DISTRICT OF COLUMBIA TAX COURT

TRUST CREATED UNDER THE WILL OF KATHERINE S. SEVERN, Stanley S. Harris, Trustee, and TIMOTHY MAYO, Petitioners,	)	FILED MAY 11 1970 District of Columbia Tax Court
v.	)	DOCKET NO. 2068
DISTRICT OF COLUMBIA, Respondent.	)	

FINDINGS, CONCLUSIONS AND OPINION

In this inheritance tax case the ultimate issue is whether the late Katherine S. Severn, formerly Katherine S. Mayo, acquired a taxable property interest in a trust estate derived from a matrimonial settlement entered into with her former husband, Paul Mayo. The issue is framed by petitioners as if it involved a simple dichotomy: Katherine was given a power of appointment in the settlement; that power is either "general" and taxable, or "special" and nontaxable. The dichotomy has some justification: under our inheritance tax law, codified for convenience as D. C. Code section 47-1601(j) --

> Whenever any person shall exercise a general power of appointment derived from any disposition of property, made either before or after the passage of this chapter, such appointment, when made, shall be deemed a transfer taxable, under the provisions of this chapter, in the same manner as though the property to which such appointment relates belonged absolutely to the donee of such power * * *.

By implication, then, the exercise of a power of appointment which is not "general", is not to be "deemed a transfer" taxable "as though" the donee owned the appointed property "absolutely". And petitioners claim that under principles of trust law, property subject to a power of appointment which cannot be appointed to the donee's creditors is not property subject to a general power

of appointment. But as everyone knows, tax law does not always "track" trust law as laid down for, e.g., creditors and beneficiaries of an estate. Tax law is concerned with substance rather than the subtilities of conveyancing. The substance, for present purposes, is the Congressional intent, manifest in section 47-1601(a), that the inheritance tax applies to every transfer of property "by will or by law" effected by a decedent (with immaterial specific exemptions) including a transfer by use of the decedent-donee's appointing power.

The facts. The Mayos lived in Colorado. On August 26, 1937, they entered into a Trust Agreement as a "fair, equitable, and just" "final settlement between said parties of all property, alimony, or other financial rights arising out of the marital contract, or otherwise." (Trust, par. 19.) Paul conveyed to the Trust assets then worth over $1.85 million. At the time, the Mayos had two children -- Daphne, age 3, and Anthony, age 1.

A divorce action, then pending, resulted in a final decree of a Colorado District Court entered February 28, 1938, which gave custody of the children to Katherine, found the Trust Agreement matrimonial settlement fair and sufficient for her support and that of the children, and approved it.

Paragraph 4 of the Trust Agreement provides as follows:

> It is expressly understood and agreed that the Trustor and the party of the second part each shall have the privilege and power of disposing of one-fourth (1/4) of the entire trust estate by will, as he or she may see fit, and, in the event of the exercise of such power, upon the death of either, all of the income from the trust estate shall thereafter be divided as follows:
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> Two-thirds (2/3) to the survivor of Katherine S. Mayo and the Trustor, and one-third (1/3) thereof to the said children [i.e., Daphne and Anthony]; if either the Trustor or the party of the second part fails to exercise said power of disposition, upon the death of such party, three-fourths (3/4) of the income thereafter arising from the trust estate shall be paid to the survivor of the Trustor and the said Katherine S. Mayo, and one-fourth (1/4) thereof to the said children.

This paragraph, *prima facie*, creates for both Paul and Katherine a general power of appointment over 25% of the "entire trust estate". They can each appoint their share to anyone -- a new spouse, or a stranger to the trust. If so exercised, it is apparently the intention that "all the income from the [remaining 75% of the corpus of] the trust estate" shall be apportioned between the survivor and the children (Daphne and Anthony) as specified above. The succeeding paragraph 5 provides that upon the death of both Paul and Katherine, the trust will continue until "the older child" reaches age 30, at which time the "corpus of the trust is to be divided equally between said children".

Katherine was a spendthrift, and paragraph 12 of the Agreement sets up spendthrift limitations with regard to the trust estate and the income therefrom. It purports to exempt such estate and income from any process or demand (set out with great specificity) against "any of the respective beneficiaries" -- not Katherine alone, but Paul, Katherine, Daphne and Anthony. During their lifetime, payments to Paul and Katherine "shall always be and be held to be created for their personal and individual use and benefit" and not subject to payment "of any debt or obligation". Payments to Katherine are to be her "sole and separate property, notwithstanding coverture"; payments to Paul are not to be subject to "any debt of or claim against any future wife of his".

Without quoting the unnecessary detail, it is clear that the terms of paragraph 12 state the broadest kind of spendthrift restrictions on invasion of either trust principal or income by either Paul or Katherine; the intent to maintain their interests inviolate from creditors' claims is manifest.

Paul Mayo died October 13, 1940, a resident of Colorado. In his Will, probated in Colorado, he exercised his power of appointment over 1/4 of the Trust Estate. The court order setting the State inheritance tax indicates that the exercise was in favor of Daphne and Anthony. (Exh. 7-G.)

Katherine died October 13, 1961, a resident of the District of Columbia. At that time, she was married to Gerald E. Severn, "more properly and accurately known as German Sevastanof", from whom she was separated and who was cut out of her Will. (Par. 25.)

Her Will, executed June 26, 1958 in Southampton, N. Y., made relatively minor specific bequests of personal property to Daphne and Anthony, specific bequests to others, and an appointment of her interest in the property covered by the 1937 Trust Agreement, in trust, to her adopted minor son, Timothy Mayo. Note that Timothy, born in 1945, was a stranger to the 1937 Trust Agreement.

In 1962, the Trustees of the Mayo Trust brought action in the Colorado courts for instructions. On the one hand, Timothy's District of Columbia guardian and Trustee claimed 1/3 of the principal and income of the trust property "as the same existed on October 13, 1961"*/. On the other hand, Daphne and Anthony (inter alia because Katherine's interest in the trust estate "must be deemed a limited power of appointment which could only be exercised by her in favor of" them) claimed to be the sole beneficiaries of the Mayo Trust. (Exh. 4-D, Petition p. 2, and Answer filed Nov. 16, 1962 p. 5.)

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*/ 100% minus 25% theretofore appointed by Paul equals 75% of the original trust estate remaining at October 13, 1961; 1/3 of such remainder allegedly equals the values over which Katherine had the appointing power.

This action was settled. The Colorado court on June 26, 1963, entered an order finding that Katherine had and exercised a power of appointment "which was not subject to the claims of creditors" over 28-1/3% of the corpus and income, therefore distributable to Timothy's Trustee. The balance of the Mayo Trust, 71-2/3%, was by the court set over to the benefit of Daphne and Anthony. (Exh. 4-D.) It is convenient to note at this point that the finding of the court on creditors' rights was in a consent decree and therefore was not a conclusive determination. Milner, 6 T.C. 874, 881.

On August 26, 1963, Katherine's Administrator c.t.a. filed the D. C. Inheritance Tax Return, excluding the Mayo Trust property left to Timothy, on the ground that her power of appointment "was not exercisable in favor of the decedent, her estate, her creditors or the creditors of her estate, but only in favor of such persons as she might name by her Will and hence was not a general power of appointment." (Exh. 3-C.) The District's Finance Office found to the contrary, and in 1965, Timothy's trustee paid $56,229.39 inheritance tax and interest, refund of which is here claimed.

Discussion. 1. The distinction between (a) general and (b) limited or special powers of appointment, for present purposes, has a very practical reason and effect. Let us assume that Katherine had the power to appoint only to Daphne, Anthony, or either of them -- a special or limited power. In that case, she is only the conduit of the property rights subject to her appointing power; the children do not in substance inherit from her, but from their father, assuming that he is the settlor of the trust and donor of the power. The case is quite different if Katherine can and does choose her beneficiary for herself; in that case the beneficiary, in substance, inherits as a result

of her transfer of property by will. So here, Katharine's exercise of her power was in favor of her adopted son Timothy, a minor born long after the creation of the Mayo Trust and Paul Mayo's death. Timothy inherited from her, and not from Paul. The realistic situation is confirmed by the 1962 Colorado court settlement setting off 28-1/3% of the Mayo Trust property to Timothy (an obvious compromise of his claim for 33% of the then remaining 75% of the original trust corpus, and the claim that he was entitled to only 25% thereof). In no substantial sense did Timothy inherit from Paul Mayo's trust, but from his mother's exercise of her unlimited and unrestricted power to choose (subject only to the spendthrift provisions relating to creditors) her beneficiary. See in general Morgan v. Com'r., 309 U.S. 78.

2. For tax purposes, Katherine was really the settlor of her part of the Mayo Trust, even though all the corpus was contributed by Paul. She is deemed to have paid for her part thereof: "her cost for this property, i.e., the value of the marital rights relinquished therefor" is ascertainable by reference to the market value of the interests conveyed to her. See United States v. Davis, 370 U.S. 65, 74.

In District of Columbia v. Lewis, 109 U.S. App. D.C. 353, 288 F.2d 137, cert. den. 368 U.S. 818, the matrimonial settlement, in pertinent part, set over $25,000 to the then wife at the husband's death. At his death, the District assessed inheritance tax thereon. The Court remanded a D. C. Tax Court ruling for the taxpayer, in order that the Court make a specific finding as to whether or not the transfer was a part of the consideration set over to the wife in lieu of the husband's support obligation (109 U.S. App. D.C. at 357):

> We therefore hold that a transfer in lieu of a husband's obligation to support his wife during their joint lives, or until her remarriage, is made for full and adequate consideration in money or money's worth. If the lump sum payment here was in lieu of the support obligation, then it is not subject to a transfer tax.

In the case at bar, no contention is or could be made that the Mayo Trust provisions for Katherine's benefit are not in lieu of the support obligation. Following Lewis, the property interests so conveyed are not taxable at Paul's death, but inferentially are subject to tax at her death.

As joint settlors of the Mayo Trust, neither Paul nor Katherine could set up valid spendthrift provisions in the trust agreement; the entire paragraph 12 thereof would seem to be ineffectual against their creditors. See Liberty Nat. Bank v. Hicks, 84 U.S. App. D.C. 198, 201 173 F.2d 631; American Security and Trust Co. v. Utley, 127 U.S. App. D.C. 235, 236, 382 F.2d 451. In the latter case, decedent wife created a testamentary trust with a spendthrift provision for her husband, who elected to take thereunder rather than "to take such rights as would devolve to him in case of intestacy." (127 U.S. App. D.C. at 236.) Held: the existence of this election does not make the husband the settlor-creator of the trust and subject it to unlimited creditors' claims. Contrary to petitioners' contention, Reply Br. 12, this case does not reflect on or detract from Katherine's situation as a joint settlor for purposes of inheritance tax. Katherine is a creator of the Mayo Trust because her interest (including the power of appointment) was "in exchange for the release of an independent legal obligation" -- the obligation to support.*/ She thus paid for her interest. See Davis, supra, 370 U.S. at 69. Utley involved

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*/ No distinction is perceived if the Trust was created to extinguish Katherine's dower rights rather than her support rights. See Bernatschke v. U. S., 364 F.2d 400 (Ct. Cls.).

a husband's option to give up a right which devolved on him by operation of law, for which he paid nothing, and which had nothing to do with the testamentary trust.

Accordingly, accepting arguendo petitioners' thesis that a power of appointment is not "general" unless subject to creditors' rights, Katherine's power qualifies as such. Restatement of the Law of Trusts (Second), Section 3, Section 156 and illustrations "c" and "f" thereto.

3. Petitioners and the District use several of the same authorities to reach opposite results. In Johnson v. Shriver, Colorado Dist. Ct. Op. of April 25, 1949, affd. 121 Colo. 397, 216 P.2d 653, the beneficiary of a spendthrift trust also had a "power of appointment virtually identical to Katherine Mayo's." (Pet. Br. 21, Resp. Br. 9.) The trust had been set up by the beneficiary-decedent's children, without consideration. Held: the trust property was not subject to creditors' rights. On the other hand, the Colorado Supreme Court specifically found that the power was a general power and not "restricted to passing the property on to certain specified individuals or to a specific class of individuals." For present purposes, the label applied by the Colorado courts to the power is more important than the fact that the result was unfavorable to creditors: we are not here concerned with creditors.

In Lane v. District of Columbia, 86 U.S. App. D.C. 337, 182 F.2d 105, the donee had the power to appoint to such person or persons as she "may by her will direct," but had no power "to pledge, encumber, sell or otherwise dispose of any part of the principal of the trust estate." Petitioners argued that the power to appoint "could not be exercised in favor of donee's estate or creditors and, therefore, was not a general power."

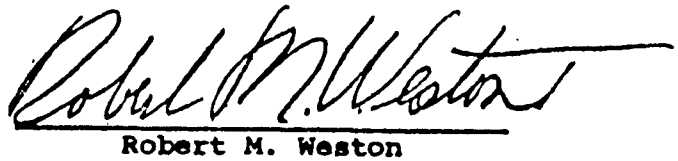
Held: the decision of the D. C. Board of Tax Appeals (now the Tax Court) upholding the assessment of inheritance tax is affirmed.

> * * * During her lifetime the beneficiary received the income from the trust without restriction upon its use; but the principal was held in trust, and so she could not encumber or dispose of it even if there had been no restrictive provisions to that effect in the contract. By her will she could dispose of the principal "to such person or persons" as she might direct. Petitioners say that the expression "person or persons" is not broad enough to include creditors or donee's estate. We think it is.

The restrictions on alienation in Lane are not as broad as those in paragraph 12 of the Mayo Trust. They are broad enough so that, had the Court desired to construe D. C. Code section 47-1601(j) restrictively, a conclusion could have been reached that the Lane power was not "general" within the meaning of our inheritance tax laws. The conclusion was to the contrary.

The case at bar has been elaborately and conscientiously briefed by both sides. The points and authorities so adduced have been fully considered, but need not be detailed here. Katherine Mayo, having had and having exercised by her Will a general power of appointment under paragraph 4 of the Mayo Trust,

Decision will be entered for respondent.



Robert M. Weston
Judge