor’s intent.

Apparently Mr. Justice Black based his conclusion “that the test of ‘intended’ was not a subjective one” on a clause, found in the last sentence of the opinion, which read “... it is unimportant what may have been the intention of the parties ...” Read in context the clause carries an entirely different meaning. The court said:

“The jury have found that the conveyance was but a scheme to defeat the commonwealth, and to deprive her of the tax; but in the view we have taken of the case, it is unimportant what may have been the intention of the parties in that respect, and we will not consider the effect of such a finding.” [emphasis added]
Thus, the meaning of the clause was that the court was not concerned with the jury’s finding that the parties intended to deprive the commonwealth of a tax because in its view the property was included in the gross estate anyway. It is submitted that a rereading of the whole opinion will then show the court’s view to have been that Reisch “intended” to make a substitute for a testamentary disposition and “in this case it [the intent] is shown by the bond.”

Turning to Mr. Justice Black’s statement that “a post-death attempt to probe the settlor’s thoughts in regard to the transfer would partially impair the effectiveness of the . . . provision,” one is probably safe in assuming that he was thinking of the contemplation of death phrase of Section 811(c) and the myriad problems it has produced. A like criticism had been voiced earlier by Paul when an attempt was made by a member of the Tax Court to “probe the settlor’s thoughts” in Francis Biddle Trust. Paul said: “Judge Opper’s [concurring] opinion, especially its framework of extrinsic references,’ is perilously akin to the content of contemplation of death with all its uncertainties.”

Though no one will dispute Mr. Justice Black’s statement, one must ask whether a court should allow itself to be influenced by the effect its decision may have on the efficiency of operation of a statute submitted to it for interpretation. It is the courts’ function to spell out in detail a nebulous concept, i.e., the legislative intent that has been compressed into the words of a statute by the legislature. And, if judicial analysis should demonstrate, for example, that it was the intention of Congress to tax inter vivos trusts only when a settlor actually intended to use the trusts as a substitute for a testamentary disposition, courts should not concern themselves with whether the statute will be difficult to administer. It is the job of Congress to express its intentions in a form that will make for simple administration.

75 Id. at 527.
76 3 T. C. 832 (1944).
77 Paul, Federal Estate and Gift Taxation, 179 (1946 Supplement).
Everyone dislikes the uncertainty which exists in the contemplation of death cases and all of us would doubtless prefer to apply a simple mechanical test in the "intended" cases rather than face the same uncertainty there. However, the simplest solution to a problem is not always a satisfactory one. And it is submitted that the muddle we find ourselves in today is due to repeated attempts to find an easy way out of a difficult situation.

In 1927 the Court offered a simple solution to the problem presented in *Shukert v. Allen*. It found that the interest of the settlor's children in the trust corpus vested when the trust was established and called the case closed without looking for evidence of the settlor's intent. In 1930 it decided *May v. Heiner*, and if there was ever a case in which the objective manifestations of the settlor might have been interpreted to indicate an intent to make a substitute for a testamentary transfer *May v. Heiner* was it. But the Court ignored intent and decided the case on the basis that the remaindermen's interest was vested when the trust was set up. Now, nineteen years later, we are forced to go through a period of soul searching and a survey of the doctrine of *stare decisis* as detailed as that in *Erie Railway v. Tompkins* in the course of correcting that mistake.

Following *May v. Heiner* there began the line of cases involving possibilities of reverter reviewed above. The question was immediately raised as to whether the *Klein* case could not be circumvented by ingenuity in drafting and the Court said yes in the *St. Louis Trust* cases. Then the *Hallock* case was decided and the Court reversed the *St. Louis Trust* cases with a warning to practitioners that Section 811(c) could not be circumvented by drafting ingenuity.

Some six years after the *Hallock* case, Paul said: "The *Hallock* decision is cogent evidence that the criteria of liability under Section 811(c) are objective rather than subjective." His author-

---

18 304 U. S. 64, 58 S. Ct. 817 (1938).
19 Note 56 supra.
ity for that conclusion is not clear,\textsuperscript{60} though it is apparent many lower courts agreed with it. Yet the confusion evidenced by the many opinions written during the period from 1940 to date show that the lower courts were having trouble finding the magic touchstone, the simple objective test which would tell whether to include any given trust in a settlor’s gross estate. They tried the express reverter \textit{vs.} reverter by operation of law test and found it wanting. They did the same with the remoteness test. Then Paul suggested that the test was: “If the reverter is such that the gift is contingent upon the grantor’s death or that his death brings the property into greater enjoyment, the transfer is one intended to take effect at death.”\textsuperscript{61} His is also an objective test which saves one from searching for the actual intent of the settlor. However, the decision of the Court in the \textit{Church} case seems to destroy even Paul’s test because the Court said the corpus of a trust would be included in the settlor’s estate unless you can show that: “After such a transfer has been made, the settlor [is] left with no present legal title in the property, no possible reversionary interest in that title, and no right to possess or to enjoy the property then or thereafter.”\textsuperscript{62} Clearly, a settlor could have a possible reversionary interest and still meet Paul’s test. So another objective test must fail in light of a subsequent court decision.

Perhaps in an attempt to save his test Paul would argue that there is implicit in the Court’s opinion the requirement that the death of the settlor enlarge or ripen the interest of another, as well as the stated requirement that he have either present legal title in the property or a possible reversionary interest before the trust will be taxed. He might also argue that the Bureau recognizes that

\textsuperscript{60} A contrary conclusion would seem to find support in the opinion of Mr. Justice Frankfurter in which he quoted with approval the statement made by Mr. Justice Stone in the St. Louis Trust Co. case, dissent, 296 U. S. 47 to the effect that: “In determining whether a taxable transfer becomes complete only at death we look to substance, not to form.” Yet one must admit that such a conclusion is weakened by the failure of the Justice to support Mr. Justice Burton’s argument in the Spiegel case that the actual intent of the settlor is the true test.

\textsuperscript{61} PAUL, FEDERAL ESTATE AND GIFT TAXATION, 195 (1946 Suppplement).

\textsuperscript{62} 335 U. S. 632, \textsuperscript{69} S. Ct. 322, 329 (1949).
the requirement of enlarging the interest of another was implicit in the opinion because the proposed amendment to the Regulations which have just been published leave untouched the dual requirement for taxability inserted in the Regulations by Treasury Decision 5512.

The answer to those arguments lies in history recited above. Immediately after the Hallock decision the Bureau promulgated Treasury Decision 5008 which purported to conform the Regulations to the law as enunciated by the Court. Its enforcement officers then proceeded to ignore the Treasury Decision and began arguing that any time a reverter exists the trust is includible in the settlor's gross estate. Certainly in the light of that history one has no right to presume that the Bureau is going to react any differently this time when it is already receiving encouragement from lower courts to look only for the single requirements of an interest in the settlor.

CONCLUSION

The foregoing should demonstrate that the solution to the problem of taxing transfers intended to take effect at death lies not in new objective tests but in throwing out the objective tests and turning to the subjective approach, much as we may dislike it. The courts should (1) read the statute as a whole, remembering that the word "intended" is a part of it, (2) read the words of the trust instruments not just for the purpose of determining what transfers it effected as a matter of law but to determine the intent of the settlor, i.e., whether he was attempting to escape the imposition of an estate tax by use of an inter vivos transfer, and (3) tax on the basis of that intent. In that way absurdity will be avoided and though the price be hard work on a case by case

---

83 Proposed Amendments §§ 81.17, 81.18 of Estate Tax Regulations 105, Amendments Reflecting Church and Spiegel Cases, Proposed April 15, 1949.
84 Page 125 supra.
85 Note 61 supra.
basis by both the taxpayer and the Government I submit it is worth the price.

In the closing section of an excellent article on the Hallock problem, published in the Harvard Law Review, Mr. Louis Eisenstein said:

"If the Government's theory [that an inter vivos trust is subject to taxation under the 'intended' phrase of Section 811 (c) simply because the settlor has a possibility of reverter] should be miraculously sustained by the Supreme Court, it will of course be legislatively overruled."\(^{87}\)

It appears that the miracle has come to pass in the Church and Spiegel cases and now we must wait to see whether Congress will "legislatively overrule" the Government's theory as Mr. Eisenstein assumes it will. It is to be hoped that if Congress speaks on the subject it will be in a voice that will need no judicial interpretation. Of course, this writer would like nothing better than a Joint Resolution (of the type passed after two decisions of the Fifth Circuit Court of Appeals in F.H.E. Oil Co. v. Commissioner\(^{88}\) wherein Congress said it approved the Bureau's Regulations on deductibility of intangible drilling costs) saying simply that the test of taxability under the "intended" phrase was subjective and not objective; but no doubt that is wishing for the moon.

In the interim, estate planners would do well to stay clear of the battleground, at least until the Bureau has made its position clear, not simply in its Regulations but in practice as well.

---


\(^{88}\) 147 F. (2d) 1002, 149 F. (2d) 238, (C. C. A. 5th 1945).