Estate of Harry Prudowsky, Deceased, Vivian Prudowsky, Administratix, Petitioner v. Commissioner of Internal Revenue, Respondent, 55 T. C. 890 (1971); 1971 U. S. Tax Ct. LEXIS 174

Assets held by a decedent as custodian under the Uniform Gifts to Minors Act are includable in the decedent's gross estate under IRC Sections 2036 and 2038 due to the retained powers of the custodian.

Summary

Harry Prudowsky died holding assets as custodian for his minor children under the Wisconsin Uniform Gifts to Minors Act. The IRS asserted these assets should be included in his estate, citing the powers retained by Prudowsky under the Act. The Tax Court agreed, holding that the assets were includable under IRC Sections 2036 and 2038 because Prudowsky had the power to use the custodial assets for his children's support and to terminate the custodianship at will. This case illustrates the importance of understanding the tax implications of custodial arrangements under state law and how they can impact estate planning strategies.

Facts

Harry Prudowsky died intestate on December 20, 1963, leaving behind his wife and three minor children, one of whom was mentally retarded. At his death, Prudowsky held various stocks and savings accounts as custodian for his children under the Wisconsin Uniform Gifts to Minors Act. These assets were purchased with checks from Prudowsky's joint account with his wife, and records were kept separately from his personal transactions. Dividends from the stocks were deposited into the children's savings accounts, and none of the custodial funds were used for Prudowsky's support obligation to his children.

Procedural History

The IRS asserted a deficiency in Prudowsky's estate tax return, claiming the custodial assets should be included in his gross estate. Prudowsky's estate filed a petition in the U. S. Tax Court challenging this inclusion. The court upheld the IRS's position, ruling that the assets were includable under IRC Sections 2036 and 2038.

Issue(s)

1. Whether the assets held by Harry Prudowsky as custodian under the Wisconsin Uniform Gifts to Minors Act are includable in his gross estate under IRC Section 2036 due to his retained power to use them for his children's support.
2. Whether the same assets are includable under IRC Section 2038 due to Prudowsky's retained power to terminate the custodianship at will.

Holding

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1. Yes, because under the Wisconsin Act, Prudowsky retained the power to use the custodial assets to satisfy his legal obligation of support, which falls within the purview of Section 2036.
2. Yes, because Prudowsky retained the power to terminate the custodianship at his discretion, which falls within the purview of Section 2038.

Court's Reasoning

The court applied the statutory provisions of IRC Sections 2036 and 2038, which require the inclusion of transferred assets in a decedent's gross estate if the decedent retained certain powers over the assets at the time of death. The Wisconsin Uniform Gifts to Minors Act gave Prudowsky the power to use the custodial assets for his children's support and to terminate the custodianship at will. The court relied on prior cases like *Stuit* and *Chrysler*, which established that such retained powers result in estate tax inclusion. The court rejected arguments that Prudowsky's financial situation or the legislative intent behind the Act should alter the outcome, emphasizing the clear language of the statutes and the powers retained by Prudowsky.

Practical Implications

This decision underscores the importance of considering the tax implications of custodial arrangements under state law. It informs estate planning by highlighting that assets held in custodianship under the Uniform Gifts to Minors Act may be subject to estate tax inclusion if the custodian retains certain powers. Legal practitioners should advise clients to consider alternative arrangements if they wish to avoid such tax consequences. The ruling has been applied in subsequent cases and remains relevant in estate planning involving custodial accounts. It also illustrates the potential harshness of the tax law in certain situations, prompting calls for legislative reform to address these issues.

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