11 T.C. 314 (1948)

When a transferor domiciled in a community property state transfers property to a trust, retaining the right to the income from that property under state law, the value of the transferred property is includible in the transferor's gross estate for federal estate tax purposes, to the extent of the transferor's retained income interest.

Summary

Ernest Hinds and his wife, residents of Texas, transferred community property to a New York trust, with income payable to the wife. The Tax Court addressed whether the transfer was made in contemplation of death and whether the value of the property should be included in Hinds' gross estate. The court held the transfer was not made in contemplation of death, but because Texas law dictated that half the trust income was community property belonging to Hinds, half the property's value was includible in his gross estate under Section 811(c) of the Internal Revenue Code.

Facts

Ernest Hinds, a retired Major General, and his wife, Minnie, resided in Texas. On December 31, 1940, they transferred community property to an irrevocable trust located in New York, designating Lawyers Trust Co. as trustee. The trust directed that income be paid to Minnie in quarterly installments. Hinds died on June 17, 1941. The trust was established after Minnie suffered an injury, leading Ernest to ensure her financial security. The trust indenture stipulated it was to be governed by New York law.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Ernest Hinds' estate tax. The Commissioner argued that the transfer to the trust was made in contemplation of death and that Hinds retained the right to income from the transferred property. The estate contested the deficiency, leading to a trial before the Tax Court.

Issue(s)

1. Whether the transfer to the trust was made in contemplation of death, thus includible in the gross estate?
2. Whether, despite the transfer, Ernest Hinds retained the right to income from the transferred property, making it includible in his gross estate under Section 811(c)?
3. Whether the full value of the homestead was includible in the gross estate, undiminished by the wife's right to occupy it as her homestead for life?

Holding

1. No, because the transfer was motivated by concerns for his wife’s financial security following her illness, not by contemplation of his own death.
2. Yes, in part, because under Texas community property law, half of the trust income was considered community property belonging to Ernest Hinds, thus constituting a retained right to income. Only half the value of his contribution to the trust was includible.
3. Yes, because the federal estate tax laws do not contemplate such a deduction for a surviving spouse’s right to occupy the homestead; the decedent had a vested community one-half interest that terminated upon his death.

Court’s Reasoning

The court relied on *United States v. Wells, 283 U.S. 102*, stating that a transfer is made in contemplation of death when the thought of death is the impelling cause. The court found that Hinds’ primary motive was to provide for his wife’s welfare after her illness. Regarding retained income, the court looked to Texas community property law, which considers income from separate property as community property unless explicitly stated otherwise in the trust document. Because the trust did not specify that the income was the wife’s separate property, Hinds retained a community interest in half of the income. Citing section 811 (c), the court reasoned that because Hinds retained the right to one-half of the income, a corresponding proportion of the property’s value should be included in his gross estate. The court cited Section 81.18 of Treasury Regulations 105 which states “If such retention or reservation is of a part only of the use, possession, income, or other enjoyment of the property, then only a corresponding proportion of the value of the property should be included in determining the value of the gross estate”. As to the homestead issue, the court followed Regulations 105, sec. 81.13, providing that property subject to homestead or other exemptions under local law is includible as a part of the gross estate.

Practical Implications

This case highlights the importance of considering state community property laws when drafting trust agreements, particularly for estate tax planning. To avoid inclusion in the gross estate, grantors in community property states must explicitly relinquish their community interest in the trust income, ensuring it becomes the separate property of the beneficiary. Furthermore, it reinforces that homestead exemptions do not reduce the value of property includible in a decedent’s gross estate for federal tax purposes. Later cases have cited Hinds to emphasize the necessity of clear and unambiguous language when intending to alter the default community property characterization of income in trust instruments.

