TAX COURT CASE UPDATE

Citation:

Estate of Dorothy Brown v. Commissioner, T.C. Memo 2013-50, February 14, 2013.

Overview:

The Tax Court found that there was a material issue of fact as to whether the fair market value of what the decedent transferred to various trusts and the fair market value received in exchange for those transfers were identical.

The Facts:

The decedent passed away in December 2007. Almost four years earlier, the decedent, as trustee of a marital trust made two transfers of two 20 percent income interests in a limited liability company (LLC) to irrevocable trusts for the benefit of her granddaughters. In return, the decedent received a 10-year promissory note for $1.875 million from each trust. Several days later, she transferred a 2.9 percent membership interest in the same LLC to each of the trusts. The decedent received nothing in exchange for these two transfers.

In April 2005, the decedent, as trustee of the marital trust, filed Form 1041 for the trust's 2004 taxable year. She reported the original transfers as related-party installment sales. In October 2005, the decedent filed a gift tax return reporting the transfer of the two 2.9 percent interests, including a value of $230,000.

Both of the granddaughters' trusts had each held a 49 percent capital interest and 37.5 percent profits interest in Woodland Ridge MHC (Woodland Ridge), a partnership that owned a mobile home park. In December 2006, the decedent, as trustee of these trusts, transferred $2.5 million to Woodland Ridge in exchange for a 25 percent capital interest and a 25 percent profits interest. She did not file a gift tax return in 2006. In 2008, a year after the death of the decedent, the estate filed a gift tax return for 2007. It reported taxable gifts totaling $30,000, with a gift tax liability of $7,380.

In 2011, the Internal Revenue Service issued a notice of deficiency with respect to taxable years 2004 (deficiency of $758,448); 2006 (deficiency of $1.150 million); and 2007 (deficiency of $720). The estate moved for summary judgment on the grounds that the IRS was barred by the applicable statute of limitations to collect gift tax attributable to the 2004 and 2006 transfers.

Discussion:

The Tax Court applied Internal Revenue Code Section 6501(a), which sets forth a three-year period after a gift tax return is filed within which the IRS may assess any gift tax. In the case of a failure to file a gift tax return, or in a case in which the value of a gift is required to be shown on a gift tax return but is not, the IRS may assess a gift tax at any time. Therefore, The Court had to determine: 1) whether the January 1, 2004 transfers resulted in gifts that required the

decedent to have reported them on her 2004 gift tax return; and 2) whether the December 2006 transfer was a gift, thus requiring the decedent to have filed a gift tax return in 2006. A finding that either transfer did not result in a gift would make the statute of limitations moot with respect to the year of that particular transfer.

The estate argued that neither transfer was a gift. Whether a transfer is a gift depends on the fair market value (FMV) of what is transferred, compared with what is received in exchange. A transfer for less than full and adequate consideration may constitute an indirect gift. In this instance, both the estate and the IRS disputed the FMV of the 20 percent income interests transferred to the granddaughters' trusts in 2004; as a result, The Court was unable to determine whether the FMV of the income interests transferred equaled the FMV of the notes received. Similarly, the parties disputed whether the decedent received full and adequate consideration in exchange for the December 2006 transfer. The decedent's estate further argued that regardless of FMV, a transfer of property is not a taxable gift if it is made in the ordinary course of business, even if it is for less than full and adequate consideration. However, the record did not establish that any of the transfers were made in the ordinary course of business.

Conclusion:

The Court concluded that the record did not establish the following:

1. The FMVs of the 20 percent interests that were transferred in 2004.
2. The FMVs of the notes received for the transferred interests in 2004.
3. The FMV of the consideration the decedent received for the $2.5 million transferred in 2006.

As a result of the previous items not being established, The Court could not settle the issue of whether the statute of limitations applied (barring the imposition of any gift tax) and The Court denied summary judgment.