Estate of Fred A. Cutter, John W. Cutter and Patricia Cooley, Co-Executors, Petitioners v. Commissioner of Internal Revenue, Respondent, 62 T. C. 351 (1974)

The absence of an ascertainable standard in a trust's discretionary income distribution power results in inclusion of the trust's assets in the settlor's gross estate under IRC Section 2036(a)(2).

Summary

Fred A. Cutter established eight irrevocable trusts for his grandchildren, serving as the sole trustee until his death. The trusts allowed Cutter to distribute income at his discretion 'for the benefit of' each beneficiary. The U. S. Tax Court held that this discretionary power did not meet the criteria for a judicially ascertainable standard, necessitating the inclusion of the trusts' principal and accumulated income in Cutter's estate under IRC Section 2036(a)(2). The decision underscores the importance of clear, enforceable standards in trust instruments to avoid estate tax inclusion.

Facts

Fred A. Cutter created eight irrevocable trusts for his grandchildren between 1951 and 1965, naming himself as the sole trustee. Each trust was funded with Cutter Laboratories stock. The trust instruments granted Cutter the power to distribute income 'in his sole discretion' as he deemed 'necessary for the benefit' of each beneficiary. Cutter retained this power until his death on February 22, 1967. At his death, the trusts had a combined value of $279,708. 50, with only the portion attributable to Cutter's contributions at issue for estate tax inclusion.

Procedural History

The Estate of Fred A. Cutter filed a timely estate tax return and elected to value the estate's assets as of the alternative valuation date. The Commissioner of Internal Revenue determined a deficiency of $117,719, asserting that the trusts' assets should be included in Cutter's gross estate. The Estate contested this, leading to the case being heard by the U. S. Tax Court.

Issue(s)

1. Whether the discretionary power to distribute trust income as deemed 'necessary for the benefit of' each beneficiary constitutes a judicially ascertainable standard under IRC Sections 2036(a)(2) and 2038(a)(1).

Holding

1. No, because the phrase 'necessary for the benefit of' lacks the specificity required to create an ascertainable standard, resulting in the inclusion of the trusts' principal

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and accumulated income in the decedent's gross estate under IRC Section 2036(a)(2).

Court's Reasoning

The Tax Court analyzed whether the discretionary power to distribute income met the criteria for an ascertainable standard. The court noted that terms like 'support, education, maintenance, care, necessity, illness, and accident' typically create ascertainable standards, while 'happiness, pleasure, desire, benefit, best interest, and well-being' do not. The phrase 'necessary for the benefit of' was deemed too broad to create an ascertainable standard, as 'benefit' suggests more than just support and 'necessary' does not sufficiently limit this broad discretion. The court rejected the Estate's argument to interpret 'necessary for the benefit of' narrowly, emphasizing that the language of the trust must be unambiguous and that extrinsic evidence of intent was inadmissible. The court concluded that the power to distribute income was not constrained by a judicially enforceable standard, thereby triggering estate tax inclusion under IRC Section 2036(a)(2).

Practical Implications

This decision highlights the critical need for precise language in trust instruments to avoid unintended estate tax consequences. Practitioners should ensure that trust provisions for discretionary distributions include clear, enforceable standards to prevent the inclusion of trust assets in the settlor's estate. This case has influenced subsequent estate planning practices, emphasizing the use of terms like 'support, maintenance, and education' to create ascertainable standards. It has also been cited in later cases to distinguish between trusts with and without such standards, affecting how trusts are drafted and interpreted in estate planning and taxation.

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