

## **TAX COURT CASE UPDATE**

### **Citation:**

*Estate of Virginia V. Kite v. Commissioner*, T.C. Memo 2013-43, February 7, 2013.

### **Overview:**

The Tax Court had three issues to deal with in this case:

1. Whether the transfer of partnership interests to the decedent's children in exchange for private annuity agreements was a disguised gift subject to gift tax.
2. Whether the transfer of QTIP trust assets constituted a disposition of the qualifying income interest for life such that the disposition was a taxable gift of the remainder interest under Code Section 2519.
3. Whether the decedent made a taxable transfer under Code Section 2514 when she effectively released her general power of appointment over the corpus of her marital deduction trust.

### **The Facts:**

The decedent created a QTIP trust for her husband who passed away a week after the trust was created. Under the terms of the trust, the assets remained in the trust for the decedent's benefit. The assets were included in the husband's estate.

Subsequent to the husband's death, the assets of the QTIP trust, a second QTIP trust and a general power of appointment marital trust were transferred to a limited partnership. These interests were sold for notes and the notes were contributed to a general partnership. In a further series of transactions, this interest in a general partnership was distributed to the decedent. Her children contributed additional assets to the general partnership and the decedent sold her interests to her children for a deferred private annuity (payments would not begin for 10 years). The decedent passed away three years later.

### **Discussion:**

The first dispute was whether the general partnership interests that were exchanged for the unsecured annuity agreements were transferred for full and adequate consideration. The IRS argued that the transfers were disguised gifts, the annuity transactions lacked substance, and the annuity agreements were illusory. The Court determined that all of the IRS's arguments lacked merit, and therefore, the private annuities were exchanged at fair market value.

To the second and third issues, The Court looked at the regulations under Code Section 2519 which included the following: "not included as a disposition for purposes of section 2519 is the conversion of QTIP property into other property in which the surviving spouse has a qualifying income interest for life." Based on The Court's analysis of the various transactions, it determined

that all of the transfers had been done properly and that there were no gifts or other taxable transfers.

**Conclusion:**

The estate prevailed on all of the issues presented in this case. Based on The Court's analysis, the annuity agreements constituted full and adequate consideration and therefore were not subject to gift tax. As to the second issue, Regulation Section 25.2519-1(f) provides that the sale and reinvestment of assets of a trust holding QTIP assets is not a disposition of the qualifying income interest, provided that the surviving spouse continues to have a qualifying income interest for life in the trust after the sale and reinvestment. Since the decedent maintained a lifetime income interest, this issue fell under the regulations.