16 T.C. 918 (1951)

A reversionary interest in a grantor-decedent is not considered to arise by the express terms of a trust instrument if it depends on intestate laws at the time of the life tenant's death and family circumstances at that future date; instead, it arises by operation of law.

Summary

The Tax Court addressed whether a reversionary interest retained by the decedent in two trusts should be included in his gross estate under Section 811(c) of the Internal Revenue Code. The decedent created trusts giving his wife a life estate with a power of appointment, and in default of appointment, the remainder would pass to those entitled under Pennsylvania's intestate laws as if she died owning the property. The court held that the reversionary interest did not arise by the "express terms" of the trust instrument but by operation of law, thus excluding it from the gross estate under the Technical Changes Act of 1949.

Facts

The decedent, Charles Marshall, induced his wife and children to transfer their McClintic-Marshall Corporation stock to him for a pending business transfer to Bethlehem Steel. He promised restitution. Subsequently, he created two trusts where his wife, Dora, received life income, and upon her death, the trust assets would be distributed as she appointed or, in default, to those entitled under Pennsylvania intestate law as if she died owning the property. Dora later relinquished her power of appointment.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the estate tax, including the value of the remainder interest in the trusts, arguing the decedent retained a possibility of reverter, triggering Section 811(c). The Tax Court was petitioned to determine if this inclusion was proper. The Commissioner later revised their argument to include only a one-third interest, based on the decedent's potential share under Pennsylvania intestate law had he survived his wife.

Issue(s)

Whether the reversionary interest retained by the decedent in the trust arose by the express terms of the trust instrument, or by operation of law, as defined under Section 811(c)(2) of the Internal Revenue Code, as amended by the Technical Changes Act of 1949.

Holding

No, because the reversionary interest depended on a combination of the trust's

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reference to intestate law and the operation of that law at the time of the wife's death, not on the "express terms" of the trust instrument itself.

Court's Reasoning

The court reasoned that the Technical Changes Act of 1949 provided relief for prior transfers, stipulating that a retained reversionary interest must arise by the "express terms" of the transfer instrument to be included in the gross estate. The court emphasized that "express" means directly and distinctly stated, not merely implied. While the decedent's reference to Pennsylvania intestate law created the possibility of him taking a one-third interest, this was not a direct, intentional provision. The court stated, "It is only transfers 'intended' to take effect in possession or enjoyment at or after the death of the decedent which are included in his gross estate under section 811 (c), and the question of intent should not be overlooked…" The court highlighted the uncertainty of future intestate laws and family conditions, noting changes in laws or a divorce could alter the outcome. The court found no evidence the decedent consciously intended the trust property to revert to him; the intestate clause was merely a catch-all provision. The court concluded that Congress intended Section 811(c)(2) to protect past transfers lacking a clear indication that the grantor's death was the indispensable event for the remainder interest to pass.

Practical Implications

This case clarifies the "express terms" requirement under Section 811(c)(2) for transfers made before October 8, 1949. It demonstrates that simply referencing intestate laws does not constitute an express reservation of a reversionary interest. For estate planning, it highlights the importance of clearly and directly stating any intended reversionary interests within trust documents to ensure tax consequences align with the grantor's intentions. Subsequent cases and IRS guidance would likely focus on distinguishing between explicit reservations and those arising indirectly through general legal principles or future contingencies. This case served to protect grantors from unintended estate tax consequences based on boilerplate language. Note that the current version of Section 2037 of the IRC, relating to transfers taking effect at death, has no "express terms" requirement.

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