1 T.C. 963 (1943)

When a trust violates the Rule Against Perpetuities under applicable state law (here, Pennsylvania), the value of the trust property, less the value of any valid life estate, is includible in the decedent's gross estate for federal estate tax purposes.

Summary

The Tax Court held that the remainder interest of a trust created by the decedent was includible in her gross estate because it violated Pennsylvania's Rule Against Perpetuities. The trust provided income to the decedent's daughter for life, then to the daughter's surviving children, and eventually distribution of the corpus to grandchildren at age 25. The court reasoned that because the trust could potentially vest beyond a life in being plus 21 years, it violated the Rule Against Perpetuities. Consequently, the value of the trust, minus the daughter's life estate, was included in the decedent's taxable estate.

Facts

Abby R. Smith (decedent) created an irrevocable trust in 1919, later amended, conveying stocks and bonds. The trust directed income to be paid to her daughter, Elizabeth Richmond Fisk, for life. Upon Elizabeth's death, income was to be paid to her surviving children, and if any child predeceased Elizabeth, their share was to go to their issue. After Elizabeth's death, the trust corpus was to be distributed to Elizabeth's children or their issue when they reached 25 years old, at the trustee's discretion. If Elizabeth died without children or grandchildren before the corpus was fully distributed, the trust fund would revert to the decedent's estate.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the estate tax. The Commissioner included the value of the trust property in the decedent's gross estate, less the value of Elizabeth Richmond Fisk's life estate. The executors of the estate, the petitioners, challenged this determination in the Tax Court.

Issue(s)

Whether the remainder value of the trust fund created by the decedent is includible in her gross estate for federal estate tax purposes, where the trust terms allegedly violate the Pennsylvania Rule Against Perpetuities.

Holding

Yes, because the terms of the trust instrument violated the Pennsylvania Rule Against Perpetuities, except for the life estate of the first income beneficiary (Elizabeth Richmond Fisk), making the remainder interest includible in the decedent's gross estate.

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Court’s Reasoning

The court applied Pennsylvania law to determine whether the trust violated the Rule Against Perpetuities, which requires interests to vest within a life or lives in being plus 21 years. The court determined that the trust provisions directing distribution to grandchildren at age 25 could potentially vest beyond the permissible period. The court emphasized that future interests must vest within the prescribed time, and the validity of the gift is tested by possible events, not actual events. Quoting , the court stated, “It is not sufficient that it may vest. It must vest within that time, or the gift is void, — void in its creation. Its validity is to be tested by possible, and not by actual, events. And if the gift is to a class, and it is void as to any of the class, it is void as to all.” Because the gift to the grandchildren was to a class and could be void as to some members, it was void as to all. As a result, the court held that the trust violated the Rule Against Perpetuities, and the remainder interest was includible in the decedent’s gross estate under Section 302(a) of the Revenue Act of 1926.

Practical Implications

This case underscores the importance of carefully drafting trusts to comply with the Rule Against Perpetuities in the relevant jurisdiction. It clarifies that if a trust violates the Rule, the assets, excluding any valid life estates, may be included in the grantor’s taxable estate, leading to unexpected estate tax liabilities. This ruling highlights that the *potential* for a violation is sufficient to trigger the Rule; actual events are irrelevant. Estate planners must consider all possible scenarios when drafting trust provisions to ensure compliance with the Rule and avoid unintended tax consequences. Later cases will cite this case to illustrate that any violation, no matter how remote the possibility, is enough to trigger a violation of the RAP. Also, the ruling applies only to the portion that violates RAP; any legal parts, such as the life estate here, are not affected.

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