7 T.C. 1190 (1946)

The value of a gift for gift tax purposes is determined at the time of the transfer and cannot be retroactively reduced by the amount of gift tax subsequently paid from the gifted property, unless the trust instrument legally mandates such payment at the time of the gift.

Summary

Estelle May Affelder created an irrevocable trust for her children, funding it with securities. The trust paid annuities to her children and the remaining income to Affelder for life, with the remainder to the children upon her death. After the gift, the beneficiaries directed the trustee to pay the gift tax from the trust corpus. The Tax Court held that the value of the gift could not be reduced by the gift tax paid after the transfer because the trust instrument did not obligate the trustee to pay the gift tax at the time of the gift. The court also upheld the Commissioner's use of the Actuaries' or Combined Experience Table for valuing the remainder interests and the annuity payment factor.

Facts

Affelder established a revocable trust in 1932. On December 27, 1941, she amended it to create an irrevocable trust. The trust required quarterly annuity payments of $600 to each of her three children for her lifetime, with the remaining income to Affelder. Upon her death, the trust property would pass to her children. The trust corpus was valued at $467,401.52, including accrued but unpaid bond interest of $2,405.13. Affelder's brother, her financial advisor, drafted the amended trust. The assets transferred represented substantially all of Affelder's property. Affelder filed a late gift tax return, claiming she was initially advised no return was due. In 1943, Affelder and her children directed the trustee to pay the gift tax of $36,345.29 from the trust corpus.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Affelder's gift tax for 1941. Affelder petitioned the Tax Court, contesting the deficiency. The Tax Court upheld the Commissioner's determination.

Issue(s)

1. Whether the value of property transferred in trust for gift tax purposes can be reduced by the amount of gift tax paid out of the property subsequent to the gift.
2. Whether the Commissioner used the correct method to determine the commuted value of the remainder interests and the correct factor in computing the gift's annuity component.
3. Whether the petitioner was entitled to any exclusion in computing the value of

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the net gift for tax purposes, given that the gift was made to a trust during 1941.
4. Whether the Commissioner erred in including accrued but unpaid interest on bonds in the value of the gift.

Holding

1. No, because at the time of the gift, the trust instrument did not legally obligate the trust to pay the gift tax; the direction to pay the tax came after the gift was completed.
2. Yes, because the Commissioner correctly used Table A from Regulations 108, section 86.19 (the Actuaries' or Combined Experience Table), and the correct factor for quarterly annuity payments, as consistently used by the Treasury.
3. No, because Section 1003 of the Internal Revenue Code, as amended in 1942, specifically disallows exclusions for gifts in trust made during the calendar year 1941.
4. No, because the gift included both the bonds and the accrued interest, as there was no reservation of the interest to the petitioner in the trust agreement.

Court's Reasoning

The court reasoned that, unlike a gift of mortgaged property, the trust corpus was not encumbered by a legal obligation to pay the gift tax at the time of the transfer. The direction to pay the tax was a subsequent decision by the beneficiaries. The court distinguished Fred G. Gruen, 1 T. C. 130; D. S. Jackman, 44 B. T. A. 704; Commissioner v. Procter, 142 Fed. (2d) 824, stating that "The trust made the payment only because directed to do so by all of the beneficiaries, who, by their joint action, could dispose of the trust corpus in any way they saw fit." Regarding the valuation of remainder interests and annuities, the court deferred to the Commissioner's long-standing use of the Actuaries' or Combined Experience Table, as specified in the regulations. It distinguished Anna L. Raymond, 40 B. T. A. 244; affd., 114 Fed. (2d) 140; certiorari denied, 311 U.S. 710, where a more modern actuarial table was used to compute what a commercial insurance company would charge, because that case involved an actual annuity purchase. Here, it was merely about valuing the transferred estate. The court also noted that the applicable statute explicitly disallowed exclusions for gifts in trust. Finally, the court determined that the gift included both the bonds and any accrued interest because Affelder did not retain any right to that interest in the trust agreement.

Practical Implications

This case clarifies that the value of a gift for gift tax purposes is fixed at the time of the transfer. Subsequent events, such as the payment of gift tax from the gifted property, do not retroactively reduce the taxable gift unless the trust instrument itself legally mandates that the gift tax be paid from the trust assets. Drafters of

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trust documents should be mindful of the gift tax implications of specifying how such taxes are to be paid. Additionally, this case reinforces the principle that courts generally defer to the IRS's established actuarial tables for valuing annuities and remainder interests in the absence of a direct commercial transaction. It also serves as a reminder of the importance of understanding and applying the specific statutory provisions regarding exclusions for gifts in trust during relevant tax years.

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