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SPECIAL POWERS OF APPOINTMENT AND THE GIFT TAX: THE IMPACT OF SELF V. UNITED STATES

INTRODUCTION

Section 2501(a) of the Internal Revenue Code states that the gratuitous transfer of any interest in property is taxable.[1] The Code further specifies, in section 2511(a), that this tax will apply regardless of the method of transfer or the nature of the interest transferred.[2]

Section 2514, the powers of appointment provision relating to gifts, renders taxable a transfer made pursuant to the exercise of a *general* power of appointment.[3] Any power of appointment which does not meet the Code's definition of a general power of appointment[4] is a non-taxable or special power of appointment.

In *Self v. United States*,[5] the Code provision relating to transfers in general [2511(a)] and the powers of appointment provision (2514) came into conflict. The taxpayer in *Self*, the life beneficiary of a trust and holder of an inter vivos special power of appointment, exercised the power in appointing a portion of the corpus to his two children. The appointment resulted in a reduction of the trust corpus and a corresponding reduction in the value of the taxpayer's life estate. The Tax Commissioner claimed that the taxpayer's life interest in the transferred corpus was taxable under section 2511(a). The Court of Claims considered the transfer non-taxable because the taxpayer did not possess a general power of appointment as defined by the Code.[6] Since only transfers made under general powers are taxable under section 2514, the court concluded that the exercise of a special power of appointment was a non-taxable event under any circumstances and could not be brought within any other Code provision, including section 2511(a). In other words, if a transfer is non-taxable under section 2514, it is non-taxable under *any* gift tax section.

Thus, the *Self* decision produced a priority system between these two gift tax sections. The result of *Self* is to allow a tax free transfer of a normally taxable interest, the gift of a life estate, when the transfer

1. INT. REV. CODE OF 1954, § 2501(a).
2. INT. REV. CODE OF 1954, § 2511(a):
Subject to the limitations contained in this chapter, the tax . . . shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. . . .
3. INT. REV. CODE OF 1954, § 2514(a).
4. *See* notes 7-15 *infra* and accompanying text.
5. 142 F. Supp. 939 (Ct. Cl. 1956).
6. INT. REV. CODE OF 1954, § 2514(c).

results from the exercise of a special power of appointment. This note will examine the reasoning of the *Self* decision in relation to the property interests involved, the Code and Regulations, and the application of other Code provisions to the *Self* decision.

General and Special Powers of Appointment Under the Code

General Powers

As defined by the Code, a general power of appointment is any power exercisable in favor of the person possessing the power himself, his estate, his creditors or the creditors of his estate.[7] If the property subject to the power can be appointed within any of the enumerated categories, the exercise of the power results in a taxable gift. That the donee of the power[8] appointed the property to someone outside the defined groups is irrelevant as long as the power to appoint within the enumerated categories exists.[9]

The Code provides that any transfer of *an interest in property* by the person possessing the interest is taxable.[10] This is the criterion for taxing any gift transfer. By appointing to himself and thereby vesting the title to the property in his own name, the donee of a general power may acquire absolute ownership. If the donee has this ability or can use the corpus to pay his debts or the debts of his estate, he has a vested interest therein. Realistically, the transfer of the corpus to another by the exercise of the power is a transfer of his own interest and thereby properly subject to a gift tax.

Although the Code section dealing with powers of appointment is inconsistent with the historical theory of powers, it is consistent with the general scheme of taxation under the estate and gift tax sections of the Code. Historically the courts have interpreted the exercise of a power

7. *Id.*

8. The possessor of the power of appointment and the individual who granted the power will be referred to as the donee and donor of the power respectively.

9. An example of this is the decision in Potter v. United States, 269 F. Supp. 595 (N.D. W.Va. 1967). It is only necessary that the donee of the power be able to use the property for his own ends. Potter was held to have a general power of appointment when the donor granted him a life estate with an unrestricted power to consume or dispose of the property forming the estate. Although the executors of Potter's estate claimed that he could only use the property for his support and maintenance according to an ascertainable standard [INT. REV. CODE OF 1954, § 2514(c)(1) provides such a power is non-taxable], the court was of the opinion that, "[I]n view of the broad powers of disposal granted, no such limiting purpose could be gleaned. . . ." As the *Potter* decision indicates, the Code test for the taxation of powers is objective. The realities of each transfer determine taxability.

10. INT. REV. CODE OF 1954, § 2501(a).

of appointment as a transfer from the donor of the power to the appointee, the donee of the power merely giving direction to the transfer.[11] This theory is called the doctrine of "relating back." For gift tax purposes, the doctrine has been superceded by section 2514.[12]

Calling the donor of a power of appointment the transferor is really a fiction. The term is not so used by the Code and the validity of its use is questioned by several authorities.[13] To call the donor of a power a transferor ignores the reality that a discretionary act by the donee of the power is necessary before the appointee can acquire any interest in the property controlled by the power.[14] The 1942 Revenue Act[15] and the 1951 Powers of Appointment Act[16] distinguish between special and general powers, a distinction that the common law doctrine of relating back failed to make. If the Code accepted the concept of relating back, a gift tax would never apply to the exercise of any power, special or general. The exercise of any power would be interpreted as a gift from the donor of the power. It is the repudiation of the relating back fiction that allows the taxation of transfers made through powers of appointment under the estate and gift tax sections of the Code.

Special Powers

Any power of appointment which cannot be exercised in favor of the classes designated in section 2514 of the Code is termed a non-general or special power.[17] Since only transfers made under a general power of appointment are taxable, the transfer of property by the exercise of a special power is necessarily non-taxable. The exercise of a special power transfers nothing which can be considered an interest of the donee. Even though the transfer is effectuated by the donee of the power, the property interests involved are those of others.

If the donee of the power is unable to appoint within any of the classes enumerated in section 2514, it cannot be maintained that he has a personal interest or can in any way be benefited by the exercise of the power. Although the donee of a special power may have some interest in the income produced by the corpus, the corpus, per se, is beyond his

11. L. Simes & A. Smith, The Law of Future Interests, § 913 (2d ed. 1956); Restatement of Property, § 318 (1940).

12. Int. Rev. Code of 1954, § 2514.

13. L. Simes & A. Smith, The Law of Future Interests, § 913 (2d ed. 1956).

14. Act of Oct. 21, 1942, ch. 619 § 452, 56 Stat. 951.

15. Int. Rev. Code of 1954, § 2514 [originally enacted as Act of June 28, 1951, ch. 165 § 2(c), 3(c), 65 Stat. 91].

16. Although these terms are not used in the Internal Revenue Code, they have come to mean any power of appointment not meeting the definition of a taxable power under section 2514.

17. 142 F. Supp. at 940.

reach. A special power is, by definition, exercisable in favor of a limited class. If the class to whom the donee can appoint is not limited, it can be argued that the donee could appoint within the taxable classes named in section 2514.

THE SELF DECISION : THE ISSUES PRESENTED

It was the exercise of a tax-exempt special power which produced the conflict created by the *Self* decision. In addition to being named the life beneficiary of the trust income, James Self was given a special power of appointment, exercisable inter vivos, to appoint the corpus to his descendants. If he failed to exercise his power the remainder was to pass to his descendants, if any, and if he had none, to charity. Self chose to exercise his special power and appointed a portion of the corpus to his son and daughter.

The government conceded that Self exercised a special power of appointment but claimed that by virtue of the exercise of the power two separate interests were transferred.[18] First, he transferred two-hundred shares of stock in which he had no rights or interest. Second, he transferred *his* vested right to the *income* from those two-hundred shares for life. It was the second interest, his personal interest, that the government claimed was taxable under section 2511(a) even though technically excluded from taxation by section 2514.[19] The issue, therefore, was not whether the corpus was taxable under section 2514, but whether a gift tax should apply to the value of the life estate the donee relinquished when he exercised his special power of appointment. It is undisputed that a gift tax would accrue under section 2511(a) to the outright gift of a life estate. What is disputed is the issue presented in *Self*: whether a gift tax should apply to the transfer of a life interest in the income from a trust when the source of the income is transferred by the life beneficiary's exercise of a tax-exempt special power of appointment.

As a result of the court's holding that such a transfer is non-taxable, a priority system is created between two gift tax sections.[20] If an outright transfer of a life interest is made, section 2511(a) can be applied to impose a gift tax. If the transfer is effectuated by the exercise of a special power of appointment, and therefore is non-taxable under section 2514, section 2511(a) is then also inapplicable and the life income passes untaxed. This priority system seems contrary to the intent of the Code, and a questionable interpretation of the Code and Regulations.[21]

18. *Id.*
19. INT. REV. CODE OF 1954, §§ 2511(a), 2514.
20. *See* notes 42-57 *infra* and accompanying text.
21. 142 F. Supp. at 941.

ANALYSIS OF THE SELF DECISION

The Basic Arguments

The court's reasoning in *Self* is that if the corpus of a trust consists of income producing stock, "automatically and necessarily,"[22] the income to be earned is transferred with the legal title. The court maintained that the interest of the donee-taxpayer was temporary and subject to the possibility of termination by the exercise of the power. They reasoned, therefore, that to the extent the power was exercised, the donee's estate was terminated, not by a desire of the income beneficiary to give up his life estate, but by the exercise of the power.

The government argued that of the two interests transferred, only the corpus passed under the tax-exempt special power of appointment. Since Self's vested right in the income was not held subject to termination by the exercise of the power, his income interest did not pass under the tax-exempt power of appointment as did the corpus. Thus, a gift tax could properly be assessed to the transfer of this income interest.

Analysis of the Arguments

As previously indicated, the principle argument relied upon by the court was that:

> The income to be earned from the property thus transferred automatically and necessarily goes with the legal title to the property, unless provision is specifically made for the contrary.[23]

To substantiate this argument, the court examined the trust instrument[24] and concluded that it was the settlor's intent that the income interest and the legal title should pass when and if the special power was exercised.[25] If in fact that was the settlor's intent when the trust instrument was executed, it is submitted this intent alone should not serve to

22. *Id.*

23. The provisions of the trust granting the power of appointment read as follows:
> The Trustees shall pay the entire net income of the trust fund to the Grantor's son, James C. Self, Jr., for and during his life. The said James C. Self, Jr., shall nevertheless have the power by deed during his lifetime to appoint all or any portion of the trust corpus to or among his descendants, or any of them, in such portions or amounts, and at such time or times, as he shall determine. Upon the exercise, or upon the various exercises of such power, the Trustees shall separate from the Trust Fund the portion or portions appointed and pay over such portions in accordance with the instructions of James C. Self, Jr.

142 F. Supp. at 941 n.1.

24. 142 F. Supp. at 941.

25.
> [T]he tax . . . shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. . . .

INT. REV. CODE OF 1954, § 2511(a).

defeat a section of the Code. Regardless of the intent of the settlor pertaining to the subsequent disposition of the trust corpus, the form of the transfer met all the requirements of a taxable gift under section 2511(a).[26] It would seem the court should have examined the trust instrument with the purpose of answering one question—Did the transfer meet the requirements of a taxable gift under any section of the Code? To that extent, the settlor's intent would be material. But the intent could serve to defeat the tax only if the intended interests presented a non-taxable situation under the Code. Thus, the settlor could defeat a tax only by creating a non-taxable interest. The mere intent to have the interest pass tax free would be insufficient.

The Property Interests

An analysis of the relationships concerning elementary property interests in *Self* poses no problems. Only when a special power of appointment is granted in addition to the life estate and remainder does an arguable question arise, and even then, contrary to the court's opinion, only if the special power is granted to the income beneficiary. The court stated:

> Unless the power of appointment concept is ignored, there is no difference between making the income beneficiary the donee of the special or limited power of appointment and making a third person who has no beneficial interest in the income or corpus the donee of the power. . . .[27]

It is submitted that the court's statement would not survive close scrutiny.

If the donee of the power is not the life beneficiary, the question of a gift tax upon the life interest transferred when the power is exercised becomes moot. Since the gift tax is based on the transfer of an interest in property by the person possessing the interest, the exercise of a power by a non-beneficiary would fail to qualify as a taxable gift. This situation is somewhat similar to the "sprinkling trust" in which the trustee or some third party has complete discretion to determine disposition of the trust income. The following example attempts to demonstrate the difference between exercise of a power of appointment by the donee-beneficiary and exercise by a mere donee (one having no interest in the trust income or corpus).

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26. 142 F. Supp. at 942.

27. This seemingly inconsistent terminology is justified. Any appointment made within the limited class would serve to cut off the life beneficiary's income to the extent of the appointment. Further, an appointment to one of the class members would serve to divest the others of any future interest to the extent of the appointment and would be an absolute divestment if the entire trust corpus were appointed to one class member.

If A is the life beneficiary of a trust with the remainder vested in B and C, and X has a special power to make inter vivos appointments to B or C, the exercise of that power results in a tax free transfer of A's life income as well as the corpus. In this situation, the reasoning of the *Self* court seems correct. The life interest of A is temporary and subject to termination by the exercise of the power held by X. In effect, A has a contingent life interest[28] subject to divestment by the exercise of the special power. The significant difference between the *Self* situation and this hypothetical is that the transfer in the latter is effectuated by the discretionary act of X, a non-beneficiary of the trust. The beneficiary, A, has no voice in the decision to exercise the power and would in fact be unable to prevent a transfer. The result of the exercise of the power by X is a non-taxable transfer of A's life interest not because the transfer resulted from the exercise of a tax-exempt power,[29] but rather because it fails to qualify as a transfer of an interest in property by the person possessing the interest.[30] Further, no tax would accrue to X, the donee of the power, because he has no interest in the corpus. A power of appointment is neither property nor an estate in property. Only when the donee of the power is also the life beneficiary, as in *Self*, can it be argued there is a taxable transfer.[31]

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28. INT. REV. CODE OF 1954, § 2514.

29. INT. REV. CODE OF 1954, § 2501(a).

30. Two interesting propositions are presented by the court's statement that when a power of appointment is exercised "over corpus consisting of income-producing property . . . the income . . . automatically and necessarily goes with the legal title. . . ."

First, the possessor of a life estate has historically been able to alienate his interest as he might any other legal estate or interest. BOGERT, TRUSTS AND TRUSTEES, § 188 (2d ed. 1964). Assuming the facts in *Self*, if the life estate is sold, would a subsequent exercise of the power of appointment over the corpus automatically pass the income interest to the appointee, thus cutting off the purchaser's right to the income? According to *Self*, the result would be a termination of the purchaser's right to the income. In other words, when the beneficiary of a trust is also the donee of a special power, the practical effect of the alienation of a life estate is the creation of a determinable or contingent estate in the purchaser, subject to termination by the exercise of the special power of appointment. This result is contrary to any existing case law or authority. Although a logical extension of the *Self* decision, it is perhaps solely academic, for if one were to purchase such a life estate, he would undoubtedly require the life beneficiary and the objects of the special power to affirm his right to the income for the life of the trust beneficiary.

The *Self* decision presents a second but more realistic problem. If the income interest automatically passes when the special power is exercised, the donee of the power is confronted with a dilemma. If the power could only be exercised inter vivos, the donee's failure to exercise it would result in a per capita distribution to the class members upon his death. Such a distribution would seem contrary to the donor's intent since special powers are usually granted to allow the corpus to be appointed according to need. However, the *Self* decision held that if an inter vivos appointment is made by the donee, his income interest will be terminated to the extent the power is exercised. Thus, he must either cut off his income interest or allow the corpus to pass regardless of his descendants' needs and contrary to the intent of the settlor.

31. 142 F. Supp. at 942.

Other Property Concepts

The *Self* court used the fictional doctrine of relating back to claim that the actual transferor of the property was the donor of the power, and that the donee merely acted as his agent by giving direction to the gift pursuant to the donor's wishes.[32] Indeed, the court seems to be combining the Code provisions on powers of appointment and the common law doctrine of relating back. As used in the Code, the concept of powers of appointment ignores the doctrine of relating back. The taxation of transfers made under these powers is based upon the transfer of an interest in property.[33] Neither the Code nor the Regulations, in either the estate or gift tax sections, mention the doctrine.

The Code and Regulations base the taxability of transfers made under powers of appointment only upon the identity of the possible appointees. Admittedly, the Code defines only general powers of appointment, but it is a logical and consistent extension of the Code's policy to conclude that since the doctrine of relating back is not recognized in the definition of general powers, it should not be applied when dealing with transfers involving special powers. As indicated in the previous example,[34] the error in the court's reasoning is that when the power and the beneficial interest are in the same person, only the voluntary and discretionary act of the donee-beneficiary can divest his life interest. This alone should be sufficient to impose a gift tax on his transfers by authority of section 2511(a). Neither the trustee, the donor of the power, the possible appointees, nor any third party could have divested James Self of his life income without his consent. Even if it is assumed that the court was correct in stating that the income interest in the stock automatically and necessarily passed when the power was exercised, it remains that the transferor of the life interest *in reality* was James Self and not the trust settlor.

Prior Cases

The taxpayer and the court placed great weight on the reasoning in *Commissioner v. Walston.*[35] The *Walston* decision held that the transfer of an income interest by the exercise of a special power of appointment was not taxable as a gift. However, this decision presents a doubtful precedent.[36] First, the court's reasoning is open to question;[37]

32. *See* notes 6-14 *supra* and accompanying text.
33. *See* notes 24-28 *supra* and accompanying text.
34. 8 T.C. 72 (1947), *aff'd,* 168 F.2d 211 (4th Cir. 1947).
35. Letter from George Craven to *Valparaiso University Law Review,* October 16, 1968.
36. *Id.*
37. 168 F.2d at 214.

and secondly, the case rests on its own particular facts and the law under which it was decided. The court held that the taxpayer did not make a taxable gift when she appointed the trust income to her brother, reasoning that the trust settlor intended that she give the income to her brother at a future date. The court is implicitly using the doctrine of relating back, but here its use can be rationalized since the decision was rendered under the 1932 Revenue Act[38] which did not contain a section dealing with powers of appointment. Thus, reliance on the *Walston* decision seems unfounded in relation to transfers governed by the 1954 Code.

It is also significant that the settlor in *Walston* gave two special powers of appointment: one over the corpus; and the other over the income from the corpus. The *Self* case involves only one power covering both income and corpus. The Regulations provide[39] that a power given a life beneficiary to appoint his income interest is not a true power of appointment, "it is only . . . a right otherwise possessed by him."[40] The example further states that such a transfer "constitutes the making of a [gift] of property under section 2511."[41] Thus, *Walston* would seem to be nothing more than the *Self* fact situation decided under prior law. Two cases decided in the 1940's contradict the *Walston* holding concerning the taxability of a beneficial interest or power.

In *Cerf v. Commissioner*,[42] the wife of a trust settlor was given a life estate in the income from the corpus but was not granted a special power of appointment. She consented to an amendment of the trust which extinguished her right to the trust income. It was held that upon signing the agreement, she had made a taxable gift of her income interest. Since the life beneficiary in *Cerf* did not have a special power, the decision may be distinguished from *Self*. However, the existence of the power in *Self* was not claimed by the government to be the criterion for taxation of the transfer. The taxation was based upon the gratuitous transfer of the right to income, a right which was voluntarily transferred in both decisions.

A similar situation arose in *Richardson v. Commissioner*.[43] There, the taxpayer had the power to either accept or refuse the trust income at any time. When he chose to set aside the income from the corpus for the

38. Treas. Reg. § 25.2514-1(c) (1968).
39. *Id.*
40. *Id.*
41. 141 F.2d 102 (3d Cir. 1944).
42. 151 F.2d 564 (2d Cir. 1945).
43. At the time of these decisions the Internal Revenue Code of 1939 was in force. The provisions governing general transfers by gift were not materially changed by the 1954 Code.

benefit of others, the court held that he made a taxable gift of his income interest. Again, there is no power of appointment but, as in *Cerf*, the court held there was a gift of the income interest. In *Richardson*, however, the transfer was held to be a gift because the taxpayer, instead of exercising his right to take the income for his own benefit, set aside the income as accumulations for other beneficiaries of the trust.

Both cases were decided prior to the 1951 Powers of Appointment Act and found the transfers involved taxable under regulations substantially similar to section 2511(a).[44] Since these two decisions, the only major change in the gift tax provisions of the Code has been the Powers of Appointment Act. Certainly the intent of Congress in passing the 1951 Act should be given some weight in any interpretation of section 2514 and its relationship to the other gift tax provisions.

CONGRESSIONAL INTENT: THE 1932 REVENUE ACT AND THE 1951 POWERS OF APPOINTMENT ACT

The expressed intentions of Congress in enacting the 1932 Revenue Act and the Powers of Appointment Act of 1951 present the most compelling arguments against the *Self* decision. Clearly, the basic facts of *Self* were contemplated and such transfers were intended to be taxable.

1932 Revenue Act

The current Code provisions dealing with the taxation of gifts are similar to those adopted in the Revenue Act of 1932:

> The gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.[45]

The House and Senate reports dealing with the gift tax sections of the 1932 Act indicate that Congress intended section 2511 to be broadly construed. The report stated that the terms property, transfer, gift and indirect were used in the "broadest and most comprehensive sense" with the full intention of reaching "every species of right or interest protected by the law and having an exchangeable value."[46]

The Supreme Court, in *Estate of Sanford v. Commissioner*,[47] stated that the intent of the section was to tax the transfer of any valuable interest or right in property. As the Court maintained, the tax regulations,

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44. INT. REV. CODE OF 1954, § 2511(1)(a).
45. H.R. REP. No. 708, 72d Cong., 1st Sess. 27 (1932); S. REP. No. 665, 72d Cong., 1st Sess. 39 (1932).
46. 308 U.S. 39 (1939).
47. *Id.*

as enacted, are far more concerned with "the actual command over the property."[48] The complexity of an interest in property should never serve to defeat a tax,[49] for Congress intended to tax the transfer of any interest in property, regardless of how conceptual or complex.[50]

Thus when the gift tax was enacted, Congress seemed aware that the essence of any transfer is the change of control over the economic benefits of the property rather than any technical change in title to the property. Although a change in title can and often does result in transactions to which the tax applies, such a change is not necessary.

1951 Powers of Appointment Act

The *Self* decision involved the exercise of a tax-exempt power to transfer the corpus. The government maintained, however, that the life estate in the income from the corpus did not pass under the power and should therefore be taxable under section 2511(a). The report of the House Ways and Means Committee and the Senate Finance Committee, relating to the 1951 Powers of Appointment Act, agrees with the government's basic contention:

> The provisions relating specifically to powers of appointment, which are proposed to be inserted in the Internal Revenue Code by this bill, are not intended to limit the scope of other subdivisions of the Code . . . which apply to the transfer at death or during life of any interest in property possessed by the taxpayer.[51]

Thus it was intended that *no limitation* be placed on section 2511 (a), or any other gift or estate tax provision, by the passage of the 1951 Powers of Appointment Act. If the court in *Self* had followed this intent, the only possible result would have been taxation of Self's life interest. That a tax-exempt power of appointment was involved should have no effect and place no limitation upon the application of other Code sections.

Section 2514 was intended to be a positive addition to the Code. The above quotation indicates that those transfers which meet the definition of a general power are to be taxed. Section 2514 was in no way intended to exclude taxation under any other gift tax provision. It was not intended to be a negative section, yet this seems to be the result of section 2514 as interpreted by the court in *Self*. The section was applied

48. *Id.*
49. *Id.*
50. H.R. REP. No. 327, 82d Cong., 1st Sess. 6 (1951); S. REP. No. 382, 82d Cong., 1st Sess. 6 (1951). Section numbers of the 1939 Code were omitted. They were sections 811 and 1000, the latter corresponding to section 2511.
51. Craven, *Powers of Appointment Act of 1951*, 65 HARV. L. REV. 78 (1951).

in a negative manner so as to exclude taxation under section 2511(a). In light of the congressional intent, the inclusion of a special power of appointment in the trust instrument should have had no effect upon the application of other provisions of the gift tax regulations and Code.

George Craven, a committee member of the American Bar Association's Tax Section, which worked with the Treasury Department in formulating the Powers of Appointment Act of 1951, stated that the committee reports of the House and Senate dealing with the act were "undoubtedly"[52] directed at the type of situation found in *Commissioner v. Walston*.[53] He further stated that the Senate and House Report dealing with the powers of appointment legislation showed:

> [T]he understanding of Congress that if through the exercise of a non-general or special power an individual gives up a beneficial interest, such as the right to income or a remainder interest, he thereby makes a transfer of that interest.[54]

It is significant that this article was published prior to the *Self* decision for it presents an extremely accurate prediction of a conflict under the powers act. Further, it presents a solution based solely upon legislative intent.

Critical of *Self*, Craven has emphasized the significance of the legislative intent.[55] After commenting on the conflict between the *Cerf*, *Richardson* and *Walston* decisions, he stated:

> The question seems to me to be whether the provisions of the gift tax statute relating to the exercise of a limited power of appointment are controlling over the provisions relating to the transfer of an interest in property. The language of statute does not require that result and it is my view that the expressed intention of Congress should govern.[56]

Prior to the Powers of Appointment Act of 1951, the gift tax regulations contained an example dealing with the *Self* fact situation.[57] The only distinction was that the donee of the special power also had a general testamentary power of appointment. The regulation states that if A, the income beneficiary, chooses to appoint the trust property and

52. *See* notes 32-35 *supra* and accompanying text.
53. Craven, *supra* note 51.
54. Letter from George Craven to *Valparaiso University Law Review,* October 16, 1968.
55. *Id.* Mr. Craven states he does not know of any other authority to support this view on the *Self* decision. Craven, *Powers of Appointment*, 5 PRAC. LAW. 91 (1959).
56. Treas. Reg. 108, § 86.2(b)(2) (1954), T.D. 6077, 1959-2 CUM. BULL. 308; Treas. Reg. § 25.2514-1(b)(2) (1968).
57. 142 F. Supp. at 942.

exercises the inter vivos special power, a taxable gift of the income interest is made. The court in *Self* distinguished the example because "the plaintiff in the instant case [does] not have . . . a general power to appoint by will."[58] This would seem to be an irrelevant distinction considering the factual situation before the court. The regulation clearly indicates that the exercise of the inter vivos power is "a transfer of her income interest which constitutes a taxable gift under section 2511(a), without regard to section 2514."[59] The example concludes that when the two powers are present, the exercise of the inter vivos power results in a relinquishment of the general testamentary power. The result is a taxable gift under section 2514. The example was apparently constructed to apply to two situations; the granting of both an inter vivos special power and a general testamentary power; and when only an inter vivos special power is granted.[60] The court became more candid in rejecting the regulation when it stated:

> [T]o the extent that the example given in the regulation implies that a donee, who has only the right to the income from the corpus subject to a special or limited power of appointment, is subject to a gift tax on the exercise of the special power of appointment, we disagree with it.[61]

In light of the congressional intent and the realities of the transfer that *Self* initiated, the court's unsupported rejection would seem the only basis upon which the decision could stand. Whether Self intended to give up his income interest as part of the gift is not material to the issue of taxation.[62] "The application of the tax is based on the objective facts of the transfer . . . rather than on the subjective motives of the donor."[63] By the exercise of the power, Self relinquished a valuable interest in property. It is, at the least, illogical to say that an income beneficiary of a trust must pay a gift tax upon the transfer of his life interest unless he is also granted the added flexibility of a special power of appointment over the source of the income.[64] Yet, this is the reality of

58. Treas. Reg. § 25.2514-1(b)(2) (1968).
59. *Compare* Treas. Reg. §§ 25.2514-1(b)(2) (1968) *and* 25.2514-3(e)(1) (1968).
60. 142 F. Supp. at 942.
61. Treas. Reg. § 25. 2511-1(g)(1) (1968).
62. *Id.*
63. Casner, *Legal Life Estates and Powers of Appointment Coupled With Life Estates and Trusts,* 45 NEB. L. REV. 342, 362 (1966).
64. Treas. Reg. § 25.2514-1(b)(2) (1968):

No provision of section 2514 or of §§ 25.2514-1 through 25.2514-3 is to be construed as in any way limiting the application of any other section of the Internal Revenue Code or of these regulations.

the *Self* decision. Since this decision it has become impractical to grant a trust beneficiary a mere life estate. The addition of a special power provides both the avoidance of a tax in the event of a gift and great flexibility over the eventual disposition of the corpus. Even if *Self* is overruled, the added tax burden in the event of a gift would only be the value of the income interest transferred.

CONCLUSION

The intent of Congress in changing the powers of appointment section of the Code in 1951 seems clear. The legislation was in no way intended to affect the application of other Code provisions. The *Self* decision is clearly contrary to that intent. Further, it can be argued that the court's reasoning is both illogical and incorrect. It combines the common law doctrine of relating back with the Code's criterion for taxation—a combination that cannot be defended.

The estate planner already possesses the tools to create greater flexibility and a more advantageous tax scheme than could be drawn under the *Self* decision. The use of a "sprinkling trust" and its derivations provides continuing income tax advantages as well as the avoidence of a gift tax in the event a special power of appointment is granted and exercised.

Two possible and somewhat obvious solutions are available to resolve the conflict that *Self* creates between section 2514 and section 2511(a). The direct overruling of *Self* would produce the desired results. Perhaps the better solution, however, would be a clarifying addition to the Code, even though the regulations presently contain a clear statement of that intent.[65] The hardship resulting from a Code change or an overruling of *Self,* and the amount of revenue it would produce is negligible. The advantage would be a scheme of taxation consistent within itself and compatible with congressional intent.