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J. David James

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Once the purchase is established, subsequent payments may properly be proved solely by computer records. *A's* cancelled checks or cash receipts should offer him sufficient protection in contesting the amount of payments. But there is a real need for protecting the consumer by requiring independent evidence of the sale because a reasonable businessman would make an independent record of the transaction that would bear the customer's signature.

The decisions in *King* and *Transport* show that computer records can and will be admitted into evidence as routinely as conventional business records have been in the past. But as fewer "conventional" records remain in use to support the computer's product, courts will have to be more diligent in examining whether the computer business record is satisfactorily qualified and authenticated for admission. The impersonal and automatic computer, which is the servant of the businessman, must also be the servant of justice and not the master of men and their laws.

NORMAN E. SMITH

Federal Estate Taxation—Application of the Reciprocal Trusts Doctrine Under the New Objective Standard

A typical reciprocal or crossed trusts situation occurs when *A* sets up an irrevocable trust to pay *B* the income for life, remainder to *C*, and *B* does likewise for the benefit of *A* for life with the remainder to *C* (or *D*). In the usual situation *A* and *B* are members of the same family. At one time it was thought that such an arrangement would avoid taxation under the retained-interest rule of section 811(c)(1) of the Internal Revenue Code of 1939—now section 2036 of the 1954 Internal Revenue Code. These sections provide that certain transferred property in which the decedent has retained a life interest is to be included in his gross estate. The general purpose underlying both sections is to insure taxation of transfers that are essentially testamentary—that is, transfers in which the transferor retained a significant interest or control over property transferred during his lifetime.

But the reciprocal trusts doctrine, which was advanced in *Lehman v. Commissioner*,[1] dissolved the belief that creation of reciprocal trusts held the answers to successful evasion of estate taxes.[2] Though the reciprocal

[1] 109 F.2d 99 (2d Cir.), *cert. denied,* 310 U.S. 637 (1940).

[2] For a complete history of the development of the reciprocal trusts doctrine

trusts situation did, in form at least, fall outside the literal terms of section 811(c)(1) (since the transferor had transferred away all of his interest in the trust property), the court in *Lehman* recognized that each settlor remained in exactly the same economic position in which he would have been had he created a trust with himself as life beneficiary. Under the rationale of the court in *Lehman,* each settlor is transposed and treated as the grantor of the trust over which he holds various incidents of ownership, at least to the extent that the two trusts are equal in value.[3] "The fact that the trusts were reciprocated or 'crossed' is a trifle, quite lacking in practical or legal significance . . . . The law searches out the reality and is not concerned with form."[4] The court in *Lehman* based its holding on statements made by leading commentators on trusts that said, "A person who furnishes the consideration for the creation of a trust is the settlor, even though in form the trust is created by another person."[5]

Thus in the example, *A* is treated as the settlor of the trust actually created by *B*, and vice versa. Since *A* is treated in this way,[6] the trust over which *A* is seen as the settlor (the trust actually created by *B*) must be included in *A*'s gross estate under section 811(c)(1)—today section 2036—because under this view *A* is considered to have retained a life estate.[7]

As the reciprocal trusts doctrine developed,[8] two divergent views

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see Colgan & Molloy, *Converse Trusts—The Rise and Fall of a Tax Avoidance Device*, 3 TAX L. REV. 271, 273-76 (1948) [hereinafter cited as *Converse Trusts*].

[3] If reciprocal trusts are created with one trust being larger than the other, the amount of the trust created by *B* which is greater than the trust created by *A* is taxable as a gift of *B* under § 2511(a), INT. REV. CODE of 1954. C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES 605 (2d ed. 1962) [hereinafter cited as LOWNDES & KRAMER].

[4] 109 F.2d at 100.

[5] 2 A. SCOTT, THE LAW OF TRUSTS § 156.3 (3d ed. 1967); 1 G. BOGERT, TRUSTS AND TRUSTEES § 41 (2d ed. 1965).

[6] "By switching the grantors of reciprocal trusts, the courts also escape the objection that the transfers were not taxable because they were made for an adequate and full consideration in money or money's worth." LOWNDES & KRAMER 193 n.36 *citing Converse Trusts, supra* note 2, at 275.

[7] "[I]t is important to notice that the fact that trusts are reciprocal does not make them taxable under the estate tax unless after switching grantors there is the basis for such a tax." LOWNDES & KRAMER 193.

[8] The reciprocal trusts doctrine was given congressional approval in the Technical Changes Act of Oct. 25, 1949, ch. 720, § 6, 63 Stat. 893. "Congress has, in effect, approved the doctrine's effort to close the loophole. In the Technical Changes Act . . . it permitted those who had used the device prior to 1940 to give up their control over a reciprocal trust without paying a gift tax on the relinquishment." Estate of Grace v. United States, 393 F.2d 939, 950-51 n.4 (Ct. Cl. 1968)

arose as to what was the proper test for invoking it. One group of cases,[9] coming mainly from the third and seventh circuits, held that before the reciprocal trusts doctrine could be invoked, it must be shown that each of the crossed trusts was established as the *quid pro quo* consideration for the other; that is, each trust must have been established in return for the creation of the other trust. A second theory, advanced mainly in the second and eighth circuits,[10] was that the presence of consideration need not be shown explicitly but can be inferred from certain objective factors such as the establishment of two similar trusts at about the same time, the presence of a tax-avoidance motive, or the fact that the same attorney drafted both trust instruments.[11] With each of these distinctions, the

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(dissenting opinion). For a discussion of the effects of this section of the Technical Changes Act, see 48 MICH. L. REV. 688 (1950).

[9] Estate of Moreno v. Commissioner, 260 F.2d 389 (8th Cir. 1958); Guenzel v. Commissioner, 258 F.2d 248 (8th Cir. 1958); McClain v. Jarecki, 232 F.2d 211 (7th Cir. 1956); Newberry's Estate v. Commissioner, 201 F.2d 874 (3d Cir. 1953); *In re* Leuder's Estate, 164 F.2d 128 (3d Cir. 1947).

[10] Orvis v. Higgins, 180 F.2d 537 (2d Cir.), *cert. denied,* 340 U.S. 810 (1950); Hanauer's Estate v. Commissioner, 149 F.2d 857 (2d Cir.), *cert. denied,* 326 U.S. 770 (1945); Cole's Estate v. Commissioner, 140 F.2d 636 (8th Cir. 1944).

[11] The case of Newberry's Estate v. Commissioner, 201 F.2d 874 (3d Cir. 1953), presents a good example of the divergent views. Newberry and his wife at the same time set up identical trusts of identical amounts for the benefit of their children. Each settlor was given certain interests and powers over the other settlor's trust. Periodically these powers were amended so that at the time of Mrs. Newberry's death each settlor had only the power to shift interests in the other settlor's trust among their children and certain charities. When Mrs. Newberry died, the Commissioner contended that the trusts were reciprocal and should be taxed accordingly. Before the Tax Court, Mr. Newberry testified that he and his wife were independently wealthy and that they had created these trusts for the benefit of their children and not to obtain any personal benefit. He further testified that he would have set up his trust even if his wife had not created her trust. The Tax Court upheld the Commissioner and included Mr. Newberry's trust in Mrs. Newberry's gross estate.

> [T]he basis of the Tax Court's decision seems to have been that the objective facts of the trusts, the identity of their terms, amounts and times of creation, and the fact that husband and wife got the same reciprocal advantages from each other's transfer raised such a strong inference that they were created in consideration of each other that viewing the evidence as a whole the estate had failed to prove that they were not.

LOWNDES & KRAMER, *supra* note 3, at 195. This reasoning has been followed mainly in the second and eighth circuits.

The Court of Appeals for the Third Circuit took the other view and held that the reciprocal trusts doctrine should not have been applied in this case. It held that since Mr. Newberry would have established his trust without regard to what Mrs. Newberry did and that since the purpose of the trusts was to benefit the children rather than the settlors, the consideration for Mr. Newberry's trust was not the trust of his wife and his trust was not, therefore, taxable to her estate. *Id.* at 194.

doctrine, which had been intended to fill a tax loophole, was narrowed and thus made less effective in preventing avoidance of estate taxes. In an effort to resolve the conflicts between the circuits and to establish concrete rules for the application of the reciprocal trusts doctrine, the Supreme Court recently decided *United States v. Estate of Grace.*[12]

On December 15, 1931, the decedent, Joseph Grace, executed a trust (the Joseph trust) that was to pay the income and any of the principal the trustees might deem advisable to decedent's wife, Janet Grace, for life. Janet was given the power to designate, by will or deed, the manner in which the trust estate remaining at her death was to be distributed to Joseph and their children. Joseph appointed himself as one of the three trusteees.

On December 30, 1931, Janet Grace executed a trust (the Janet trust) that was virtually the same as the Joseph trust. All the property in this trust had been conveyed to Janet during the preceding twenty-three years by the decedent.[13] Both trusts were prepared by one of the decedent's employees in accordance with the decedent's plan, and Janet executed her trust in accordance with the decedent's wishes.

The Joseph trust was terminated by Janet Grace's death in 1937. Janet Grace's federal estate tax return showed the Janet trust but reported it as a nontaxable transfer.[14] The Commissioner asserted that the Janet and Joseph trusts were "reciprocal" and asserted a deficiency to the extent of the mutual value. Compromises on unrelated matters[15] resulted

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[12] 395 U.S. 316 (1969).

[13] That the property was given to Janet by her husband should have been irrelevant in deciding whether the reciprocal trusts doctrine applied. However, the Supreme Court mentioned this fact several times in its opinion, probably because the lower court considered it important to show a pattern of family giving that dispelled an inference of consideration. The Court, by hearing a case in which there was a pattern of family giving and by asserting the reciprocal trusts doctrine in the face of it, emphasized that the doctrine will be applied regardless of the presence of consideration.

[14] *But see* Justice Douglas' dissent in *Grace* in which he asserts that the Janet trust should have been included in Janet Grace's gross estate. 395 U.S. at 325-26.

[15] During the course of these negotiations, the representatives of the estate countered the contention of the Internal Revenue Service by contending that the gross estate should be adjusted by (1) a reduction in value . . . of [certain] shares of stock . . . owned by Janet Grace at the date of her death . . . and (3) elimination from the assets shown on the return as Janet Grace's property of certain household effects which . . . [allegedly] belonged to the decedent.

Estate of Grace v. United States, 393 F.2d 939, 963-64 (Ct. Cl. 1968).

in fifty-five per cent of the *value* of the Janet trust being included in Janet Grace's gross estate.[16]

Joseph Grace died in 1950. His federal estate tax return also disclosed both trusts. The Joseph trust was shown as a non-taxable transfer; the Janet trust was reported as a trust under which the decedent held a limited power of appointment.[17] Neither trust was included in the decedent's gross estate. The Commissioner determined that the trusts were "reciprocal" and included the amount of the Janet trust in the decedent's gross estate. This deficiency was paid by the estate and a claim for refund was filed.

The United States Court of Claims held that the reciprocal trusts doctrine should not have been applied. Using certain language in *Lehman* and decisions[18] from the Courts of Appeals for the Third and Seventh Circuits, the majority of the court held that the crucial factor was whether the decedent had established his trust as consideration for the establishment of the trust of which he was the beneficiary. The court then held that each trust had not been established as the *quid pro quo* for the other trust but that they were merely part of an established pattern of family giving.[19] The plaintiff, decedent's estate, was thus entitled to recover the amount of overpayment plus interest.

The Supreme Court, rather than adopting either of the two major views regarding reciprocal trusts, advanced an objective test that dis-

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[16] In discussing the issue as to the reciprocity of the Janet Grace trust and the Joseph Grace trust . . . the negotiators believed that the value of the Janet Grace trust was less than the value of the Joseph Grace trust, and that if the doctrine of reciprocal trusts were applicable, it would be the *value* of the lesser trust, *i.e.*, the Janet Grace trust, that would be taxable as part of the estate of Janet Grace.

Id. at 964 (emphasis added).

[17] The power of appointment given to Joseph Grace in the Janet trust is not taxable since it is not a general power as defined by INT. REV. CODE of 1954, § 2041 (b)(1). Property over which decedent holds a power of appointment is includable in his gross estate only if he holds a *general* power of appointment. As defined in section 2041(b)(1), a general power of appointment is a power that is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate. Since Joseph Grace could only appoint the remainder of the trust among his wife and children, this power does not fall within the definition of a general power.

[18] McLain v. Jarecki, 232 F.2d 211 (7th Cir. 1956); Newberry's Estate v. Commissioner, 201 F.2d 874 (3d Cir. 1953); *In re* Leuder's Estate, 164 F.2d 128 (3d Cir. 1947).

[19] The court rejected the "inferred consideration" test, but said in passing that if this test had been used, inference of consideration was rebutted by the evidence in the case. 393 F.2d at 946-47.

regards consideration completely.[20] The Court concluded that the Court of Claims had placed too much emphasis on the decedent's subjective intent and had thus hindered the proper application of the federal estate tax laws. The Court again stressed what it said in *Estate of Speigel v. Commissioner*:[21] "any requirement [of] a post-death attempt to prove the settlor's thought in regard to the transfer, would partially impair the effectiveness of [section 811(c)] as an instrument to frustrate estate tax evasion."[22] Therefore, it is important that the courts look not to the settlor's motives but to the nature and operative facts of the trust transfer.

The Court found that it was particularly important that the objective facts control in the reciprocal-trust situation because (1) inquiries into subjective intent, especially in interfamily transfers, are particularly perilous; (2) there is a high probability that such a trust arrangement is for a tax-avoidance motive;[23] (3) even if there is no tax-avoidance motive, the settlor did actually retain an economic interest while purporting to give away his property; (4) and, finally, it is unrealistic to think that the settlors of trusts such as this, usually members of the same family, would create a trust as the bargained-for consideration for the other trust since such traditional consideration does not normally enter into intrafamily transfers.[24] For all of these reasons the Supreme Court held that there was no need to show that each trust was created as the *quid pro quo* for the other because such a showing of consideration would require too great a delving into the settlor's subjective intent. The Court

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[20] This test, which was advocated by Judge Davis in his dissenting opinion to the Court of Claims decision in *Grace*, 393 F.2d at 948-54, had been advanced by Professor Lowndes. Lowndes, *Consideration and the Federal Estate and Gift Taxes: Transfers for Partial Consideration, Relinquishment of Marital Rights, Family Annuities, the Widow's Election, and Reciprocal Trusts*, 35 GEO. WASH. L. REV. 50, 76-81 (1966).

> [T]esting the taxability of the transfers by any doctrine of consideration which depends on the subjective intentions of the transferors to bargain at the time they made the transfers is completely unrealistic. It is impossible to determine what the transferors actually had in mind. . . . It would be more sensible to impose a tax upon the basis of the objective operation of reciprocal transfers. . . . [If the transferor ends up in the same economic position] there is no obvious inequity in treating him as though he made the transfer in which he acquired a taxable interest.

Id. at 80.

[21] 335 U.S. 701 (1949).

[22] *Id.* at 705-06.

[23] In fact, "[I]t is hard to see why anyone would indulge in this sort of transaction except to avoid taxes . . . ." LOWNDES & KRAMER, *supra* note 3, at 200.

[24] See Lowndes, *supra* note 20, at 79-80.

determined for the same reason that there was no need to show a tax-avoidance motive.

The Supreme Court in *Grace* required that only two tests must be met before the reciprocal trusts doctrine can be applied. First, the trusts must be interrelated.[25] Second, the arrangement, to the extent of mutual value, must leave the settlors in approximately the same economic position in which they would have been had they created trusts naming themselves as life beneficiaries.

Applying these principles to the facts of *Grace*, the Court held that the value of the Janet trust must be included in the decedent's gross estate. The two trusts were obviously interrelated. They were identical in terms and were created at approximately the same time. They were part of a single transaction designed and carried out by the decedent. Second, the two trusts objectively left each settlor, to the extent of mutual value, in the same economic position. "Joseph Grace's estate remained undiminished to the extent of the value of his wife's trust and the value of his estate must accordingly be increased by the value of that trust."[26]

While the Court's decision is laudable in that it requires objective factors be used in determining when the reciprocal trusts doctrine is to be invoked, it is regretable that the Court selected *Grace* in which to present this holding. Justice Douglas seems correct in his analysis that "the use of a reciprocal trust device to aid the avoidance of an estate tax is simply not presented by this case."[27]

The purpose in setting up reciprocal trusts is to evade federal estate taxation by having a settlor rid himself of all taxable power over the trust that he has created while he remains in the same economic position because of the trust set up in his favor by the other settlor. In *Grace*, though the trusts were reciprocal under the standards enunciated, neither settlor ridded himself of all taxable powers over the trust he himself had created. Each trust could have been included in the gross estate of the actual settlor under section 811(d)(2) of the 1939 Code—section 2038

[25] In determining whether there is an interrelation, it is important to look only to objective factors. An examination of the settlor's subjective intent must be avoided or the courts will find themselves in the same dilemma that existed before *Grace*. A few appropriate factors (but by no means a complete listing) to be considered include: whether the terms, amounts, or times of creation of the trusts are nearly identical; whether the trusts were drafted by the same attorney; and whether both trusts were created as part of a single transaction.

[26] 395 U.S. at 325.

[27] *Id.* at 326 (dissenting opinion).

(a)(2) of the 1954 Internal Revenue Code. Under these sections the gross estate must include the value of all property transferred by the decedent over which he had at his death the power to alter, amend, revoke, or terminate the enjoyment, alone or in conjunction with any other person. Since Janet Grace as one of the trustees of the trust she had created (or Joseph Grace as one of the trustees of the trust he had created) could pay, with the approval of one of the other trustees, any of the principal of the trust to the main beneficiary, section 811(d)(2) (now section 2038(a)(2)) would apply to include this trust in her (or his) gross estate. Without invoking the reciprocal trusts doctrine, each trust could have been taxed to the estate of the actual settlor.[28] There being no tax evasion possible in this case, the use of the reciprocal trusts doctrine must be seen as inappropriate.

If the use of the reciprocal trusts doctrine was inappropriate in *Grace*, when exactly should it be invoked? It should be used only in those cases in which tax evasion would be made possible merely because crossed trusts were used. The original purpose of the reciprocal trusts doctrine was to make tax evasion in the crossed trusts situation impossible, and this purpose should still be given effect. Justice Douglas believed that the reciprocal trusts doctrine should not have been invoked in *Grace* because it may have been possible to tax the trusts to the respective estates under a statutory provision. If this reasoning is followed, it would mean that in any crossed trusts situation in which the settlors have retained taxable powers over their own established trusts, the reciprocal trusts doctrine is to be abandoned and the statute applied. However, Justice Douglas' reasoning should not be utilized so broadly, for to do so would open, in certain situations, the possibility for estate-tax avoidance.

[28] However, if the reciprocal trusts doctrine was not applied in this case, neither trust could have been included in Joseph Grace's gross estate. This exclusion would have occurred because Joseph Grace had only a non-taxable interest in the Janet trust (see note 17 *supra*) and because completion of the transfer of the Joseph trust before Joseph Grace's death left him with no taxable power over it.

Justice Douglas pointed out in his dissent that Janet Grace held at her death a reserved power to amend the trust that she had created and, therefore, that this trust should have been included in her gross estate under § 811(d)(2). *Id.* at 325-26 (1969). There was a similar provision in the Joseph trust, and if the transfer set up there had not been completed before Joseph Grace's death (if Janet Grace had not predeceased him), the Joseph trust could have been included in his gross estate for the same reasons. Thus, except for these factors, the trusts could have been included in his gross estate without invoking the reciprocal trusts doctrine. That they would not have been included is the result not of a tax-evasion plan, but of permissible methods of minimizing estate taxation that Congress has written into the federal estate tax laws.

There are many situations today in which settlors intentionally retain a taxable power over property that they have transferred but still set up their estates in such a way that estate taxes are avoided. Such schemes obviously defeat the purposes of the federal estate tax. In dealing with crossed trusts, the courts, therefore, should insure that the purposes of the estate tax are met by applying the reciprocal trusts doctrine rather than the statutory scheme when by such action estate-tax evasion can be thwarted. When taxation under the statutory scheme would adequately meet the policies behind the estate tax, this method should be followed, just as Justice Douglas has suggested, even though the reciprocal trusts doctrine could be invoked. But when following the statutory scheme would result in estate-tax avoidance, Justice Douglas' reasoning should be abandoned and taxation imposed under the reciprocal trusts doctrine.

It is important to realize that application of the above principles does not require a consideration of possible tax-avoidance motives of the settlor—a line of inquiry ruled out in *Grace* as a controlling factor in deciding when the reciprocal trusts doctrine should apply. Rather, adoption of these principles would be in accordance with the majority's admonition to look to the objective factors in the case. One of these factors should be whether there are tax-evasion *consequences* because the trusts are reciprocal. If there are no tax-evasion *consequences*, and taxation is possible under the statutory scheme, courts should not invoke the reciprocal trusts doctrine, but should allow taxation under the applicable statute.

J. David James

Federal Jurisdiction—Suits Against Federal Officers for Violation of the Fourth Amendment

When an individual is injured at the hands of federal officers conducting an unlawful search and seizure in violation of the fourth amendment, what redress does the law provide for injuries to his person and to his property? Clearly, the Federal Tort Claims Act[1] would not provide compensation for the plaintiff because immunity to the government from suit[2] is specifically granted by the Act for the very injuries that a plaintiff

[1] The Federal Tort Claims Act is scattered throughout 28 U.S.C. (1964).

[2] *Cf.* West v. Cabell, 153 U.S. 78 (1894), a case in which a United States marshal was sued on his bond. A violation of the fourth amendment's proscription that a warrant shall particularly describe the person to be seized was deemed a breach of the bond. *Id.* at 87.