Estate of Thomson v. Commissioner, 58 T. C. 880 (1972)

Each addition of trust income to principal after March 4, 1931, constitutes a separate “transfer” under Section 2036(a)(2) of the Internal Revenue Code, subject to estate tax inclusion.

Summary

James L. Thomson created a trust in 1928, reserving the right to distribute income to beneficiaries or add it to principal. After his death in 1966, the issue was whether post-1931 income additions to the trust should be included in his estate under Section 2036(a)(2). The court held that each income addition post-1931 was a separate “transfer,” thus taxable under Section 2036(a)(2) but not exempted by Section 2036(b). The court determined that $153,664. 92 of the trust’s value at Thomson’s death was includable in his gross estate. This ruling emphasizes the importance of timing and the nature of retained powers in estate planning.

Facts

James L. Thomson created a trust on June 4, 1928, for his son and daughter, initially funded with securities worth $31,237. The trust allowed Thomson to either distribute income to the beneficiaries or add it to the principal, a power he retained until his death on July 23, 1966. From 1933 to 1966, $97,260. 56 in trust income was added to the principal, with $80,000. 16 net income after taxes. At Thomson’s death, the trust was valued at $222,235. 77, and no value was initially reported in his estate for the trust.

Procedural History

The Commissioner determined deficiencies in estate tax for both James L. Thomson and his wife, Adelaide L. Thomson. The executors of the estates contested the inclusion of the trust’s value in the gross estate, leading to the case being heard by the U. S. Tax Court. The court addressed whether post-1931 income additions to the trust were taxable under Section 2036(a)(2) and, if so, the amount to be included.

Issue(s)

1. Whether trust income added to principal periodically from 1933 through 1966 was “transferred” to the trust after March 4, 1931, the effective date of Section 2036, where the decedent had created the trust prior to March 4, 1931, reserving the discretionary power to distribute income or accumulate it.
2. If so, what portion of the value of the trust is allocable to the post-1931 transfers of income and therefore includable in the decedent’s gross estate under Section 2036(a)(2).

Holding

1. Yes, because each addition of income to principal after March 4, 1931, constituted a separate "transfer" under Section 2036(a)(2), as the decedent's retained power to designate beneficiaries applied to such income.
2. The court held that $153,664. 92 of the trust's value at Thomson's death was allocable to post-1931 income additions and thus includable in his gross estate.

Court's Reasoning

The court reasoned that Thomson's power to decide whether to distribute income or add it to principal was a power to designate beneficiaries under Section 2036(a)(2). The court relied on *United States v. O'Malley*, which established that each addition of income to principal was a separate "transfer. " The court rejected the argument that only the initial transfer in 1928 should be considered, holding that post-1931 additions were not exempt under Section 2036(b). The court used a formula to determine the includable amount, despite challenges in tracing specific assets, and found petitioners' figure to be the most reasonable based on the available evidence.

Practical Implications

This decision clarifies that for trusts created before March 4, 1931, any income added to principal after that date is a separate "transfer" subject to estate tax under Section 2036(a)(2). Estate planners must consider the tax implications of retained powers over trust income, especially for long-term trusts. The ruling may influence how trusts are structured to minimize estate tax exposure, particularly regarding the timing of income additions. Subsequent cases may need to address similar issues of tracing income and applying formulas to determine includable amounts. The decision underscores the need for detailed trust accounting to accurately allocate values for tax purposes.

