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Inheritance Tax upon Failure to Exercise Special Power of Appointment

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She also has implied power under article 4623 to become, *jointly* with her husband, the *joint* [italics added] maker of a note or a surety on any bond or obligation of another." So it would seem that if the husband does not consent to become jointly bound with his wife as surety, she may not so bind herself. However, if the consent of the husband is to be considered as a matter of course, then Texas belongs in Class II.

The theory behind the rule in this third class is that the law, while it has removed the wife's disabilities with regard to the ownership and disposition of property, should nevertheless protect the interest of the *feme covert* from being wasted and impaired by the assumption, through undue family influence, of debts for the benefit of others. While these states are willing to remove disabilities for her interest, they were not willing to allow her to enter into contracts from which no benefit could be derived.

PHILLIP SCHIFF

INHERITANCE TAX UPON FAILURE TO EXERCISE SPECIAL POWER OF APPOINTMENT.

Property may be deeded or devised subject to the exercise of two types of powers, namely, general and special. Under a general power the donee is unrestricted in his selection of the person or persons to whom he may appoint;¹ under a special power his selection is restricted to a named class or group.² Generally, when property is deeded or devised subject to the exercise of a power, the donor provides that it shall pass to a certain person or persons in default of an exercise of the power by the donee. This note will be devoted to a discussion of the imposition of a succession tax upon the failure of the donee to exercise a special power.

Under the Federal Estate Tax Act,³ property subject to a general power of appointment is made a part of the gross estate of the donee for the purpose of computing the estate tax, but only when the power is exercised and the property appointed to someone other than the person or persons named to take in default of an exercise of the power.⁴

Most state statutes⁵ impose a succession tax upon the passage of the property to the beneficiary at the death of the donee, whether

¹ *Leser v. Burnet*, 46 F. (2d) 756 (1931); *Johnstone v. Comr. of Internal Revenue*, 76 F. (2d) 55 (1935), certiorari denied 56 S. Ct. 89, 296 U. S. 578, 80 L. Ed. 408 (1935); *St. Matthews Bank v. De Charette*, 259 Ky. 802, 83 S. W. (2d) 471 (1935); *Lyon v. Alexander*, 304 Pa. 288, 156 Atl. 84, 76 A. L. R. 1427 (1931).

² *Id.*

³ 26 U.S.C.A. sec. 411(f). Mississippi also has a similar statute, Miss. Code (1930), sec. 5069.

⁴ *Helvering v. Grinnell*, 294 U. S. 153, 55 S. Ct. 354 (1935).

⁵ *Arizona Rev. Code* (Struckmeyer, 1928) sec. 3160; *Colo. Sess. Laws* (1933) Chap. 106, sec. 2(8); *Idaho Code* (1932) sec. 14-402(6); *Kan. Rev. Stat.* (1923) sec. 79-1520; *Ky. Stat.* (Carroll, 1936) sec. 4281a-14; *Mass. Gen. Laws* (1932) Chap. 65, sec. 2; *Mich. Comp. Laws*

the power be general or special, and whether the donee does or does not exercise it. The general form of state statute is exemplified by the Wisconsin statute,⁶ which follows:

"Whenever any person or corporation shall exercise a power of appointment derived from any disposition of property, made either before or after the passage of sections 72.01 to 72.24, inclusive, such appointments, when made, shall be deemed a transfer taxable under the provisions of sections 72.01 to 72.24, inclusive, in the same manner as though the property to which such appointment relates belonged absolutely to the donee of such power, and had been bequeathed or devised by such donee by will; and whenever any person or corporation possessing such a power of appointment so derived shall omit or fail to exercise the same within the time provided therefor, in whole or in part, a transfer taxable under the provisions of sections 72.01 to 72.24, inclusive, shall be deemed to take place to the extent of such omission or failure, in the same manner as though the persons or corporations becoming entitled to the possession and enjoyment of the property to which the power related had succeeded thereto by a will of the donee of the power failing to exercise such power, taking effect at the time of such omission or failure."

The constitutionality of this type of statute has been attacked in several cases. The majority of these cases have involved the exercise of, or the failure to exercise, a general power of appointment, but generally the courts have made no distinction between general and

(1929) sec. 3672(4); Minn. Gen. Stat. (1923) sec. 2292(5); Mo. Rev. Stat. (1929) sec. 571; Mont. Rev. Code (Anderson & McFarland, (1935) sec. 10400.1(5); N. M. Stat. (1929) sec. 141-1118; N. C. Code (1927) sec. 7380(1); N. D. Supp. to Comp. Laws of 1913 (1913-25) sec. 2346b-1 (5); Ohio Gen. Code (Page, 1939) sec. 5332(4); R. I. Gen. Laws (1926) Chap. 810, sec. 5(3), (it is to be noted that an alternative method is provided in sec. 18); S. C. Code (1932) sec. 2430(e); S. D. Comp. Laws (1929) sec. 6827(3); W. Va. Code (1937) sec. 842(e); Wis. Stat. (1937) sec. 72.01(5).

The following states impose the tax as if the property had been devised or bequeathed by the donee, but only when the power is exercised; Ill. Rev. Stat. (1937) Chapt. 120, sec. 375(4); N. Y. Consd. Laws (Cahill, 1930) Chap. 61, sec. 220(4); Wash. Laws (1931) Chap. 134, sec. 2.

The following states have statutes taxing property subject to powers in different manners: Calif. Gen. Laws (Deering, 1937) Act 2495, sec. 2(6), taxes as a transfer from donor to donee at donor's death, superseding Calif. Gen. Laws (Deering, 1931) Act. 8443, sec. 2(6); Iowa Code (1930) sec. 7307(4), provides for tax on property "passing under power. . ."; Me. Rev. Stat. (1930) Chap. 77, sec. 2, taxes property subject to a power as a succession from the donor to the beneficiary named to take in default; Miss. Code (1930) sec. 5069, same as federal estate tax; N. J. Rev. Stat. (1937) sec. 54:34-1(d), taxes "property transferred pursuant to a power of appointment . . ."; Tenn. Code (1932) sec. 1260, "Transfers under powers of appointment shall be taxable in like manner and to the same extent as if property of the testator or donor was transferred."

⁶ Wis. Stat. (1937) sec. 72.01(5).

special powers, whether exercised or not, and have upheld the statutes.⁷

From the decisions, it appears that three views have been taken in cases involving the failure to exercise a power. The New York view, expressed in *re Lansing's Estate*,⁸ is that the beneficiary named to take in default of an exercise of the power takes a vested interest in the property at the time of the donor's deed or death; that nothing passes to him upon the donee's death without exercising the power; and, therefore, there can be no tax imposed at the donee's death. This case also involved the so-called New York doctrine of election.⁹ The donee, by his will, had appointed the property to the beneficiary named to take in default. The court held that the beneficiary could elect to take under the deed of the donor, rather than under the will of the donee, and the result would be the same as if the power had not been exercised. In a later decision, the New York court has taken away any actual election by the beneficiary, and held that the election will be presumed where it will benefit him.¹⁰

A second view is expressed in *Manning v. Board of Tax Commissioners*,¹¹ a Rhode Island case. The court there held that the beneficiary named to take in default receives a vested interest in the property under the will or deed of the donor, but, upon the death of the donee without exercising the power, there is a new right—the right to possession and enjoyment—which accrues to the beneficiary, and which is a proper subject of the tax.

Massachusetts advances still a third view, in *Minot v. Stevens*.¹² There the court considered the property not vested in anybody until the death of the donee, and held that, when it vests in possession, through a proper disposition of it which is dependent upon the will and conduct of the donee (in appointing or failing to appoint), there is a succession which is a proper subject of the tax.

The few cases found which involve the failure to exercise a special power appear to follow the same trend expressed in the cases involving the failure to exercise a general power. However, in states in which the New York view is not followed, it would seem that the question might become one of degree. If the beneficiary named to take in default of an exercise of the power is not one of the group or class to whom the donee could appoint, there would seem to be no difference in the problem presented than in the case of a general power; also, where the beneficiary named to take in default is one of that group or class, and there is more than one member of that group or class living at the donee's death, the problem appears to be the same as in the

⁷ See *in re Lansing's Estate*, 182 N. Y. 233, 74 N. E. 882 (1905), in which New York held the statute unconstitutional in the case of a failure to exercise a power. California also followed the Lansing case in *in re Murphy's Estate*, 133 Cal. 740, 190 Pac. 46 (1920).

⁸ 182 N. Y. 233, 74 N. E. 882 (1905).

⁹ For a discussion of this doctrine, see, Thompson, *Inheritance Taxation and Powers of Appointment*, 1939 Wis. L. R. 254, 266-70.

¹⁰ *In re Sanford's Estate*, 290 N. Y. Supp. 959 (1936).

¹¹ 46 R. I. 400, 127 Atl. 865 (1925).

¹² 207 Mass. 588, 93 N. E. 973 (1911).

case of a general power; but, where the beneficiary named to take in default is the only member of that class or group surviving the donee, the question of whether there is a taxable succession becomes a closer one.

There have been no cases found in which the first of the above mentioned situations was present, namely, where the beneficiary named to take in default is not one of the group or class to whom the donee could appoint, but due to the broad discretion rested in the donee in that situation, there would seem to be little doubt that the statute would be upheld.

The problem presented in the second situation, namely, where the beneficiary is one of the named group or class and two or more of the group or class survive the donee, has been decided in the cases of *Burnham v. Stevens*²³ and *Montague v. State*.²⁴

In the *Burnham* case, the donor left property in trust to his son for life, with power in the son to appoint among his children or grandchildren as he saw fit, and in default of an exercise of the power to the son's children equally. The son died without exercising the power. The court said the question to be determined was, whether it should give the same effect to a failure to exercise a special power which it had given to the failure to exercise a general power in the *Minot* case, *supra*. In upholding the statute, the court answered that question in the affirmative, saying:

"Until the death of the donee and his exercise or failure to exercise the power of appointment it could not be known in what proportions the children or grandchildren would take. Until that event happened the estate in children did not become complete and the succession was not fully determined. It cannot be said therefore that the estate had so vested in the children as to render the imposition of a tax under the statute above referred to unconstitutional."

The facts of the *Montague* case were similar to those of the *Burnham* case. The court said:

"The provision (of the statute) that *a transfer resulting from the failure of the donee to appoint shall be deemed to constitute a taxable transfer equally with a transfer resulting from an appointment*, is valid, because the failure to act equally effects the course of succession and until such failure is complete the succession is not fully determined."²⁵

From these cases, it appears that the courts, for the purposes of taxation, regard the failure to exercise a special power, in a case in which there is another of the group or class besides the beneficiary named to take in default, surviving the donee, in the same light as the failure to exercise a general power. The decisions in the two types of cases are, therefore, based upon the same theory, which is,

²³ 212 Mass. 165, 98 N. E. 603 (1912).

²⁴ 163 Wis. 53, 157 N. W. 508 (1916).

²⁵ Italics ours.

that until the death of the donee the succession is not complete and upon his death there is a passage of possession and enjoyment, which is a proper subject of a succession tax.¹⁶

Should this second situation arise in a state in which the non-illusory appointment doctrine is followed, and the power be a non-exclusive one, the problem assumes an additional aspect.

Under a non-exclusive power, the donee must appoint at least a part of the property to each member of the class or group;¹⁷ under the non-illusory appointment doctrine, a substantial part of the property must be appointed to each member.¹⁸ The question would then arise—does not the beneficiary named to take in default have a non-defeasible vested interest in a substantial part of the property under the deed or will of the donor, which interest could not be taxed upon the donee's death? Obviously, the beneficiary does have such an interest under the will or deed of the donor, but it seems probable that the tax would still be upheld under the theory that the grouping of all powers into one classification for the purposes of taxation is just and reasonable, and further, it cannot be known until the donee's death just what proportion the beneficiary will take.

The problem presented in the third situation above has been found only in the *Lansing* case, *supra*, and, as these situations were set forth for a discussion of cases arising in jurisdictions which do not subscribe to the New York view, that case is of little aid. This factual situation, namely, where the beneficiary named to take in default is the only member of the class or group (to whom the donee can appoint) surviving the donee, represents the exceptional and closest case which can arise under this type of statute, because upon the death of the donee the property would pass to that beneficiary whether the power was exercised or not. Although there have been no decisions concerning this situation, it is submitted that the courts could, and probably would, uphold the statute under the same theory expressed in the *Burnham* and *Montague* cases, *supra*, because, as was said above, it appears reasonable, for the purposes of taxation, to group all powers, whether exercised or not, in the same class, regardless of whether the donee could change the course of succession. There appears to be little basis for upholding the statute in this situation upon the ground that the action or inaction of the donee determines the succession.

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¹⁶ *Minot v. Stevens*, 207 Mass. 538, 93 N. E. 973 (1911); *Burnham v. Stevens*, 212 Mass. 165, 98 N. E. 603 (1912); *Manning v. Bd. of Tax Com'rs*, 46 R. I. 400, 127 Atl. 365 (1925); *Montague v. State*, 163 Wis. 58, 157 N. W. 508 (1916).

¹⁷ *Barrett's Ex'r. v. Barrett*, 166 Ky. 411, 179 S. W. 396 (1915).

¹⁸ *Id.*