TAX COURT CASE UPDATE

Citation:

Estate of Clyde W. Turner, Sr., et al. v. Commissioner, 138 TC No. 14, March 29, 2012.

Overview:

This case is a supplement to an earlier Tax Court decision (T.C. Memo 2011-209) which ruled that the estate had to include assets that had been transferred by the decedent to a family limited partnership.

In this case the estate filed a motion for reconsideration of the Court's decision in the original case regarding the application of code section 2036. In addition, the estate asks the Court to look at an alternative position, "that even if section 2036 applies, the estate has no estate tax deficiency because it is entitled to an increased marital deduction equal to the increased value of the estate."

The Facts:

In 2002, after forming Turner & Co., the decedent and his wife each contributed assets with a fair market value of $4,333,671 (total value of $8,667,342) to Turner & Co. In exchange, they each received a 0.5 percent general partnership interest and a 49.5 percent limited partnership interest. By January 1, 2003, the decedent had transferred 21.7446 percent of his limited partnership interest in Turner & Co. as gifts to family members. On the date of his death, he owned a 0.5 percent general partnership interest and a 27.7554 percent limited partnership interest in Turner & Co.

The estate reported that an 18.8525 percent limited partnership interest was allocated to the surviving spouse and an 8.9029 percent interest was allocated to a bypass trust. The decedent's estate claimed a marital deduction of $1,820,435, of which $1,072,000 pertained to the 18.8525 percent interest in Turner & Co. that passed to the spouse.

The estate put forth the argument that the spouse's right to the marital bequest required her to receive assets equal to the amount necessary to reduce the estate taxes to zero, and that the decedent's will include a complex provision to accomplish this.

Discussion:

The estate put forth four arguments for The Court to consider in its motion for reconsideration. The Court ruled,

> In Estate of Turner I we considered and addressed the estate's arguments, witnesses' testimony, and documentary evidence. The estate has not demonstrated any manifest error of fact. We will therefore deny the motion regarding the application of section 2036.

The Court then moved on to a discussion of the marital deduction beginning with a summary of the facts from the initial hearing, and the inclusion of the marital deduction formula provision from the decedent's will.

The Court proceeded to discuss the problem that code section 2036 causes with respect to the marital deduction. The IRS contended that the estate could not claim a marital deduction for the assets or partnership interest that passed to the surviving spouse. The estate on the other hand, claimed that under the formula marital deduction clause of the will, the estate could recalculate the marital deduction. "In the estate's view, Code Sec. 2036 applies a legal fiction for purposes of calculating the gross estate, and, for consistency, the marital deduction can also be increased to reflect that fiction."

The Court rejected the estate's arguments based on provisions governing the marital deduction. According to the Tax Court, the marital deduction is based on a property interest that passes to a surviving spouse as beneficial owner. In this case, neither the limited partnership interests that were given to family members other than the surviving spouse or the underlying assets passed to the surviving spouse as beneficial owner. Therefore, the estate could not deduct the value of either the gifted limited partnership interests or the underlying assets.

Conclusion:

The gifted limited partnership interests or the underlying assets were not available to fund the marital deduction. Rather, they represented lifetime transfers to individuals other than the surviving spouse, and the estate could not rely on the formula marital deduction clause in the will to increase the marital deduction.