5 T.C. 1079 (1945)

A transfer of property to a trust is not a taxable gift if the grantor retains the power to revest title to the trust property in themselves, as per Section 501(c) of the Revenue Act of 1932.

Summary

Elizabeth Hettler transferred property in trust to her son, Sangston, as trustee and life beneficiary. As part of the same transaction, Sangston agreed to pay Elizabeth $25,000 annually, which both knew he could not afford. Both the trust deed and an annuity contract stipulated that Elizabeth could reacquire the trust property upon Sangston's expected default. The Tax Court held that Elizabeth retained the power to revest title to the trust property in herself, rendering the transfer incomplete for gift tax purposes under Section 501(c) of the Revenue Act of 1932. The court emphasized the pre-arranged plan for default and reconveyance.

Facts

Elizabeth Hettler, an elderly woman, transferred all of her property into a trust on January 4, 1934, naming her son, Sangston, as trustee and life beneficiary. The trust instrument stated it was irrevocable. Contemporaneously, Elizabeth and Sangston entered into a contract where Sangston would pay Elizabeth $25,000 annually. Both parties were aware that the trust income (approximately $8,000 annually) and Sangston's other income were insufficient to meet this obligation. The trust deed and the annuity contract both allowed Elizabeth to reacquire the trust property if Sangston defaulted on the annuity payments. They intended for Sangston to pay Elizabeth only the income from the trust, and anticipated a swift default, triggering Elizabeth's right to reclaim the property. The payments were in default from the start.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Elizabeth's gift tax for 1934. Elizabeth contested the deficiency, arguing she hadn't made a taxable gift because she retained the power to revest title to the trust property. The Tax Court heard the case to determine if the transfer in trust was a completed gift for tax purposes.

Issue(s)

Whether the transfer of property in trust constituted a completed gift for gift tax purposes under Section 501(c) of the Revenue Act of 1932, when the grantor simultaneously retained the power to revest title to the property in herself due to a pre-arranged default on an annuity agreement.

Holding

No, because Elizabeth retained the power to revest title to the trust property in herself by prearrangement, the transfer was not a completed gift under Section 501(c) of the Revenue Act of 1932.

Court's Reasoning

The Tax Court focused on the pre-arranged plan between Elizabeth and Sangston. They deliberately structured the transaction to ensure Sangston's default on the annuity payments, which would then trigger Elizabeth's right to reclaim the trust property. The court noted, "They anticipated and intended that there would be an immediate default under the annuity contract, which would immediately give the petitioner the right to revest title in the trust property in herself." Because Elizabeth retained the power to revest title, Section 501(c) of the Revenue Act of 1932 applied, stating the gift tax does not apply when such a power is retained. The court emphasized that the transfer was not intended to be irrevocable, and the annuity was a sham. The court stated, "The power to revest in the donor title to the property transferred in trust was vested in the donor immediately after the transfer. Section 501 (c) provides that under such circumstances the tax shall not apply…"

Practical Implications

The Hettler case clarifies that a transfer to a trust is not a completed gift if the grantor retains control over the property by possessing the power to reclaim it. This case serves as a warning against using sham transactions to avoid gift tax. Taxpayers cannot use artificial means to create the appearance of a gift while retaining effective control. Later cases distinguish Hettler by emphasizing that the power to revest must be genuine and not based on a pre-arranged scheme or sham. The case highlights the importance of examining the substance of a transaction rather than its form when determining tax consequences. This principle is applicable beyond gift tax, informing the analysis of various tax-related transactions where control and beneficial ownership are key considerations.

