## *Schwarzenbach v. Commissioner, 4 T.C. 179 (1944)*

A transfer of property to a trust is not a taxable gift if the grantor retains substantial control over the property, either through a power of revocation or through an understanding with the trustees that they will consent to revocation upon the grantor's request.

### Summary

The Tax Court held that the transfer of property to a trust with a power of revocation, subject to the consent of the trustees, was not a taxable gift. The court emphasized that the trustees had an understanding with the grantor to consent to revocation once the emergency that prompted the trust's creation had passed. This understanding, coupled with the grantor's continued control over the property, indicated a lack of donative intent, rendering the transfer incomplete for gift tax purposes. The court distinguished this case from situations where the grantor lacked a revocation power and the trustee's discretion was unfettered.

### Facts

The petitioner, facing potential property confiscation by the German government, established a trust for her benefit during her lifetime, with the remainder to her children. The trust instrument included a provision for revocation, but only with the unanimous consent of the three trustees, one of whom was also a beneficiary (a remainderman). The trustees were aware the trust was created to shield assets from confiscation and had a tacit agreement to allow revocation after the threat subsided. The petitioner subsequently made withdrawals from the trust.

### Procedural History

The Commissioner of Internal Revenue determined that the transfer to the trust constituted a taxable gift. The petitioner challenged this determination in the Tax Court.

### Issue(s)

Whether the transfer of property to a trust, with a power of revocation subject to the unanimous consent of the trustees (who had an understanding to consent to revocation upon the grantor's request), constituted a completed gift for gift tax purposes.

### Holding

No, because the grantor retained substantial control and dominion over the property due to the understanding with the trustees and the power of revocation, indicating a lack of intent to make a completed gift.

## Court's Reasoning

The court reasoned that the agreement among the grantor and the trustees effectively placed the power of revocation solely in the grantor's discretion, despite the formal requirement of trustee consent. The court emphasized that the grantor did not relinquish sufficient control over the property to constitute a taxable gift. The court found that the evidence clearly showed the grantor did not have the "clear and unmistakable intention * * * to absolutely and irrevocably divest * * * [herself] of the title, dominion and control of the subject matter of the gift, in praesenti * * *." The court viewed the trust arrangement as a "sham, a fetch, a disguise" intended to deceive the German government. The court distinguished this case from *Herzog v. Commissioner*, 116 F.2d 591, because in *Herzog*, the grantor had no power of revocation, and any benefit the grantor received was entirely at the trustee's discretion. The court emphasized that here, the grantor's power to withdraw principal and revoke the trust (with the trustees' agreement) created a different situation.

## Practical Implications

This case illustrates that the substance of a transaction, rather than its form, dictates its tax treatment. A trust that appears to be an irrevocable gift may still be considered incomplete for gift tax purposes if the grantor retains de facto control over the assets. Attorneys must carefully examine the grantor's intent, the trust provisions, and any side agreements when assessing the gift tax implications of trust transfers. Later cases may distinguish *Schwarzenbach* if the grantor's retained control is less explicit or if there is a genuine adverse interest held by the trustees. This case highlights the importance of clear documentation and arm's-length transactions in trust creation to avoid unintended tax consequences. It also underscores the principle that tax law looks to the practical realities of control and dominion, not merely the formal legal structures.

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