Estate of Anders Jordahl, Deceased, United States Trust Company of New York, and Wendell W. Forbes, Co-Executors v. Commissioner of Internal Revenue, 65 T. C. 92 (1975)

A settlor's power to substitute trust assets of equal value does not constitute a power to alter, amend, or revoke the trust under IRC section 2038(a)(2) if the settlor is bound by fiduciary standards.

Summary

In Estate of Jordahl v. Commissioner, the U. S. Tax Court held that the decedent's power to substitute trust assets of equal value did not amount to a power to alter, amend, or revoke the trust under IRC section 2038(a)(2). The decedent established a trust with life insurance policies and other assets, retaining the power to substitute assets of equal value. The court reasoned that this power was akin to directing investments and was constrained by fiduciary duties, thus not subject to estate tax inclusion. Additionally, the court determined that the insurance proceeds were not includable in the estate under IRC section 2042(2) since the decedent did not possess incidents of ownership in the policies. This decision impacts estate planning by clarifying the boundaries of asset substitution powers in trusts.

Facts

On January 31, 1931, Anders Jordahl created an irrevocable trust, naming himself, his wife, and Guaranty Trust Co. as trustees. The trust's corpus included life insurance policies on Jordahl's life and other income-producing assets. The trust agreement required the trustees to pay policy premiums from trust income, with any excess income distributed to Jordahl. Upon his death, income was to be paid to his daughter until she reached 50, at which point she would receive the principal. Jordahl retained the power to substitute securities, property, and policies of equal value. The trust's income always exceeded the premiums and administrative expenses, and no substitutions were made during Jordahl's lifetime.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Jordahl's estate tax, arguing that all trust assets, including insurance proceeds, should be included in the gross estate under IRC sections 2038(a)(2) and 2042(2). The estate contested this determination, leading to the case being fully stipulated and heard by the U. S. Tax Court.

Issue(s)

1. Whether the decedent's power to substitute trust assets of equal value constituted a power to alter, amend, or revoke the trust under IRC section 2038(a)(2)?
2. Whether the proceeds of the insurance policies were includable in the decedent's gross estate under IRC section 2042(2)?

Holding

1. No, because the decedent’s power to substitute assets was no greater than a settlor’s power to direct investments and was constrained by fiduciary standards.
2. No, because the decedent did not possess incidents of ownership in the policies, as the right to substitute other policies of equal value did not give him access to the economic benefits of the policies.

Court’s Reasoning

The court analyzed the trust agreement, noting that Jordahl’s substitution power was limited to assets of equal value, which prevented him from depleting the trust corpus. The court likened this power to directing investments and cited prior cases where such powers, when bound by fiduciary duties, were not considered powers to alter, amend, or revoke. The court emphasized that Jordahl, even as a trustee, was accountable to the trust’s beneficiaries and could not use his substitution power to shift benefits detrimentally. Regarding the insurance policies, the court found that Jordahl’s powers as trustee were strictly limited and never exercised, as income was always sufficient to pay premiums. The court concluded that the power to substitute policies of equal value did not constitute an incident of ownership under IRC section 2042(2), as any substitution would require surrendering nearly identical benefits.

Practical Implications

This decision clarifies that a settlor’s power to substitute trust assets of equal value, when bound by fiduciary duties, does not trigger estate tax inclusion under IRC section 2038(a)(2). Estate planners can use this ruling to structure trusts that allow for asset substitution without incurring estate tax liability. The decision also impacts the treatment of life insurance policies in trusts, as it establishes that limited substitution rights do not equate to incidents of ownership under IRC section 2042(2). Subsequent cases, such as Estate of Skifter, have relied on this ruling to distinguish between substitution powers and incidents of ownership. This case underscores the importance of clear trust language and fiduciary constraints in estate planning to minimize tax exposure.

