Estate of Eckhardt v. Commissioner, 5 T.C. 673 (1945)

The reciprocal trust doctrine holds that trusts are treated as if each grantor created the trust nominally created by the other, particularly when trusts are interrelated and create similar benefits; however, the inclusion of trust property in a gross estate does not occur when a decedent's death does not enlarge or affect the beneficiary's interest, even if a remote possibility of reverter existed.

Summary

The Tax Court addressed whether trusts established by a husband and wife were reciprocal, thus requiring the inclusion of the trust corpus in their respective estates, and whether a remote reversionary interest caused inclusion of a separate trust in the gross estate. The court held that the trusts were reciprocal due to the interconnected financial history and simultaneous creation of the trusts, effectively treating each spouse as the grantor of the other's trust. However, the court found that a separate trust with a remote possibility of reversion to the grantor did not require inclusion in the gross estate because the grantor's death did not enlarge the beneficiary's interest.

Facts

John and Kate Eckhardt, husband and wife, executed trusts in July 1935. John created a trust (the "John Trust") with Kate as a trustee, and Kate created a trust (the "Kate Trust") shortly thereafter. The subject matter of both trusts was jointly owned real estate. The trusts provided successive life estates for the spouse and daughter, Alice Becker, with the principal going to Alice's appointees upon her death. The Eckhardts had a history of joint financial management. Kate also created a separate trust in April 1935 for her grandson, Dean Becker (the "Dean Trust"), with income to Dean and distribution of principal in installments, with a remote possibility of reversion to Kate if Dean and his issue and Dean's mother predeceased her.

Procedural History

The Commissioner of Internal Revenue determined that the John Trust and Kate Trust were reciprocal and included the corpus of each trust in the respective decedent's estate. The Commissioner also included the value of the Dean Trust in Kate's estate, arguing it was a transfer intended to take effect at death. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether the trusts executed by John and Kate Eckhardt were created independently of each other, or whether they were reciprocal and made in consideration of each other.

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2. Whether the value of a reversionary interest in the trust created by Kate L. Eckhardt for the benefit of her grandson, Dean Becker, is includible in her gross estate as a transfer intended to take effect in possession or enjoyment at or after her death.

Holding

1. No, the trusts were not created independently. Because the trusts were executed under circumstances that justify the determination that they were reciprocal and executed in consideration of one another, the court considered each decedent to be the real settlor of the trust nominally created by the other. Since each decedent retained a life estate in the trust created by him or her, the value of the corpus of such trust is includible in his or her gross estate under section 811 (c) of the Internal Revenue Code.

2. No, the value of the reversionary interest in the Dean Becker trust is not includible in Kate's gross estate. Because the decedent's death could not enlarge his estate or affect his interests, the court held that the trust was not intended to take effect at her death.

Court's Reasoning

Regarding the reciprocal trusts, the court emphasized the decedents' intimate financial history, the near-simultaneous creation of the trusts, and the similarity of their terms. The court inferred a tacit agreement between the spouses, stating, "From the evidence, we are satisfied that these trusts were executed under such circumstances as would justify the respondent in determining that they were reciprocal and executed in consideration of one another." This inference overcame the petitioners' argument that the trusts were created independently. The court distinguished Estate of Samuel S. Lindsay, 2 T.C. 174 (where trusts were deemed independent) by emphasizing the interconnectedness of the Eckhardt's financial affairs.
Regarding the Dean Trust, the court relied on Frances Biddle Trust, 3 T.C. 832, holding that the decedent's death did not enlarge or augment the estate of the remainderman. The court reasoned that the decedent intended to make a complete gift, with principal payable to Dean in installments, and her death would not alter those interests. The court distinguished Fidelity-Philadelphia Trust Co. v. Rothensies, 324 U.S. 108, and Helvering v. Hallock, 309 U.S. 106, where the settlors retained control, making their deaths determinative factors in which beneficiaries would take.

Practical Implications

This case reinforces the importance of scrutinizing trusts created by related parties, especially spouses, for reciprocal arrangements. Attorneys drafting trusts for related parties should carefully document the independent motivations and lack of

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coordination to avoid the application of the reciprocal trust doctrine. Tax planners must consider the potential estate tax consequences when grantors retain any interest, however remote, in trust property, while simultaneously understanding that a remote reversionary interest, without additional control, may not cause inclusion in the grantor's estate if the grantor's death does not alter the beneficiary's interest. Later cases have cited Eckhardt to either support or distinguish the finding of reciprocal trusts based on the specific facts and circumstances surrounding their creation. Practitioners should be aware that the unified credit and other changes in estate tax law since 1945 may alter the impact of these types of arrangements but the underlying principles remain relevant.

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