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# Robinette v. Helvering: Valuation of Gifts to Split-Interest Trusts

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# *Robinette v. Helvering*: Valuation of Gifts to Split-Interest Trusts

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*Robinette v. Helvering*[1] was decided in tandem with *Smith v. Shaughnessy*[2] on February 15, 1943. Together, these cases provide the legal basis for the gift taxation of interests in split-interest trusts and, most important, for the valuation rules of Code section 2702.

To understand *Robinette*, one must first take a look at its companion case. *Smith* was decided first and had a simpler fact pattern. The petitioner, Mr. Smith, made a gift to an irrevocable trust, with income payable to his wife for life. Upon his wife's death, the trust principal would revert to the petitioner, if he was then living, or if not, it would go to such persons as his wife may appoint by will, or in default of such appointment, to her intestate successors under applicable New York law. The Court reasoned that there were three interests involved in the case: the life estate, the remainder, and the reversion.[3] There was no dispute that the transfer of the life estate was a completed gift. The reversionary interest to the donor, in the event he outlived his wife, was an interest having value which could be calculated actuarially. The Court determined that the reversionary interest was not a completed gift on the grounds that the donor had retained economic control over such interest, but held that the remainder interest was a completed gift because the grantor had neither the form nor the substance of control and never would have unless he outlived his wife.[4] The Court further held that the complexity of a property interest created by a trust cannot serve to defeat a tax, especially when the complexity is purposely created by the grantor of the trust.[5]

The Court rejected the argument that because the value of the remainder would be includible in the grantor's gross estate for estate tax purposes, the same property would thus be taxed twice, first as a gift and

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1 318 U.S. 184 (1943).

2 318 U.S. 176 (1943).

3 *Id.* at 177-78.

4 *Id.* at 181.

5 *Id.* at 180.

second as an asset of the estate. The Court reasoned that the gift tax amounts to a security deposit or down payment that secures the eventual payment of the estate tax, and that double inclusion does not equal double taxation.[6] Thus, *Smith* stands for the proposition that a remainder interest, even though it may be a completed gift, can be subject both to gift tax (as a completed gift) and estate tax (as a reversion).[7] However, *Smith* did not answer the question of how to value such a remainder interest for gift tax purposes.

*Robinette* involved a more complicated trust arrangement that forced the Court to address the valuation of split interests. The petitioners, Ms. Robinson, and her mother, Mrs. Robinette, each created a trust, reserving a life estate in the income to herself, and then creating a second life estate in the income interest for each other. Both assigned the remainder interest to Ms. Robinson's issue upon the issue's reaching the age of twenty-one. Ms. Robinson did not yet have any issue at the time of the gifts.[8]

The parties acknowledged that the transfers of the secondary life income interests constituted taxable gifts. The issue was whether the petitioners had made a taxable gift of the remainder interests.[9] The petitioners argued that they had not relinquished economic control because there were no ascertainable donees in existence at the time of the gifts.[10] The Court relied on its reasoning in *Smith* and held that the transfers of the remainder interests were clearly gifts because the property could not be returned to the grantors except for contingencies beyond their control.[11]

The question remained, though, as to how to value those remainder interests. The petitioners argued that in computing the value of the remainder interests, they should be allowed a deduction for the value of the grantor's reversionary interest, i.e., the possibility that the grantor would survive Ms. Robinson without her having had issue who had then reached age twenty-one. The Court distinguished the *Smith* case, in which the grantor's reversionary interest depended solely upon his surviving his wife, a contingency capable of ascertainment by recognized actuarial methods.[12] On the contrary, in *Robinette*, the grantors' reversionary interest depended not only on survivorship but also on the death of the daughter without issue who should reach the age of twenty-one

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[6] *Id.* at 179.
[7] *Id.*
[8] Robinette v. Helvering, 318 U.S. 184, 185-86 (1943).
[9] *Id.* at 186.
[10] *Id.*
[11] *Id.* at 186.
[12] *Id.* at 188.

years. The Court did not believe there was any recognized method by which it would be possible to determine the value of such a contingent reversionary remainder,[13] which necessarily includes considerations of whether or not the daughter would marry, whether or not she would have children, and whether or not the children would reach the age of twenty-one. Therefore, the Court denied any deduction for the reversionary interest, in effect valuing such interest at zero, in the absence of any convincing evidence to the contrary.[14] As a result, the donors had made a completed gift of the full value of the remainder interest in the property.[15]

This result was codified in Treasury Regulation section 25.2511-1(e), which provides as follows:

> If a donor transfers by gift less than his entire interest in property, the gift tax is applicable to the interest transferred. The tax is applicable, for example, to the transfer of an undivided half interest in property, or to the transfer of a life estate when the grantor retains the remainder interest, or vice versa. However, if the donor's retained interest is not susceptible of measurement on the basis of generally accepted valuation principles, the gift tax is applicable to the entire value of the property subject to the gift. Thus if a donor, aged 65 years, transfers a life estate in property to A, aged 25 years, with remainder to A's issue, or in default of issue, with reversion to the donor, the gift tax will normally be applicable to the entire value of the property.[16]

The example in the last sentence directly adopts the facts of *Robinette*.

Until the adoption of Code section 2702 in 1990, though, any accepted actuarial valuation method was valid to carve out retained interests as non-gifts. There was a concern that this allowed the manipulation of income and remainder interests by donors, such as in the "grantor retained income trust," or GRIT, which allowed the donor a deduction for the actuarial value of the grantor's retained income interest in a trust but did not preclude the trustee from investing the trust assets in such a manner to minimize the actual income paid to the grantor (and thereby maximize the value of the remainder interest).

Code section 2702 eliminated this arrangement, so it is no longer sufficient for a retained interest to be capable of ascertainment by recognized actuarial methods; instead, the grantor's retained interest must

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13 *Id.*
14 *See id.* at 189.
15 *Id.* at 186-89.
16 Treas. Reg. § 25.2511-1(e).

be a "qualified interest"[17] in order to be deductible from the value of the entire interest gifted to the trust. If the retained interest is not a qualified interest, it will be valued at zero if the transferee is a "member of the family" of the transferor.[18] Although this might have seemed to be a very restrictive rule in 1990, when the Code section 7520 rate (which is used to value retained interests under Code section 2702) was averaging over 10%, in today's low interest rate environment, a GRAT is an extremely effective estate-planning technique notwithstanding the qualified interest requirements.

But from a theoretical perspective, both *Robinette* and Code section 2702 share a conceptual problem that goes against well-established rules of gift taxation. Under these constructs, although the apportionment of value in the initial transfer is well settled, the subsequent treatment of a retained interest that has no ascertainable value (or fails the 2702 definition of a qualified interest) is unclear. Arguably, a problem of double taxation will arise if the retained interest, initially valued at zero, enters the transfer tax base a second time as a gift, and/or a third time as an estate. It would seem logical that if the donor subsequently gives away the retained interest as a lifetime gift, this later gift should be disregarded, regardless of the value of the interest at the time of the actual gift (because it was already taxed once). This view may give consistency to the valuation of the retained interest and prevent double taxation; however, this pragmatic approach goes against the generally-accepted gift tax principle that a gift is only taxable when complete. There is a gap in timing between when the gift tax is imposed (at the initial transfer) and when the completed gift is actually made (at the subsequent transfer).

Similarly, when the subsequent transfer occurs at death (because the retained interest is includable in the donor's estate), the value of this retained interest will be the fair market value at the time of the donor's death. This result is required under Code section 2001(b). Between the initial transfer and the subsequent transfer, the retained interest may have changed in value significantly. It seems as if the government gets a second bite at the apple by taxing the same interest once, and then again (even though double taxation can be abated to a certain extent, but not completely, as explained below) at a potentially much higher value.

Code section 2001(b) may not work to avoid double taxation in all circumstances because it only applies to "taxable gifts" that are included

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[17] I.R.C. § 2702(b).

[18] I.R.C. §§ 2702(a)(2)(A), (e), 2704(c)(2). Note that other arrangements, such as GRITs, still are perfectly acceptable as long as the transferee is not a member of the grantor's family. This has made GRITs useful, for example, for wealth transfers between same-sex couples who are not married.

in the gross estate.[19] It works well when a donor has made a completed gift of property (and there was a clearly established valuation for that gift) and then subsequently that property was included in the donor's estate because of a string. However, when a donor retains an interest and the retained interest subsequently is includible in the donor's estate, it is difficult to argue that the retained interest is a completed, "taxable gift." Even if one can argue that Code section 2001(b) technically applies in these situations, the section 2001(b) adjustment may be unworkable because it consists of an exclusion from adjusted taxable gifts of the value of the initial taxable gift that is subsequently included in the gross estate, even though this value could not be ascertained at the time of the gift, or was by statute valued at zero. It would seem difficult to argue that the retained interest has an ascertainable value for purposes of section 2001(b) adjustment, or to establish what that value might be, if for gift tax purposes that retained interest clearly had a value of zero.

Therefore, although the holding in *Robinette* is defensible from an administrative perspective, i.e., both donors and the IRS must have to follow actuarial principles in valuing gifts, the case is problematic because it seems to support the proposition that an interest can be valued in one manner for gift tax purposes and yet another manner for estate tax purposes, which should not be the result since the gift tax and the estate tax are to be construed *in pari materia*.[20]

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19 *See* I.R.C. § 2001.

20 Harris v. Comm'r, 340 U.S. 106, 107 (1950).