2 T.C. 967 (1943)

An estate tax return filed late precludes the estate from using the optional valuation date, and the grantor's retained power to direct trust investments, without the power to revoke or amend, does not automatically include the trust corpus in the grantor's gross estate.

Summary

The executrix of Henry S. Downe's estate petitioned the Tax Court, contesting the Commissioner's determination of a deficiency in estate tax. The Commissioner valued the estate as of the date of death because the estate tax return was filed late. The Commissioner also included the corpora of two trusts, one created by the decedent and the other by his wife, in the gross estate. The Tax Court held that the late filing precluded the estate from using the optional valuation date. However, the court found that neither trust should be included in the decedent's gross estate because the decedent's retained powers were insufficient to warrant inclusion.

Facts

Henry S. Downe died on December 8, 1938. His estate tax return was mailed on Friday, March 8, 1940, and received on March 9, 1940. On January 14, 1930, Downe created a trust with his wife as the primary income beneficiary. Upon her death, Downe, if living, would be the beneficiary. The trust instrument allowed Downe to direct the trustee regarding voting proxies and investment decisions. Downe's wife also created a similar trust on the same day, with Downe as the initial beneficiary. The Commissioner sought to include both trusts in Downe's gross estate.

Procedural History

The Commissioner determined a deficiency in Henry S. Downe's estate tax. The executrix, Ethel Lestrade Downe, petitioned the Tax Court for a redetermination of the deficiency. The case was submitted to the Tax Court based on pleadings, testimony, and stipulated facts.

Issue(s)

1. Whether the Commissioner erred in valuing the estate as of the date of the decedent's death.
2. Whether the Commissioner erred in including the corpora of the two trusts in the gross estate of the decedent.

Holding

1. No, because the estate tax return was filed late, and the estate did not prove the late filing was due to reasonable cause.
2. No, because the decedent's retained powers over the trusts were insufficient to

warrant inclusion under Section 302(c) or (d) of the Revenue Act of 1926, as amended.

Court's Reasoning

The court reasoned that Section 302(j) of the Revenue Act of 1926, as added by Section 202(a) of the Revenue Act of 1935, allows an estate to elect an optional valuation date one year after death only if the return is filed timely. Since the return was due on March 8, 1940, and was received on March 9, 1940, it was filed late. The court emphasized that it lacked information about the mailing time or any reasonable cause for the late filing. Regarding the trusts, the court found that the possibility of reverter was too remote to justify inclusion under Section 302(c). The court also determined that Downe's power to direct investments was not equivalent to a power to alter, amend, or revoke the trust under Section 302(d)(1). The court distinguished this case from *Commonwealth Trust Co. of Pittsburgh v. Driscoll*, where the grantor had the unrestricted right to substitute securities. Finally, the court rejected the argument that the reciprocal trust doctrine required inclusion, reasoning that even if Downe were treated as the grantor of his wife's trust, his interest as an income beneficiary was not enough to warrant inclusion under the principles established in *Helvering v. Clifford*.

Practical Implications

This case highlights the importance of timely filing estate tax returns to preserve the option of using the alternate valuation date. It also clarifies that a grantor's retained power to direct trust investments does not automatically trigger inclusion of the trust corpus in the grantor's gross estate, especially if the grantor lacks the power to revoke or amend the trust. This decision provides guidance on the scope of Section 302(d)(1) and emphasizes the need to analyze the specific powers retained by the grantor. Later cases have cited *Downe* for its analysis of grantor-retained powers and its distinction between the power to direct investments and the power to substitute assets freely, which could amount to a power to revoke.

