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UNITED STATES v BYRUM—THE MANAGEMENT POWER QUESTION IN ESTATE TAXATION

The Supreme Court recently approved a technique which permits the holder of a majority interest in a close corporation to reduce his estate tax burden significantly without relinquishing lifetime control over the business.[1] In *United States v. Byrum*,[2] the Supreme Court affirmed the principle that a settlor may retain broad management powers over property transferred to an irrevocable trust without suffering the adverse effect of having that property included in his gross estate.[3] Section 2036[4] of the Internal Revenue Code[5] provides that the gross estate will include property transferred by the decedent if he has retained certain proscribed rights in the property conveyed during his lifetime.[6]

It is frequently the objective of the taxpayer to retain maximum powers over the property transferred without encountering the costly consequences of section 2036 and its companions, section 2037 and section 2038.[7] This objective is particularly important where the stock

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1. 92 S. Ct. 2382 (1972).

2. *Id.*

3. "Management powers" or "powers of administration" include, among others, the powers to sell and invest, to exchange trust property, to vote trust investments, and to allocate receipts between corpus and income. This Comment is primarily concerned with the power to vote the stock in trust. For a discussion of this subject see Gray & Covey, *State Street—A Case Study of Sections 2036(a)(2) and 2038*, 15 TAX L. REV. 75 (1959) [hereinafter cited as Gray & Covey]; Pedrick, *Grantor Powers and Estate Taxation: The Ties That Bind*, 54 NW U.L. REV. 527, 552 (1959) [hereinafter cited as Pedrick].

4. INT. REV. CODE OF 1954, § 2036(a) provides in relevant part:

> (a) General Rule—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—
>
> > (1) the possession or enjoyment of, or the right to the income from, the property, or
> >
> > (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

5. All textual references to the "Internal Revenue Code" are to the INT. REV. CODE OF 1954, unless otherwise indicated.

6. See Llewellyn, *Estate and Gift Tax Reform: Inter Vivos Transfers With A Testamentary Flavor*, 13 WM. & MARY L. REV. 553 (1972).

7. INT. REV. CODE OF 1954, § 2037 deals with transfers taking effect in possession or

in a closely held corporation is the subject of the transfer, and where the attendant loss of voting rights would divest the settlor of control.

In *Byrum*, the Court dealt with a gift of stock in three unlisted corporations to an irrevocable trust for the benefit of the grantor's children. In the event of their death before the termination of the trust, the remainder was to pass to their surviving children.[8] The power to pay or withhold income was vested exclusively in an independent trustee.[9] However, the settlor retained the right to vote the shares of stock held in trust.[10] The retention of this power, when combined with his other holdings, enabled him to maintain voting control of two companies.[11] In addition, Byrum reserved the right to disapprove the sale or transfer of the trust assets and to remove the trustee and name another corporate trustee as successor.[12] The Commissioner claimed that the retention of voting rights and the power to veto the sale of stock placed the transfer within the purview of section 2036(a)(1) and (2).[13] In response, the executrix paid an additional tax and brought a refund action.[14] The Court of Appeals for the Sixth Circuit[15] and the Supreme Court[16] affirmed the district court ruling in favor of the estate.

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enjoyment at death. INT. REV. CODE OF 1954, § 2038 deals with the settlor's retention of power to alter, amend, revoke or terminate. Although the overlap of these two sections with section 2036 is considerable, this Comment will be confined to an analysis of section 2036. For a discussion of the relationship of section 2036 to sections 2037 and 2038 see W WARREN & S. SURREY, FEDERAL ESTATE AND GIFT TAXATION 257-68 (1961).

8. 92 S. Ct. 2382, 2384 (1972).

9. *Id.*

10. *Id.*

11. Control of the third company would have been maintained even if there had been no reservation of voting rights. The actual proportions were:

	Percentage Owned by Decedent	Percentage Owned by Trust	Total Percentage Owned
Company One	59	12	71
Company Two	35	48	83
Company Three	42	46	88

Id. at 2387 n.2.

12. 92 S. Ct. at 2385. If Byrum had retained the power to remove the trustee and appoint himself the stock would have been included in his estate under section 2036 (a)(2) or section 2038. Sharpe, *The Irrevocable Trust: Some Benefits and Risks Compared with Revocable Trust: How to Provide for the Possibility of Statutory and/or Administrative Changes*, N.Y.U. 28TH INST. ON FED. TAX. 941, 955 (1970).

13. 92 S. Ct. at 2384.

14. Byrum v. United States, 311 F Supp. 892 (S.D. Ohio 1970).

15. United States v. Byrum, 440 F.2d 949 (6th Cir. 1971).

16. 92 S. Ct. 2382.

RETAINED ENJOYMENT: SECTION 2036(a)(1)

According to section 2036(a)(1), any gifted property in which a grantor has retained "the possession or enjoyment . . or the right to income" during his life is included in the grantor's estate for tax purposes. In *Byrum*, the Commissioner argued that retention of voting control guaranteed the grantor continued employment as well as the right to determine whether and when the corporation would be liquidated or merged.[17] According to the Commissioner, such retained control amounted to "enjoyment" under the statute.[18]

In order to decide whether Byrum retained the requisite "enjoyment" of the transferred stock so as to subject it to estate tax, it is first necessary to determine whether the mere retention of voting rights is sufficient to trigger the operation of section 2036(a)(1). In 1929 the Supreme Court in *Reinecke v. Northern Trust*[19] held that the retention of management powers, including the power to vote stock held in trust, could not be classified as "enjoyment." *Northern Trust* was decided under section 402(c) of the Revenue Act of 1921, which required transferred property to be included in the gross estate of the grantor if the lifetime disposition was intended to take effect in possession or enjoyment at his death.[20] In holding that the extinguishment of management powers at the death of the settlor did not constitute the passage of "possession" or "enjoyment" to the beneficiaries, the Supreme Court held that retention of voting rights was not an "enjoyment" of the gifted property Because section 402(c), under which *Northern Trust* was decided, did not contain a clause comparable to section 2036(a)(2), the dissent in *Byrum* strongly criticized the majority's reliance upon the case.[21] This objection, however, is not well founded, since section 2036(a)(1) parallels section 402(c), both statutes deal with the grantor's retention of possession or "enjoyment" of transferred property.[22] It is therefore reasonable to assume that the enactment of section 2036(a)(1)

17. *Id.* at 2395.

18. *Id.*

19. 278 U.S. 339, 346 (1929).

20. *Id.* at 344-45.

21. 92 S. Ct. at 2399.

22. The dissenting opinion in *Byrum* attempted to distinguish *Northern Trust* on the ground that the settlor in that case did not have voting control. 92 S. Ct. at 2399. However, considering the difficulty of deciding what constitutes control in a given corporation, the majority was prudent in not viewing this factor as determinative. 92 S. Ct. at 2388 n.4, 2390 n.10, 2391 n.13.

signified congressional acquiescence in the judicial interpretation of "enjoyment" under section 402(c).[23]

Thus, it seems clear that the mere existence of a power to vote stock does not constitute "enjoyment." However, this proposition does not foreclose the possibility of subjecting such property to estate tax, in a case where the grantor abuses his power. It was argued in *Byrum* that retention of voting rights by the grantor not only enabled him to determine whether the corporation would liquidate or merge, but also guaranteed his continued employment as a corporate officer.[24] Assuming, *arguendo*, that voting control did give Byrum the power to make these decisions, the question whether such power constitutes "enjoyment" will turn on the manner and permissible extent to which it may be exercised.

The Supreme Court in *Commissioner v. Estate of Holmes*[25] held that enjoyment as used in the estate tax statute connotes "substantial present economic benefit rather than technical vesting of title or estates." [26] It is also generally accepted that the retention of *any* enjoyment of the transferred property, as opposed to *all* of the enjoyment, will nevertheless result in estate tax liability.[27] Through a literal application of these tax definitions of enjoyment, the Court in *Byrum* held that the right to merge or liquidate was not a "present" benefit but merely a speculative one.[28] The Court might also have noted that the exercise of a power to merge or liquidate, even if present, would not necessarily bestow a disproportionate economic benefit upon the grantor.

The contention that retained control of the corporation assures the

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23.
> A statute literally or substantially re-enacting a prior statute after its words have received a judicial interpretation must be regarded as adopted with knowledge of such construction and with the intention that it should thereafter be interpreted in the same way. Therefore the prior decisions, in which the construction of the statute was settled, are binding precedents for its interpretation after the re-enactment.

H. BLACK, HANDBOOK ON THE LAW OF JUDICIAL PRECEDENTS § 75 (1912).

24. 92 S. Ct. at 2395.

25. 326 U.S. 480 (1946).

26. The Regulations are in basic accord. Treas. Reg. § 20.2036-1(b)(2) (1954) provides:

> The "use, possession, right to the income, or other *enjoyment* of the transferred property" is considered as having been retained by or reserved to the decedent to the extent that the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent, or otherwise for his *pecuniary benefit.* (Emphasis supplied).

27. Commissioner v. Estate of Church, 335 U.S. 632, 645 (1949).

28. 92 S. Ct. at 2397.

grantor of continued status as a salaried officer[29] is not novel; it has been satisfactorily decided by the Tax Court in similar cases. In 1943, for example, the court considered a situation in which the decedent and her husband transferred shares in a family-owned business to their children while retaining rigid control over the stock, including the right to vote it.[30] In addition, they reserved $25,000 per year as compensation for negligible services, thus usurping corporate profits. The holding that the stock was properly included in the decedent's gross estate did not turn upon the mere retention of voting rights, but was influenced by the unwarranted compensation which was guaranteed by the arrangement.[31] Two years later, the Tax Court reached an opposite result under slightly different conditions. In *Estate of Hofford v. Commissioner*,[32] the decedent donated corporate stock to a trust and retained a yearly salary. In this case, however, the compensation reserved was reasonable in relation to the services actually performed and was held not to constitute "enjoyment" within the meaning of section 2036(a)(1). In a 1957 memorandum decision the court, again emphasizing the reasonableness of the settlor's yearly salary, excluded the transferred stock from his gross estate.[33]

In considering the employment question in *Byrum*, the Supreme Court apparently ignored the standard established by the Tax Court. The majority simply held that the right to employment was not a "substantial benefit" because of constraints of corporation law; the payment of an unwarranted salary would have subjected the director to a derivative suit. Although this conclusion is not refuted by the reported facts, the circumstances of Byrum's employment should have been carefully examined.[34] If Byrum merely reserved reasonable compensation for his services, the beneficiaries would not be deprived of any enjoyment from the transferred stock and he would not be retaining taxable enjoyment

29. *Id.* at 2395.

30. Estate of Holland v. Commissioner, 47 B.T.A. 807 (1942), *supplemental opinion*, 1 T.C. 564 (1943).

31. The grantor in *Estate of Holland* carefully reserved control of the stock during his lifetime, attaching conditions precedent to the absolute vesting of title in the grantees. In fact, the instrument of transfer expressly provided that: "upon the death of [transferor] the title of said [transferees] to said stock shall become absolute," and that "all of the provisions of this contract are to be and always construed to be *conditions precedent to the right and title of* [*transferees*] in and to the stock " (Emphasis supplied). 47 B.T.A. 807 (1942).

32. 4 T.C. 790 (1945).

33. Estate of William L. Belknap, P-H 1951 Tax Ct. Mem. Dec. ¶ 51,243.

34. *See* text following note 56 *infra*.

for himself by means of a wrongful appropriation. On the other hand, if the threat of a derivative suit was illusory, and in fact the salary stemmed from control, the Court should have found that taxable enjoyment resulted. This approach to the problem yields a result consistent with prior Tax Court holdings without opening a loophole for settlors who desire to retain enjoyment of transferred property by means of corporate manipulation.

The Court in *Byrum* thus reaffirmed the *Northern Trust* rationale that management powers do not inherently constitute enjoyment. In addition, without any inquiry into the presence of abuse, they extended that principle to indicate that even specific benefits derived from such powers will not be considered "enjoyment," where sufficient constraints against abusive appropriation are present.

It would be unrealistic to ignore the fact that management powers over gifted assets can be of indirect benefit to the manager. It would be equally improper to conclude absolutely that the mere possibility of wrongful appropriation or misuse necessitates the finding of a taxable retention of enjoyment. The difficulties inherent in any case-by-case treatment are of course to be considered, but the judicial effort required in using the approach of the Tax Court is no more problematic than the method already utilized in the policing of unreasonable compensation in income tax cases.

RIGHT TO DESIGNATE: SECTION 2036(a)(2)

Revenue Ruling 67-54 established the Commissioner's position that where a donor retains effective control over the issuer's dividend policy, a gift of nonvoting stock constitutes a proscribed transfer under 2036 (a)(2). This de facto concept of a "right to designate" was flatly rejected in *Byrum* when Justice Powell observed that "[t]he use of the term 'right' implies that restraints on power are to be recognized and that such restraints deprive the person exercising the power of a right to do so."[35] In other words, the Court began its reasoning by defining the term "right" within the meaning of section 2036(a)(2) as an unconstrained power or discretion.

Historically, the "right to designate" problem has arisen in cases[36]

35. 92 S. Ct. at 2392 n.14.

36. Michigan Trust Co. v. Kavanaugh, 284 F.2d 502 (6th Cir. 1960); Estate of Hays v. Commissioner, 181 F.2d 169 (5th Cir. 1950); Jennings v. Smith, 161 F.2d 74 (2d Cir. 1947); Delaney v. United States, 264 F. Supp. 904 (W.D. Ark. 1967); Estate of Pardee, 49 T.C. 140 (1967); Estate of Wier, 17 T.C. 409 (1951); Estate of Wilson, 13 T.C. 869

where the grantor appointed himself trustee while reserving the power to invade the trust corpus for the benefit of the income beneficiaries.[37] In this context, courts have rejected the argument that reservation of *any* discretionary power in the grantor is a "right to designate." Rather, they have developed a test to determine when discretion ceases to be a "right."

The landmark case of *Jennings v. Smith*,[38] the first to articulate such a standard, held that where the grantor's powers over trust assets are subject to the limitations of determinable external standards, the retention of such rights will not violate the underlying policies of section 2036(a)(2).[39] The application of the *Jennings* test to a multitude of factual situations has not been uniform.[40] But, in spite of the disagreement over precisely when a trust instrument provides a sufficiently ascertainable standard, the courts agree that even a reserved power to divert income from one beneficiary to another (which seemingly is within the express proscription of the statute) is not a "right" in the sense of section 2036 *if* a standard is in fact ascertainable.[41] Although the facts

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(1949), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951); Estate of Yawkey, 12 T.C. 1164 (1949); Estate of Frew, 8 T.C. 1240 (1947); Estate of Budlong, 7 T.C. 756 (1946), *aff'd in part and rev'd in part on other grounds sub nom.* Industrial Trust Co. v. Commissioner, 165 F.2d 142 (1st Cir. 1947); Estate of Matson, 3 CCH Tax Ct. Mem. 309 (1944). *Cf.* Budd v. Commissioner, 49 T.C. 468 (1968), where the court began its analysis by stating:

> Decedent was a trustee . . . so that the powers granted to the trustees of that trust must be considered held by him for purposes of [§ 2036(a)(2)], . . . even though they were exercisable only in his fiduciary capacity.
> The question remains, however, whether the powers granted the trustees in those two trust agreements left the decedent with "the right . . . to designate the persons to possess or enjoy the property or the income therefrom."

37. It should be noted that in those cases the grantor had retained considerably more direct power than that attributed to Byrum so that the reasoning of those cases should be clearly applicable in *Byrum.*

38. 161 F.2d 74 (2d Cir. 1947).

39. *Id.* at 78.

40. In some of these cases the reasoning of the courts has been clear. For example in Estate of Markson, 3 CCH Tax Ct. Mem. 309 (1944), the grantor's power to invade corpus for the beneficiary's "comfort and happiness" failed to provide a standard which an equity court could apply to limit the grantor's discretion. The same result was reached in Hurd v. Commissioner, 160 F.2d 610 (1st Cir. 1947), where invasion was allowed "if circumstances so required." In Estate of Wier, 17 T.C. 409 (1951), the power to invade corpus to maintain, support, and educate the beneficiary "in the manner appropriate to her station in life" was held to provide an ascertainable standard. *Accord,* Estate of Budlong, 7 T.C. 756 (1946) ("sickness and emergency" held to constitute an ascertainable standard). *Compare* Estate of Hays v. Commissioner, 181 F.2d 169 (5th Cir. 1950), *with* Estate of Yawkey, 12 T.C. 1164 (1949), reaching opposite conclusions on the same language.

41. *See, e.g.,* Jennings v. Smith, 161 F.2d 74 (2d Cir. 1947).

in *Byrum* do not involve a trustee's reserved power to invade the trust corpus, the *Jennings* line of cases demonstrates by analogy that Byrum's retained control will not constitute a right to designate if the Court is able to find an ascertainable standard limiting the power. Indeed, the Court found such a standard based upon the constraints of applicable trust principles and corporate law.

Corporate Constraints on Grantor

Jennings and the other "ascertainable standards" cases could have been cited had the majority in *Byrum* examined the facts presented and recognized that a trustee-beneficiary problem was raised. The Court concerned itself with a different type of fiduciary obligation—that of a controlling stockholder to the minority. Consequently, Justice Powell argued that even though Byrum (in his capacity of controlling stockholder) and the corporation directors were not obligated to consider the relationship between income beneficiaries and remaindermen within the trust, they were under a duty to the trust itself (a minority stockholder) to pay dividends when financial circumstances so warranted. Recognizing the chilling effect of a suit by the trustee against the settlor for wrongful action either as a director or as a shareholder, the majority was unwilling to equate Byrum's alleged power with the "right to designate" under section 2036.

The government and the dissent had no strong counter argument to Powell's reasoning at this juncture.[42] The heart of the argument, as in the ascertainable standards cases, concerned the Court's application of the test to the factual situation presented. The majority stressed the restraining influence caused by the economic realities of small corporations. The fiduciary obligations of directors, and the duties of majority stockholders which prevent them from placing their own interests above those of the corporation were deemed sufficient to preclude the personal exercise of the voting powers retained.[43] The dissent asserted that although these factors presented a modicum of restraint, Byrum never-

42. *See* Justice White's dissent in *Byrum* where he states: "I do not deny the existence of such constraints, but their restraining effect on an otherwise tempting gross abuse of the corporate dividend power hardly guts the great power of a controlling director to accelerate or retard, enlarge or diminish most dividends." 92 S. Ct. at 2382.

43. The argument is that in the typical closely-held corporation, dividend policy is dictated almost entirely by such factors as the availability of net earnings, the need for retained earnings, access to capital markets, etc., all of which are "ignored at the directors' peril."

theless retained sufficient latitude to divert the flow of dividends[44] and, as a consequence, to effect the distribution of income between income beneficiaries and remaindermen. This was, and will continue to be, the government's strongest argument. But adopting this approach in defining "right to designate" supplies no objective means of determining when practical constraints on power are sufficient to preclude the finding of a "right."

Constraints Imposed by Trust Principles

Even if the government had carried its argument that Byrum controlled *corporate* dividend policy, that issue loses significance if Byrum's control over disposition of trust assets is constrained. Clearly, the power to veto all sales of trust assets was crucial to the government's "right to designate" argument. Had that power not existed, the unlimited power of disposition in the trustee would have effectively checked the grantor's control over the beneficial enjoyment of the trust. This is true because the reinvestment of trust assets could completely sever any power retained by the grantor.

In an analogous line of cases,[45] the Commissioner has consistently contended that the retention of broad management powers by a grantor enables him to designate the persons who are to receive trust income. Under this rationale, the "right" allegedly arises from the power to select investments in growth stocks to favor the remaindermen or conversely to purchase other assets to favor the income beneficiary. If Byrum's control over corporate dividend policy enabled him to transform the trust corpus (stocks frozen in trust by means of his veto power) into high or low yield securities, the exercise of such discretion could determine indirectly whether the trust would pay income or accumulate earnings. Yet in the management power cases,[46] where this identical

44. Perhaps the dissent's best argument on this point is that equity courts are loath to interfere with the corporate director's discretion and will accept almost any excuse to avoid doing so. *See* W CARY, CASES AND MATERIALS ON CORPORATIONS 17 (4th ed. 1969). This point is particularly important because the whole "ascertainable standards" concept is dependent upon the willingness of equity courts to step in and enforce the standards.

45. *See, e.g.,* Old Colony Trust Co. v. United States, 423 F.2d 601 (1st Cir. 1970); United States v. Powell, 307 F.2d 821 (10th Cir. 1962); Budd v Commissioner, 49 T.C. 468 (1968); Estate of Peters, 23 CCH Tax Ct. Mem. 994 (1964); Estate of King, 37 T.C. 973 (1962); Estate of Wurts, 1960 P-H Tax Ct. Mem. Dec. ¶ 60,102; Estate of Wilson, 13 T.C. 869 (1949), *aff'd per curiam,* 187 F.2d 143 (3d Cir. 1951); Estate of Neal, 8 T.C. 237 (1947); Estate of Hall, 6 T.C. 933 (1946); Estate of Downe, 2 T.C. 967 (1943).

46. Cases cited in note 45 *supra.*

power has been challenged, the lower courts have held consistently that section 2036 is not operative, since there are restraints inherent in the grantor's role as a fiduciary.[47] In *Estate of Willard V. King*,[48] the Tax Court stated:

> It is our conclusion that in so far as the management of the trust in the instant case was concerned, *the grantor had in effect made himself a fiduciary*, and that under the law of New York he was not at liberty to administer the trust for his own benefit or to ignore the rights of the beneficiaries, even though he no doubt would be permitted wide latitude in the exercise of his discretion as to the types of investments to be made.[49]

Apparently the court in *King* answered the initial question—whether management powers were reserved for the benefit of the trust beneficiaries or for the benefit of the grantor—by interpreting the trust instrument and looking to the intent of the grantor.[50] Since it found that the power was reserved for the benefit of the trust beneficiaries, the court examined applicable state law[51] for an enumeration of duties imposed on a grantor in such a situation. The rule that retention of investment powers by the grantor carries with it a fiduciary prohibition against frustrating the purposes of the trust is either stated or assumed[52] in all the management powers cases.[53] Accordingly, since Byrum's re-

47. State Street Trust Co. v. United States, 263 F.2d 635 (1st Cir. 1959), is the one apparent exception to this statement. In that case the grantor had retained not only normal investment powers, but also the right to invest in non-legals, the right to classify gain as income or principal, and several other powers. The court held that while the powers might be permissible individually, when accumulated they were enough to make the corpus taxable under section 2036(a)(2). The case is apparently an abberation and has never been followed. In 1970 it was overruled by *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970).

48. 37 T.C. 973 (1962).

49. *Id.* at 980 (emphasis supplied).

50. *See also* Cushman v. Commissioner, 153 F.2d 510, 514 (2d Cir. 1946), where the court held: "It is a question of interpretation whether or not the powers reserved as grantor are held in a fiduciary capacity or for the grantor's own purposes." *Accord*, Fifth Ave. Bank v. Nunan, 59 F Supp. 753 (E.D.N.Y. 1945).

51. Carrier v. Carrier, 226 N.Y. 114, 123 N.E. 135 (1919).

52. Covey, *Section 2036—The New Problem Child of the Federal Estate Tax*, 4 TAX COUNSELOR'S Q. 121, 148 (1960).

53. *But see* United States v. Powell, 307 F.2d 821 (10th Cir. 1962); Estate of Peters, 23 CCH Tax Ct. Mem. 994 (1964); Estate of Wurts, 1960 P-H Tax Ct. Mem. Dec. ¶ 60,102. The grantors were the trustees and it was unnecessary to attribute such duties to them.

tained right to veto all sales or acquisitions of trust assets is just such a management power, he implicitly assumed the duty *not* to use the power to defeat the purposes of the trust.

The question therefore is whether Byrum's fiduciary obligations are sufficient to restrain him from using his veto to enforce any shifting of interests within the trust which might result from his "control" of corporate dividend policy. According to the *Restatement of Trusts*,[54] investment powers of a fiduciary must be exercised impartially between income beneficiaries and remaindermen.[55] Thus, any exercise of Byrum's veto power would be restrained by a court of equity to the extent that he attempted to reallocate interests within the trust. In sum, since the government's theory required that Byrum have both corporate power (over dividends), and trust power (over transfer of assets), this additional check on his veto power makes its position untenable.

Summary Judgment

The question whether Byrum's influence over dividend policy was, as a practical matter, sufficiently constrained by external standards to prevent his abuse of discretion, was the primary focus in the majority's "right to designate" analysis. In this regard, the fact that the case was decided on cross-motions for summary judgment may be significant. In discussing the effect of economic factors upon the payment of dividends, Justice Powell of necessity was referring to a typical situation involving a small corporation.[56] Had the specific facts been available, it might have been found that the financial posture of the corporations did allow considerable latitude in making dividend policy. The issue then would have been narrowed to whether the respective fiduciary obligations allowed Byrum any real discretion. In that event the case would have been clearly analogous to the "ascertainable standards"

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54. RESTATEMENT (SECOND) OF TRUSTS (1935).

55. *Id.* § 232 states:

> If a trust is created for beneficiaries in succession, the trustee is under a duty to the successive beneficiaries to act with due regard to their respective interests.
>
> > (d) Although the trustee is not under a duty to the beneficiary entitled to the income to endanger the principal in order to produce a large income, he is under a duty to him not to sacrifice income for the purpose of increasing the value of the principal. *Thus, the trustee is under a duty to a life beneficiary not to purchase or retain unproductive property* (Emphasis supplied).

56. 92 S. Ct. at 2392.

cases,[57] and the impact of the Court's holdings would have been clear. As the case stands, the additional factor of economic constraints is sufficient to cloud the relationship between *Byrum* and the "ascertainable standards" cases.

CONCLUSIONS

The Supreme Court's treatment of the "right to designate" issue under section 2036(a)(2) will reinforce the lower court decisions in the "ascertainable standards" cases and the "management power" cases. In light of the obvious dissimilarity of the powers retained by Byrum to the disguised testamentary dispositions at which section 2036(a)(2) was aimed, the holding in this case certainly is consistent with the Congressional mandate. There are, however, no objective means of determining at what point the fiduciary obligations of company directors, coupled with economic considerations, will be substantial enough to curtail the donor-majority stockholder's discretion in "controlling" dividend policy. To further complicate the situation, the case was decided on cross-motions for summary judgment, thus preventing the Court from considering a specific fact situation to provide an exemplar upon which these tests could operate. As a result, an extremely amorphous test has arisen and no clear statement of its application has been presented.

Although the approach taken by the Court in defining the phrase "right to designate" was well reasoned as far as it went, the decision could have had greater impact had an attempt been made to ascertain what Congress intended to proscribe by the use of that phrase.[58] It is clear that the general purpose of section 2036(a) and its predecessors has been to prevent estate tax avoidance by the use of testamentary dispositions disguised in the form of an incomplete *inter vivos* gift. The history of this section indicates that in its present form it is a mere patchwork of amendments tailored to meet specific situations in order to effectuate the law's basic purpose. A prime example is the 1931 amendment to the Revenue Act of 1926, which was rushed through Congress in one day to overrule three Supreme Court decisions adverse to the government.[59]

57. See cases cited note 36 *supra* & accompanying text.

58. *See generally* Murtagh, *The Role of the Courts in the Interpretation of the Internal Revenue Code*, 24 TAX LAWYER 523 (1971).

59. The only record of legislative intent, statements made on the floor of the House of Representatives, clearly indicate that the bill was a response to McCormick v. Burnett, 283 U.S. 784 (1931); Morsman v. Burnett, 283 U.S. 783 (1931); and Burnett v. Northern Trust Co., 283 U.S. 782 (1931). The Commissioner of Internal Revenue apparently was

It has been widely recognized[60] that the wording of section 2036 (a)(2) was inspired solely by one case, *McCormick v. Burnett*,[61] and that it was intended to do no more than tax trusts over which the grantor retained a *specific* and *direct* right to designate the income beneficiaries. Yet in the lower courts[62] it has been implicitly assumed that Congress also intended to reach indirect powers; otherwise, the issue of the existence of such powers would never have been reached. In *Byrum*, the Supreme Court's approach to the definition of "right to designate" was obviously based on the same unstated assumption.

Certainly from the point of view of the estate planner who desires more certainty in the estate tax laws, it would have been preferable for the Court to have treated the question by inquiring into congressional intent. Had the Court recognized that such powers as Byrum retained and as existed in the management power cases (which affect the relative interests of income beneficiaries and remaindermen only indirectly) were never intended to be within reach of section 2036(a)(2), the question would have been handed back to Congress. In all probability we would have witnessed a re-run of the passage of the 1931 amendment,[63] but the possibility exists that Congress would have seriously reconsidered the underlying policy considerations of this section.

so disturbed over the three decisions that he immediately drafted a letter to the House Ways and Means Committee requesting that it amend section 302 of the 1926 Act to insure that any reserved life interests in inter vivos transfers would be taxable. The bill was pushed through both houses in one day under suspension of the rules, and the President signed it into law the evening after the decisions were handed down. Consequently, there was no committee report and the bill was not printed. From the conversations on the floor of the House, however, the conclusion is inescapable that the amendment was intended to do no more than meet those specific decisions. 74 CONG. REC. 7198 (1931).

60. *See, e.g.*, Industrial Trust Co. v. Commissioner, 165 F.2d 142 (1st Cir. 1947) (dissenting opinion); Gray & Covey, *supra* note 3; Covey, *supra* note 52. *But see* Pedrick, *supra* note 3.

61. 283 U.S. 784 (1931).

62. *See* case cited notes 36 & 45 *supra*.

63. *See* note 59 *supra*.