North Carolina Central Law Review

Volume 12
Number 1 *Volume 12, Number 1* Article 8

10-1-1980

Estate Tax: Effect of Revenue Ruling 79-353 upon Settlor's Power to Appoint a Successor Trustee under Sections 2036 and 2038 of the Internal Revenue Code

Maureen Stewart

Estate Tax: Effect of Revenue Ruling 79-353 upon Settlor's Power to Appoint a Successor Trustee under Sections 2036 and 2038 of the Internal Revenue Code

I. Introduction

Suppose a settlor creates an irrevocable inter vivos trust for the benefit of his children for life, remainder to his grandchildren. The trust is to be administered by a corporate trustee which is given unlimited authority to distribute corpus and income to the life tenants as it deems proper. The settlor retains the right for life to remove the trustee without cause and to replace it with another corporate trustee, but under the terms of the instrument he may not name himself as a successor trustee. When the settlor dies five years later, the original trustee is still serving, none of the corpus has been distributed, and some income has accumulated. Under these facts, is the value of the corpus and of the accumulated income includible in the settlor's taxable estate under section 2036(a)(2)[1] or 2038(a)(1)[2] of the Internal Revenue Code of 1954?

According to Revenue Ruling 79-353,[3] the property described above is includible under both sections by reason of the settlor's retained power to appoint a successor trustee. Until now, it has been accepted that if a settlor retains certain trustee powers or makes provisions by which he may appoint himself as a trustee, then the property of the trust which he has created is includible in his gross estate. The Ruling under consideration would extend that principle to include property whenever the settlor may replace a trustee, even if the settlor provides

1. I.R.C. § 2036(a)(2) provides:

SEC. 2036. TRANSFERS WITH RETAINED LIFE ESTATE.

(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—

(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.

2. I.R.C. § 2038(a)(1) provides:

SEC. 2038. REVOCABLE TRANSFERS.

(a) IN GENERAL.—The value of the gross estate shall include the value of all property—

(1) TRANSFERS AFTER JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer . . . , by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjuction with any other person . . . , to alter, amend, revoke, or terminate . . . .

3. Rev. Rul. 79-353, 1979-44 I.R.B. 27.

that he may not be the successor trustee or even if only a corporate trustee may succeed to the position of the original.

II. CRITIQUE

There are two problems with the holding in Revenue Ruling 79-353. First, it attempts to treat sections 2036 and 2038 as mutually inclusive. However, there are separate requirements which must be considered for each section and, although some trust property may be includible in both, it is incorrect to automatically include it in both simply because it is includible in one.

The second problem is that the analysis is defective in that it fails to address the specific issue because it does not follow a logical progression of reasoning in reaching its conclusion. The first step in such a progression is to state, and to support, the general rule that if the settlor has, or for any reason is deemed to have, powers of a trustee which operate to control beneficial enjoyment of the trust property, then the property is includible in the settlor's estate upon his death.[4] The second step is to show which circumstances satisfy the general rule and to distinguish those areas to which exceptions apply. Only then is it possible to reach a rational conclusion on the specific issue of whether trust property will be included in the settlor's estate when a corporate trustee, and not the settlor, is given distributory powers over the trust property.

The result reached in Revenue Ruling 79-353 is incorrect because the analysis is confined primarily to the general issue. When it does consider the specific issue, it not only relies on an obsolete income tax case[5] but it also cites and then glosses over a 1977 Ruling which held that trust property is not includible in the estate when a corporate trustee is substituted for the original.[6] Furthermore, it fails to even mention

4. The basic estate tax provision is I.R.C. § 2033, which provides: "The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death." Treas. Reg. § 20.2033-1(a)(1965) amplifies that statement to include property if it is ". . . beneficially owned . . ." at death. That language, therefore, operates to include property which the decedent devised by will and which was distributed after his death. The reason for that is simple: wills are ambulatory documents and, though the testator may indicate that he wishes a certain beneficiary to receive a certain item of property, the testator may nevertheless use, dispose of, or otherwise transfer the property before his death and therefore deprive others of its enjoyment. As long as he has such control over the property, it is absolutely his until he dies. Testators who wish to make binding gifts, but postpone them, may reduce their estate tax liability by transferring property into a trust and therefore relinquishing beneficial ownership. If, however, such excessive controls are retained so as to allow the settlor to deal with the property with impunity (as though it were a devise in an ambulatory instrument rather than a binding document), the Internal Revenue Service treats the transfer as a circumvention and includes the property or property interest in the decedent's gross estate despite the form of the transfer.

5. *See* text accompanying notes 56-59 *infra*.

6. *See* text accompanying notes 39-40 *infra*.

three cases which are supportive of the correct result: one in which the settlor expressly relinquished ownership of the trust property and two more recent cases which also deal with independent trustees.[7]

Given such serious defects, the only conclusion which one may reasonably draw is that Revenue Ruling 79-353 is inadequately analyzed and therefore incorrect.

III. ANALYSIS

A. *The Statutes*

The most obvious difference in the requirements of the two statutes is found in the language itself, in which the specific retained interests are enumerated. Section 2036(a)(2) includes trust property if the settlor has a right to designate who may receive the income from that property. Section 2038(a)(1), in contrast, mandates the inclusion of an interest in property if the settlor retains a power over that interest. Although the control which is retained may be covered under both statutes in some instances, there are fine distinctions to be made in others. For example, the Treasury Regulations require different treatment of powers subject to contingencies. Under section 2036,[8] property is includible if the settlor retains a right to designate receipt of income from the property even if the right or the power[9] is subject to a contingency over which the settlor has no control and which does not occur before his death. The cited Regulation under section 2036 refers the reader to the Regulations governing section 2038, which state that section 2038 is not applicable to a power subject to a contingency beyond the settlor's control which has not yet occurred.[10]

7. *See* text accompanying notes 41-53 *infra*.

8. Treas. Reg. § 20.2036-1(b)(3) (1960) provides in part as follows:

The phrase "right . . . to designate . . ." includes a reserved power to designate the person or persons to receive the income from the transferred property, . . . during the decedent's life . . . . With respect to such a power, it is immaterial (i) whether the power was exercisable alone or only in conjunction with another person or persons, . . . ; (ii) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent; and (iii) whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death. . . . The phrase, however, does not include a power over the transferred property itself which does not affect the enjoyment of the income received or earned during the decedent's life. (See, however, section 2038 for the inclusion of property in the gross estate on account of such a power.) Nor does the phrase apply to a power held solely by a person other than the decedent. But, for example, if the decedent reserved the unrestricted power to remove or discharge a trustee at any time and appoint himself as trustee, the decedent is considered as having the powers of the trustee.

9. Note that, although the terms "right" and "power" are used as distinct terms in the language of the statutes, the Regulations and judicial interpretations (*e.g.*, United States v. Byrum, 408 U.S. 125, 137-38 (1972)) regularly interchange them. Therefore, they will be used interchangeably throughout this article as well.

10. Treas. Reg. § 20.2038-1(a) (1962), which provides:

. . . section 2038 does not apply—

(3) To a power held solely by a person other than the decedent. But, for example, if the

Because the distinction may not always be clear, a recent case explains the difference by considering the perspective from which the rights and powers are viewed.[11] Under section 2038, one considers what the settlor may or may not do at the precise moment of his death; therefore, contingent powers are not includible because they do not exist as exercisable powers at that moment. By contrast, section 2036 requires a consideration of what is retained at the time of the transfer. If the settlor may do something from that time forward, whether due to the occurrence of a contingency or not, then the property which he transferred in trust will be included in his gross estate upon his death.[12]

The contingency aspect of section 2036 was also discussed in a 1973 Revenue Ruling.[13] Under that Ruling, because the trustee was authorized to distribute or accumulate income at its discretion and because the settlor could have appointed himself as a successor trustee upon the resignation of the original, the property he transferred was included in his taxable estate. The rationale was that, by the terms of the trust, he retained a contingent right to designate enjoyment of the property because of his potential freedom—if he had become trustee he had the potential power to distribute some or all of the property to one class of beneficiaries and therefore to alter the rights of another class. (Note, furthermore, that although that property was held to be includible under section 2036, it would not be includible under section 2038 because the contingency under which the settlor could exercise the power was beyond his control.)

A similar discussion was offered in a case confined to the issue of includibility under section 2038.[14] The court stated that the taxable incident is the transfer by the settlor, whenever made, and that the estate is taxed if, at the time of the settlor's death, he has any control over the property or over any interest in the property. The policy behind the decision was that if a settlor holds a strong rein over the actual possession or enjoyment of the property, his death is the first time such possession or enjoyment by the beneficiaries is certain, and then he has

decedent had the unrestricted power to remove or discharge a trustee at any time and appoint himself trustee, the decedent is considered as having the powers of the trustee. However, this result would not follow if he only had the power to appoint himself trustee under limited conditions which did not exist at the time of his death . . . . (b) . . . section 2038 is not applicable to a power the exercise of which was subject to a contingency beyond the decedent's control which did not occur before his death . . . .

11. Estate of Farrel v. United States, 553 F.2d 637, 640 (Ct. Cl. 1977).

12. Note, however, that if the grantor dies within three years of making the transfer, I.R.C. § 2035(a) supersedes to require inclusion of the transferred property notwithstanding other considerations.

13. Rev. Rul. 73-21, 1973-1 C.B. 405.

14. Walter v. United States, 341 F.2d 182, 185 (6th Cir. 1965).

not relinquished sufficient control to escape the requirements of the statute.[15]

Under the facts of Revenue Ruling 79-353 the settlor's only retained right was to replace the corporate trustee without cause, and it was specified that he could not be named as successor trustee. Given that restriction, he had neither a specifically retained right nor a contingent right to distribute the property or to modify the terms of the trust; thus, neither section could apply to include the property in his estate.

B. *Prior Statutory Interpretations on the General Issue*

Generally, a settlor who is or may be named as trustee will incur an estate tax liability upon his death.[16] However, because this is not an inflexible rule, circumstances under which property is taxable in the settlor's estate will be examined at this point.

"It is common ground that a settlor will not find the corpus of the trust included in his estate merely because he named himself a trustee. . . . He must have reserved a power to himself which is inconsistent with the full termination of ownership."[17] Retention of purely administrative powers, for example, will not result in inclusion of property in the settlor's estate because his exercise of those powers does not effect the enjoyment of the property. On the other hand if the trustee's powers are extended to permit unrestricted freedom to deal with the principal or the income to the possible detriment of any beneficiary's interest, the result is different. In that situation if the settlor is a trustee, or if he has the contingent right to be named as trustee, the requirements of section 2036 are met and the property or property interest is includible in his estate.[18] (But note again that if the right is only contingent, then section 2038 is correspondingly *not* applicable.) The theory is that if the trustee has certain distributive powers over the trust property, and if the settlor may succeed to those distributive powers, it follows that the settlor has power to modify the trust and possibly frustrate the interests of the beneficiaries until the moment of his death.

Another exception to inclusion when the settlor is or may be the trustee is the situation in which the settlor-trustee's actions are limited by an ascertainable standard which is unambiguously specified in the terms of the trust instrument. A common example of this is where a settlor is co-trustee with the power to increase payments of income in the event of a beneficiary's illness. Because illness is a definite standard, capable of definition by a court, the condition is within the

15. *Id.* at 186. Noted that this principle comes from § 811(d)(2) of the Internal Revenue Code of 1939. However, as the court points out, the former language is substantially unchanged by the current § 2038, and both are controlled by the same principle.

16. *See* notes 8 & 10 *supra.*

17. Old Colony Trust Co. v. United States, 423 F.2d 601, 602 (1st Cir. 1970).

18. *Id.* at 603.

court's power of enforcement.[19] Judge Learned Hand explained this exception in the course of his decision in an income tax case:

> [N]o language, however strong, will entirely remove any power held in trust from the reach of a court of equity. After allowance has been made for every possible factor which could rationally enter into the trustee's decision, if it appears that he has utterly disregarded the interests of the beneficiary, the court will intervene. Indeed, were that not true, the power would not be held in trust at all; the language would be no more than a precatory admonition.[20]

It is recognized under this notion that the duty of the trustee is to act solely in the interests of the beneficiary, and in doing so, the trustee is empowered to distribute the trust property only upon the occurrence of some condition for which the settlor provided in the trust instrument. If the trustee disregards the terms of the trust and fails to distribute the property as he has been required to do, then a court of equity may intervene to determine whether the condition has occurred, and if so, to compel the trustee to make the required distribution. It is understood that in these circumstances the trustee's discretion is not absolute, but rather that it is limited to or by the standard. Therefore, the settlor who is or may be a trustee in this situation has not retained the degree of control required under the statutes and therefore is not taxed. Another example of the ascertainable standard is where a change in distribution is authorized for a beneficiary's education.[21] The same is true in the case of extraordinary financial problems. In one case in which this standard was applied, the court determined that the power was sufficiently beyond the settlor's control and that even if he was the trustee, the enjoyment of the property by the beneficiary was not affected.[22]

The problem with ascertainable standards is encountered when the standard is too vague. The primary example of vagueness is where the settlor has the power to decrease income if such an alteration would be in the beneficiary's "best interests," especially if the beneficiary is a member of the settlor-trustee's family.[23] The offending phrase can be given a variety of definitions that neither adds to the trustee's usual duties, nor limits his discretion and therefore is not accorded the status of a bona fide ascertainable standard for tax purposes.

Another problem occurs where the settlor retains the right to appoint a successor trustee, but leaves open the possibility that he, the settlor,

---

19. *Id.* at 604.

20. Stix v. Commissioner, 152 F.2d 562, 563 (2d Cir. 1945).

21. Estate of Wilson v. Commissioner, 13 T.C. 869, 870 (1949), *aff'd*, 187 F.2d 145 (3d Cir. 1951).

22. Jennings v. Smith, 161 F.2d 74, 78, 79 (2d Cir. 1947). Note that these cases involving the ascertainable standard arose under both the current Code and its 1939 predecessor. As stated in note 15 *supra*, however, this principle has not been altered despite other statutory changes.

23. 423 F.2d at 604.

may be appointed. Under these circumstances, the court must determine (in most states) whether the settlor intended to be named as successor trustee, either by looking to the instrument itself, by admitting extrinsic evidence, or by resort to the law of the state which governs the trust.[24]

Such an examination was conducted of an instrument litigated under section 2038, whose terms were construed according to the laws of New York.[25] Although the instrument was silent about whether the settlor could exercise her power to appoint a successor trustee in favor of herself, because the trustee had full discretion over distribution, such discretion would require inclusion of the property in her estate if the evidence revealed any possibility that she could have become trustee. The court accepted the testimony of the settlor's husband, who was her agent in drafting the trusts. He stated that it was his intention that she should be able to appoint herself if it had become necessary, and that she relied on his judgment in the creation of the trust in question.[26] After his testimony was considered together with the state law, which would permit her to appoint herself, the court was able to decide that the trust property was includible even if the settlor never exercised the power in her own favor and even if she did not intend to do so.[27]

A similar situation arose in Connecticut under section 2036.[28] Here, although the grantor could not have caused a vacancy to occur and although the instrument did not refer to the possibility that she could have appointed herself, the state law would have allowed her to fill any vacancy that might have occurred. This was characterized as a contingent power within the scope of section 2036 and was furthermore considered to have been not only foreseeable at the time of drafting, but also legally enforceable due to the operation of state law, and therefore inclusion was warranted.[29]

Both sections 2036 and 2038 were litigated and found inapplicable in a case in which the choice of law governing the instrument was Ohio.[30] Here, there were two trustees, at least one of which was required to be a

24. In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), a case involving another aspect of the estate tax, the Court determined that the highest court of a state is the best authority in ruling on a substantive rule upon which tax liability is based. If there is no such decision, however, the federal courts must apply what they find that law to be after giving due regard to lower court decisions of that state.

25. Mathey v. United States, 491 F.2d 481 (3d Cir. 1974).

26. *Id.* at 485.

27. *Id.* at 485-86.

28. Estate of Farrel v. United States, 553 F.2d 637 (Ct. Cl. 1977). The decision in this case rested upon the rules of § 2036: though § 2038 was also discussed in the argument. The court dispensed with further consideration of including the property under that section after defining the differences as based on contingencies, as discussed in the text accompanying note 11 *supra*.

29. *Id.* at 642.

30. Durst v. United States, 559 F.2d 910 (3d Cir. 1977).

corporate entity, and again, the trustees had wide discretion to distribute. Once more, both the instrument and state law were considered as evidence in determining whether the settlor could be appointed as a successor trustee.[31] Although it was found that the law of Ohio would allow the settlor to succeed to an open trusteeship, the settlor's intent was accorded greater weight. In this case there was sufficient indication that the settlor had no such intent. Furthermore, the lower court[32] held that under Ohio law lack of intent was shown from the settlor's failure to expressly reserve to herself the right to be appointed as trustee.[33]

In another case, the settlor did not expressly exclude himself from appointment as a successor trustee, but he did expressly surrender any right of ownership he may have had in the property.[34] Again, the evidence failed to show any intent on his part to succeed to any vacancy, and the court determined that the law would probably have disallowed any such succession because of the express relinquishment of ownership interest.[35] Given those findings, the court held that the property was not taxable to the settlor's estate.

Given these precedents, especially those of the cases which relied so heavily on inferential evidence, it is difficult to understand how, in 1979, there was any justification for including property wherein the settlor expressly forebade his own appointment as trustee and buttressed his intent by specifying that only an independent trustee could succeed to any vacancy.

C. *The Specific Issue: Corporate Trustee as Successor*

As in the analysis of the general issue above, the starting point here is again to be found in the language of Regulations issued by the Internal Revenue Service. Treasury Regulation section 20.2036-1(b)(3)[36] states that "[t]he . . . right to designate . . . *[does not] apply to a power held solely by a person other than the decedent*. But, . . . if the decedent reserved the unrestricted power to remove . . . a trustee . . . *and appoint himself*, . . . the decedent is considered as having the powers of the trustee."[37] This phrase is the starting point of step two of the proper analysis (discussed in Part II, above) in that the negative inference of

31. *Id.* at 912.

32. Durst v. United States, 409 F. Supp. 1046, 1048 (W.D. Pa. 1976).

33. Note that the Commissioner argued in this case that the denial of the power of self-appointment in the event of vacancy should appear expressly. 559 F.2d at 912. Yet in the Ruling at issue, only two years later, the Commissioner would include trust property in the settlor's estate notwithstanding the appearance of such an expression.

34. Estate of Wilson v. Commissioner, 13 T.C. 869 (1949), *aff'd*, 187 F.2d 145 (3d Cir. 1951).

35. *Id.* at 872.

36. Treas. Reg. § 20.2036-1(b)(3) (1960) (emphasis added).

37. Although there was a citation to this Regulation in the Ruling, the phrase which is quoted was omitted. Such an omission supports the position that the negative inference from this lan-

the phrase indicates exceptions to the general rule of includibility. When this phrase is applied to the facts at issue in Revenue Ruling 79-353, it can be seen that the property should not be included because first, a corporate trustee is a person other than the settlor, and second, the settlor did not have the power to appoint himself. Treasury Regulation section 20.2038-1(a)[38] contains similar language which demonstrates that the trust property in question is also not includible under section 2038.

There is support for the correct result through sources other than a mere negative inference from the language of the Regulations. In fact, the Internal Revenue Service, in one of its own 1977 rulings, determined that trust property is not includible under section 2036 when a successor *corporate* trustee may be named.[39] In that Ruling, as in Revenue Ruling 79-353, the trustee was given discretion to distribute income and the settlor was empowered to appoint a successor corporate trustee. That settlor's power to reappoint, however, was granted only in the event that the original trustee resigned or was removed by judicial process. Notwithstanding the contingent nature of the settlor's powers, section 2036 was held not to require inclusion because only a corporate trustee could be substituted.[40]

Revenue Ruling 79-353 should have reached the same result under section 2036 because of the emphasis on the corporate trustee and under section 2038 because the settlor's power to reappoint was subject to no contingencies.

In addition, there are two supportive judicial interpretations which arose under section 2036.[41] In both cases, the settlor not only reserved the right to appoint a successor trustee other than the settlor, but also reserved the right to vote stock in a closely-held corporation whose stock was part of the trust corpus. Although the latter reservation was the primary focus of each case, the provision relating to successor trustees was also vehemently argued and decided in favor of the taxpayer's estate in both cases.

In the first,[42] the grantor provided for two trustees, at least one of which was required to be a bank or a trust company.[43] The Commissioner argued that although the grantor had no power to control the

---

guage is strong enough that the desired result in the Ruling could not have been reached had it been used.

38. Treas. Reg. § 20.2038-1(a) (1962).

39. Rev. Rul. 77-182, 1977-1 C.B. 273.

40. This Ruling was also cited in Revenue Ruling 79-353, but was neither discussed in detail nor applied to the facts. Again, the omission supports the conclusion that the analysis was result-oriented.

41. Again, the cases discussed here (notes 42 & 46 *infra*) were not mentioned in the Ruling.

42. Estate of Beckwith v. Commissioner, 55 T.C. 242 (1970).

43. *Id.* at 244.

actual amounts or the timing of the distributions, the replacement provision allowed him, as a practical matter, to retain control over the income by setting the dividend policy of the family corporation that issued the stock.[44] The court rejected this argument and emphasized that the grantor retained no right to be named as one of the trustees and that the administration of the trust was always within the control of third parties whose duty it was to act for the benefit of the beneficiaries.[45]

Byrum v. United States[46] is the more interesting case because of the consistent results in favor of the estate, from the initial request for summary judgment through the denial of rehearing before the United States Supreme Court. In *Byrum*, the trust agreement named a bank as sole trustee with the sole discretion to distribute the trust property. The settlor retained the power to vote stock, to veto the sale or investment of the corpus, and to replace the trustee at his option with another corporate trustee.[47] In the initial proceeding, the Government argued that a case cited by the estate[48] was distinguishable because in the cited case the settlor was also a trustee and therefore was under a fiduciary duty enforceable in a court of equity.[49] The court's response was that because the settlor, Byrum, was not a trustee he was further removed from the powers possessed by one holding that position, and further, that because he could only have named a successor corporate trustee, he would never have possessed those powers and, therefore, could not have abused the trust or the interests of the beneficiaries.[50]

In the first appeal from that result, the court affirmed this point by referring to Treasury Regulation section 20.2036-1(b)(3)[51] and by comparing the obligation of trustees and of corporate directors with those of a trustee who is limited by an ascertainable standard.[52] When the Government appealed the case to the United States Supreme Court, it was again affirmed that the corporate trustee, and not the settlor, had the right to determine distribution and that the settlor, therefore, had no power to designate benefits under section 2036(a)(2) despite his retained power to remove and replace the trustee.[53]

---

44. *Id.* at 248.
45. *Id.* at 250.
46. Byrum v. United States, 311 F. Supp. 892 (S.D. Ohio 1970); *aff'd*, 440 F.2d 949 (6th Cir. 1971); *aff'd*, United States v. Byrum, 408 U.S., 125 (1972); *rehearing denied*, 409 U.S. 898 (1972).
47. United States v. Byrum, 408 U.S. 125, 128 (1972).
48. Yeazel v. Coyle, 68-1 U.S.T.C. ¶ 12,524.
49. Byrum v. United States, 311 F. Supp. 892, 895 (S.D. Ohio 1970).
50. *Id.* (Note that this argument pertains to § 2036(a)(1), which deals with possession, enjoyment, or right to income from the property, but the discussion is equally relevant to § 2036(a)(2)).
51. *See* text accompanying notes 39 & 40 *supra*.
52. Byrum v. United States, 440 F.2d 949, 952 (6th Cir. 1971).
53. United States v. Byrum, 408 U.S. 125, 138 (1972).

The Court also pointed out that when the tax laws need reconsideration, it is the task of Congress and not of the courts to re-define the consequences which will require taxation, because if the courts undertake the task, taxpayers will be unable to rely on a consistent standard when an issue is litigated.[54] Congress heeded this statement in 1976 when it enacted section 2036(b),[55] which includes property in an estate when a decedent has retained voting rights in a closely-held corporation. Therefore, under the new subsection both *Beckwith* and *Byrum* would be decided differently if they were to be re-litigated today on the voting issue. However, because there was no accompanying amendment to cover replacement of trustees, it appears that Congress had no intent to alter the results under that issue.

As noted earlier, both of these cases were litigated under section 2036. However, because no powers were held to have been retained at the inception of either trust, it cannot be argued that the settlors possessed any powers at their death to warrant inclusion under section 2038. The same must be said of the fact situation set forth in Revenue Ruling 79-353.

Despite the above support, there is one case[56] cited in the Ruling that must be discussed because, on its face, it appears to require the result reached in the Ruling. *Corning v. Commissioner*, involved inclusion of income from trust property in a settlor's gross *income* under the Internal Revenue Code of 1939.[57] It would be simple enough to dismiss the cited case as inconsequential on the ground that its holding is no longer relevant in view of the more recent decisions. However, the more practical reason for disregarding it is that the Internal Revenue Code of 1954 contains a new provision rendering the result in *Corning* obsolete.[58]

54. *Id.* at 136.

55. Tax Reform Act of 1976, Pub. L. No. 95-600, 90 Stat. 1520:

§ 2036(b) VOTING RIGHTS—

(1) IN GENERAL.—For purposes of subsection (a)(1), the retention of the right to vote (directly or indirectly) shares of stock of a controlled corporation shall be considered to be a retention of the enjoyment of the transferred property.

(2) CONTROLLED CORPORATION.—(defined as the right to vote stock possessing at least 20 percent of the total combined voting power of all classes of stock.)

56. Corning v. Commissioner, 24 T.C. 907 (1955).

57. *Id.* at 908.

58. I.R.C. § 674, which treats the grantor as owner of a trust where beneficial enjoyment is subject to a power of disposition. Section 674(c), however, makes an exception to that rule if the power is exercisable solely by an independent trustee. And in Treasury Regulation § 1.674(d)(2)(a), an example of such exclusion is given as the situation in which the grantor's power to substitute the trustee is limited to replacement with another independent trustee.

D. *Trust Principles*

The other aspect of *Corning* requiring discussion is the following quote which was repeated in the Ruling:

> Petitioner argues that . . . he is precluded from appointing himself as trustee and would be permitted to appoint only a corporate trustee in the event that he chose to substitute trustees . . . . In any event, petitioner could substitute an independent corporate trustee after first ascertaining that such trustee would follow his directions. Should this corporate trustee subsequently fail to follow his instructions, petitioner could then replace it with another. Petitioner's power to substitute trustees was subject to no restrictions and, in practical terms, gave him the broad powers possessed by the trustee.[59]

First, although the argument about "practical considerations" was accepted in 1955, the same court refused to accept it in 1970,[60] and courts will probably maintain that refusal. Second, the hypothetical situation proposed there may be no longer considered in current litigation because a court determined in 1972 that the powers, which are to be reached under section 2036 and 2038, are "those retained powers over a transferred property interest that are actual, real, and demonstrable, but not speculative or conjectural."[61]

The strongest argument against acceptance of such a notion, however, is found in the settled principles of trust law. A trustee's fundamental duty is to administer a trust solely in the interests of the beneficiaries,[62] and a court of equity will intervene to prevent an abuse of this duty if, for example, the trustee is pressured to further another party's interests, even in a purely collateral matter.[63] Because the duty is to act in the beneficiaries' interests, they may elect to request court intervention to enforce their rights even if the trustee's action is such that it does not harm their interests per se.[64]

If the grantor has the unlimited power to remove a trustee, the court will not permit that power to be exercised in any way that will prejudice the rights of the beneficiaries.[65] Even if the grantor intends to grant the trustee a power to contravene good faith standards, the court will not be deprived of its right to enforce public policy interests in protecting the beneficiaries and in ensuring that fiduciaries perform ac-

59. 24 T.C. at 915.

60. Estate of Beckwith v. Commissioner, 55 T.C. 242 (1970). A similar argument by the Commissioner was characterized as "far-fetched" by the court in Estate of Wilson v. Commissioner, 13 T.C. 869, 873 (1949), *aff'd*, 187 F.2d 145 (3d Cir. 1951).

61. Harris v. United States, 29 A.F.T.R.2d ¶ 147,656 (D.C.D. Cal. 1972).

62. A. SCOTT, ABRIDGEMENT OF THE LAW OF TRUSTS § 170 (1960).

63. G. BOGERT & G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 520 (2d rev. ed. 1978).

64. *Id.*

65. A. SCOTT, *supra* note 62, at § 107.2.

cording to the strict duty of care owed by them.[66]

Furthermore, a successor trustee succeeds to the rights and duties of its predecessor[67] and, as the Court pointed out in *Byrum*, a settlor would be unwise to exercise his power to replace a trustee under a complaint by the trustee of the settlor's misconduct because the new trustee succeeds to the former trustee's right to complain.[68]

Therefore, because the trustee is under such a duty and because more courts are requiring a higher standard for professional fiduciaries than for individuals,[69] there is good reason to exclude property from taxation when the settlor is not a trustee, and even better reason to exclude it when the trustee is a corporate entity. A prudent trustee will not allow the settlor to influence him to disregard his duties, but even if he does, both the beneficiary and a court of equity will have recourse against the offending party. In this respect, a fiduciary obligation is similar to an ascertainable standard, and the former should receive the same protection under sections 2036 and 2038 as the latter. Any contrary position suggested by the Ruling under the anachronistic precedent of *Corning* cannot be taken seriously.

IV. CONCLUSION

Considering the analysis presented in Part III above, a quote from *Byrum* provides an appropriate comment: "Rulings . . . do not have the force of law and are at most merely persuasive. . . . Insofar as such Ruling might be applied to the facts of this case, it is in conflict with the law as interpreted by the courts and should be disregarded."[70]

Given the holding of Revenue Ruling 79-353, it is fortunate that a court will not consider the Ruling to have the force of law. Indeed, this Ruling is not even slightly persuasive in light of the precedents and in light of its haphazard approach. It is not only inconsistent with judicial interpretations of the relevant sections of the Internal Revenue Code, but it is also inconsistent with the deeply-imbedded principles of the law governing trusts and trustees. Revenue Ruling 79-353 certainly should be disregarded.

Cautious practitioners, however, cannot afford to ignore the Ruling because the Commissioner may choose to litigate and courts may ultimately accept the Commissioner's position frustrating the settlor's intentions and thereby resulting in malpractice suits. Also, because

66. *Id.* at § 187.4. *See also* text accompanying note 1 *supra.*
67. A. SCOTT, *supra* note 62, at § 196.
68. United States v. Byrum, 408 U.S. 125, 143-44 (1972).
69. G. BOGERT & G. BOGERT, *supra* note 63, at § 541.
70. Byrum v. United States 440 F.2d 949, 952-53 (6th Cir. 1971).

declaratory judgments are expressly inapplicable to most tax issues,[71] that remedy is not available as a means of expediting a solution to the problem. Fortunately, the foregoing analysis implies some possible alternatives which would fit within the restraints mandated by the Ruling while retaining flexibility for the grantor to substitute trustees without incurring estate tax liability.

The simplest solution, and one that does not require lengthy additions to the language of the instrument, is to provide that, while the settlor retains the right to replace the trustee, he also relinquishes any ownership interest he has in the trust property, as well as any right to name himself as successor trustee.

Another alternative is to set forth the purposes of the trust and further to provide that if the trustee's actions are deemed by the court or by the settlor to conflict with such purposes, or to be otherwise harmful to the beneficiaries' interests, the settlor may replace the trustee. If the cause for which the settlor may remove the trustee is in the nature of an ascertainable standard, that is capable of unambiguous definition, the provision probably would be further protected because, as discussed above, such standards enjoy a privileged position in both the courts and the Internal Revenue Code. Additionally, such removal for cause would arguably be safe from inclusion under section 2036 despite its contingent nature because of the 1977 Ruling cited earlier.[72] Even if the Internal Revenue Service indeed has changed its position since that Ruling, the focus in both Rulings was on the trustee rather than on the reasons for substitution. Because the 1979 Ruling did not rebut the 1977 position on the contingent nature of removal for cause, it seems reasonable to conclude that such a provision would not be covered by the possible change in position.

Finally, the laws of the state which govern the trust should be considered carefully to determine how much weight is given to the settlor's intent and how much extrinsic and inferential evidence would be allowable in the event that the settlor's intent is considered to be ambiguous and, therefore, subjected to a suit for construction. If the governing law is not favorable to the settlor's wishes, then a choice of a different state's law may be desired as long as such choice does not violate principles of conflicts of laws.

Because the Ruling did not support its conclusion with strong rea-

71. *See* 28 U.S.C. § 2201 (1976), which provides:

In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of 1954 or a proceeding under section 505 or 1146 of title 11, any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relation of any interested party seeking such declaration, whether or not further relief is or could be sought. . . .

72. Rev. Rul. 77-182, 1977-1 C.B. 273.

soning, one cannot be certain whether any of these alternatives will be free from scrutiny by the Commissioner. Estate planners, therefore, should draft instruments which are as detailed as possible and which include provisions which are most likely to withstand attack. This way, the client's wishes may be better served, there is less chance of unfavorable adjudications, the attorney is subject to less risk of suit, and the Ruling may be withdrawn or replaced with a more reasonable statement.

MAUREEN STEWART