Estate of Luman L. Shaffer v. Commissioner, 4 T.C. 902 (1945)

A transfer of property is considered to be made in contemplation of death, and therefore includible in the gross estate for estate tax purposes, if the dominant purpose of the transfer was to provide for beneficiaries after the death of the decedent as a substitute for a testamentary disposition, even if tax avoidance was also a motive.

Summary

The Tax Court addressed whether the value of property transferred to a trust by the decedent, Luman L. Shaffer, should be included in his gross estate as a transfer made in contemplation of death under Section 811(c) of the Internal Revenue Code. Shaffer created an irrevocable trust, the income of which was to be accumulated during his lifetime and distributed to his wife and sons after his death. The court held that the transfer was indeed made in contemplation of death because the trust served as a substitute for a testamentary disposition, despite the decedent's secondary motive to save on income taxes. The court, however, excluded the income earned by the trust between its creation and the decedent's death from the gross estate.

Facts

Luman L. Shaffer, at age 72, created an irrevocable trust in 1936. The trust terms stipulated that the income was to be accumulated during Shaffer's lifetime. After his death, the income was to be paid to his widow, and upon her death, the principal was to be distributed to his sons according to a method prescribed by Shaffer. The beneficiaries were prohibited from anticipating any benefits during Shaffer's life. Shaffer passed away eight years later from a heart attack. The Commissioner argued that the trust was a substitute for a will and therefore was made in contemplation of death.

Procedural History

The Commissioner determined a deficiency in the estate tax, arguing that the trust property should be included in the gross estate. The Estate of Luman L. Shaffer petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether the transfer of property to the irrevocable trust by the decedent was made in contemplation of death within the meaning of Section 811(c) of the Internal Revenue Code, thereby requiring its inclusion in the decedent's gross estate for estate tax purposes.

Holding

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Yes, because the dominant purpose of the transfer was to provide for beneficiaries after the death of the decedent by a substitute for testamentary disposition, even though a desire to save income taxes may have been a secondary motive.

Court's Reasoning

The court reasoned that the chief purpose of Section 811(c) is to prevent the evasion of estate tax by reaching substitutes for testamentary dispositions, citing *United States v. Wells, 283 U. S. 102*. Even though Shaffer lived for eight years after creating the trust and might have had a secondary motive of avoiding income taxes, the terms of the trust, particularly the accumulation of income during his lifetime and the distribution scheme following his death, closely mirrored a testamentary disposition. The court quoted *Igleheart v. Commissioner, 77 Fed. (2d) 704; Oliver v. Bell, 103 Fed. (2d) 760; Allen v. Trust Co. of Georgia, Executor, 326 U. S. 630* noting that a disposition which is in effect a testamentary disposition is made in contemplation of death even though, to save taxes, it may be put in the form of an inter vivos trust rather than as a part of a will. The court found that the tax-saving purpose was insignificant compared to the dominant purpose of disposing of property through a substitute for a will. The court cited *Estate of James E. Frizzell, 9 T. C. 979; affd., 177 Fed. (2d) 739*, holding that income from the trust property between the creation of the trust and the date of death should not be included in the gross estate.

Practical Implications

This case clarifies that even if a transferor has a mixed motive in establishing an inter vivos trust, including a life-related motive such as income tax savings, the transfer will be deemed to be in contemplation of death if its dominant purpose is to serve as a substitute for a testamentary disposition. This decision necessitates a careful analysis of the terms of the trust and the circumstances surrounding its creation to determine the transferor's true intent. Legal practitioners must advise clients that simply structuring a disposition as an inter vivos trust will not necessarily avoid estate tax inclusion if the arrangement functions as a will substitute. Subsequent cases will scrutinize the specific provisions of the trust and the timing of distributions to assess whether the primary intent was to dispose of property at death rather than for lifetime purposes. This case helps to distinguish valid lifetime transfers from those designed to avoid estate taxes. It reinforces the principle that the substance of a transaction, rather than its form, will govern its tax treatment.

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