***Estate of Julia Crawford Hornor, F. Raymond Wadlinger and Caleb W. Hornor, Executors, Petitioner, v. Commissioner of Internal Revenue, Respondent*, 36 T.C. 337 (1961)**

Property initially included in a predeceased spouse's gross estate can also be included in the surviving spouse's gross estate to the extent of the surviving spouse's retained life interest in a trust that became irrevocable upon the predeceased spouse's death.

Summary

William and Julia Hornor, husband and wife, owned property as tenants by the entirety. William, who originally owned the properties, transferred them to himself and Julia as tenants by the entirety. They then created a revocable trust, naming themselves and their son as trustees, and transferred the entirety property into it. The trust reserved income to William and Julia jointly for life, then to the survivor, and retained a joint power to revoke or amend. Upon William's death, the trust became irrevocable. William's estate was previously taxed on the full value of the trust property. Upon Julia's subsequent death, the Tax Court held that half the value of the trust property was includible in Julia's gross estate under Section 811(c)(1)(B) of the 1939 Internal Revenue Code because she retained a life interest in the property after the trust became irrevocable upon William's death. The court allowed credits for gift tax paid and state death taxes.

Facts

1. William Hornor originally owned 107 parcels of real estate.
2. William transferred these properties to himself and his wife, Julia, as tenants by the entirety; Julia provided no consideration for this transfer.
3. In 1935, William and Julia, as tenants by the entirety, established a revocable trust and transferred the 107 properties and some cash into it. They named themselves and their son as trustees.
4. The trust terms provided for income to be paid to William and Julia jointly for their lives, then to the survivor for life, with remainder interests to their sons.
5. William and Julia retained a joint power to revoke, amend, or withdraw trust property during their joint lives, making the trust revocable.
6. Upon the death of the first spouse, the trust became irrevocable.
7. William died in 1937. His estate was taxed on the full value of the trust property under Section 302(e) of the Revenue Act of 1926, as property held in tenancy by the entirety.
8. Julia died in 1954. The Commissioner included a portion of the trust property in Julia's gross estate, representing the actuarial value of her life income interest.

Procedural History

1. Commissioner determined a deficiency in Julia Hornor's estate tax, including a portion of the trust property.
2. Estate of Julia Hornor petitioned the Tax Court to contest the deficiency.
3. Previously, in *Estate of William Macpherson Hornor*, the Board of Tax Appeals (affirmed by the Third Circuit) upheld the inclusion of the entire trust property in William's gross estate.

Issue(s)

1. Whether a portion of the value of property held in an irrevocable trust at the time of Julia Hornor's death is includible in her gross estate under Section 811(c)(1)(B) of the 1939 Internal Revenue Code, where the property was initially held as tenants by the entirety and the trust became irrevocable upon her husband's prior death, and where the full value of the trust was previously included in her husband's gross estate.
2. Whether Julia's estate is entitled to a credit for gift tax paid by Julia on the transfer of property to the trust.
3. Whether Julia's estate is entitled to a credit for additional state death taxes.

Holding

1. Yes. One-half of the value of the property held in the trust at the time of Julia's death is includible in her gross estate under Section 811(c)(1)(B) because Julia made a transfer with a retained life interest when the revocable trust became irrevocable upon William's death.
2. Yes. Julia's estate is entitled to a credit for gift tax paid to the extent provided by Sections 813(a)(2) and 936(b) of the 1939 Internal Revenue Code.
3. Yes. Julia's estate is entitled to a credit for additional state death taxes to the extent provided by Section 813(b) of the 1939 Internal Revenue Code.

Court's Reasoning

The Tax Court reasoned that while the full value of the trust property was included in William's estate under Section 302(e) as entirety property, Julia's estate tax liability arises under a different section, 811(c)(1)(B), concerning transfers with retained life interests. The court distinguished the prior ruling in William's estate, stating that the prior case determined the taxability under the joint tenancy provisions applicable at William's death, whereas Julia's case concerns her transfer with a retained life interest that became fixed when the trust became irrevocable at William's death.

The court relied on *Estate of A. Carl Borner*, 25 T.C. 584 (1956), which held that when tenants by the entirety transfer property to an irrevocable trust, reserving life income, only half the property's value is includible in each spouse's estate under Section 811(c). The court reasoned that despite the tenancy by the entirety, each spouse effectively owns and transfers only a one-half interest for the purposes of

Section 811(c). The court stated, "We conclude as a practical matter, the tenancy by entirety and joint tenancies are so much alike that the rule applied in the joint tenancy cases should be applied here where the tenancies are by the entirety, which means each tenant owns one-half."

The court rejected the petitioner's argument that the prior decision in William's estate precluded taxing any portion of the trust in Julia's estate. The court clarified that the prior ruling addressed Section 302(e) and the inclusion of entirety property in the first spouse's estate, while the current case addresses Section 811(c) and Julia's retained life interest. Judge Mulroney, in concurrence, emphasized that Section 811(c) taxes transfers where the decedent retained life income, and Julia's transfer became complete and taxable when the revocable trust became irrevocable upon William's death.

Judge Murdock dissented, arguing that taxing the same property in both estates is inconsistent and contradicts the principle that entirety property originally belonged to William and should only be taxed in his estate.

Practical Implications

Estate of Hornor illustrates the potential for estate taxation in both spouses' estates when dealing with tenancy by the entirety property transferred into trust, even if the entire value was initially taxed in the first spouse's estate. It highlights that estate tax law considers each spouse as transferring their respective half interest in entirety property for purposes of transfers with retained life income under Section 811(c), even though the entirety property is fully taxed in the first spouse's estate under different provisions related to joint ownership. This case underscores the importance of considering the interplay of different estate tax code sections and the timing of when trusts become irrevocable in estate planning, particularly for jointly held property. It suggests that even if property is fully taxed in the first spouse's estate due to joint ownership rules, the surviving spouse's retained interests can trigger further estate tax upon their death under different transfer-related provisions. Later cases distinguish *Hornor* based on specific trust terms and the nature of the retained interests, but the core principle of potential double taxation based on different estate tax sections remains relevant for estate planners.

