

TAX COURT CASE UPDATE

FCG Valuation Case E-Flash

Authored by John Walker and Chris D. Treharne, ASA, MCBA, BVAL of Gibraltar Business Appraisals, Inc. a member firm of FCG

Citation:

Estate of Sylvia Riese, Deceased v. Commissioner of Internal Revenue, T.C. Memo 2011-60, March 15, 2011.

Overview:

Although the Decedent's qualified personal residence trust terminated six months before her death, the Tax Court determined that her personal residence was not includable in her estate under IRC §2036. In addition, because the Court determined that the residence had transferred to trusts that benefited the Decedent's daughters, the estate was able to take a deduction for accrued rent expense for the Decedent, even though no lease agreement had been signed. However, the estate itself was not entitled to a deduction for rent expense because the estate had no need to occupy the residence and no lease agreement was entered into even though all parties were capable of doing so.

The Facts:

The Decedent owned an expensive home and substantial fortune, which she inherited upon her husband's death in 1990. Ms. Grimes and Ms. Zipp were The Decedent's daughters and co-executors of the Decedent's estate. Ms. Zipp spent much of her time taking care of The Decedent in the latter's last few years of life, while Ms. Grimes was entrusted with the Decedent's financial affairs. The Decedent received significant financial planning toward the end of her life from Stefan F. Tucker.

Beginning in 1999, Mr. Tucker and Ms. Grimes began discussing the establishment of a qualified personal residence trust ("QPRT"). In September of that year, Mr. Tucker sent Ms. Grimes a letter outlining the benefits and costs associated with a QPRT. Upon discussing the matter with the Decedent, The Decedent liked the idea and instructed Ms. Grimes and Mr. Tucker to proceed.

In February 2000, Mr. Tucker met with Ms. Grimes to discuss the QPRT and other estate planning options for The Decedent. They agreed that the QPRT was the best option for the Decedent's residence. Mr. Tucker called The Decedent to inform her of their agreement. After explaining the costs and benefits to The Decedent during this telephone call, the Decedent agreed to establish the QPRT.

Two weeks after the meeting with Ms. Grimes, Mr. Tucker sent a letter to the Decedent informing her that she would have to pay fair market rent to her daughters (as trustees of trusts to which the residence would transfer after the QPRT's termination) if she continued to live in

the residence after the termination of the QPRT. Ms. Grimes and The Decedent discussed the contents of the letter, and, after the discussion, the Decedent decided on a three-year term for the QPRT.

The QPRT was established on April 19, 2000. The Decedent executed a deed that transferred the residence and filed a gift tax return for 2000 which reported the transfer. The QPRT agreement required that, if The Decedent survived the termination date of the QPRT, the QPRT would terminate and the residence would be distributed 50 percent to two trusts, each established for the benefit of the Decedent's daughters. The QPRT terminated on April 19, 2003.

Although Ms. Grimes never directly discussed rent with the Decedent after the QPRT expired, she did call Mr. Tucker to ask how fair market rent could be determined. Mr. Tucker instructed Ms. Grimes to contact local real estate brokers, and, as long as she had done so by December 31, 2003, she should be fine from a legal standpoint. Mr. Tucker made a note in his calendar to check in with Ms. Grimes around Thanksgiving to ensure she would take care of all of the details before the end of the year.

The Decedent died from a stroke on October 26, 2003, before Ms. Grimes had determined fair market rent and before Mr. Tucker was to call her. After the Decedent passed away, the estate continued to pay property taxes, maintenance, and upkeep on the residence until it was sold on October 6, 2004. The trusts to which the residence was transferred did not maintain homeowners' insurance for the residence, nor did the trusts directly pay any of the aforementioned expenses.

On its January 24, 2005, Form 706, the estate did not include the residence, claimed a deduction of more than \$46,000 for fair market value rent (estimated at \$7,500 per month) owed from The Decedent to the trusts from the termination of the QPRT to the date of death, and claimed another deduction of more than \$46,000 for fair market value rent for the estate from the date of death to April 30, 2004.

Discussion:

The IRS argued that the Decedent retained an interest in the residence due to an implied agreement. The IRS's argument rested on its assertion that nothing changed in The Decedent's relationship to the home after the expiration of the QPRT. The Decedent did not execute a lease, did not pay rent, and still lived in the home. The estate argued that no such agreement existed, that there was evidence The Decedent intended to pay rent, and that the trustees of the trusts which owned the residence intended to collect rent. The estate argued that rent was never collected due to The Decedent's unexpected death before the establishment of fair market value for such rent.

Due to the credible testimony of Ms. Grimes and Mr. Tucker, the Court accepted that the Decedent intended to pay fair market value rent, that no agreement existed for the Decedent to retain an interest in the property, and that the residence was not includable in The Decedent's estate.

Although the Decedent had not entered into a lease agreement with the trustees of the trusts, the Tax Court determined that her occupancy of the residence (which was owned by the trusts from the time of expiration of the QPRT to her date of death) constituted a tenancy-at-will under New York state law. Accordingly, rent due to the trusts constituted a liability to the trusts, which

the estate was required to pay on The Decedent's behalf. Because the liability existed, the estate was entitled to deduct the amount of fair market value rent from April 19, 2003 through October 26, 2003.

In contrast, the Court denied the estate's ability to deduct fair market value rent after The Decedent's death. The estate did not require the residence as a place to conduct its affairs and was not obligated to pay rent to the trusts. The tenancy-at-will obligation died with the Decedent.

Conclusion:

Based on the facts as presented, the Tax Court determined that The Decedent intended to pay fair market value rent which was evidence of her no longer owning or retaining an interest in her personal residence. As a result, the residence was not includable in her estate under IRC §2036. In addition, because The Decedent intended to pay fair market value rent, the value of such rent payments was deductible from her estate tax burden as a debt of the Decedent. However, The Decedent's tenancy-at-will status died with her, and the estate was not entitled to deduct accrued rent after the Decedent's date of death.