Washington and Lee Law Review

Volume 32 | Issue 4 Article 15

Fall 9-1-1975

Iv. Powers Of Appointment Under § 2041

decedent's estate because the " 'decedent strayed materially from the plan's payment provisions' "[45] and thus "removed them from the statutory category of 'payment receivable . . . under a contract purchased by an employees' trust . . .[as] part of a pension . . . plan."[46] As one concurring opinion stated, the overly broad language employed by the majority contravened the intent of Congress to protect and facilitate the establishment of annuities by employers for their employees.[47]

However, the most important ramification of *Silverman* is that the provisions of a qualified plan must be closely followed to ensure that contracts issued and payments rendered remain excludable as part of a qualified plan. If a contract or method of payment fails to conform with the qualified plan, then the amounts attributable to the contracts or the payments owed are subject to taxation in the deceased participant's estate.

IV. POWERS OF APPOINTMENT UNDER § 2041

Under § 2041 of the Code,[1] a decedent's possession at his death of

[45] CCH [1974 Transfer Binder] TAX CT. REP. ¶ 32,449, at 2337 (concurring opinion, J. Tannenwald).

[46] *Id.* (concurring opinion, J. Hall).

[47] *Id.* In stating that too strict a reading of the provisions of § 2039 contravenes the intent of Congress to treat annuities leniently in the tax area, Judge Hall refers to the Employee Retirement Income Security Act of 1974. *Id.* n.1. The Act was signed into law by President Ford on September 2, 1974 as Public Law 93-406. P-H 1974 FED. TAXES ¶ 60,417, at 60,669 (Sept. 5, 1974). Congress stated a dual policy behind the Act intending to provide full disclosure and reporting to retirement plan participants and to establish minimum standards of responsibility and soundness in regard to retirement plans. 29 U.S.C.A. § 1000(b) and (c) (Supp. 1974). Reference was specifically made to the loss of anticipated benefits by employees with many years of employment apparently precipitated by the absence of full disclosure and the absence of minimum standards. *Id.* at § 1001(a). To help alleviate some of these problems Congress established a declaratory judgment section in the laws governing the Tax Court to allow parties to seek review of administrative decisions on the initial or continuing qualification of pension plans of the type in § 2039(c). 29 U.S.C.A. § 7476 (Supp. 1975). Also, because of the belief that the Internal Revenue Service is primarily concerned with the collection of revenues without giving sufficient consideration to the purposes for which certain employees benefit plans are exempt, Congress established the "Office of Employee Plans and Exempt Organizations" headed by an Assistance Commissioner, which is designed to be better able to meet and understand the purposes and requirements of exempt plans and organizations. 29 U.S.C.A. § 7802 (Supp. 1975); *see* S. REP. No. 93-383, U.S. CODE CONG. & AD. NEWS 609 (Pension Reform Act, 1974).

[1] INT. REV. CODE OF 1954, § 2041.

a power of appointment[2] may render the property affected by the power subject to federal estate taxation. The increasing use of the power of appointment as a method of disposition is attributed to its efficiency,[3] flexibility, and favorable tax treatment.[4] Although the power of appointment appears to be a simple device, its pervasive and varied usage often reveals hidden difficulties particularly with regard to estate taxation.[5]

Basically, only general powers of appointment are taxed under the Code.[6] A general power of appointment is defined as being a power by which the holder, the donee, can appoint the property subject to the power for the benefit of himself, his estate, his creditors, or the creditors of his estate.[7] One exception to the inclusion in the donee's taxable estate of property subject to a general power of appointment arises when the donee's power is limited by an "ascertainable standard."[8] However, the term "ascertainable standard" has often been the subject of litigation.[9] Among the cases concerning § 2041 that were decided in 1974[10] was *First Virginia Bank v. United States*,[11] a

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[2] A succinct definition of "power of appointment" is the "power to dispose of property which the holder of the power does not own." C. LOWNDES, R. KRAMER, AND J. MCCORD, FEDERAL ESTATE AND GIFT TAXES § 12.1, at 298 (3d ed. 1974) [hereinafter cited as C. LOWNDES].

[3] *See* 1 H. HARRIS, HANDLING FEDERAL ESTATE AND GIFT TAXES § 161 (J. Rasch rev. ed. 1972) [hereinafter cited as H. HARRIS].

[4] J. TRACHTMAN, ESTATE PLANNING 201 (rev. ed. 1968) [hereinafter cited as J. TRACHTMAN].

[5] *See id.*

[6] INT. REV. CODE OF 1954, § 2041(a)(1)(2).

[7] *Id.* at § 2041(b)(1) Treas. Reg. § 20.2041-1(c)(1) (1958), *as amended*, T.D. 6581, 26 F.R. 11861 (1961). *See* C. LOWNDES, *supra* note 2, § 12.5, at 207; J. DUKEMINIER AND S. JOHANSON, FAMILY WEALTH TRANSACTIONS 232-33 (1972) [hereinafter cited as J. DUKEMINIER]; J. TRACHTMAN, *supra* note 4, at 203-05; 2 J. MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION § 19.07 (1959, Supp. 1974) [hereinafter cited as J. MERTENS].

[8] INT. REV. CODE OF 1954, § 2041(b)(1)(A). A sufficient limitation on the power to consume, invade, or appropriate property for the benefit of the decedent exists when the ascertainable standard is related to the health, education, support or maintenance of the decedent. *Id.*; Treas. Reg. § 20.2041-1(c)(2) (1958). *See* C. LOWNDES, *supra* note 2, § 12.6, at 311. H. HARRIS, *supra* note 3, at § 166; J. MERTENS, *supra* note 7, at § 19.13; J. DUKEMINIER, *supra* note 7.

[9] *See* C. LOWNDES, *supra* note 2, § 12.6, at 311 n.71 for a listing of cases where the limitation failed to meet the requisite standard for exclusion of the property from the decedent's taxable estate.

[10] Other 1974 decisions concerning § 2401 in addition to those in textual discussion, are Carson v. Commissioner, 33 CCH Tax Ct. Mem. 1434 (1974); Stewart v. United States, 74-1 U.S. Tax Cas. ¶ 12,998, at 8439 (M.D. Fla 1974); Also the I.R.S. handed down a revenue ruling, CUM. BULL. REV. RUL. 492, 1974 INT. REV. BULL. No.

Fourth Circuit decision discussing the parameters of ascertainable standards.

In *First Virginia Bank*, the decedent's husband gave her the right during her lifetime, in regard to stocks and other holdings in a corporation that he left to her in his will, "to dispose, sell, trade or use said holdings . . . for her comfort and care as she may see fit."[12] The issue before the court centered upon the words "comfort and care" in the phrase creating the power of appointment. The government contended that the decedent possessed a general power of appointment at her death because she could sell or spend the proceeds for reasons not related to her health, support, or maintenanee.[13] Therefore, the value of the stock, the government argued, should be included in her estate under § 2041(a)(2).

The administrator of the decedent's estate advanced two arguments in an attempt to refute the government's contention. The first was that the decedent's right to consume the property for her comfort

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41, at 13, stating the opinion that a wife, not provided for in her husband's will, who died during the six month election period without making an election to take against her husband's will did not possess a general power of appointment. Therefore the value of property subject to an election was excluded from her gross estate.

Both *Carson* and *Stewart* are pre-1942 power of appointment decisions and such powers are usually dealt with by § 2041(a)(1). In *Carson*, the decedent was deemed to possess only a "special power of appointment" because his control over the property was limited to disposing of the property only to his surviving spouse and children. 33 CCH Tax Ct. Mem. 1434, 1438 (1974). A special power of appointment is not technically an exception to a general power of appointment and to taxation under § 2041. Rather, a special power of appointment is a power to appoint property to a limited class of persons who are not within the four categories defined as being within the scope of a general power of appointment—the power to dispose of property to the donee himself, his estate, his creditors, or the creditors of his estate. Since the surviving spouse and children were not within any of the four categories, the power was not a basis for inclusion of the property subject thereto. Treas. Reg. § 20.2041-1(c)(1)(a) (1958), *as amended*, T.D. 6581, 26 F.R. 11861 (1961); see H. HARRIS, *supra* note 3, at § 165; DUKEMINIER, *supra* note 7 at 233.

In *Stewart* the decedent was given a testamentary general power of appointment over property that could be exercised "any law, custom or usage to the contrary notwithstanding." 74-1 U.S. Tax Cas. ¶ 12,988, at 84,394-94. The decedent was deemed to have exercised the power, without mentioning the power specifically, in the residuary clause of his will regardless of intent, in the absence of renunciation of an expressed intent, not to exercise the power. *Id.* at 84,396. For discussion on pre-October 21, 1942 powers of appointment see C. LOWNDES, *supra* note 2, at § 12.10; H. HARRIS, *supra* note 3, at § 167; J. MERTENS, *supra* note 7, at § 19.07.

[11] 490 F.2d 532 (4th Cir. 1974).

[12] *Id.* at 533.

[13] *See* note 8 *supra* concerning the exception to the existence of a general power of appointment when the decedent's power is limited by an ascertainable standard.

and care was limited by state law to the standard of living to which she was accustomed. According to the administrator, the decedent's standard of living was frugal and countenanced expenditures only for health, support, or maintenance. The second argument offered by the administrator was that state law would give effect to the inference that decedent's husband intended for the decedent to use the holdings for her support only after other resources were depleted. The implication of the second argument appeared to be that if the decedent had failed to consume her other property, then the power of appointment could not have been exercised and the property subject to the power could not therefore be taxed in decedent's estate.[14]

The Fourth Circuit acknowledged the well established principle that a decedent's power to control property is defined by state law. However, concomitant with this principle of state law determination is the principle that federal law determines whether the power is subject to federal taxation.[15] Under these accepted principles, the court, therefore, initially had to determine the nature of the dispository power created by decedent's husband for the decedent according to Virginia law.

The court stated that under Virginia law the qualifying words "comfort and care" did not limit the full power of disposition that decedent possessed over the stocks. Reference was made to both statutory[16] and case[17] law to support the position that the words of limi-

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[14] 490 F.2d at 534.

[15] *Id.* In Morgan v. Commissioner, 309 U.S. 78 (1940), the Supreme Court stated:

> State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed. Our duty is to ascertain the meaning of the words used to specify the thing taxed. If it is found . . . that an interest or right created by local law was the object intended to be taxed, the federal law must prevail no matter what name is given to the interest or right by state law.

Id. at 80-81. Treasury Regulation § 20.2041-1(b)(1) embodies this concept of substance over form in regard to powers of appointment and state law. *See* Lehman v. United States, 448 F.2d 1318, 1319 (5th Cir. 1971).

[16] The court referred to Va. Code § 55-7 (1969) which prevented the remainder of a fee simple in the donee's legatees from being destroyed by the absolute power of appointment given to the done. The court was careful to point out that the statute did not restrict the life tenant's power of disposition. 490 F.2d at 534 & n.61; see Rawlings v. Briscoe, 214 Va. 44, 47, 197 S.E.2d 211, 213 (1973)..

[17] The case relied upon by the court was Rawlings v. Briscoe, 214 Va. 44, 197 S.E. 2d 211 (1973). 490 F.2d at 535. In *Rawlings*, the decedent as life tenant was authorized to sell and use any part of the property that "may be necessary for her care and maintenance." The life tenant gave a portion of the property to her grandchild and this gift was challenged on the basis that the life tenant was empowered only to sell and use the property for her own care and maintenance. The Virginia Supreme Court stated

tation merely showed the donor's motive for giving the decedent a power of appointment. The words were not to be construed as forming an ascertainable standard relating to decedent's health, support or maintenance.[18] The court implied that in Virginia and other states which lack limitations on powers of appointment, it is necessary to use the limiting words found in § 2041(b)(1)(a)[19] or the treasury regulations[20] to avoid the power being classified as a general power of appointment. The absence of any limitations on the powers over the property under state law and of any limiting terms as set forth in the federal statute or regulations refuted the administrator's contention in *First Virginia Bank* that an adequate limitation existed.[21]

The Fourth Circuit also summarily disposed of the administrator's second contention that state law implicitly required the decedent to deplete her other resources before selling the stock. The court pointed to a treasury regulation which stated that "[i]n determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised."[22] Therefore, the court concluded that because of the absence of an ascertainable standard the property was includable in decedent's gross estate for taxation purposes.[23]

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that the words "care and maintenance" had to be construed consistently with past interpretations that such words merely evidenced the donor's motive. *See* Mowery v. Coffman, 185 Va. 491, 494, 39 S.E.2d 285, 286-87 (1946); Davis v. Kendall, 130 Va. 175, 195-96, 107 S.E. 751, 757 (1921); Conrad v. Conrad's Ex'r, 123 Va. 711, 716-17, 97 S.E. 336, 338 (1918).

[18] 490 F.2d at 535.

[19] *See* notes 8 & 9 and accompanying text *supra*.

[20] Besides health, education, support, and maintenance, the terms found in § 2041(b)(1)(A), the regulations provide some examples of words of limitation meeting the requisite standard: " 'support in reasonable comfort,' 'maintenance in health and reasonable comfort,' 'support in his accustomed manner of living.' 'education, including college and professional education,' 'health,' and 'medical, dental, hospital and nursing expenses and expenses of invalidism.' " Treas. Reg. § 20.2041-1-(c)(2) (1958), *as amended*, T.D. 6581, 26 F.R. 11861 (1961).

[21] *See* note 14 and accompanying text *supra*.

[22] 490 F.2d at 535 n.7; Treas. Reg. § 20.2041-1(c)(2) (1958), *as amended*, T.D. 6581, 26 F.R. 11861 (1961).

[23] 490 F.2d at 535. There is further support for the decision reached by the court in the fact that the decedent was the spouse of the creator of the power of appointment, and therefore the most natural object of the creator's bounty. It has been stated that where the decedent appears to be the main object of the testator's (decedent's husband in this case) bounty, that the power to invade the property should be given its broadest meaning. Miller v. United States, 387 F.2d 866, 868 (3d Cir. 1968); Strite v. McGinnes, 215 F. Supp. 513, 517 (E.D. Pa. 1963), *aff'd*, 330 F.2d 234 (3d Cir.), *cert. denied*, 379 U.S. 836, *rehearing denied*, 379 U.S. 910 (1964). A power of appointment given its

The position taken by the Fourth Circuit in *First Virginia Bank* represents adherence to the doctrine of strict interpretation of terms employed to limit general powers of appointment by an ascertainable standard.[24] However, the courts are not always at a loss to find an ascertainable standard despite the absence of the exact terms employed by § 2041(b)(1)(A) and the treasury regulations.[25] An example of the court finding an ascertainable standard despite a failure to conform exactly with statutory and regulatory provisions is found in another 1974 decision, *Tucker v. United States*.[26]

In *Tucker*, a power of appointment in the trustee-decedent, who was also the beneficiary, was limited by the terms "reasonable care, comfort and support." Despite nonconformity with the terms promulgated under § 2041(b)(1)(A) or under the treasury regulations,[27] the district court found the power of appointment to be limited by an ascertainable standard. The court noted that a state court reviewing an invasion of the trust corpus would not find it difficult to ascertain a standard to limit the trustee's discretion. Therefore, the decedent was not deemed to have held a general power of appointment thereby excluding the property subject to the power from decedent's estate.[28]

The difference between the holdings in *First Virginia Bank* and *Tucker* might be reconciled on two bases. First, the decedent in *Tucker* was a trustee of the property subject to the power of appointment, while the decedent in *First Virginia Bank* was not a trustee. Under many state statutes the fiduciary responsibilities of a trustee prohibit use or consumption of a trust's income or corpus for the trustee's own benefit.[29] This factor alone would seem to limit severely the exercise of a power of appointment for the trustee's benefit. How-

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broadest meaning in *First Virginia Bank* would further substantiate the court's belief that the term "comfort and care" represented a motive rather than a limitation.

[24] *See* Miller v. United States, 387 F.2d 866, 868 (3d Cir. 1968); Strite v. McGinnes, 330 F.2d 234, 240 (3d Cir.), *cert. denied*, 379 U.S. 836, *rehearing denied*, 379 U.S. 910 (1964); Stafford v. United States, 236 F. Supp. 132, 134 (E.D. Wis. 1964).

[25] *See, e.g.*, Pittsfield Nat'l Bank v. United States, 181 F. Supp. 851, 853 (D. Mass. 1960); note 20 *supra*.

[26] 74-2 U.S. Tax Cas. ¶ 13,026 at 85,838 (S.D. Cal. 1974).

[27] In Treas. Reg. § 20.2041-1(c)(2) (1958), the examples of ascertainable standards include "support in reasonable comfort" which is closely analogous to the standard in *Tucker*.

[28] 74-2 U.S. Tax Cas. (P6 13,026, at 8859-81).

[29] *See* G.G. BOGERT AND G.T. BOGERT, TRUSTS AND TRUSTEES § 1.9 (2d ed. 1965); 2 A. SCOTT, THE LAW OF TRUSTS § 170.23 (3d ed. 1967). Also, the Fourth Circuit itself in *First Virginia Bank* appeared to recognize the significant difference between powers of appointment in the hands of a trustee and a non-trustee. *See* 490 F.2d at 535 in regard to the court's reference to Hughes v. Williams, 99 Va. 312, 38 S.E. 138 (1901).

ever, in addition to the fact that the decedent was a trustee, the decedent's right of invasion in *Tucker* was limited by a standard of "reasonableness" in regard to the terms "care, comfort and support." This requirement of reasonableness was absent in the terms of the power of appointment created in the decedent in *First Virginia Bank*. The nonexistence of this added limitation on the exercise of the power of appointment could serve to justify the decision in *First Virginia Bank*.[30] Neither *Tucker* nor *First Virginia Bank* decided, however, whether the fact that the holder of the power of appointment, solely because he is a trustee, will suffice to place restrictions on the power tantamount to an ascertainable standard.

In *Maytag v. United States*,[31] a recent Tenth Circuit decision, the court considered whether the limitations on a trustee, solely because of his fiduciary responsibilities, were sufficient to constitute an ascertainable standard. The decedent's father created two irrevocable trusts with a bank as the trustee and two individuals as co-trustees. The decedent, who was the principal beneficiary of the trusts, was to become a co-trustee upon reaching majority pursuant to the trust's terms. The co-trustees were given supreme power over the trusts with the trustee bank relieved of all responsibility when acting in accord with the directions of the co-trustees. Both trusts could be terminated when all the trustees agreed that the trust should be terminated and the proceeds given to the beneficiary. The power to terminate remained unexercised at the death of the decedent who had reached majority prior to his death.[32]

The Tenth Circuit summarily dismissed the relevance of the nonexercise of the power by decedent[33] and the fact that decedent shared the power with non-adverse trustees.[34] A general power of appoint-

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[30] *See* note 27 *supra* where it is shown that the term "reasonable" is included in a standard of limitation similar to that in *Tucker*.

[31] 493 F.2d 995 (10th Cir. 1974).

[32] *Id.* at 996-97. If the decedent had died before reaching majority, then apparently there would be little question that the value of the trusts would not be includable in decedent's estate for taxation purposes. It is stated that if the power to appoint property is contingent upon an occurrence, other than the giving of notice or the passing of a stated time period after the exercise of the power for the exercise to be effective, which has not taken place before decedent's death, then the power does not exist at decedent's death. Therefore the property contingently subject to the power is not taxable to decedent's estate. Treas. Reg. § 20.2041-3(b) (1958); C. LOWNDES, *supra* note 1, § 12.11, at 317.

[33] Non-exercise of a general power of appointment fails to prevent taxation of the property subject to the power to the holder's estate. INT. REV. CODE OF 1954 § 2041(a)(2); *see* Peoples Trust Co. v. United States, 412 F.2d 1156, 1158 (3d Cir. 1969).

[34] The Internal Revenue Code requires, in regard to post-October 21, 1942 powers

ment existed, the court in *Maytag* stated, unless the decedent under state law[35] was proscribed from participation in any decision as co-trustee to allow him to distribute the property to himself.

The court found that unde applicable Colorado case law the intent of the settlor prevailed as to the construction and interpretation of a trust unless in violation of public policy or statutory provisions.[36] The court cited the extensive povers given the decedent by the settlor as well as the specific provision that the decedent could not be removed as a co-trustee as indications of the intent of the settlor not to restrict the decedent's power by an ascertainable standard. Furthermore, no cases existed under Colorado law which stood for the proposition that a beneficiary of a trust could not participate as a trustee in any decision to distribute trust proceeds to himself.[37]

The executor of the decedent's estate made reference to cases from New York to support the contention that Colorado should adopt the rule that "absent a very clear and specific expression of intent to the contrary by a settlor" the decedent as trustee could not have participated in any decision to distribute trust proceeds to himself.[38] The court, however, stated that New York had a statute prohibiting beneficiaries from participating as trustees in decisions to benefit themselves. Therefore, the court reasoned that in the absence of a specific prohibition in state law, as in New York, giving rise to a restriction on the decedent's power over the property, the trustee is free to hold a general power of appointment unless either an ascertainable standard, as set forth in the federal statutes and regulations, or an adverse party, as co-holder of the power, exists. The absence of such a showing in *Maytag* precipitated the inclusion of the trusts' proceeds subject to the power in the decedent's estate for taxation purposes.[39] The Tenth Circuit's decision appears to represent the traditional view on

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of appointment, that in order for the power of appointment not to be considered as a general power of appointment that the co-holders of the power have "a substantial interest in the property, subject to the power, which is adverse to the exercise of the power in favor of the decedent . . . ." INT. REV. CODE OF 1954, § 2041(b)(1)(C)(ii). The other trustees in *Maytag* had no such substantial adverse interest. If the power of appointment had been created on or before October 21, 1942, the mere existence of the co-holders of the power would have removed the general power of appointment classification. *Id.* § 2041 (b)(1)(B).

[35] *See* note 15 and accompanying text *supra* as to the relationship between state and federal law in estate taxation cases.

[36] 493 F.2d at 998. *See* Ketcham v. International Trust Co., 117 Colo. 559, 192 P.2d 426, 427 (1948).

[37] 493 F.2d at 998.

[38] *See* 493 F.2d at 999 & n.6.

[39] 493 F.2d at 999-1000.