7 T.C. 219 (1946)

For gift tax purposes, a beneficiary's interest in a trust, even if contingent, can be considered a "substantial adverse interest" if it represents a real and significant economic stake in the trust, thereby rendering the gift complete upon creation of the trust.

Summary

Leon Gillette created two trusts in 1929, one for his son and one for his daughter, each revocable with the consent of either his wife or son. Distributions were made to the son in 1936 and 1941. In 1941, Gillette relinquished his power to revoke the daughter's trust. The Commissioner argued that the distributions to the son and the relinquishment of the power to revoke the daughter's trust were taxable gifts in those years because Gillette's power to revoke the trusts initially made the gifts incomplete. The Tax Court held that the wife's and son's interests were substantial and adverse, making the original gifts complete in 1929, and thus the later distributions and relinquishment were not taxable gifts.

Facts

Leon Gillette created two trusts on December 6, 1929: the first for his son, William, and the second for his daughter, Jeanne. The first trust paid income to William until he reached 30, then distributed half the corpus; the remainder was distributed when he reached 35. If William died before termination, the remainder went to Leon, then Bessie (Leon's wife), then as William appointed in his will, or to William's issue, or to Jeanne. Leon retained the right to revoke the first trust with the written consent of either Bessie or William. The second trust paid income to Jeanne for life, with the remainder to Leon, then Bessie, then Jeanne's issue, then William. Leon retained the right to revoke this trust with the written consent of either Bessie or William. On June 21, 1941, Leon, Bessie, and William renounced their rights of revocation under the second trust. Distributions were made to William in 1936 and 1941 from the first trust.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Gillette's gift tax for 1936 and 1941, arguing that the distributions to the son and the relinquishment of the power to revoke the daughter's trust were taxable gifts. Gillette petitioned the Tax Court for a redetermination. Leon Gillette died, and his executors were substituted as petitioners. The Tax Court ruled in favor of the petitioners.

Issue(s)

1. Whether distributions to the decedent's son in 1936 and 1941, pursuant to the terms of a trust created by the decedent, constitute taxable gifts in those years.

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2. Whether the relinquishment by the decedent in 1941 of the power to revoke a second trust created by him for the benefit of his daughter constituted a taxable gift to her in 1941.

Holding

1. No, because the gifts to the trust were complete in 1929 when the trust was created as the wife and son held substantial adverse interests, meaning that the distributions in later years did not constitute new gifts.

2. No, because the gift to the trust was complete in 1929 when it was created, as the wife and son held substantial adverse interests, and therefore the relinquishment of power did not constitute a new gift in 1941.

Court's Reasoning

The Tax Court reasoned that the critical question was whether Gillette's right of revocation was limited by the required concurrence of a person possessing a substantial adverse interest. Citing *Burnet v. Guggenheim, 288 U.S. 280*, the court acknowledged that a gift is incomplete if the donor retains the power to revest the beneficial title in himself. The Commissioner argued that because Leon could revoke the trusts with the consent of his wife or son, and because their interests were contingent, they were not substantial and adverse. The court disagreed, stating, "Neither the family relationship to decedent of his wife and son nor the remoteness of their contingent remainders suffice to persuade us that their respective interests in the trusts fail to be both substantial and adverse." The court found the situation analogous to *Meyer Katz, 46 B.T.A. 187*, where a wife's contingent interest was held to be a substantial adverse interest. Even though the wife's and son's interests were contingent on surviving certain beneficiaries, the court found the trusts were substantial in amount. The Tax Court concluded that because the wife and son held substantial adverse interests, the initial gifts to the trusts were complete in 1929, and the subsequent distributions and relinquishment of the revocation power did not constitute taxable gifts.

Practical Implications

The *Gillette* case clarifies the definition of "substantial adverse interest" in gift tax law. It demonstrates that even contingent interests can be considered substantial if they represent a real economic stake for the beneficiary. This ruling is crucial for estate planning attorneys when drafting trust agreements. The case highlights the importance of carefully assessing the nature and extent of beneficiaries' interests when determining whether a gift is complete for tax purposes. *Gillette* illustrates that family relationships alone do not negate the possibility of adverse interests. Later cases have cited *Gillette* to support the argument that a beneficiary's power, even if seemingly limited, can be sufficient to establish an adverse interest and thus complete a gift for tax purposes. Practitioners should analyze the specific facts of

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each case to determine if a beneficiary’s interest is truly adverse to the grantor’s power.

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