15 T.C. 752 (1950)

A trust is included in a decedent's gross estate for tax purposes when the decedent retained a reversionary interest in the trust that exceeded 5% of the trust's value immediately before their death, arising from the express terms of the trust instrument, not by operation of law.

Summary

The Tax Court addressed whether a trust created by the decedent, Francis Louis Slade, should be included in his gross estate for estate tax purposes. The Commissioner argued that the trust, which provided income to Slade during his life and then to his wife, Caroline, took effect at Slade's death and included a reversionary interest. The court found that a letter from the trustee agreeing to resign upon Slade's request after Caroline's death created a reversionary interest that exceeded 5% of the trust's value, thus the value of Caroline's life estate was includible in Slade's gross estate.

Facts

Francis Louis Slade created a trust in 1929, funding it with $500,000 in bonds. The trust provided income to Francis during his life, then to his wife, Caroline, for her life. Caroline had the power to terminate the trust during Francis's life, and the trust would also terminate if the bank trustee resigned during Francis's life. Upon termination, the corpus would revert to Francis if he was alive; otherwise, it would go to named charities. A letter, contemporaneous with the trust's creation, from a bank vice-president stated that the bank would resign as trustee at Francis's request after Caroline's death. Caroline never terminated the trust, and the bank never resigned during Francis's lifetime. Francis died in 1944.

Procedural History

The Commissioner determined a deficiency in estate tax, including the value of Caroline's life estate in the gross estate under Sections 811(c) and 811(d) of the Internal Revenue Code. The estate petitioned the Tax Court, contesting the inclusion of the trust in the gross estate.

Issue(s)

Whether the value of the life estate of the decedent's widow in a trust, created by the decedent, is includible in the decedent's gross estate under Section 811(c)(1)(C) and 811(c)(2) of the Internal Revenue Code, as amended, because the decedent retained a reversionary interest in the trust property having a value exceeding 5% of the corpus value.

Holding

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Yes, because the decedent retained a reversionary interest in the trust through an agreement with the trustee, as evidenced by the letter, and the value of this reversionary interest exceeded 5% of the trust's value immediately before his death.

Court's Reasoning

The court reasoned that the transfer of the wife's life estate took effect at the decedent's death. The court applied Section 811(c)(1)(C), as amended in 1949, which includes in the gross estate property transferred in trust to take effect at death if the decedent retained a reversionary interest exceeding 5% of the property's value. The court found that the letter from the trustee, agreeing to resign at the decedent's request after his wife's death, constituted a reversionary interest arising from the express terms of the trust agreement, not by operation of law. The court rejected the estate's argument that the letter was without legal force, stating it was part of the whole agreement creating the trust and did not contradict the trust terms. The court noted the petitioner bore the burden of proof to show the reversionary interest was less than 5% and, absent such evidence, assumed it exceeded that threshold. The dissent argued that the letter should not be considered part of the trust agreement, and the reversionary interest was not susceptible to valuation.

Practical Implications

This case highlights the importance of carefully structuring trusts to avoid unintended estate tax consequences. Specifically, it emphasizes the impact of retained reversionary interests, even those created through side agreements or understandings with trustees. Attorneys drafting trust documents must consider any potential scenarios where the trust property could revert to the grantor and ensure that such interests are either eliminated or properly accounted for to minimize estate tax liability. Later cases have cited Slade for its interpretation of "reversionary interest" and the determination of whether such an interest arises from the express terms of the trust instrument.

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