TAXATION - ESTATE TAX - INCLUSION IN GROSS ESTATE OF TRUST WHERE DECEDED RETAINED POWER TO TERMINATE

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In 1935 the settlor irrevocably conveyed to himself as trustee in trust for his sons corporate stocks,
which upon termination of the trust were to be distributed to named beneficiaries other than the settlor. The settlor reserved power during his lifetime to terminate any of the trusts and distribute the principal to beneficiaries then entitled to receive it. Each trust was to continue for fifteen years unless earlier terminated by the grantor. He retained no power to revest in himself or his estate any portion of the corpus or income. The Tax Court and the Circuit Court of Appeals for the Fifth Circuit ruled that the reservation of power was not includible in the gross estate of the decedent. The Tax Commissioner maintained that it should be included and certiorari was granted. Held, reservation of power was within the coverage of §811(d) (2) of the Internal Revenue Code, including in decedent’s gross estate for estate tax purposes property subject to a power to “alter, amend, or revoke.” Commissioner of Internal Revenue v. Holmes Estate, (U.S. 1946) 66 S.Ct. 257.

Any discussion of this case involves, of necessity, a consideration of the Revenue Act of 1936, which enacted, inter alia, the provisions presently found in §811(d) 1 and 2 of the Internal Revenue Code. The effect of the revision made at that time was to change the phrase “to alter, amend, or revoke,” which applied to transfers on or prior to June 22, 1936, to read “to alter, amend, revoke, or terminate” as applied to transfers made after that date. Since the trust involved in the principal case was created in 1936 and thus not subject to §811(d) (1), the question was presented whether the inter vivos trust was taxable in the decedent’s gross estate on the theory that its enjoyment was subject to a reserved power to “alter, amend, or revoke” under §811(d) (2). By analogy to a recent gift tax case, where the right to present enjoyment by the beneficiaries was made to depend upon their being in a condition where provision for maintenance and education was a necessity, it would seem that in this case the right to present enjoyment is dependent upon the contingency that the settlor will terminate the trust. Such a termination of the trust would constitute an alteration in the enjoyment of the trust property by the beneficiaries. Supported by the opinion of the House Ways and Means Committee, the Court

1 “§ 811. Gross Estate. ... (d). Revocable Transfers—(1) Transfers after June 22, 1936. To the extent of any interest therein of which the decedent has at any time made a transfer ... by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power ... to alter, amend, revoke, or terminate. ... (2) Transfers on or prior to June 22, 1936 ... through the exercise of a power ... to alter, amend, or revoke. ...” 26 U.S.C. (1940) §811.

2 Fondren v. Commissioner of Internal Revenue, 324 U.S. 18, 65 S.Ct. 499 (1944). Enjoyment was held to be at a future date where an irrevocable trust for minors provided for distribution when beneficiaries attained certain ages. Trustee could invade income and corpus of the trust for maintenance and education of beneficiaries if necessity arose. The Court said that since any present enjoyment was contingent, it was a gift of “future interest” in property so that the $5,000 exclusion allowed by section 504 (b) of the Revenue Act of 1932 could not be taken.

3 “Another change made in subsection (a) of section 206 has been to expressly include a power to terminate along with the powers to alter, amend or revoke ... Since in substance the power to terminate is the equivalent of a power to revoke, this question should be set at rest. Express provision to that effect has been made and it is
had little difficulty in deciding that it was properly includible. The question as to whether retention of the power to terminate was enough to render the trust includible in the gross estate had been raised in another case, which led to the revision. It seems clear that decedent’s failure to reserve any beneficial interest or power to recapture one was no serious obstacle to inclusion of the trust in the gross estate. A power to terminate when all beneficiaries join in so declaring is not held a power to “alter, amend, or revoke.” But the mere fact that he could not select new beneficiaries and was limited to changing enjoyment among the group mentioned in the trust deed would not place the power outside the statute. Similarly, a power to change the proportions in which descendants should take the property has been held such a reservation as to put the trust property in decedent’s gross estate. In the Holmes case the surviving issue of each son should take his share; if a son died without issue, his share to go pro rata to the other two sons or their surviving issue per stirpes. The power reserved allowed the settlor to accelerate enjoyment and to make certain that each of the sons received a share, a share that he might otherwise never have received had he died without issue before termination of the trust. Thus it does not involve too great a stretch of the imagination to say that the power reserved by the settlor to terminate was a very important power, and one having substantial economic value. It was clearly a power, in effect, not only to accelerate the enjoyment of the beneficiaries but, and even more important, he could thus determine for a certainty that the trust property would be divided among his sons as they then existed. It has been suggested that there may be some powers

believed that it is declaratory of existing law. H. Rep. 2818, 74th Cong., 2d sess. (1936). See also Treasury Regulations 105, §81.20 (1945), stating “Such addition is considered but declaratory of the meaning of the subdivision prior to the amendment. A power to terminate capable of being so exercised . . . and when otherwise so exercisable as to effect a change in the enjoyment is the equivalent of a power to ‘alter.’ ”

4 White v. Poor, 296 U.S. 98, 56 S.Ct. 66 (1935). While alive, the decedent conveyed property to herself and two others as trustees upon a trust which was terminable by joint action but in which she reserved no power to modify. She resigned but was later reappointed by the other trustees with the consent of the beneficiaries. The court held the power thus acquired to participate in terminating the trust, not being reserved by her in the trust instrument, was not a power to “alter, amend, or revoke” within the meaning of §302(d), Revenue Act 1926.

5 Porter v. Commissioner, 288 U.S. 436, 53 S.Ct. 451 (1933). The court suggests the reservation was of some value, in that “... it made the settlor dominant in respect of other dispositions of both corpus and income.” Id. at 444.

6 Helvering v. Helholtz, 296 U.S. 93, 56 S.Ct. 68 (1935), where it was said such a provision is just an expression of a condition the law itself imposes. See 2 Trusts Restatement, §338 (1) (1935).


8 Commission v. Chase National Bank, (C.C.A. 2d, 1936) 82 F. (2d) 157 at 158: “The power she reserved was not to change the trust provision in a trivial way, but went right to the heart of them and gave the decedent a substantial though quali-
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recently retained that are so limited as not to fall within the scope of the Revenue Act.9 But the power retained here is far too substantial in its effect to be held to fall within such a category of exempt powers. The power to terminate here was as great as one to alter the beneficiaries, which would admittedly put the trust in the gross estate, for the settlor could determine who should divide the trust corpus rather than leaving it to be determined by survival at the end of the trust period. Whether considered as a power to effect a change in the enjoyment by acceleration, or to assure the proportions in which the beneficiaries would share the trust property, it seems clear that the court was right in holding that the power was such as to be properly includible in the gross estate of the decedent.

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