Estate of Brockway v. Commissioner, 18 T.C. 488 (1952)

The creation of a revocable trust funded with property held as tenancy by the entirety does not sever the tenancy for estate tax purposes when the grantors retain significant control and economic interest in the property during their lives.

Summary

The Tax Court held that the full value of properties held as tenancy by the entirety was includible in the decedent's gross estate, despite a transfer to a trust. The decedent and his wife created a trust, conveying properties they held as tenants by the entirety, but retaining significant control including the power to revoke or amend the trust and collect income. The court reasoned that the trust was a passive vehicle for testamentary disposition and did not effectively sever the tenancy, thus failing to remove the property's full value from the decedent's estate. The court also upheld a penalty for the estate's failure to file a timely return, finding no reasonable cause for the delay.

Facts

The decedent and his wife owned six parcels of real property as tenants by the entirety. They conveyed these properties to a trustee. The trust instrument declared that each spouse owned an undivided half-interest. The trustors (decedent and wife) retained exclusive power to operate the property, collect income, and amend or revoke the trust. The trustors even withdrew real property back to themselves as husband and wife, again creating tenancy by the entirety interests. The trustee had bare legal title, with no real power to manage the property during the decedent's lifetime.

Procedural History

The Commissioner of Internal Revenue included the full value of the properties in the decedent's gross estate. The estate contested this inclusion in the Tax Court. The Commissioner also imposed a penalty for late filing of the estate tax return, which the estate also contested.

Issue(s)

1. Whether the conveyance of property held as tenants by the entirety into a revocable trust, where the grantors retain significant control and economic benefit, effectively severs the tenancy for estate tax purposes.
2. Whether the estate's failure to file a timely estate tax return was due to reasonable cause and not willful neglect.

Holding

1. No, because the trust was essentially a passive vehicle for testamentary

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disposition and the grantors retained significant control and economic interest in the property.
2. No, because the estate failed to demonstrate that the delay was due to reasonable cause and not willful neglect, especially considering the expertise of the trust company acting as the fiduciary.

Court's Reasoning

The court applied Oregon law, which requires a valid conveyance to sever a tenancy by the entirety. While a conveyance from one spouse to the other is valid, there was no evidence of a written agreement to sever the tenancy before the transfer to the trust. Citing *Coston v. Portland Trust Co.*, the court likened the trust to a passive trust created solely for testamentary disposition, which does not prevent the inclusion of the property in the gross estate.

The court also relied on *Estate of William Macpherson Hornor, 44 B. T. A. 1136*, where a similar trust arrangement was deemed ineffective to remove property from the gross estate. The court quoted *Hornor*, stating: "But, other than the creation of a purely legalistic title in the spouses and their son as trustees instead of the spouses alone as owners, the trust, for present purposes, accomplished nothing…Revocability and reservation of income for life leave the property in the settlor's gross estate as effectively in one case as in the other." The court distinguished *Sullivan's Estate v. Commissioner*, which involved a bona fide conversion of joint estates into tenancies in common for money's worth.

Regarding the penalty, the court noted the estate's failure to demonstrate reasonable cause for the delay. The court stated that as a banking institution operating a trust department, the petitioner is presumed to know when estate tax returns should be filed.

Practical Implications

This case illustrates that simply transferring property held as tenants by the entirety into a trust will not automatically exclude it from the gross estate. The key is the degree of control and economic benefit retained by the grantors. To effectively remove such property from the estate, the grantors must relinquish significant control and benefits.

This case highlights the importance of considering the substance of a transaction over its form when dealing with estate tax planning. Attorneys should advise clients that retaining too much control over trust assets can negate any potential estate tax benefits. Further, this case serves as a reminder of the importance of timely filing of tax returns and the high burden of proving 'reasonable cause' for late filing, especially for professional fiduciaries.

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