T.C. 138 (1947)

A grantor's retention of the right to designate beneficiaries of a trust causes the trust corpus to be included in the grantor's gross estate for estate tax purposes, even if the trust was reshaped or remolded by a subsequent declaration of trust.

Summary

The Tax Court addressed whether assets held in a trust established by the decedent, Theodore MacManus, were includible in his gross estate for estate tax purposes. The decedent had created trusts in 1923, later modified in 1934 via a declaration of trust executed by his son, John MacManus. The court held that because Theodore MacManus retained the power to designate the beneficiaries of the trust, the trust assets were includible in his gross estate under Section 811(c) of the Internal Revenue Code, irrespective of the 1934 changes. The court also determined the proper valuation of certain annuity contracts held by the trust.

Facts

Theodore F. MacManus created trusts in 1923 for the benefit of his children. In 1934, being dissatisfied with the management of the trusts by the Detroit Trust Company, Theodore sought to reconstitute them. He transferred the assets to his son, John R. MacManus, who executed a declaration of trust acknowledging he held the assets as trustee for his siblings and himself, share and share alike. Theodore wrote a letter to John stating that the original spirit behind the creation of the trust was not changed and that the four trusts were to remain intact. Theodore retained the right to designate the beneficiaries of the trusts. The estate also included annuity contracts providing for installment payments. Upon Theodore's death, the remaining unpaid amount was to be repaid in annual installments without interest.

Procedural History

The Commissioner determined a deficiency in the estate tax. The executors of Theodore F. MacManus's estate petitioned the Tax Court for a redetermination. The Sixth Circuit Court of Appeals previously addressed a similar issue regarding income taxes related to these trusts in *MacManus v. Commissioner*, 131 F.2d 670 (6th Cir. 1942), reversing the Board of Tax Appeals decision.

Issue(s)

1. Whether the declaration of trust made by John R. MacManus on May 9, 1934, constituted a new and separate trust, independent of the original trusts created by the decedent.
2. Whether the value of the annuity contracts at the date of the decedent's death should be based on their unpaid original cost or their commuted or discounted value.

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Holding

1. No, because the decedent remained the grantor of the trusts, and the rights, powers, and interests he reserved in the original trusts were retained by him until his death, making the trust corpus subject to estate tax under Section 811(c) of the Internal Revenue Code.
2. The commuted or discounted value is the proper basis because the contracts provided for installment payments without interest, and the companies were not regularly engaged in selling annuity contracts comparable to the obligations they had.

Court's Reasoning

The court relied heavily on the Sixth Circuit's decision in *MacManus v. Commissioner*, which held that the 1934 declaration of trust did not create entirely new trusts but rather reshaped or remolded the original trusts. The court emphasized Theodore MacManus's intent to continue the existing trusts, with the only change being the trustee. Because Theodore retained the right to designate the beneficiaries, Section 811(c) applied, which includes in the gross estate property transferred where the decedent retained the right to designate who shall possess or enjoy the property. Regarding the annuity contracts, the court found that the regulation cited by the Commissioner (Regulations 105, section 81.10 (i) (2)) was inapplicable because the contracts were not typical annuity contracts sold by companies regularly engaged in such sales. The court determined that the commuted or discounted value of the contracts accurately reflected the estate's right to receive installment payments without interest.

Practical Implications

This case illustrates the importance of carefully analyzing trust agreements to determine whether the grantor retained powers that would cause the trust assets to be included in their gross estate. It emphasizes that even modifications to existing trusts may not eliminate estate tax liability if the grantor retains control over beneficial enjoyment. The case also provides guidance on valuing non-traditional annuity contracts for estate tax purposes, suggesting that a discounted value may be appropriate when the contract provides for installment payments without interest. Subsequent cases will analyze trust instruments to determine the scope of retained powers, focusing on whether the grantor truly relinquished control over the trust assets. This can affect estate planning, influencing how trusts are drafted and managed to minimize estate tax liability while still meeting the grantor's objectives. Attorneys should advise clients to relinquish all powers over trusts where the goal is to remove assets from the gross estate.

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