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TAXATION-ESTATE AND GIFT TAXES-RECIPROCAL TRUSTS-MITIGATING FEATURES OF THE TECHNICAL CHANGES ACT OF 1949

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TAXATION—ESTATE AND GIFT TAXES—RECIPROCAL TRUSTS—MITIGATING FEATURES OF THE TECHNICAL CHANGES ACT OF 1949¹—Where two trusts are created by separate donors under circumstances indicating reciprocity,² the doctrine of the *Lehman* case³ requires that each donor be treated as the grantor of the trust over which he holds various incidents of ownership to the extent that the amounts in the two trusts are equal. For tax purposes the nominal grantors are transposed. The legal basis of this doctrine is the principle of trust law that one who furnishes the consideration for the creation of a trust is the settlor, although in form the trust was created by another.⁴ Thus if the settlor of trust *A* is given the power to invade the corpus of reciprocal trust *B*, the corpus of trust *B* is taxable to him under section 811(d) of the Internal Revenue Code.⁵ If he is given a life estate in a reciprocal trust, the trust property is included in his gross estate under section 811(c).⁶

To mitigate the retroactive application of the *Lehman* doctrine to trusts created prior to that case,⁷ Congress, by means of section 6⁸ of the

¹ P.L. 378, 81st Cong., 1st sess. (1949).

² For a discussion of what circumstances are necessary to prove reciprocity in converse trusts, see Callmann, "The Lehman Doctrine, Its Significance and Application," 26 TAXES 233 (1948); Colgan and Molloy, "Converse Trusts—The Rise and Fall of a Tax Avoidance Device," 3 TAX L. REV. 271 (1948).

³ *Lehman v. Comr.*, (C.C.A. 2d, 1940) 109 F. (2d) 99, cert. den. 310 U.S. 637, 60 S.Ct. 1080 (1940).

⁴ 1 SCOTT, LAW OF TRUSTS §156.3 (1939) cited in *Lehman v. Comr.*, (C.C.A. 2d 1940) 109 F. (2d) 99 at 100. 1 BOGERT, LAW OF TRUSTS AND TRUSTEES, §41 (1935).

⁵ *Hanauer v. Comr.*, (C.C.A. 2d, 1945) 149 F. (2d) 857, cert. den. 326 U.S. 770, 66 S.Ct. 175 (1945).

⁶ *Estate of F. S. Fish*, 45 B.T.A. 120 (1941).

⁷ "The court decisions in 1940 and subsequent years put taxpayers on notice as to the probable tax consequences of reciprocal trusts in the future." Statement of Senator George on the floor of the Senate, September 16, 1949, 95 CONG. REC. 13234 (1949).

⁸ Section 6 provides: "RELINQUISHMENT OF POWERS IN CASE OF RECIPROCAL TRUSTS. (a) Section 1000 of the Internal Revenue Code (relating to imposition of gift tax) is hereby amended by adding at the end thereof the following new subsection: '(g) CERTAIN RECIPROCAL TRUSTS.—In the case of property in a trust created prior to January 1, 1940, if and to the extent that such property may be deemed to have been transferred to such trust by a person other than the nominal grantor of such property (by reason of the fact that such person has made a reciprocal transfer of property in trust), then a relinquishment by such person on or before December 31, 1950, of any power over such property or over the income therefrom shall not be deemed a transfer of property for the purposes of this chapter. In the event of such relinquishment, the reciprocal transfer made by the person relinquishing such power shall be deemed, for the purposes of this chapter, to have been a completed gift at the time such reciprocal transfer was made. This subsection shall apply only if, at the time such person made the aforesaid reciprocal transfer of property, a law was in effect imposing a tax upon the transfer of property by gift and a gift tax was paid with respect to such reciprocal transfer, and not credited or refunded'. . . . (c) In the case of a decedent who relinquished on or before December 31, 1950, a power described in section 1000(g) of the Internal Revenue Code, such relinquishment shall, for the purposes of section 811(d) of such code, be deemed not to have been made in contemplation of the death of such decedent if such relinquishment,

Technical Changes Act of 1949, added a new subsection to section 1000 of the code. This new subsection provides that holders of powers in reciprocal trusts may release those powers without being subjected to estate or gift tax liability because of the release. This relief is limited, however, to donors who had paid a gift tax at the time the trusts were created and to cross trusts set up before January 1, 1940, if the donor died after 1939. In addition, section 8 of the Technical Changes Act permits donors of reciprocal trusts to make a tax free release of any life interests they may have been given in the arrangement.⁹ Relief under both section 6 and section 8 is limited to donors who act before the end of 1950.

Paul E. Anderson, S.Ed.

by virtue of the enactment of this section, is not deemed a transfer of property for the purposes of the gift tax. The provisions of this subsection shall be applicable with respect to estate of decedents dying after February 10, 1939."

⁹ For a discussion of the terms of section 8, see p. 669, *supra*.

A statement by the House Managers on the Conference Committee Report clearly indicates that Congress intended the tax free release to be extended to donors of reciprocal trusts. It was stated, "In the case of reciprocal trusts which were created each in consideration of the other, these tax-free privileges are available to a life tenant of a trust which he constructively created." H. Rep 1412, 81st Cong., 1st sess. (1949), reported in 1949-23 I.R.B. 31 at 32.