17 T.C. 304 (1951)

When a decedent transfers property but retains the lifetime possession, enjoyment, and income rights, the value of that property is included in the decedent's gross estate for estate tax purposes under Section 811(c)(1)(B) of the Internal Revenue Code, regardless of the methods used to accomplish this result.

Summary

George L. Shearer transferred his farm to a corporation he controlled, leased it back for a nominal fee, gifted shares to his daughters, and eventually dissolved the corporation, receiving a life estate in the farm while his daughters received the remainder. The Tax Court held that the farm's value was includible in Shearer's gross estate because he effectively retained lifetime possession, enjoyment, and income rights, thus making the transfer testamentary in nature under Section 811(c)(1)(B) of the Internal Revenue Code.

Facts

George L. Shearer owned a farm in Virginia. In 1932, he transferred the farm to Meander Farms, Inc., a corporation he formed and controlled, in exchange for all of its stock. He then leased the farm back from the corporation for $1 per year, agreeing to pay taxes, insurance, and maintenance. Shearer gifted shares of the corporation to his daughters over several years. In 1942, the corporation was dissolved, and Shearer received a life estate in the farm, with the remainder to his daughters. Shearer continued to pay all farm expenses and reported all farm income/losses until his death.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Shearer's estate tax, including the value of the farm in the gross estate. The estate challenged this determination in the United States Tax Court.

Issue(s)

Whether the value of Meander Farm should be included in the decedent's gross estate for estate tax purposes under Section 811(c)(1)(B) of the Internal Revenue Code, given that the decedent transferred the farm to a corporation, leased it back, gifted shares, and ultimately received a life estate upon the corporation's dissolution.

Holding

Yes, because the decedent retained lifetime possession, enjoyment, and the right to income from the farm, making the transfer essentially testamentary in nature and thus includible in his gross estate under Section 811(c)(1)(B).

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Court’s Reasoning

The court reasoned that the series of transactions (transfer to corporation, leaseback, gifts of stock, dissolution and life estate) were designed to allow Shearer to retain control and enjoyment of the farm during his life while transferring ownership to his daughters at his death. The court emphasized that Shearer’s intent was for the daughters to eventually have the property, but in the interim, he would retain its use and benefit. The court stated, “Thus, in a real sense he retained during his life the possession of, enjoyment of, and the right to the income from the property although, during the life of the corporation, he retained those rights by a lease which was terminable by the corporation.” The court found that this arrangement effectively created a retained life estate, which is specifically covered by Section 811(c)(1)(B). The court noted, “The situation is not substantially different for estate tax purposes from one in which a decedent transfers a remainder directly and retains a life estate, a situation clearly within section 811 (c) (1) (B).”

Practical Implications

This case demonstrates that the IRS and courts will look beyond the form of transactions to their substance when determining estate tax liability. It highlights the importance of relinquishing true control and benefit from transferred property to avoid inclusion in the gross estate. Attorneys should advise clients that retaining a life estate, even through a series of complex transactions, will likely result in the property’s inclusion in the taxable estate. Subsequent cases have cited *Shearer* as an example of how the substance-over-form doctrine applies in estate tax matters, particularly concerning retained interests and controls. Careful planning is needed to avoid triggering Section 2036 (the successor to Section 811(c)) when transferring assets within a family.

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