### *62 T.C. 400 (1974)*

Under 26 U.S.C. § 2033, only vested property interests of a decedent are included in their gross estate for federal estate tax purposes; contingent interests that lapse at death are excluded.


**Summary**

The Tax Court held that the value of a decedent's interest in a testamentary trust was not includable in his gross estate for federal estate tax purposes because his interest was contingent, not vested, at the time of his death. The trust, established by the decedent's uncle, was to terminate 21 years after the death of the last of the uncle's sisters. The will stipulated that upon termination, the trust corpus would be divided among the 'heirs' of the sisters. The court determined, based on Kentucky law and the testator's intent, that the decedent's interest was contingent upon surviving until the trust's termination, and therefore, not taxable in his estate.


**Facts**

Joseph L. Friedman's will, probated in Kentucky in 1913, established a trust. The trust income was to benefit Friedman's mother and three sisters, and upon their deaths, their children. The trust was set to terminate 21 years after the death of the last surviving sister, with the corpus then distributed 'one-third to the heirs of each of my said sisters.' Clarence A. Williams, a nephew of Friedman through his sister Ida, received income from the trust until his death in 1968. Williams predeceased the termination of the trust, which was set for 1975. The IRS sought to include a portion of the trust corpus and income in Williams's gross estate, arguing it was a vested interest.

**Procedural History**

The Estate of Clarence A. Williams petitioned the U.S. Tax Court to challenge the Commissioner of Internal Revenue's deficiency determination, which sought to include the value of Williams's trust interest in his gross estate. The case was heard by the Tax Court.

**Issue(s)**

1. Whether the decedent, Clarence A. Williams, held a vested interest in a portion of the corpus of the testamentary trust established by his uncle, Joseph L. Friedman, at the time of his death, such that it is includable in his gross estate under 26 U.S.C. § 2033.
2. Whether the decedent, Clarence A. Williams, held a vested interest in the income from a portion of the corpus of the testamentary trust established by his uncle, Joseph L. Friedman, at the time of his death, such that it is includable in his gross estate under 26 U.S.C. § 2033.

 

**Holding**

1. No, because under Kentucky law and the testator's intent as discerned from the will, the decedent's interest in the trust corpus was contingent upon him surviving until the trust termination date, and thus, not a vested interest includable in his gross estate.
2. No, because the decedent's interest in the trust income was akin to a life estate, terminating at his death, and not a vested interest extending beyond his lifetime and includable in his gross estate.

**Court's Reasoning**

The Tax Court reasoned that the determination of whether the decedent had a taxable interest under 26 U.S.C. § 2033 depended on state property law, in this case, Kentucky law. Citing *Blair v. Commissioner*, 300 U.S. 5 (1937) and *Morgan v. Commissioner*, 309 U.S. 78 (1940), the court emphasized that state law defines the nature of the legal interest, while federal law determines taxability. The court analyzed Friedman's will to ascertain his intent, noting Kentucky law prioritizes testator intent over technical rules of construction, as stated in *Lincoln Bank & Trust Co. v. Bailey*, 351 S.W.2d 163 (Ky. Ct. App. 1961). The will language, particularly the phrase 'then the estate…shall be divided, one-third to the heirs of each of my said sisters' at the trust's termination, indicated an intent to postpone both termination and determination of 'heirs' until 21 years after the last sister's death. The court found the use of 'heirs' and the explicit 21-year period mirroring the rule against perpetuities, suggested a contingent remainder. Regarding income, the court interpreted 'heirs' to mean lineal descendants, ensuring income stayed within the bloodlines of Friedman's sisters, and not a vested interest passing to the decedent's estate. The court concluded, 'decedent Williams had only a contingent interest in the trust corpus at the time of his death and that interest is not taxable in his estate,' and similarly, 'only a life estate in the income from the trust which terminated at his death and was not taxable in his estate.'

**Practical Implications**

*Estate of Williams v. Commissioner* reinforces the critical role of state law in determining property interests for federal tax purposes, particularly in estate taxation. It clarifies that for interests in trusts to be includable in a decedent's gross estate under 26 U.S.C. § 2033, they must be vested, not contingent. This case highlights the importance of carefully drafting trust instruments to clearly define beneficiaries and the nature of their interests, especially when aiming for estate tax planning. It serves as a reminder that ambiguous will language regarding 'heirs' and trust termination can lead to litigation and that courts will prioritize testator intent and the rule against perpetuities in interpreting such ambiguities. Later cases analyzing similar trust provisions must consider both the specific language of the trust and the relevant state law governing property rights to determine whether trust interests are vested or contingent for estate tax purposes.