4 T.C. 987 (1945)

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The value of trust assets is includible in a decedent's gross estate under Section 811(d)(2) of the Internal Revenue Code if the decedent, as trustee, retained the power to alter, amend, or revoke the trust, materially affecting the beneficiaries' enjoyment of the property, but only to the extent of the interest that is subject to the power.

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Summary

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The Tax Court addressed whether the corpus of two trusts created by the decedent should be included in his gross estate for estate tax purposes. The decedent served as a co-trustee and the trust instruments granted the trustees discretion to invade the trust principal for the benefit of the life beneficiary. The court held that the decedent's power, as trustee, to invade the corpus constituted a power to alter, amend, or revoke the trust under Section 811(d)(2) of the Internal Revenue Code. However, the court limited the inclusion to the remainder interest following the life estate, as the decedent's power to alter only extended to that portion.

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Facts

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Albert E. Nettleton (decedent) created two irrevocable trusts in 1932 and 1935, naming himself, his daughter Alice N. Edwards, and the Syracuse Trust Co. as trustees. The trust income was payable to Alice N. Edwards for life, and upon her death, the corpus was to be divided among her living children and the descendants of any deceased children. The trustees had the power to use such part of the principal of the trust estate held for any beneficiary as they may consider suitable and necessary in the interest and for the welfare of such beneficiary. The decedent was a trustee of each trust at the time of his death in 1939.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in the decedent's estate tax, including the corpora of the two trusts in the gross estate. The Syracuse Trust Co., as executor of the estate, filed an estate tax return but did not include the trust assets. The Tax Court reviewed the Commissioner's determination.

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Issue(s)

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1. Whether the decedent's power, as co-trustee, to invade the corpus of the trusts for the benefit of the life beneficiary constituted a power to alter, amend, or revoke the trusts, causing the trust assets to be includible in his gross estate under Section 811(d)(2) of the Internal Revenue Code.

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2. If so, whether the entire corpus or only the remainder interest following the life estate should be included in the gross estate.

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Holding

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1. Yes, because the power granted to the trustees to invade the corpus for the benefit of the life beneficiary was effectively a power to alter or amend the trust, as it allowed the decedent to shift beneficial interests.

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2. Only the remainder interests are includible, because the decedent's power to alter extended only to the remainder interests following the irrevocably vested life estate.

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Court's Reasoning

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The court reasoned that the power to "alter, amend, or revoke" under Section 811(d)(2) encompasses any power that allows the grantor to materially vary the enjoyment of property interests transferred in trust. The court cited numerous cases establishing this principle, noting that "the reservation of the power to shift the interests of the beneficiaries is an attribute to ownership of property, and is substantially equivalent to any power of a decedent to dispose of property which renders the property subject to estate tax." The court rejected the petitioner's argument that the decedent's express surrender of the power to alter, amend, or revoke the trust in his individual capacity as grantor negated his power as trustee. The court clarified the trustee role was separate. The court also dismissed the argument that the power to invade corpus was contingent, finding the condition for invasion ("suitable and necessary in the interests and for the welfare" of the beneficiary) was too broad to be considered a true condition precedent.

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However, the court emphasized that only the portion of the trust corpus over which the grantor retained the power of change and alteration is includible in his estate. Since the life estate was irrevocably vested in Alice N. Edwards, and the decedent retained no power to decrease her interest, only the remainder interests following her life estate were includible.

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Practical Implications

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This case highlights the importance of carefully drafting trust instruments to avoid unintended estate tax consequences. Grantors who serve as trustees and retain powers that could be construed as altering, amending, or revoking the trust may cause the trust assets to be included in their gross estate. The case also illustrates that even a seemingly broad standard for invading trust principal may not be considered a contingent power. Estate planners must consider the scope of powers granted to trustees and the potential tax implications. This case is frequently cited in disputes regarding the scope of retained powers in trust agreements and the application of Section 2036 and 2038 of the Internal Revenue Code, which are the modern counterparts to Section 811(d)(2). Later cases distinguish this ruling by focusing on the specific language defining the trustee's discretionary powers and whether those powers are truly limited by ascertainable standards. The degree of control retained by the grantor-trustee is a key factor in determining includibility.

