Estate of John A. Alexander, Dartmouth National Bank of Hanover and Herbert Crawford, Coexecutors, Petitioner v. Commissioner of Internal Revenue, Respondent, 81 T. C. 757 (1983)

The retained power to accumulate trust income, even without control over the ultimate disposition of the trust assets, can trigger inclusion of the trust in the settlor's gross estate under IRC Section 2036(a)(2).

Summary

In Estate of Alexander v. Commissioner, the U. S. Tax Court ruled that the decedent's trust, where he retained the power to accumulate income, was includable in his gross estate under IRC Section 2036(a)(2). John A. Alexander created a trust for his daughter, retaining the right to accumulate income and appoint successor trustees. Despite resigning as trustee and appointing successors, the court held that he retained the power to control the present enjoyment of trust income, necessitating inclusion in his estate. The decision underscores that the power to control present enjoyment, rather than ultimate disposition, is crucial for Section 2036(a)(2) analysis.

Facts

In 1943, John A. Alexander created an irrevocable trust for his nine-month-old daughter, Louise, naming himself as trustee. The trust allowed him to accumulate income or distribute it at his discretion. Upon reaching certain ages, Louise was to receive distributions from the trust. Alexander retained the power to appoint successor trustees. In 1950, he resigned as trustee and appointed a successor, followed by additional appointments in subsequent years. At his death in 1977, the trust's value was significant, and the Commissioner sought to include it in his estate under IRC Section 2036(a)(2).

Procedural History

The Commissioner determined a Federal estate tax deficiency against Alexander's estate, leading to a dispute over the inclusion of the trust assets. The case was brought before the U. S. Tax Court, which ultimately ruled in favor of the Commissioner, affirming the inclusion of the trust in the decedent's gross estate.

Issue(s)

1. Whether the decedent's retained power as trustee to accumulate trust income constituted "the right * * * to designate the persons who shall possess or enjoy the property or the income therefrom" under IRC Section 2036(a)(2)?
2. Whether the decedent effectively released this right when he resigned as trustee and appointed successors?

Holding

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1. Yes, because the power to accumulate income allowed the decedent to control Louise's present enjoyment of the trust income, which is a form of designation under Section 2036(a)(2).
2. No, because the decedent did not release his power to redesignate himself as trustee after appointing successors, thus retaining the Section 2036(a)(2) right.

Court's Reasoning

The court focused on the decedent's power to control the present enjoyment of trust income, citing precedents such as Struthers v. Kelm and Estate of O'Connor v. Commissioner. It emphasized that the ability to deny immediate enjoyment to beneficiaries is sufficient to trigger Section 2036(a)(2), even if the settlor cannot control the ultimate disposition of the trust assets. The court rejected the estate's argument that the decedent released his power by appointing successors, finding no evidence that he could not redesignate himself as trustee. The court's interpretation aligns with the policy of preventing settlors from avoiding estate taxes through trusts while retaining significant control over the trust's benefits.

Practical Implications

This decision informs estate planning by highlighting the importance of considering the retained powers over trust income when structuring trusts to avoid estate inclusion. Practitioners should be cautious about granting settlors discretion over income distribution, as it may lead to inclusion under Section 2036(a)(2). The ruling also underscores the need for explicit language in trust instruments regarding the release of powers, especially when appointing successor trustees. For businesses and families, this case emphasizes the potential tax consequences of retaining control over trust assets, even indirectly. Subsequent cases, such as Estate of Farrel v. United States, have continued to apply and refine the principles established in Alexander, affecting how similar trusts are analyzed for estate tax purposes.

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