17 T.C. 1467 (1952)

A grantor's power, as a trustee, to terminate a trust by selling trust property, which would alter the remainder beneficiaries, is a power to alter, amend, or revoke the trust, causing the value of the remainder interest to be included in the grantor's gross estate for estate tax purposes under Section 811(d)(1) of the Internal Revenue Code.

Summary

The Tax Court addressed whether the value of a trust created by the decedent, Frank Clowe, should be included in his gross estate. Clowe created a trust for his daughter, Martha, with himself and two others as trustees. The trust allowed the trustees to sell the trust's stock, which would terminate the trust. Upon termination, the trust assets would go to Martha, if living, and if not, to her children or heirs. The court held that Clowe's power, as a trustee, to terminate the trust subjected the remainder interest to a change, making it includible in his gross estate under Section 811(d)(1) of the Internal Revenue Code. The value of Martha's income interest was to be excluded from the taxable value.

Facts

Frank Clowe created a trust in 1937, naming himself, John Cowan, and R.G. Mills as trustees. The trust held 500 shares of Clowe & Cowan, Inc. stock, with the net income payable annually to Clowe's daughter, Martha. The trust was to last for 25 years, but could terminate earlier if the trustees sold the stock. Upon termination, assets were to be delivered to Martha, or if deceased, to her children or heirs. Clowe died in 1946. At the time of his death, he still held the power, as trustee, to sell the stock and terminate the trust.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Clowe's estate tax, including the value of the trust in the gross estate. The estate petitioned the Tax Court, arguing that the trust should not be included. The Tax Court ruled in favor of the Commissioner, holding that the power to terminate the trust was a power to alter or amend, making the trust includible in the gross estate.

Issue(s)

1. Whether the trust violated the rule against perpetuities under Texas law, thus resulting in Martha receiving a fee simple interest.
2. Whether the decedent, as a trustee, possessed a power to alter, amend, or revoke the trust within the meaning of Section 811(d)(1) of the Internal Revenue Code, thus requiring the inclusion of the trust's value in his gross estate.

Holding

1. No, because the trust could be interpreted to vest the remainder interest within a life in being at the time of the trust's creation, plus 21 years.
2. Yes, because the decedent, as a trustee, had the power to sell the trust's stock, which would terminate the trust and alter the remainder beneficiaries.

Court's Reasoning

The court reasoned that the trust did not violate the rule against perpetuities because it could be interpreted to vest the remainder interest in Martha's children or heirs at her death, which is within the permissible time frame. The court emphasized that when construing ambiguous trust instruments, courts should strive to give effect to the grantor's intent, and interpretations upholding the validity of the trust are favored. Regarding Section 811(d)(1), the court found that the decedent's power, in conjunction with the other trustees, to sell the stock and terminate the trust constituted a power to alter, amend, or revoke the trust. This power subjected the enjoyment of the remainder interest to change, as it could cut off the interests of Martha's children or heirs. The court cited Section 811(d)(3), which states that the power to revoke shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the revocation takes effect only on the expiration of a stated period after the exercise of the power. The court distinguished *Estate of Mary H. Hays v. Commissioner*, noting that in *Hays*, the beneficiary received a fee simple estate, whereas Martha only received a contingent interest in the remainder. The court noted that "The power of the decedent over the remainder was of the kind described in section 811 (d) (1)."

Practical Implications

This case reinforces that a grantor's retained powers over a trust, even if held in a fiduciary capacity as a trustee, can have significant estate tax consequences. Specifically, the power to terminate a trust, which alters the beneficial interests, will likely cause the trust assets to be included in the grantor's gross estate. When drafting trust instruments, practitioners must carefully consider the powers granted to the grantor, even as a trustee, and advise clients of the potential estate tax ramifications. This case also serves as a reminder that courts will attempt to construe ambiguous trust instruments in a way that gives effect to the grantor's intent and upholds the validity of the trust. It highlights the importance of clear and specific language in trust documents to avoid unintended consequences and potential estate tax liabilities. Later cases have cited *Clowe* for the proposition that a power to terminate a trust is equivalent to a power to alter, amend, or revoke the trust for purposes of estate tax inclusion.

