Estate of Resch v. Commissioner, 20 T.C. 171 (1953)

A grantor's power to control trust income, even indirectly through the purchase of life insurance policies within a trust, can result in the inclusion of trust assets in the grantor's gross estate for estate tax purposes.

Summary

The Tax Court ruled that the corpus of a trust created by the decedent was includible in his gross estate because he retained the right to the trust income for life. Although the trustee had discretion over income distribution, the decedent had the power to direct the trust to purchase life insurance policies on his life, with policy earnings payable to him. The court also held that Federal Farm Mortgage Corporation bonds are not exempt from estate tax for nonresident aliens. Finally, the court found that a separate trust created by the decedent's wife was not includible in his estate because she was the true settlor, and the decedent's powers were fiduciary.

Facts

Arnold Resch created a trust in 1931, later amended in 1932, naming a corporate trustee. The trust agreement allowed the trustee to use trust income and corpus to pay premiums on life insurance policies on Resch's life, should such policies be added to the trust. The agreement also gave Resch the right to add such policies to the trust and to receive any dividends or payments from those policies. Resch died in 1942. The Commissioner argued the trust should be included in his gross estate for estate tax purposes. Separately, Resch gifted bonds to his wife, Tottie, who then created a trust. The IRS sought to include the assets of this trust in Resch's estate as well.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the estate tax for the Estate of Arnold Resch. The Estate petitioned the Tax Court for a redetermination. The Tax Court considered the case to determine the includability of the trusts in the gross estate.

Issue(s)

1. Whether the corpus of the Arnold Resch trust is includible in his gross estate under Section 811(c)(1)(B) of the Internal Revenue Code, as amended.
2. Whether Federal Farm Mortgage Corporation bonds held in the Arnold Resch trust are exempt from estate tax due to the decedent's status as a nonresident alien not engaged in business in the United States.
3. Whether the non-insurance assets of the trust created by Tottie Resch, funded with gifts from the decedent, are includible in the decedent's gross estate.

Holding

1. Yes, because the decedent retained the right to the trust income by retaining the power to add life insurance policies to the trust, the earnings of which would inure to his benefit.
2. No, because Federal Farm Mortgage Corporation bonds are not "obligations issued by the United States" within the meaning of Section 861(c) of the Code.
3. No, because Tottie Resch was the true settlor of the trust, and the decedent's powers were fiduciary in nature.

Court's Reasoning

The court reasoned that Arnold Resch, by retaining the power to add life insurance policies to the trust and receive dividends from them, effectively retained the right to the trust's income. The court stated, "the decedent-settlor had at his command the means by which he could legally enforce the payment of the trust income and principal to himself." The court distinguished this case from Commissioner v. Irving Trust Co., where the trustee had sole discretion over distributions. Regarding the bonds, the court held that exemptions must be strictly construed. As the bonds were guaranteed but not directly issued by the U.S. government, they were not exempt. Regarding Tottie Resch's trust, the court determined that the gift of bonds to Tottie was unconditional, and she acted independently in creating the trust. Therefore, the decedent's powers were fiduciary and did not warrant inclusion in his gross estate.

Practical Implications

This case highlights the importance of carefully structuring trusts to avoid unintended estate tax consequences. Grantors must avoid retaining powers that could be interpreted as control over trust income or principal. The decision underscores that even indirect control, such as the power to direct investments into assets that benefit the grantor, can trigger inclusion in the gross estate. It also demonstrates that exemptions from taxation are narrowly construed. Further, it reaffirms the principle that trusts created by a separate settlor, acting independently, will generally not be included in the estate of the donor, provided the donor's powers are limited to those of a fiduciary. This case remains relevant for estate planning attorneys advising clients on trust creation and administration, particularly when considering life insurance trusts or trusts involving nonresident aliens.