June 1931

Trusts–Use of the Trust Device to Escape Federal Estate Taxes

Donald M. Hutton
West Virginia University College of Law

Follow this and additional works at: https://researchrepository.wvu.edu/wvlr

Part of the Estates and Trusts Commons, and the Taxation-Federal Estate and Gift Commons

Recommended Citation
Available at: https://researchrepository.wvu.edu/wvlr/vol37/iss4/9

This Student Note is brought to you for free and open access by the WVU College of Law at The Research Repository @ WVU. It has been accepted for inclusion in West Virginia Law Review by an authorized editor of The Research Repository @ WVU. For more information, please contact researchrepository@mail.wvu.edu.
the requirement to almost nothing more than the agreement itself.

An agent in the case of Henderson v. Henrie bought under a prior oral agreement to hold in trust for his principal. The court declared the agreement directly within the teeth of the statute and there was no independent equity to raise a constructive trust. The court announced as the rule in West Virginia, that oral agreements by the grantee with a third person before legal title is taken, to hold in trust for such third persons are not express trusts, but contracts to convey, which are in violation of the statute, and no trust will be declared unless there are facts creating an independent equity, so as to constitute a constructive trust.

As mentioned before, the new code requires, in addition to the provisions that conveyances of land and contracts for the sale of land must be in writing, that all declarations of trust must be in writing to be enforceable, except declarations of trust for the grantor or a third person accompanying a conveyance not fraudulent. All doubt as to the validity of oral agreements by the grantee with third persons before legal title is taken is now seemingly removed by statute, and only oral trusts declared by the grantor are enforceable.

—JOHN HAMPTON HOGE.

TRUSTS—USE OF THE TRUST DEVICE TO ESCAPE FEDERAL ESTATE TAXES.—The federal estate tax is levied on the privilege of transmission of property, the shifting of the legal interest at death. Undoubtedly the trust, long a device used for avoiding burdens imposed by law, has been used to evade this tax. Congress has closed this avenue of escape by legislation, hindered however, by the frequently reiterated words of the Supreme Court of the United States, that “such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer.”

---

38 68 W. Va. 562, 71 S. E. 172 (1911).
39 W. VA. REV. CODE (1931) c. 36, art. 1, §§ 1, 3.
40 Supra n. 4.

The pertinent provisions of the Revenue Act provided in part as follows:

"Sec. 302. The value of the gross estate of the decedent shall be determined by including the value . . . of all property . . . (c) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death, (whether such transfer or trust is made or created before or after the passage of this act), except in case of a bona-fide sale for a fair consideration in money or money's worth."

In view of the aforementioned policy of the Supreme Court a grantor honestly seeking "to avail himself to the full of what the law permits" might reasonably expect a trust reserving a life estate in himself would not make his estate chargeable with the value of the property for the purpose of the estate tax.

The question arose in three recent cases, Commissioner of Internal Revenue v. Northern Trust Co., Commissioner of Internal Revenue v. McCormick, and Commissioner of Internal Revenue v. Morsman. They involved conveyances of property in trust by a transferror who reserved to himself for life the income from the property or the right to designate who should enjoy the income therefrom. All were appealed and on March 2nd, 1931 the Supreme Court of the United States, citing May v. Heiner, held the value of such property at the date of the transferror's death should not be included in computing his federal estate tax, the transfer of such property not being "in contemplation of or intended to take effect in possession or enjoyment at or after his death" within the meaning of the federal estate tax laws.

On March 3rd, 1931 a bill was introduced in the House of Representatives to amend section 302 (c) of the Revenue Act of 1926, to provide specifically for including in the gross estate of a decedent, for federal estate tax purposes, the value of property which may have been transferred by the decedent in trust or otherwise where "the transferror has retained for life or any period

---

5 41 F. (2d) 732 (C. A. 7th, 1930); Aff'd. 75 L. ed. 458 (Mem.).
6 43 F. (2d) 277 (C. A. 7th, 1930); Rev'd. 75 L. ed. 458 (Mem.).
7 44 F. (2d) 992 (C. A. 8th, 1930); Rev'd. 75 L. ed. 458 (Mem.).
9 H. J. Res. 529.
not ending before his death (1) the possession or enjoyment of, or the income from, the property, or, (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom."

The bill was passed unanimously by both Houses of Congress and signed by the President on the same day it was introduced in the House. Therefore, where a settlor conveys property for the use after his death of those whom he intended should ultimately have it, and at the same time reserves to himself the income or enjoyment just the same as if no conveyance had been made, the settlement is thus made, by legislation, ineffective as a means of escaping the federal estate tax.

When the settlor reserves powers of amendment, control, or revocation such transfer is taxable, if the exercise of such powers would enable the settlor to divert to himself the possession or enjoyment of the property.

If the transferrer made an absolute conveyance under an arrangement by which the grantee at once leased the property to the grantor for his life without rent or for a nominal rent; or if the transferee executed a bond or other contract that would insure the transferrer the enjoyment of the property for his life it seems a taxable succession would result, for the substance of the transaction would be a remainder in the transferee that he can only enjoy after the transferrer’s death.

A trust containing a reservation reserving the possession or enjoyment to the settlor for an arbitrarily fixed term of years, approximating his life expectancy, would doubtless be no more efficacious. Certainly the beneficial interest of the settlor would have to terminate at least as great a length of time before his death as would be required in the case of a gift inter vivos, otherwise it would seem taxable as a transfer made in contemplation of death.

It seems, therefore, that the trust device has been made worthless as a means of avoiding the federal estate tax, when the settlor wishes also to retain the economic benefits of the trust estate for life."

—Donald M. Hutton.

---

11 For an extensive discussion of the question see Leaphart, The Use of the Trust to Escape the Imposition of Federal Income and Estate Taxes (1930) 15 Cornell L. Q. 587; see also Rottschaefer, Taxation of Transfers Intended to Take Effect in Possession or Enjoyment at Grantor’s Death (1930) 14 Minn. L. Rev. 453, 613.