5 T.C. 991 (1945)

A beneficiary’s vested interest in trust income, even if undistributed at the time of death, is includible in their gross estate for federal estate tax purposes, unless effectively disclaimed or waived.

Summary

The Tax Court addressed whether undistributed income from a testamentary trust should be included in Emma Earle’s gross estate. George Earle’s will directed income from a trust be distributed to his wife, Emma, and their two sons. The trustees accumulated a significant portion of the income. The court held that Emma Earle had a vested interest in one-third of the trust income, and her statements declining further distributions did not constitute a valid waiver. Therefore, her share of the undistributed income was included in her gross estate. The court also clarified that income during executorial administration is included, but capital gains/losses are not considered when computing undistributed income.

Facts

George W. Earle died in 1923, leaving his estate in trust, with income to be distributed as the trustees deemed best: one-third to his wife, Emma Earle, and one-third to each of his sons, G. Harold and Stewart Earle. The trust was to terminate upon Emma’s death, with the corpus divided between the sons. The trustees accumulated a large portion of the income. After 1935, when asked if she wanted more distributions, Emma Earle stated she did not want any more money from the trust, but never filed a written waiver.

Procedural History

The Commissioner of Internal Revenue determined that a portion of the undistributed income of the George W. Earle trust was includible in Emma Earle’s gross estate and disallowed a deduction for notes paid to her grandchildren. The Tax Court consolidated proceedings involving estate tax deficiencies and fiduciary/transferee liability.

Issue(s)

1. Whether any of the undistributed income of the George W. Earle testamentary trust is includible in the gross estate of Emma Earle?

2. What is the correct amount of the undistributed income of the trust?

3. Whether the estate is entitled to a deduction for notes given by the decedent to her grandchildren without consideration?

Holding

1. Yes, because Emma Earle had a vested right to one-third of the trust income, and her statements declining distributions did not constitute a valid waiver or disclaimer.

2. The correct amount includes income accruing during the period of executorial administration but excludes capital gains and losses.

3. No, because the notes were given without adequate consideration in money or money's worth, as required by section 812 (b) (3) of the Internal Revenue Code.

Court's Reasoning

The court reasoned that the will language directed the distribution of all income, not merely such amounts as the trustees deemed best. The court stated that "the testator did not say that so much of the income as the trustees deemed best should be distributed. He stated that 'the income' should be distributed." The provision allowing the trustees discretion pertained to the timing and amounts of distribution, not whether all income should be distributed. Emma Earle's statements declining distributions did not constitute a valid waiver or disclaimer because she had already accepted benefits under the trust. Michigan law requires conveyances of trust interests to be in writing. The court included income from the period of estate administration because intent was to provide for her from the date of her husband's death. The court excluded capital gains and losses because these typically affect the principal, not the distributable income, absent specific provisions in the trust document.

Regarding the notes to grandchildren, the court emphasized that section 812 (b) (3) limits deductions for claims against the estate to those contracted in good faith and for adequate consideration. Since the notes were gifts, they lacked the required consideration.

Practical Implications

This case clarifies that a beneficiary's right to income from a trust is a valuable property interest includible in their estate, even if not physically received before death. Tax planners should counsel clients on the importance of formal disclaimers or waivers of trust interests if they intend to forego those benefits. This case illustrates the importance of carefully drafting trust documents to specify the trustees' discretion regarding income distribution and the treatment of capital gains and losses. It also reinforces the requirement of adequate consideration for estate tax deductions related to claims against the estate; gratuitous promises will not suffice, regardless of state law allowing such claims.

