

23 T.C. 588 (1954)

The primary motive behind a property transfer must be connected with life rather than death to avoid inclusion of the transferred property in the gross estate under estate tax law, and the retention of a possibility of reverter may cause inclusion of the transferred property in the gross estate.

Summary

The Estate of Elizabeth D. Hill contested the Commissioner's inclusion of property transferred to a trust in her gross estate for estate tax purposes. The Tax Court addressed two primary issues: whether the transfer was made in contemplation of death and whether the decedent retained a possibility of reverter. The court found that the primary motive for establishing the trust was likely estate tax avoidance and that the decedent had retained a reverter interest in the trust property. Consequently, the court sided with the Commissioner, concluding that the value of the transferred property was properly included in the gross estate under sections 811(c)(1)(A) and (C) of the Internal Revenue Code.

Facts

Elizabeth D. Hill died in 1948. In 1929, Elizabeth and her two sisters each created trusts with their inheritance from their mother's estate. Elizabeth's trust provided income to Henrietta (her sister) for life, then to Elizabeth and Sarah (other sisters) for life, with the remainder to Mary Hill Swope's children. The other two trusts were similar, each sister being a beneficiary of the other sisters' trusts. A key feature of Elizabeth's trust was that one-half of the corpus could revert to her if certain conditions occurred. The Commissioner determined that the trust property was includible in the gross estate because the transfer was in contemplation of death or because Elizabeth retained a reverter interest. The executor contested this determination.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in estate tax and included the value of the transferred property in the gross estate. The Estate petitioned the United States Tax Court to contest the deficiency. The Tax Court heard the case based on a stipulation of facts and the testimony of Gerard Swope, and ultimately sided with the Commissioner.

Issue(s)

1. Whether the transfer of property to the trust was made in contemplation of death, thus includible in the gross estate under Section 811(c)(1)(A) of the Internal Revenue Code.
2. Whether the decedent retained a possibility of reverter in the transferred

property, making it includible in the gross estate under Section 811(c)(1)(C).

Holding

1. Yes, because the primary motive for creating the trust was likely the avoidance of estate taxes, and the evidence did not demonstrate a significant life-related motive.
2. Yes, because the trust instrument contained provisions that could result in a portion of the trust assets reverting to Elizabeth, the decedent.

Court's Reasoning

The court applied sections 811(c)(1)(A) and (C) of the Internal Revenue Code. For the contemplation of death issue, the court considered the motives behind the trust creation. The court found that the evidence did not show that the primary motive for the transfer was related to life, such as managing the property. Instead, the court inferred that the primary motive was estate tax avoidance. The court noted, "If the primary purpose behind the creation of the trusts was the avoidance of estate tax, then the transfer here in question was in contemplation of death within the meaning of section 811 (c)(1)(A)." The court gave significant weight to the fact that the sisters consulted with legal counsel and that the trust was designed to avoid estate taxes. Regarding the reverter, the court found the trust instrument explicitly provided for a reversionary interest in Elizabeth, triggering the application of section 811(c)(1)(C).

Practical Implications

This case underscores the importance of demonstrating life-related motives when structuring property transfers. The court's focus on the primary motive behind the transfer serves as a warning for estate planners. Without a clear showing that life-related motives (such as providing for a beneficiary's needs) were paramount, the IRS may interpret the transfer as being made in contemplation of death. Further, the decision highlights the need for careful drafting to avoid the inadvertent creation of a reverter interest. The case also indicates that substance over form is a principle in estate tax planning. The use of reciprocal trusts, even if intended to avoid taxes, will not always succeed if the economic reality is that a reverter interest was retained. This case demonstrates that courts will look closely at the specifics of the arrangement and may disregard the form if it does not align with the economic substance.