19 T.C. 672 (1953)

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A transfer to a trust, even if made for the support of children pursuant to a divorce settlement, may be partially included in the grantor's gross estate for estate tax purposes to the extent the transfer exceeds the value of the support obligation; furthermore, trust income can be taxed to the grantor if the grantor retains powers to alter or revoke the trust in conjunction with a person who does not have a substantial adverse interest.

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Summary

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D.G. McDonald created a trust primarily to support his children during their minority, with the children later becoming income beneficiaries and receiving the corpus at age 35. McDonald retained the power to alter, amend, or revoke the trust, but only with his divorced wife's consent. The Tax Court addressed whether the trust assets were includible in McDonald's gross estate and whether the trust income was taxable to him. The court held that McDonald made a transfer to the trust, part of which was for adequate consideration (the children's support rights). Only the excess of the trust's fair market value over the children's support value was includible in the estate. The court also ruled that the trust income was taxable to McDonald because he retained powers over the trust in conjunction with a person without a substantial adverse interest.

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Facts

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D.G. McDonald and his wife, Lenore, experienced marital difficulties leading to a separation in 1930 and eventual divorce. On November 10, 1930, D.G. McDonald created Trust No. 924, transferring 12,000 shares of J.C. Penney stock. The trust provided income to Lenore, then to their children, Delos and Nedra, with the corpus ultimately distributed to the children at age 35. The trust instrument reserved to the trustor (D.G. McDonald) the right to amend or revoke the trust in conjunction with Lenore. A property settlement agreement and amended trust were executed on November 30, 1931, transferring 5,500 shares to Lenore outright and modifying the income distribution terms for the children's benefit.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in McDonald's estate tax and income taxes, arguing the trust assets should be included in his gross estate and the trust income should be taxed to him. The Tax Court consolidated proceedings related to the estate tax deficiency, income tax deficiencies, and transferee liability of the trustees. The Tax Court reviewed the Commissioner's determination.

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Issue(s)

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1. Whether all or any part of the value of the assets of Trust 924 are includible in the gross estate of D.G. McDonald?

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2. Whether the income from Trust 924 is taxable to D.G. McDonald?

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3. Whether the 5-year limitation in Internal Revenue Code Section 275(c) applies to the 1944 tax year?

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Holding

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1. No, only the excess of the fair market value of the trust assets at the time of death over the value of the children's right to support is includible in the gross estate, because the transfer was partially made for adequate consideration.

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2. Yes, the income from Trust 924 is taxable to D.G. McDonald, because he retained powers to alter or revoke the trust in conjunction with a person lacking a substantial

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adverse interest.

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3. Yes, the 5-year limitation in Internal Revenue Code Section 275(c) applies because the omitted income exceeds 25% of the gross income reported.

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Court’s Reasoning

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The court determined that D.G. McDonald was the grantor of the trust, rejecting arguments that the assets originated from community property and were rightfully Lenore’s. Applying Section 811(i), the court considered whether the transfer was for adequate consideration. Citing *Helvering v. United States Trust Co.*, the court recognized that transfers for child support constitute “money’s worth.” However, since the trust provided benefits beyond the legal obligation of support, only the portion representing the children’s right to support ($30,000) was considered adequate consideration. The remainder of the trust assets’ value was includible in the gross estate.

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On the income tax issue, the court dismissed the applicability of *Helvering v. Clifford* but found Sections 166 and 167 relevant. The power to alter, amend, or revoke the trust required Lenore’s consent. The court then examined if Lenore had a

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