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ESTATE TAX TREATMENT IN CASE OF FAILURE TO RELINQUISH CERTAIN POWERS ON ACCOUNT OF MENTAL DISABILITY

JULY 8, 1959.—Ordered to be printed

Mr. BYRD of Virginia, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 1219]

The Committee on Finance, to whom was referred the bill (H.R. 1219) to amend section 2038 of the Internal Revenue Code of 1954 (relating to revocable transfers), having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

GENERAL STATEMENT

This bill adds a provision to the 1954 code relating to persons who have been mentally incompetent for a period beginning at least 3 months prior to December 31, 1947, and who remain so until the date of their death. The bill provides that any powers such persons have at the date of their death to change beneficiaries of a trust they created (of the type referred to in sec. 1000(e) of the 1939 code) are not to result in such property being included in their gross estate for estate tax purposes. This provision is the same as a 1939 code provision (sec. 811(d)(4)) which was applicable with respect to decedents dying after December 31, 1947, and on or before August 16, 1954.

Under present law (sec. 2038 of the 1954 code) there is required to be included in the gross estate for purposes of the Federal estate tax, property held in trust where the grantor of the trust has reserved the right to change the trust beneficiaries even though in all other respects he has completely divested himself of any interest in the trust property. However, grantors of trusts created prior to January 1, 1939, who retained the power to change trust beneficiaries were, under the 1939 code (sec. 1000(e)) permitted to relinquish these powers on or after January 1, 1940, and on or before December 31, 1947, without the imposition of a gift tax. This latter provision (sec.

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1000(e)) of the gift-tax law was added to the 1939 code by the Revenue Act of 1943 and amended by Public Law 112, 80th Congress (1947). The Technical Changes Act of 1953 (Public Law 287, 83d Cong.) further modified this rule to provide that decedents who were mentally incompetent and who died after December 31, 1950, were not required to include in their estates for purposes of the estate tax trust property which would have been free of gift tax had the power to change beneficiaries been relinquished in the specified period of time provided in section 1000(e) of the 1939 code. To obtain this treatment the decedent must have been under a mental disability for a period beginning at least 3 months prior to December 31, 1947, and continuing from that date to the date of his death. The committee report indicated that the term "mental disability" was intended to encompass those cases in which the decedent during the requisite period prior to his death was, in fact, incapable, because of his mental condition, of relinquishing the power, whether or not he was legally declared mentally incompetent during all, or any part, of such period. Public Law 414 of the 84th Congress extended this provision back to decedents dying after December 31, 1947.

However, the change made by the 1953 act and by Public Law 414 applies only to 1939 code years. Thus, presently a decedent's gross estate includes all trust property in which he has a discretionary power even if the decedent was mentally incompetent 3 months or more before December 31, 1947, and continued to be so to the date of his death, so long as the date of his death is after August 16, 1954.

This bill is intended to place the estates of such decedents on an equal footing with estates of decedents dying in years to which the 1939 code applies. This bill would add a new subsection to section 2038 of the 1954 code. This subsection would provide that where a decedent was for a continuous period beginning not less than 3 months before December 31, 1947, and ending with his death, under a mental disability to relinquish a power, the term "power" for purposes of determining is includible in the decedent's gross estate (under sec. 2038) is not to include a power, the relinquishment of which is the period from January 1, 1940, to December 31, 1947, inclusive, would, as a result of section 1000(e) of the 1939 code, have been free of the gift tax imposed by the 1939 code.

The provision that would be added to the 1954 code by this bill would apply with respect to estates of decedents dying after August 16, 1954. Thus, as a result of this bill, and previous actions, the exception for mentally incompetent would apply to all years from 1947 forward, so long as the decedent involved is mentally incompetent from October 1, 1947, to the date of his death.

The bill also provides that no interest is to be allowed or paid on any overpayment resulting from the amendment made by this bill with respect to payments made before the date of enactment of this bill.

TREASURY DEPARTMENT REPORT

As indicated in the following report, the Treasury Department does not object to the enactment of H.R. 1219:

OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, May 18, 1959.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

MY DEAR MR. CHAIRMAN: This is in reference to a request for the Treasury Department's views on H.R. 1219 to amend section 2038 of the 1954 Revenue Code, which relates to the treatment of revocable transfers under the estate tax, to limit its application in the case of certain mentally disabled decedents.

Under section 2038 of the 1954 Revenue Code, there is required to be included in the gross estate for estate tax purposes certain property held in trust where the trust grantor reserves the right to change the trust beneficiaries, although he has otherwise divested himself of interest in the trust property. H.R. 1219 would exempt from this requirement for inclusion in the gross estate certain of these trusts where the grantor has been under a disability for a specified period of time.

The purpose of the bill is to extend under the 1954 code the same type of relief as existed under the 1939 Revenue Code. The latter also generally required the inclusion in the gross estate for estate tax purposes of property held in trust where the grantor retained the right to change the trust beneficiaries. However, section 811(d)(4) of the 1939 code, adopted by section 208 of the Technical Changes Act of 1953, provided that trusts of this type left by decedents dying after December 31, 1950, were not required to be included in the gross estate if (1) the grantor was under a disability which began at least 3 months before December 31, 1947, and continued until his death, and (2) he was entitled under section 1000(e) of the 1939 code to have released without payment of gift tax his power to change the trust beneficiaries during the period from January 1, 1940, to December 31, 1947, inclusive. Section 1000(e) which exempted the release from gift tax was adopted because of the uncertainty existing before the Supreme Court decision in *Sanford* v. *Commissioner* as to whether a taxable gift had occurred when a trust of the type considered here was first established or when the power to change beneficiaries was released. Section 811(d)(4) of the 1939 code provided the relief from the estate tax on the assumption that, had he been competent, the grantor would have taken advantage of his right under section 1000(e) to release his power to change the trust beneficiaries without payment of gift tax. Had he actually released his power in this way the trust property would not have been included in his gross estate.

Since section 811(d)(4) of the 1939 code was not carried over into the 1954 code when the latter was adopted, the relief granted by this section was limited to the estates of decedents dying after December 31, 1950, and before August 17, 1954. H.R. 1219 amends the 1954 Revenue Code to extend exactly the same estate tax relief provided under section 811(d)(4) of the code to estates of decedents dying after August 16, 1954. Consequently, if the bill is adopted, the relief will apply to all decedents dying any time after December 31, 1950, provided the required conditions are met.

In view of the legislation adopted on this subject in 1953, the Treasury Department would not object to enactment of H.R. 1219.

The Bureau of the Budget has advised the Treasury Department that there is no objection to the presentation of this report.

Sincerely yours,

DAVID A. LINDSAY,
Assistant to the Secretary.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

Subtitle B—Estate and Gift Tax

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CHAPTER 11—ESTATE TAX

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Subchapter A—Estates of Citizens or Residents

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PART III—GROSS ESTATE

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SEC. 2038. REVOCABLE TRANSFERS.

(a) IN GENERAL.—The value of the gross estate shall include the value of all property (except real property situated outside of the United States)—

(1) TRANSFERS AFTER JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), 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 (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter,

amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death.

(2) TRANSFERS ON OR BEFORE JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), 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, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph.

(b) DATE OF EXISTENCE OF POWER.—For purposes of this section, the power to alter, amend, revoke, or terminate shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the alteration, amendment, revocation, or termination takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised. In such cases proper adjustments shall be made representing the interests which would have been excluded from the power if the decedent had lived, and for such purpose, if the notice has not been given or the power has not been exercised on or before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.

(c) EFFECT OF DISABILITY IN CERTAIN CASES.—For purposes of this section, in the case of a decedent who was (for a continuous period beginning not less than 3 months before December 31, 1947, and ending with his death) under a mental disability to relinquish a power, the term "power" shall not include a power the relinquishment of which on or after January 1, 1940, and on or before December 31, 1947, would, by reason of section 1000(e) of the Internal Revenue Code of 1939, be deemed not to be a transfer of property for purposes of chapter 4 of the Internal Revenue Code of 1939.

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