1 T.C. 791 (1943)

When a grantor retains significant control over an inter vivos trust, including the power to change beneficiaries and withdraw principal, the trust is considered revocable for tax purposes, and the basis of assets received from the trust after the grantor's death is the fair market value at the time of the grantor's death.

Summary

The petitioner received securities from a trust established by her father, who retained the right to change beneficiaries and withdraw principal. The Tax Court addressed whether the basis for determining gain or loss on the sale of these securities should be their cost to the trust or their fair market value at the time of the grantor's death. The court held that because the grantor retained significant control, the trust was effectively revocable. Therefore, the basis of the securities was their fair market value at the time of the grantor's death, aligning with the treatment of testamentary transfers.

Facts

Thomas Allen Hilles (the grantor) established an inter vivos trust in 1924, naming the Wilmington Trust Co. as trustee. The grantor retained the right to change beneficiaries, substitute new beneficiaries, and withdraw up to $50,000 from the principal. The trust income was payable to the grantor, and if the trust terminated before his death, the principal was to be distributed to him. Upon the grantor's death, the principal was to be distributed to named beneficiaries. The grantor extended the trust term several times, declaring it irrevocable during each extension. Prior to his death, the grantor amended the trust to provide a specific distribution to the petitioner. The grantor died in 1935, and the trustee distributed securities to the petitioner as part of her share of the trust residue. The petitioner then sold these securities in 1937.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the petitioner's income tax liability for 1937, arguing that the basis for determining gain or loss on the sale of the securities was the fair market value on the date of the grantor's death. The petitioner contested this determination, arguing that the basis should be the cost of the securities to the trust. The case was brought before the United States Tax Court.

Issue(s)

1. Whether the grantor retained a power to revoke the trust at all times prior to his death within the meaning of Section 113(a)(5) of the Revenue Act of 1936.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. Yes, because the grantor retained such significant control over the trust, including the power to change beneficiaries and withdraw principal, that the trust was effectively revocable for tax purposes.

Court’s Reasoning

The court reasoned that Section 113(a)(5) of the Revenue Act of 1936 applies when a grantor retains the right to revoke a trust at all times prior to death. The court emphasized that the grantor’s power to change beneficiaries, including the ability to name himself or his estate, coupled with the power to withdraw principal, gave him substantial control over the trust property. The court stated, “There is nothing to indicate that the term ‘right * * * to revoke’ was used in any technical sense…” The court further noted, “Here the grantor never gave up completely the power to draw the property back to himself… There was nothing to prevent the exercise of that power in favor of his estate or his legal representatives in the event of the termination of the trust by reason of his death. The existence of that right gave to the grantor such power over the trust property that it must be treated, for all practical purposes, as belonging to him and not to the beneficiary.” The court also drew an analogy to cases under Section 166, where income from a trust is taxable to the grantor if they retain the power to revest title to the corpus, highlighting that the power to change beneficial interest, which does not prevent a change in favor of the grantor, is sufficient.

Practical Implications

This case clarifies the circumstances under which an inter vivos trust will be treated as revocable for tax purposes, particularly concerning the determination of basis for assets distributed from the trust after the grantor’s death. The key takeaway is that the grantor’s retained powers, not just the explicit right to revoke, are critical. If the grantor maintains significant control, allowing them to effectively reclaim the trust assets or direct them to their estate, the trust will be deemed revocable. This ruling informs how estate planners structure trusts to achieve specific tax outcomes, especially when considering the basis of assets for beneficiaries. Later cases applying this ruling would likely focus on the extent of control retained by the grantor and whether that control effectively equates to a power of revocation.

© 2025 SCOTUSreports.com. All rights reserved.