31 T.C. 1148 (1959)

Under the reciprocal trust doctrine, when two trusts are created in consideration of each other, the IRS can "uncross" the trusts and tax them as if the settlor of each trust had created the other.

Summary

The United States Tax Court addressed whether the values of two trusts were includible in the respective gross estates of the settlors, Ernest and Laura Carter. The IRS argued that the trusts were reciprocal. Ernest created a trust with income to Laura for life, with the remainder to their children and grandchildren. Laura created a trust with income to Ernest for life, and a remainder to their children. The court held that the trusts were reciprocal because they were executed in consideration of each other, and each settlor furnished consideration for the other's trust. The Court looked at the timing of the trusts, the identical provisions in many respects, and the fact that the settlors gave each other life estates.

Facts

Ernest and Laura Carter, married in 1891, created trusts for each other's benefit in December 1935. Ernest's trust provided income to Laura for life, with a secondary life estate to their children and the remainder to grandchildren. Laura's trust provided income to Ernest for life, with a remainder in two-thirds of the trust to two children and a secondary life estate in one-third to their other child, with a remainder to that child's children. Both trusts were prepared by the same attorney and contained identical provisions in many respects. Each settlor knew the other was executing his or her trust. The IRS determined that the values of both trusts were includible in the respective gross estates of Laura and Ernest.

Procedural History

The IRS determined deficiencies in the estate taxes of both Laura and Ernest Carter, arguing that the trusts were reciprocal and should be included in their gross estates. The executors of both estates challenged the IRS's determination in the U.S. Tax Court. The Tax Court addressed whether the value of the trusts were includible in the gross estates. The court found in favor of the IRS.

Issue(s)

1. Whether the value of the trust created by Ernest was includible in Laura's gross estate.

2. Whether the value of the trust created by Laura was includible in Ernest's gross estate.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. Yes, because the trust created by Ernest was found to be reciprocal and was executed in consideration of the trust created by Laura.

2. Yes, because the trust created by Laura was found to be reciprocal and was executed in consideration of the trust created by Ernest.

Court’s Reasoning

The court applied the reciprocal trust doctrine, as established in *Allan S. Lehman et al., Executors*. The court focused on whether the trusts were executed in consideration of each other. Key factors included that the trusts were executed on consecutive days, the size of the trusts were similar, the same attorney prepared the trusts, the trustees of each trust were identical, and the trust agreements were identical in many respects. Most importantly, the court highlighted that each settlor made the other a life tenant of his or her trust. Because the trusts were reciprocal, the court treated each trust as if it had been created by the other, thereby including the trust assets in the settlors’ gross estates under section 811(c)(1)(B) of the Internal Revenue Code of 1939.

The court rejected the petitioners’ arguments that Ernest’s intention was to secure the grandchildren’s future. They argued that Laura did not decide to create a trust until she was advised that federal gift tax rates were going to be increased. The court found these explanations to be weak, especially considering that they did not provide a reason for the gifts of life estates.

Practical Implications

This case provides clear guidance on the application of the reciprocal trust doctrine. Attorneys should carefully scrutinize the facts and circumstances surrounding the creation of trusts, particularly those created around the same time by related parties. The presence of crossed life estates, identical provisions, and a lack of independent purpose for each trust strongly suggests reciprocity. To avoid the application of the reciprocal trust doctrine, settlors must establish that the trusts were created independently, without consideration of the other, and for different purposes. Estate planners should advise clients on the importance of documenting the independent motivations behind trust creation and the economic substance of transactions.

© 2025 SCOTUSreports.com. All rights reserved.