12 T.C. 242 (1949)

A settlor's transfer of property to a trust, where the settlor retains the income for life, results in the inclusion of the trust property's value in the settlor's gross estate for tax purposes because the transfer doesn't take effect in possession or enjoyment until the settlor's death.

Summary

In 1914, the decedent created a trust, naming himself and a bank as co-trustees, with the income payable to himself for life, then to his wife if she survived him, and finally, the income and corpus to be divided among his surviving children. The trustees had discretionary power to use up to one-half of a child's prospective share for their maintenance and education, a power never exercised. The Tax Court held that the value of the trust property at the decedent's death was includible in his gross estate because he retained the income for life, meaning the transfer's possession or enjoyment was deferred until his death. This decision follows the Supreme Court's ruling in *Commissioner v. Estate of Church*, 335 U.S. 632 (1949).

Facts

On April 17, 1914, Stockwell Reynolds Diaz-Albertini (the decedent) transferred £15,000 to a trust, naming himself and City Bank Farmers Trust Co. as co-trustees. The trust terms dictated that income be paid to Diaz-Albertini for life, then to his wife Nora if she survived him, and subsequently, the trust funds and income were to be divided equally among his children. The trustees, with the settlor's consent, could use up to half of a child's prospective share for their maintenance and education. Diaz-Albertini died on June 7, 1942, survived by his wife and two sons. The trustees never exercised their power to apply a child's share for maintenance or education.

Procedural History

The executrix of Diaz-Albertini's estate filed an estate tax return, excluding the trust assets from the gross estate. The Commissioner of Internal Revenue determined that the trust property's value should be included, resulting in a deficiency. The Commissioner also determined that the City Bank Farmers Trust Co., as trustee, was liable as a transferee for the deficiency. The Tax Court consolidated the estate's petition and the trustee's petition, ultimately holding in favor of the Commissioner regarding the inclusion of the trust property in the gross estate and the trustee's transferee liability.

Issue(s)

1. Whether the value of the property transferred to the trust in 1914 should be included in the decedent's gross estate for estate tax purposes.
2. Whether the City Bank Farmers Trust Co., as trustee, is liable as a transferee for the estate tax deficiency.

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Holding

1. Yes, because the decedent retained the income from the trust for his life, meaning the transfer didn't take effect in possession or enjoyment until his death.
2. Yes, because the trust assets were included in the gross estate and the estate was insolvent, making the trustee liable to the extent of the trust's value at the time of the decedent's death.

Court's Reasoning

The Tax Court relied on *Commissioner v. Estate of Church*, 335 U.S. 632 (1949), which held that a trust where the settlor reserved a life income is intended to take effect in possession or enjoyment at the settlor's death, thus requiring the inclusion of the trust corpus in the gross estate. The court stated that the *Church* decision was conclusive because the decedent directed that the trust income be paid to him for life. Regarding transferee liability, the court cited Section 827(b) of the Internal Revenue Code, which makes a trustee liable for estate tax to the extent of the value of the property included in the gross estate under Section 811 if the estate tax isn't paid. Given the estate's insolvency and the trust's value, the trustee was deemed liable.

Practical Implications

This case, decided shortly after *Commissioner v. Estate of Church*, reinforces the principle that retaining a life income interest in a trust will cause the trust assets to be included in the settlor's gross estate, regardless of other trust provisions. It highlights the importance of understanding the implications of retaining control or enjoyment of assets transferred to a trust. This impacts estate planning by discouraging the use of trusts where the grantor retains a life income if the goal is to remove assets from the taxable estate. Later cases have distinguished this ruling based on differing factual scenarios, such as trusts created before the relevant statutory changes or trusts without a retained life income.

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