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## Taxation - Federal Estate Tax - Includibility of Accumulated Income of Trust Where Corpus Included in Gross Estate

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TAXATION—FEDERAL ESTATE TAX—INCLUDIBILITY OF ACCUMULATED INCOME OF TRUST WHERE CORPUS INCLUDED IN GROSS ESTATE—Decedent created eight inter vivos trusts for the benefit of his immediate family, reserving the power as trustee to invade the corpus in unusual circumstances for the benefit of the beneficiaries, and to accumulate all or part of the income and add it to the corpus. The Commissioner included both the corpus and the accumulated income in the decedent's gross estate. The Tax Court held that the corpus was properly included, but not the accumulated income.<sup>1</sup> On appeal by the Commissioner, *held*, affirmed. The accumulated income of the trusts should not be included in the decedent's gross estate as it was not "property . . . of which the decedent has at any time made a transfer" within the language of the taxing statute.<sup>2</sup> *Commissioner v. McDermott's Estate*, (7th Cir. 1955) 222 F. (2d) 665.

The court in the principal case had respectable though somewhat sparse authority on which to base its decision. In *Burns v. Commissioner*<sup>3</sup> and *Commissioner v. Gidwitz' Estate*,<sup>4</sup> it was held that the accumulated income of a trust was not includible in the decedent's gross estate because it was not transferred by him, although in both cases the trust corpus was included as a transfer made in contemplation of death. There are two Tax Court decisions to the contrary,<sup>5</sup> and the only distinguishing feature is that in the latter two cases the corpus was included because of a reserved power or interest. There have been several attempts to reconcile the apparent conflict. One approach has been that the distinction lies in the point of time at which the transfer becomes complete. In the contempla-

<sup>1</sup> 22 P-H T.C. Mem. ¶53,154 (1953).

<sup>2</sup> I.R.C. (1939), §§811 (c) (1) (B) (ii), 811 (d) (1); now I.R.C. (1954), §§2036 (a) (2), 2038 (a) (1).

<sup>3</sup> (5th Cir. 1949) 177 F. (2d) 739, noted in 50 COL. L. REV. 391 (1950).

<sup>4</sup> (7th Cir. 1952) 196 F. (2d) 813.

<sup>5</sup> Estate of Yawkey, 12 T.C. 1164 (1949); Estate of Showers, 14 T.C. 902 (1950). These decisions relied primarily on authority holding that property included in a decedent's gross estate is valued at the death of the donor and not at the time of the inter vivos transfers. *Igleheart v. Commissioner*, (5th Cir. 1935) 77 F. (2d) 704; *Kroger v. Commissioner*, (6th Cir. 1944) 145 F. (2d) 901, cert. den. 324 U.S. 866, 65 S.Ct. 915 (1945); *Humphrey's Estate v. Commissioner*, (5th Cir. 1947) 162 F. (2d) 1, cert. den. 332 U.S. 817, 68 S.Ct. 157 (1947).

tion of death cases it is when the original gift is made, while in the reserved power cases the crucial time is not until the settlor's death.<sup>6</sup> Another argument has been that the difference lies between gifts in trust and outright gifts.<sup>7</sup> Both arguments meet with the same obstacle, for, in so far as the transfer is included in the decedent's gross estate, the valuation is made at the time of the donor's death, regardless of the kind of transfer involved.<sup>8</sup> Another possibility for reconciliation of the authorities is to draw the distinction on the basis of what is to be valued and included, in addition to the transferred corpus. Along with the corpus, there are three types of property that might be included: an increase in value of the original assets;<sup>9</sup> capital gains realized on the sale or exchange of original assets;<sup>10</sup> and accumulated income. That the first two should be included in the gross estate is fairly well settled, for, in the first, the increase in value is still part of the original property transferred, within the language of the code, and in the second the new assets are merely substitutes for the original property transferred and are directly traceable to it. Quite a different situation exists in the case of accumulated income which was neither transferred originally nor a mere substitute for the subject matter of the original transfer.<sup>11</sup> The distinction between increase in value and capital gains on the one hand and accumulated income on the other

<sup>6</sup> Estate of Showers, note 5 supra, and other cases discussed in MONTGOMERY'S FEDERAL TAXES, ESTATES, TRUSTS AND GIFTS 606-611 (1951).

<sup>7</sup> It is true that in most cases there will be no accumulated income in an outright gift, but the proponents of this view consider the instant problem in conjunction with that of an increase in value of property originally transferred. See 96 UNIV. PA. L. REV. 706 (1948). The English courts seem to follow this distinction. Attorney General v. Oldham, [1940] 2 K.B. 485; In re Payne, [1940] 1 Ch. 576.

<sup>8</sup> I.R.C. (1939), §811; now I.R.C. (1954), §2031(a); Treas. Reg. 105, §81.15(c); Igleheart v. Commissioner, note 5 supra; Kroger v. Commissioner, note 5 supra; Humphrey's Estate v. Commissioner, note 5 supra. Many courts and writers have approached the problem as essentially one of valuation. See Pavenstedt, "Taxation of Transfers in Contemplation of Death: A Proposal for Abolition," 54 YALE L. J. 70, 87 (1944); MONTGOMERY'S FEDERAL TAXES, ESTATES, GIFTS AND TRUSTS 530 (1946); 61 HARV. L. REV. 891 (1948).

<sup>9</sup> Kroger v. Commissioner, note 5 supra. See also Liebmann v. Hassett, (1st Cir. 1945) 148 F. (2d) 247; Estate of Vanderlip, 3 T.C. 358 (1944). The latter two cases involved the valuation of life insurance policies transferred inter vivos but included in the transferor's gross estate.

<sup>10</sup> Estate of Guggenheim, 40 B.T.A. 181 (1939), mod. (2d Cir. 1941) 117 F. (2d) 469, cert. den. 314 U.S. 621, 62 S.Ct. 66 (1941). In Commissioner v. Hager's Estate, (3d Cir. 1949) 173 F. (2d) 613, cert. dismissed 337 U.S. 937, 69 S.Ct. 1515 (1949), accumulated income of a trust was included with the corpus, as well as capital gains, but the court did not dwell on the question or give any reasons for the inclusion of either the income or the gains.

<sup>11</sup> An argument can be made that the right to future income is an incident of the transferred property and ought to be included with such property, the right being measured by the amount of income accumulated. The difficulty with this approach is that the same theory should apply to distributed income, which would clearly not be included, and it is unlikely that such an extended meaning of the word "property" was intended by Congress.

can be applied to reconcile all of the cases except two<sup>12</sup> and may be helpful as a future guide. It is true that the purpose of the federal estate tax is to tax those transfers which are testamentary in character and treat them as if they were made at death instead of during life, and that exclusion of accumulated income may open the way for possible tax avoidance.<sup>13</sup> However, in view of the crucial language of the statute, stressing the necessity of a transfer,<sup>14</sup> the decision in the principal case was inevitable.

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<sup>12</sup> Estate of Yawkey, note 5 supra; Estate of Showers, note 5 supra.

<sup>13</sup> The Commissioner claimed that this was in fact the situation in the principal case. It was maintained that the decedent created the inter vivos trusts by transferring stock in a wholly owned corporation and then causing the only dividend to be declared on such stock. Commissioner's brief on appeal, p. 28.

<sup>14</sup> I.R.C. (1939), §§811 (c) (1) (B) (ii), 811 (d) (1); now I.R.C. (1954), §§2036 (a) (2), 2038 (a) (1). The following language of *Helvering v. Hallock*, 309 U.S. 106 at 111, 60 S.Ct. 444 (1940), has been quoted in support of including accumulated trust income: "The taxable event is the transfer *inter vivos*. But the measure of the tax is the value of the transferred property at the time when death brings it into enjoyment." By placing the emphasis on the words "transferred property" the quotation supports the opposite result.