4 T.C. 191 (1944)

A gift tax is imposed when the donor's power to revoke a trust terminates, other than by the donor's death, resulting in a completed transfer of property.

Summary

Adele Goodman established two trusts in 1930, funding one with securities (Trust A) to pay premiums on life insurance policies on her husband's life held in the second trust (Trust B). She retained the right to revoke the trusts during her husband's lifetime and to withdraw a portion of Trust A after his death. When her husband died in 1939 without her revoking the trusts, the IRS assessed a gift tax on the value of the trust assets. The Tax Court held that the termination of the revocation power upon her husband's death constituted a taxable gift. The court also ruled that the value of Trust B for gift tax purposes was the insurance policy proceeds.

Facts

In 1930, Adele Goodman created Trust A with securities, the income from which was designated to pay premiums on five life insurance policies she owned on her husband's life, which comprised Trust B. She reserved the right to revoke the trusts during her husband's lifetime. After her husband's death, she could withdraw up to 50% of Trust A's assets. Upon her husband's death in March 1939, the life insurance policies became payable to the beneficiaries designated in the trust.

Procedural History

The IRS assessed a gift tax deficiency against Adele Goodman for 1939, arguing that the termination of her power to revoke the trusts upon her husband's death constituted a taxable gift. Goodman petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether the termination of a donor's power to revoke a trust, due to the death of a third party, constitutes a taxable gift under the 1932 Revenue Act.

2. Whether the value of a life insurance trust (Trust B) for gift tax purposes is the amount of the proceeds payable upon the death of the insured.

Holding

1. Yes, because the termination of the power to revoke constituted a completed transfer of property and thus a taxable gift.

2. Yes, because the amount payable under the life insurance policies is the value of the property that becomes absolute in the donees.

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Court’s Reasoning

The court reasoned that the gift tax supplements the estate tax, preventing avoidance of death taxes through inter vivos gifts. The court emphasized that if the termination of a revocable trust upon a contingency *wasn’t* considered a gift, a person could create a revocable trust, dependent upon some unpredictable event, and avoid both gift and estate taxes. The court cited Burnet v. Guggenheim which established that the relinquishment of a power to revoke a trust constitutes a taxable gift, even if the trust was created before the gift tax law was in effect. Since the gift tax and estate tax are in pari materia, the court applied the estate tax valuation rule to the gift tax context, holding that the value of the life insurance policies is their proceeds.

Practical Implications

This case clarifies that gift tax liability can arise not only from intentional acts of relinquishment but also from the termination of a power to revoke a trust due to external events, such as the death of a third party. Attorneys should advise clients creating revocable trusts with contingencies that the termination of those powers can trigger gift tax consequences. The decision highlights the importance of considering gift and estate tax implications together, as the gift tax aims to prevent avoidance of estate taxes. The case supports the IRS’s valuation of life insurance policies at their proceeds for gift tax purposes when transferred via trust upon the insured’s death, reinforcing consistent valuation principles between gift and estate taxation.

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