Estate of William H. Lee, 33 T.C. 1073 (1960)

When a trust instrument directs that income be used for the support of a beneficiary whom the grantor has a legal obligation to support, the trust's value is included in the grantor's gross estate for estate tax purposes, as the grantor is deemed to have retained enjoyment of the income.

Summary

The case concerns the estate tax liability for a trust created by William H. Lee for his wife. The IRS argued, and the Tax Court agreed, that the trust's value should be included in Lee's gross estate because the trust instrument directed that the income be used for his wife's maintenance and support. The court held that this language meant Lee had retained the enjoyment of the trust income, satisfying his legal obligation to support his wife, and thus the trust's value was subject to estate tax. The court distinguished this case from others where the trustee had discretion, emphasizing the binding nature of the direction in this instance.

Facts

- William H. Lee created an irrevocable trust in 1945, with the Lockport Exchange Trust Company as trustee.
- He transferred $125,000 in securities and cash to the trust.
- The trust income was to be paid to Lee's wife, Elizabeth M. Lee, for her maintenance and support during her lifetime, then to their son.
- Lee retained no power to alter the trust or control the trustee's activities.
- Lee had a substantial net worth, and his wife had her own income and assets.
- The trust instrument stated that the law of New York would govern the indenture.

Procedural History

- The IRS determined an estate tax deficiency, including the value of the trust in Lee's gross estate under Internal Revenue Code §811(c).
- The executors of Lee's estate challenged the deficiency in the U.S. Tax Court.
- The Tax Court ruled in favor of the IRS.

Issue(s)

1. Whether the value of the trust created by the decedent is includible in the decedent's gross estate under §811(c) of the Internal Revenue Code of 1939 because the income was to be used to fulfill decedent's support obligations.

Holding

1. Yes, because the trust instrument specifically directed that the income be used for the maintenance and support of the decedent's wife, the value of the trust

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is includible in the decedent's gross estate.

Court's Reasoning

The court relied on Section 811(c) of the Internal Revenue Code of 1939 and regulations which state that the value of transferred property is included in a decedent's gross estate if they retained the enjoyment of the property or the income therefrom. The court focused on whether the decedent retained the enjoyment of the trust income by having it applied towards the discharge of his legal obligation to support his wife. The key was the specific language in the trust instrument directing that the income be used for the wife's "maintenance and support."

The court distinguished this case from situations where a trustee has discretion over income distribution, emphasizing that the trust language was not ambiguous, and the income was restricted for the wife's support. The court referenced *Commissioner v. Dwight's Estate*, where similar language was interpreted by the Second Circuit to determine the trust income would serve as a pro tanto defense in any suit for support brought by the wife. The court determined that the husband had by the trust, in part at least, discharged his obligation to support his wife.

The court also rejected the argument that the trust language was merely surplusage or customary, stating the plain meaning of the words was that the income should be used for the wife's support. The court emphasized that the instrument's language, in the context of New York law, meant the decedent had retained the right to have the income applied to his support obligation.

Practical Implications

The decision reinforces that when drafting trust instruments, clear language should be used to delineate the purpose of the trust income. If the intent is not for the income to satisfy the grantor's support obligation, care should be taken to grant the trustee discretion in distributing income, and avoid language which would make the income restricted or dedicated towards fulfilling any support obligation. The IRS and the courts will scrutinize trust instruments for such language. This case serves as a caution for estate planners to be precise and to understand the tax consequences of how trust income is designated. It is essential that the attorney understand the state law, as well as the terms of the trust, to determine the tax consequences.

This case is important when considering:

- Estate planning strategies involving trusts where the grantor has support obligations.
- The importance of precise language in trust documents.
- Distinguishing between situations where the trustee has discretion and when income is directed for support.
- Analyzing whether a trust instrument creates an enforceable right for the

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settlor to have income used for their legal obligations.

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