Estate of German v. Commissioner, 7 T.C. 951 (1946)

When a settlor creates a trust and grants the trustee sole discretion to distribute the trust corpus to the settlor during their lifetime, the trust assets are not included in the settlor's gross estate for federal estate tax purposes under Section 811(c) or 811(d)(2) of the Internal Revenue Code.

Summary

The Estate of German case addresses whether trust assets should be included in the decedent's gross estate for federal estate tax purposes. The settlor created trusts giving the trustee absolute discretion to disburse the trust corpus to the settlor during their life. The Commissioner argued that these trusts were includable under sections 811(c) and 811(d)(2) of the Internal Revenue Code because the settlor's death determined when the remaindermen's interests took effect. The Tax Court disagreed, holding that because the settlor had no power to compel the trustee to return the trust property, the trust assets were not includable in the gross estate.

Facts

The decedent (settlor) established two trusts. The trust instruments granted the trustee the absolute discretion to distribute the trust's principal to the settlor during their lifetime. The remaindermen's interests were contingent on the trustee not disbursing the trust corpora to the settlor before the settlor's death. The settlor died, and the Commissioner sought to include the trust assets in the settlor's gross estate for estate tax purposes.

Procedural History

The Commissioner determined a deficiency in the decedent's estate tax return. The Estate petitioned the Tax Court for a redetermination of the deficiency. The Tax Court considered the arguments of both parties and rendered its decision.

Issue(s)

1. Whether the remainder interests in the two trusts are includable in the gross estate of the decedent settlor as transfers to take effect in possession at or after death under the doctrine of *Helvering v. Hallock* and section 811(c) of the Internal Revenue Code.

2. Whether the remainder interests are includable under section 811(d)(2) of the Internal Revenue Code.

Holding

1. No, because the settlor possessed no power to compel the trustee to disburse the trust corpus to them. The trustee's discretion was absolute and not controlled by the

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settlor.

2. No, because the decedent-settlor had no power under the trust instruments, either alone or in conjunction with any person, to alter, amend, or revoke the trusts.

Court's Reasoning

The court reasoned that section 811(d)(2) was inapplicable because the settlor retained no power to alter, amend, or revoke the trust. Regarding section 811(c) and the *Hallock* doctrine, the court acknowledged that the remaindermen's interests were contingent on the trustee's discretionary decision not to distribute the trust corpus to the settlor. However, this possibility existed because of the trustee's absolute discretionary power, not because of any power reserved to the settlor. The court distinguished this case from *Hallock*, where the grantor retained some control or reversionary interest. The court stated, "This possibility existed, however, not by reason of any power reserved to the decedent grantor, but because of an absolute and unlimited discretionary power lodged in the trustee, the exercise of which could in no way be controlled by the grantor. Under these circumstances we are of the opinion that the rule in the Hallock case does not apply." The court cited prior cases like *Herzong v. Commissioner* and *Estate of Payson Stone Douglass* to support its conclusion.

Practical Implications

This case clarifies that a settlor's transfer to a trust, where an independent trustee has complete discretion to distribute the corpus to the settlor, does not automatically result in the trust assets being included in the settlor's estate for federal estate tax purposes. The key factor is the settlor's lack of control over the trustee's decision. The *Estate of German* reinforces the importance of carefully drafting trust instruments to avoid unintended estate tax consequences. Legal practitioners must advise clients that granting trustees broad discretionary powers, without any retained control by the settlor, can prevent estate tax inclusion. Later cases distinguish *Estate of German* when the settlor retains some form of control or influence over the trustee's decisions, even if it is not a legally binding power.

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