10 T.C. 537 (1948)

A trust corpus is includible in a decedent's gross estate under Section 811(d)(2) of the Internal Revenue Code if the decedent retained the power to designate beneficiaries, even if that power was never exercised.

Summary

The Tax Court held that the value of a trust created by the decedent, Mary M. Reed, was includible in her gross estate for federal estate tax purposes. Reed had created the trust in 1893, reserving the income for life and retaining the power to designate, via her will, which of her lineal descendants would receive the remainder interests. The court determined that this power to designate beneficiaries constituted a power to alter, amend, or revoke the trust, thus triggering inclusion under Section 811(d)(2) of the Internal Revenue Code. The court also rejected arguments that the transfer was a bona fide sale and that inclusion violated the Fifth Amendment.

Facts

Byron Reed died in 1891, leaving a will that made provisions for his widow, Mary M. Reed, and his children. Mary M. Reed initially rejected the will's provisions and claimed her statutory share of the estate. Subsequently, she, along with Byron Reed's children, reached a compromise agreement where she would receive one-third of the estate. As part of that agreement, Mary M. Reed created a trust in 1893, placing her share into it. She reserved the income for life and retained the power to designate, via her will, which of her and Byron Reed's lineal descendants would receive the remainder. If she failed to designate beneficiaries, the trust would pass to her children. Mary M. Reed did not designate any beneficiaries in her will. The trust corpus was valued at $344,900.18 at her death.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the federal estate tax, including the value of the trust corpus in Mary M. Reed's gross estate. The United States National Bank of Omaha, Nebraska, as executor of Reed's estate, petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether the value of the corpus of the trust deed is includible in the decedent's gross estate under Section 811(d)(2) of the Internal Revenue Code.
2. Whether the transfer in trust was a bona fide sale for adequate consideration, thus exempting it from inclusion under Section 811(d)(2).
3. Whether the inclusion of the trust estate in the decedent's gross estate is forbidden by the Fifth Amendment to the Federal Constitution.

Holding

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1. Yes, because the decedent retained the power to designate beneficiaries of the trust, which constitutes a power to alter, amend, or revoke the trust under Section 811(d)(2).
2. No, because the agreement was a compromise to avoid litigation, not a bona fide sale.
3. No, the court found no substance in this argument.

Court's Reasoning

The court reasoned that Mary M. Reed's power to appoint beneficiaries via her will constituted a power to alter, amend, or revoke the trust, as the remainder interests of previously unnamed beneficiaries could be changed. The court cited several cases, including *Commissioner v. Chase National Bank*, to support this conclusion. The court emphasized that the mere existence of the power at the time of death, not whether it was actually exercised, was the determining factor. The court rejected the argument that the agreement settling the estate was a bona fide sale, stating that it was a compromise to avoid litigation. The consideration was the mutual exchange of promises. The court dismissed the Fifth Amendment argument, finding no supporting evidence or argument presented by the petitioner. The court stated, "It is the existence of the power at death that subjects the trust estate to the taxing statute."

Practical Implications

This case reinforces the principle that the power to designate beneficiaries in a trust can trigger estate tax inclusion, even if the power is unexercised. It serves as a reminder to carefully consider the estate tax consequences when drafting trust instruments, especially those involving powers of appointment. The case illustrates that compromise agreements, while valid, may not necessarily qualify as bona fide sales for estate tax purposes. It highlights the importance of understanding the scope of Section 811(d)(2) (now Section 2038 of the Internal Revenue Code) and its potential impact on estate planning. Later cases cite this ruling for the proposition that the power to designate beneficiaries is equivalent to the power to alter, amend or revoke a trust.

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