Estate of McKeon, 25 T.C. 697 (1956)

When a decedent transfers property to a trust but retains the right to income for a period that does not end before his death, the value of the trust corpus is includible in the decedent's gross estate, but transfers for the support of children are considered transfers for consideration, while those for the support of a spouse are not.

Summary

The Estate of McKeon concerns the taxability of a trust's corpus under the 1939 Internal Revenue Code. The decedent transferred assets to a trust, the income of which was used to satisfy his support obligations to his wife and children under a divorce agreement. The Tax Court addressed whether the corpus should be included in the decedent's gross estate due to his retained income interest. The court also considered whether the decedent received consideration for the trust transfer, specifically the release of his support obligations to his children and his wife. The court held that the value of the trust was includible in the estate, but that consideration was given for support of the children, but not the wife, and that amount should be deducted from the gross estate.

Facts

The decedent, McKeon, established a trust (Trust B) during his lifetime, the income of which was used to satisfy his legal obligation to support his wife and two minor children. This obligation arose from a separation agreement. The decedent died while the trust income was still being paid for the support of his wife and children. The value of the trust corpus was not in dispute. The estate argued that the value of the trust corpus should not be included in the gross estate under Section 811(c)(1)(B) of the 1939 Code. Further, the estate asserted that a portion of the transfer should be excluded from the gross estate under section 811(i) because the decedent received consideration for the transfer in the form of the release of his obligations to support his children and his wife.

Procedural History

The Commissioner of Internal Revenue determined that the value of the corpus of Trust B was includible in the decedent's gross estate under section 811(c)(1)(B) of the 1939 Internal Revenue Code, as the decedent had retained the right to the income. The Commissioner further contended that the estate was not entitled to exclude the value of the trust corpus under section 811(i). The estate challenged the Commissioner's determination in the Tax Court.

Issue(s)

1. Whether the value of the corpus of Trust B is includible in the decedent's gross estate under section 811(c)(1)(B) of the 1939 Code because the decedent retained

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the right to income from the trust.

2. Whether the transfer of property to Trust B was made for consideration in money or money's worth, specifically, the release of the decedent's obligation to support his children, entitling the estate to exclude the value of the children's support from the gross estate.

3. Whether the transfer of property to Trust B was made for consideration in money or money's worth, specifically, the release of the decedent's obligation to support his wife, entitling the estate to exclude the value of the wife's support from the gross estate.

Holding

1. Yes, because the decedent's interest in the trust income did not end before his death, as it was still used to fulfill his support obligations.

2. Yes, because the release of the obligation to support the children constituted consideration in money or money's worth.

3. No, because the release of the obligation to support the wife was not consideration in money or money's worth, as such rights are considered marital rights under Section 812(b).

Court's Reasoning

The court first addressed the applicability of Section 811(c)(1)(B). This section required inclusion in the gross estate of property transferred where the decedent retained the right to income for a period that did not end before his death. The court found that the statute's language was clear and unambiguous and applied because the decedent's right to the income did not, in fact, end before his death. The fact that the termination of the support obligation was dependent on the wife's death or remarriage, or the children's reaching majority, was irrelevant.

The court then considered the estate's argument that the transfer to the trust was made for consideration, thereby reducing the value of the included property under Section 811(i). The court held that the release of the support obligations for the children did constitute consideration in money or money's worth, relying on prior cases. The court concluded that this amount was to be deducted from the gross estate. However, the court also held that the support rights of the wife constituted "marital rights in the decedent's property or estate" and therefore, under Section 812(b), the release of these rights could not be considered consideration in money's worth. As a result, the value of the support of the wife could not be excluded from the gross estate.

The court's decision emphasized the literal interpretation of the tax code regarding retained income interests and the distinction between support obligations to

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children and spouses. In essence, “The language of the statute ‘for any period which does not in fact end before his death’ is clear and unambiguous.”

Practical Implications

This case highlights the importance of understanding the precise language of the Internal Revenue Code when planning estates and trusts. Specifically, it demonstrates that any retained interest in trust income, even if dependent on events other than the death of the transferor, triggers inclusion of the trust property in the gross estate under certain circumstances. It also illustrates the different treatment the code accords support obligations to children versus spouses. The decision underscores the need for careful drafting of trust agreements and separation agreements to avoid unintended tax consequences.

This case is important to understand the interplay of different sections of the tax code. The holding has informed estate planning by clarifying the tax consequences of trusts designed to satisfy support obligations, affecting the amount of taxes owed by the estate. Additionally, the ruling in this case, that the children’s support is a transfer for consideration, helps to provide guidelines on what transfers for consideration are for the purpose of estate tax.

Later cases citing McKeon reinforce its principles regarding retained income interests and the distinction between support obligations. Practitioners should take care to review the current tax code to stay abreast of changes which could impact the holding.

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