E. Norman Peterson Marital Trust v. Commissioner, 102 T. C. 790 (1994)

The generation-skipping transfer (GST) tax applies to transfers from irrevocable trusts created before the enactment of the tax, if assets are constructively added to the trust after the effective date.

Summary

E. Norman Peterson established a marital trust for his wife, Eleanor, upon his death in 1974, giving her a lifetime income interest and a testamentary general power of appointment. Upon Eleanor's death in 1987, she did not exercise her power, resulting in the assets passing to Peterson's grandchildren. The Tax Court held that the GST tax applied to these transfers because Eleanor's failure to exercise her power of appointment constituted a constructive addition to the trust after the enactment of the tax, and the transfers did not qualify for any exceptions. The court also clarified that interest on GST tax deficiencies should be excluded from the tax base when calculating the GST tax liability.

Facts

E. Norman Peterson died in 1974, establishing a marital trust for his wife, Eleanor, under his will. The trust provided Eleanor with a lifetime income interest and a testamentary general power of appointment over the trust assets. If Eleanor did not exercise this power, the assets were to pass to Peterson's grandchildren from a prior marriage. Eleanor died in 1987 without exercising her power of appointment, except to pay federal estate taxes, causing the trust assets to transfer to the grandchildren's trusts. The trustee contested the applicability of the GST tax to these transfers.

Procedural History

The Commissioner determined a GST tax deficiency of $810,925 against the marital trust. The trustee filed a petition with the U. S. Tax Court, challenging the deficiency. The case was submitted fully stipulated, and the court issued its opinion on June 28, 1994, upholding the applicability of the GST tax but adjusting the calculation of the tax base to exclude interest on the deficiency.

Issue(s)

1. Whether the effective date rules of the Tax Reform Act of 1986 (TRA 1986) prevent the application of the GST tax to the transfers from the marital trust?
2. Whether the GST tax exception provided by TRA 1986, relating to certain transfers to grandchildren, applies to these transfers?
3. Whether the imposition of the GST tax on these transfers violates the Due Process Clause or equal protection principles of the Fifth Amendment?
4. Whether, in calculating the GST tax liability, the amount of interest payable on the GST tax deficiency must be excluded from the GST tax base?

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Holding

1. No, because the failure of Eleanor Peterson to exercise her testamentary power of appointment constituted a constructive addition to the trust after the effective date of the tax.
2. No, because the transfers were not to the grandchildren of the transferor, Eleanor Peterson, as defined by the statute.
3. No, because the imposition of the GST tax was not retroactive and did not violate equal protection principles.
4. Yes, because the interest on the GST tax deficiency should be excluded from the tax base to reflect the actual amount transferred to the grandchildren's trusts.

Court's Reasoning

The court applied the constructive addition rule from the Temporary GST Tax Regulations, which deemed Eleanor's non-exercise of her power of appointment as a post-effective-date addition to the trust, thus subjecting the transfers to GST tax. The court found this regulation to be a valid interpretation of the statute, as it aligned with the purpose of protecting reliance interests while preventing post-effective-date transfers from escaping the tax. The court also determined that the transfers did not qualify for the grandchild exclusion because Eleanor, not Peterson, was the transferor. The court rejected constitutional challenges, noting that the tax's application was not retroactive and that distinctions in the tax code between different types of trusts were rationally based. Finally, the court held that interest on the GST tax deficiency should be excluded from the tax base to accurately reflect the value of property transferred to the grandchildren's trusts.

Practical Implications

This decision clarifies that the GST tax can apply to trusts established before its enactment if there are constructive additions post-enactment, such as through the lapse of a general power of appointment. Practitioners should be aware that the identity of the transferor is crucial in determining eligibility for exemptions, and that the tax base for direct skips should not include interest on tax deficiencies. The ruling underscores the importance of estate planning to minimize GST tax exposure, particularly in the structuring of marital trusts and the use of powers of appointment. Subsequent cases have relied on this decision to interpret the scope of the GST tax and the validity of related regulations.

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