Estate of Lee D. Jalkut, Deceased, Nathan M. Grossman, Executor, Petitioner v. Commissioner of Internal Revenue, Respondent, 96 T. C. 675 (1991)

Gifts from a revocable trust within three years of death are included in the gross estate if the decedent relinquished control over the trust assets through the transfer.

Summary

Lee Jalkut created a revocable trust in 1971, serving as its sole trustee and beneficiary during his lifetime. In 1984, upon learning of his terminal illness, Jalkut made gift transfers from the trust. In 1985, after being declared incapacitated, substitute trustees made additional transfers. The issue was whether these gifts should be included in Jalkut's gross estate under I. R. C. sections 2035(d)(2) and 2038(a)(1). The court held that the 1984 gifts, made while Jalkut was still competent, were not included in the estate because they were effectively withdrawals followed by personal gifts. However, the 1985 transfers, made by the substitute trustees after Jalkut's incapacity, were included in the estate as a relinquishment of Jalkut's control over the trust assets.

Facts

In 1971, Lee D. Jalkut established a revocable trust, appointing himself as the sole trustee and beneficiary during his lifetime. In 1984, upon learning he had inoperable cancer, Jalkut made gift transfers from the trust. On January 25, 1985, Jalkut's physician declared him unable to manage his affairs, and substitute trustees were appointed. On the same day, the substitute trustees made additional gift transfers from the trust. Jalkut died testate on February 6, 1985.

Procedural History

The executor of Jalkut's estate filed a Federal estate tax return in November 1985, excluding the 1984 and 1985 gift transfers from the gross estate. The Commissioner of Internal Revenue determined a deficiency, asserting that the transfers should be included in the estate. The case was submitted fully stipulated to the U. S. Tax Court, which issued its opinion on April 29, 1991.

Issue(s)

1. Whether gift transfers made from the decedent's revocable trust in 1984, within three years of his death, are included in his gross estate pursuant to I. R. C. sections 2035(d)(2) and 2038(a)(1)?
2. Whether gift transfers made from the decedent's revocable trust in 1985, within three years of his death, are included in his gross estate pursuant to I. R. C. sections 2035(d)(2) and 2038(a)(1)?

Holding

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1. No, because the 1984 transfers were treated as withdrawals by Jalkut followed by personal gifts, not as a relinquishment of his power over the trust assets.
2. Yes, because the 1985 transfers by the substitute trustees were a relinquishment of Jalkut's power to alter, amend, revoke, or terminate the trust with respect to the transferred assets.

Court's Reasoning

The court applied sections 2035 and 2038 of the Internal Revenue Code, which address the inclusion of transfers within three years of death and revocable transfers, respectively. The court distinguished between the 1984 and 1985 transfers based on Jalkut's capacity at the time of each. For the 1984 transfers, Jalkut was still competent and acting as trustee, so the court viewed them as withdrawals from the trust followed by personal gifts, not subject to inclusion under section 2038. In contrast, the 1985 transfers were made by substitute trustees after Jalkut's incapacity, constituting a relinquishment of his control over the trust assets and thus includable in the gross estate under sections 2035(d)(2) and 2038(a)(1). The court emphasized the importance of the form of the transactions in estate planning, rejecting the argument that the substance should override the form.

Practical Implications

This decision clarifies that gifts made from a revocable trust within three years of death are subject to estate tax inclusion if they represent a relinquishment of the decedent's control over the trust assets. Estate planners must consider the timing and method of transfers from revocable trusts, especially when the grantor becomes incapacitated. The ruling emphasizes the significance of maintaining control over trust assets until the time of death to avoid unintended estate tax consequences. Subsequent cases have applied this principle, notably in situations involving similar trust structures and transfers. This case also highlights the need for careful drafting of trust agreements to specify the powers of substitute trustees and the conditions under which they may make distributions.

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