7 T.C. 756 (1946)

A grantor's retained power, as trustee, to distribute or accumulate trust income constitutes a right to designate who enjoys the property or income, causing inclusion of the trust assets in the grantor's gross estate for estate tax purposes if the transfer occurred after March 3, 1931.

Summary

The Tax Court addressed whether the value of certain trusts created by the decedent should be included in his gross estate under Section 811(c) or (d) of the Internal Revenue Code. The decedent created trusts in 1929 and 1937, retaining the power to distribute or accumulate income as trustee. The court held that the power to invade corpus for emergencies did not constitute a power to alter, amend, or revoke the trust. However, the retained power to distribute or accumulate income was deemed a right to designate who enjoys the property, requiring the inclusion of the post-March 3, 1931 transfers in the gross estate. Pre-March 3, 1931 transfers were excluded based on the prospective application of relevant amendments.

Facts

Milton J. Budlong created five trusts on July 1, 1929, one each for his daughter, two sons, and sister. Budlong served as the sole trustee of these trusts until his death in 1941. The trust instrument allowed the trustee to distribute or accumulate income at his discretion, with a minimum annual payment of $2,500 for his sister. The trustee also had the power to expend trust principal for beneficiaries in cases of sickness or other emergencies. The trusts were irrevocable with remainders to grandchildren. In 1937, Budlong created three additional trusts for his children, retaining the power to distribute or accumulate income, but without the power to invade the corpus for emergencies. Property was transferred to these trusts both before and after March 3, 1931.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the decedent's estate tax. The Commissioner included the value of all the trusts in the decedent's gross estate. The executor petitioned the Tax Court for review of this determination. The Commissioner later conceded a portion of the initial determination related to a different trust.

Issue(s)

1. Whether the decedent's power to invade the corpus of the 1929 trusts in case of sickness or other emergency constitutes a power to alter, amend, or revoke the trust within the meaning of Section 811(d)(2) of the Internal Revenue Code.
2. Whether the decedent's retained power to distribute or accumulate income in

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both the 1929 and 1937 trusts constitutes a right to designate the persons who shall possess or enjoy the property or the income therefrom within the meaning of Section 811(c) of the Internal Revenue Code.

Holding

1. No, because the power to invade corpus was limited by an ascertainable standard (sickness or other emergency) and did not provide the grantor with absolute control over the corpus.
2. Yes, because the decedent's power to distribute or accumulate income allowed him to shift economic benefits and enjoyment between the beneficiaries and remaindermen.

Court's Reasoning

Regarding the power to invade corpus, the court reasoned that the power was conditional and limited by a definite standard, namely, the sickness or emergency of the beneficiaries. The court stated, "*It is obvious that the power in question gave the trustee no absolute and arbitrary control over the corpus. On the contrary, it was conditional and limited. A definite standard — the sickness or other emergency of the respective beneficiaries — was provided to govern its exercise.*" The court further noted that the exercise of this power could not benefit the decedent.

Regarding the power to distribute or accumulate income, the court reasoned that the decedent's retained control allowed him to shift economic benefits between the income beneficiaries and the remaindermen. The court held that this power to designate who enjoys the income brings the transfers within the ambit of Section 811(c), requiring inclusion in the gross estate. The court stated that as a practical matter, the decedent could give all the income to the primary beneficiaries or take it away and give it to remaindermen, persons other than income beneficiaries, thereby retaining "*a right to shift economic benefits and enjoyment from one person to another.*" Since the decedent retained this right until death, the transfers after March 3, 1931, were includible. The court distinguished transfers made before March 3, 1931, based on the Supreme Court precedent in *Hassett v. Welch*, holding that the amendments to the code regarding retained rights had prospective application only.

Practical Implications

This case highlights the importance of carefully drafting trust instruments to avoid the grantor retaining powers that could cause inclusion of the trust assets in their gross estate. Specifically, it illustrates that retaining the power to distribute or accumulate income, even as a trustee, can be construed as a right to designate who enjoys the property, triggering estate tax consequences under Section 811(c) (now Section 2036 of the Internal Revenue Code). Grantors should consider relinquishing such discretionary powers or utilizing ascertainable standards to limit their control.

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This ruling also demonstrates the distinction between pre- and post-March 3, 1931, transfers, emphasizing the need to consider the effective dates of relevant tax laws. Later cases have cited *Budlong* to reinforce the principle that retained discretionary control over trust income can result in estate tax inclusion.

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