The Burger Court Opinion Writing Database

United States v. Byrum

408 U.S. 125 (1972)

Paul J. Wahlbeck, George Washington University
James F. Spriggs, II, Washington University
Forrest Maltzman, George Washington University

To: The Chief Justice
Mr. Justice Douglas
Mr. Justice Brennan
Mr. Justice Stewart
Mr. Justice White
Mr. Justice Marshall
Mr. Justice Blackmun
Mr. Justice Rehnquist

From: Powell, J.

Circulated: SEP 28 1972

Recirculated: _____

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE LEWIS F. POWELL, JR.

September 28, 1972

No. 71-308 - U. S. v. Byrum - Petition for Rehearing

Dear Member of the Conference:

I send to each of you herewith a memorandum in which I have commented - at too great a length, I fear - on the SG's Petition for a rehearing.

As the Petition has not been placed on the discuss list, I hesitate to add to the volume of "paper" in your chambers. But at least you will have the memorandum in your file if there is any occasion to refer to it.

Sincerely,

Lewis

lfp/ss

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE LEWIS F. POWELL, JR.

Memorandum to Conference September 28, 1972

From: Lewis F. Powell, Jr.

No. 71-308 U.S. v. Byrum - Petition for Rehearing

The purpose of this memorandum is to comment on the petition for rehearing filed by the Solicitor General.

Nothing New

Although the rehearing petition emphasizes what the Solicitor General believes may be the unwelcome consequences of our decision, it relies essentially on cases previously cited and arguments previously made. The petition does draw, in terms of some of its argument, upon the excellent dissenting opinion of Mr. Justice White.

In the absence of new and compelling arguments and authorities, I think the petition lacks merit and should be denied. I will, nevertheless, and for the benefit of members of the Conference, summarize the facts and comment on some of the Solicitor General's arguments.

The Facts

Byrum transferred (over a period of three years) to an irrevocable

trust for the benefit of his children stock in three unlisted corporations in which he owned not less than 71% of the outstanding stock of each. In the trust instrument, he retained the right to vote the transferred stock, to veto the transfer by the trustee (an independent bank) of any of the stock, and to remove the trustee and appoint another corporate trustee as successor.

Byrum was not co-trustee and the corporate trustee was authorized in its "absolute and sole discretion" to pay the income and principal of the trust to or for the benefit of the beneficiaries "with due regard to their individual needs for education, care, maintenance and support."

The trust was created in 1958. When he died in 1964, leaving a taxable estate of $106,000, Byrum owned 59% of the stock in one of the corporations, and less than 50% in the other two. The trust had retained the shares transferred to it.* Thus Byrum had continued to have the right to vote not less than 71% of the stock in each of the corporations.

During the five years prior to his death, only nominal dividends (totaling $339) were paid into the trust. The year of Byrum's death $1,498 in dividends was paid. The case was tried in the District Court on a motion for summary judgment with affidavits and no testimony. The record

* The share of a fourth corporation transferred to the trust had been sold by the trust.

does not disclose anything with respect to the earnings or financial conditions of these corporations. It is not known what earnings available for dividends, if any, were earned by each of these corporations, whether there was an earned surplus in any of them or whether - if some earnings be assumed - they were adequate in light of other corporate needs to justify dividend payments.* Nor does the record indicate the nature of the businesses of the three corporations, beyond what may be inferred from their names.**

Although the government's entire case is based on Byrum's "control" of the three corporations, and his resulting alleged control of the "flow" of dividends to the trust, these are conclusory assumptions. Byrum did have the right to elect the boards of directors (assuming cumulative voting was not provided), but the record does not show how many directors there were, the identity of the directors, or the extent - if any - to which Byrum dictated to the directors.

An affidavit does show that there were a number of minority stockholders, unrelated to Byrum, in each corporation.

---

* There is no explanation in the record of the increase (still a modest amount) in the year of Byrum's death.

** Based on their names, one was a lithographing concern, another a real estate holding corporation, and a third (Bychrome Co.) a family type corporation of some kind.

The Commissioner included the transferred stock in Byrum's gross estate, and assessed an additional tax of $13,202. In a refund suit, the District Court ruled for Byrum's executrix and this was affirmed (one judge dissenting) by the Sixth Circuit Court of Appeals.

The Government's Position

In the case before this Court, the Solicitor General relied upon § 2036(a) of the Code which provides for the inclusion in a decedent's gross estate of all property which the decedent has transferred by inter vivos transaction if he has retained for his lifetime "(1) the possession or enjoyment of, or the right to the income from, the property" transferred, or "(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom."

In its petition for rehearing, the Solicitor General relies only on subsection (2) of § 2036(a). In the government's Brief (filed December 23, 1971), its position with respect to subsection (2) was as follows:

> "By retaining voting control of the corporations whose stock he transferred in trust, decedent was in a position to dictate corporate dividend policy. Through exercise of that retained power, he could increase or decrease corporate dividends (or stop them entirely), and thereby shift or defer the beneficial enjoyment of trust income. This retained power is tantamount to the power to accumulate income, which this Court has recognized constitutes the power to designate the persons who shall enjoy income from transferred property under Section 2036(a)(2). See United States v. O'Malley, 383 U.S. 627, 631." (Government's Brief, p. 5)

This remains the government's basic position.

Implied Corporate Manipulation

There is an undertone of argument, new to the rehearing petition, that somehow Byrum was manipulating corporate power or entities in "a new way to beat estate taxes."* The rehearing petition talks of "the utilization of corporate sophistication and skill" to avoid estate taxes. Yet there is nothing in the record to support an inference of manipulation for tax avoidance.

Nor is there justification for the suggestion that the Byrum trust points "a new way to beat estate taxes." Irrevocable trusts, into which shares of corporations of all kinds and sizes are transferred, have been widely used in estate planning for many years. It has not been uncommon (especially where close corporation shares are transferred) for the settlor to reserve the right to vote the transferred stock and to veto its sale. I know of no decision holding that the mere presence of these reservations subjects the transferred stock to an estate tax.**

* The Solicitor General's brief quotes the Kiplinger Tax Letter (not heretofore notable as a legal authority) for this view. Rehearing petition, p. 2, note 1.

** See amicus brief, p. 3. The amicus brief filed by Simon H. Rifkind (of Paul, Weiss, Rifkind, Wharton & Garrison) states that trusts of this kind have been sustained by the courts for "a period of over 40 years."

It can hardly be said, therefore, that there is anything new about the type of trust established by Byrum. Indeed, the government does not assert that retention by a settlor of voting and veto rights result in taxability of the transferred shares. Rather, the position is that "control" of the corporations, however this may exist,* is what converts a nontaxable transaction into a taxable one under § 2036(a)(2).

Stockholders in Close Corporations Disadvantaged

Apart from the central question (whether § 2036(a)(2) can be read to cover such a situation), the government's position would disadvantage the owners of stock in small, family-type corporations.

This disadvantage becomes apparent if Byrum's position is compared with that of Settlor A whose estate is composed of $106,000 of stock in large listed corporations (e.g. General Motors and ITT), or with Settlor B whose estate is composed of $1,000,000 of stock in a diversified list of major New York Stock Exchange corporations. We may assume that the trust instruments were drawn in exactly the

* In the case of what appears to be the principal corporation involved here, Byrum Lithographing Co., the settlor owned more than 50% of its stock at the time of his death. It was therefore quite immaterial, under the Solicitor General's theory, whether Byrum reserved the right to vote the minority shares he transferred. See Opinion of Court, Note 4.

same manner with respect to Byrum, Settlor A and Settlor B. Under the government's theory the shares transferred by Byrum would be taxable to his estate whereas the shares in the trusts of the other two settlors would not be taxable.

There are many thousands of small, family-type corporations with unlisted stock in which the founder of the business may have built up his entire life savings. Wealth created and saved in this manner presents difficult problems for estate planners and in the settlement of estates because of lack of liquidity and uncertainty as to value. Accordingly, the principal owners of such businesses have a greater need for the availability - as an instrument of prudent estate planning - of trusts of the Byrum type than do persons whose wealth (whether inherited or earned) is represented by listed securities in national corporations where there is no possible question of "control." Yet, the government's position would make it virtually impossible for a major owner in a family-type corporation to use an inter vivos trust.

Another category of settlors would be put in a difficult position by the government's theory. These are persons who own less than 50% of the voting shares of a corporation, but who nevertheless may "control" it. The test advocated by the Solicitor General is de facto control and not merely the ownership of 50% or more of the voting shares of a corporation. As pointed out in the Court's opinion (footnotes

10 and 13 in particular), de facto control is too imprecise and amorphous a test to constitute a basis for imposing tax liability under § 2036(a).*

The Statute Does Not Apply

This unduly long memorandum has been devoted, to this point, to meeting the Solicitor General's policy arguments and inferences. However, one may view these, this case turns on the construction of § 2036(a)(2). As it seems to me that the Court's opinion is sound on this central issue, I will not restate the supporting analysis.

It is important, however, to recall that the statute is expressed in terms of "retention" of a "right," either alone or in conjunction with other persons, to "designate" who shall enjoy the income from the transferred property. The government's position is that "retention of control" over the corporations is the equivalent of retention of "the right" specified in the statute. I know of no

* Effective control to elect the board of a corporation may, and frequently does exist, where there is a right to vote far less than 50% of the shares, as this de facto power will vary with the size of the corporation, the number of shareholders and the concentration (or lack of it) of ownership. It often varies from year to year, depending upon these and other unpredictable factors.

authority which supports this interpretation of § 2036(a)(2). The two cases principally relied upon by the government do not, in my opinion, support it.*

The trust instrument itself (Article VI) empowered the corporate trustee alone, not Byrum, to pay out or withhold income and thereby "to designate the persons" who shall enjoy the income from the trust. Whatever power Byrum may have possessed (and apart from the shares he could vote, the record is silent as to this), it was derived not from an enforceable legal right specified in the trust instrument, but from the fact that he could elect a majority of the corporate directors. But this power to elect directors conferred no legal right to command them to pay or not to pay dividends, or to dictate the amount thereof, even if funds had been available for the purpose.

Byrum, himself, as a majority shareholder in corporations with a number of minority shareholders, had a fiduciary duty not to misuse his position by promoting his personal or family interest at

* These cases are U.S. v. O'Malley, 383 U.S. 627 and Helvering v. City Bank Co., 396 U.S. 85. In both of these cases the settlors had expressly reserved legally enforceable rights in the trust instruments which authorized the precise action which resulted in imposition of the tax.

the expense of the interest of the corporation or its other stockholders. Certainly, the directors - who may (so far as the record shows) have been independent, community leaders - had a fiduciary duty to serve only the interest of the corporation and all of its stockholders. Whatever Byrum's influence may have been with the corporate directors, their responsibilities as directors are determined by corporate law and are entirely unrelated to the needs of a personal trust created by a stockholder, whether controlling or otherwise.

* * * * * * * * * * *

It seems to me that the Court decision comports with the statute and the relevant cases. It is also consistent, I think, with the sound policy of even handed application of tax laws. If the Congress wishes to impose a special tax disadvantage on settlors who happen to "control" closely held corporations, it should do so deliberately and in language explicit enough to put the bar and taxpayers on notice.

L. F. P., Jr.

LFP, Jr.:pls