TAX COURT CASE UPDATE

Citation:

Jean Steinberg v. Commissioner, 141 T.C. No 8, September 30, 2013.

Overview:

The Tax Court concluded that where a taxpayer gave her children property in exchange for their promise to pay any estate tax liability arising under Code Section 2035(b)'s "gross-up rule," which increases a decedent's gross estate by the amount of any gift tax paid by the decedent or the decedent's estate on any gift made by the decedent during the three-year period preceding the decedent's death, the fair market value of that property for gift tax purposes might be reduced by the value of the children's assumption of the potential estate tax liability.

The Facts:

The taxpayer entered into a binding gift agreement with her daughters under which she gave them cash and securities. In exchange, the daughters agreed to assume and to pay (among other things) any estate tax liability imposed under Code Section 2035(b) as a result of the gifts in the event that their mother (age 89) passed away within three years of the gifts. The agreement was the result of several months of negotiation between the mother (donor) and her daughters (donees). Ms. Steinberg and her daughters were represented by separate counsel. The agreement also provided remedies if any daughter failed to pay her share of any estate tax liability.

In calculating the gross fair market value of the property transferred to the daughters for gift tax purposes, the taxpayer reduced the fair market value of the cash and securities by (among other things) an amount representing the value of the daughters' assumption of the potential estate tax liability.

On audit, the IRS disallowed the discount for the donees' assumption of the potential Code Section 2035(b) estate tax liability. The taxpayer sought relief in the Tax Court, and IRS filed a motion for summary judgment.

Discussion:

The IRS's sole claim was that the donees' assumption of the potential estate tax liability did not increase the value of Ms. Steinberg's estate, and therefore, did not constitute consideration in money or money's worth under Code Sec. 2512(b) in exchange for the gifts.

The Tax Court's majority opinion concluded that, because the value of the obligation assumed by the daughters was not barred as a matter of law from being consideration in money or money's worth under Code Section 2512(b), the fair market value of the taxable gift could be determined with reference to the daughters' assumption of the potential estate tax liability.

The Tax Court denied the IRS's motion for summary judgment, concluding that it would no

longer follow its own holding in *McCord*[1]. Noting that the Fifth Circuit was not alone in considering potential tax liability in valuation cases, the Tax Court agreed with the Fifth Circuit's conclusion in *McCord* that a willing buyer and a willing seller in appropriate circumstances may take into account a donee's assumption of potential Code Section 2035(b) estate tax liability in arriving at a sale price.

The Tax Court reasoned that a donee's assumption of potential estate tax liability may provide a tangible benefit to the donor's estate, and so as a matter of law it could meet the requirements of the estate depletion theory. Under Federal tax law, the cost of any estate tax liability is generally borne by the donor's estate and not the donee of the gift. When the decedent gave the gifts to the donees, her assets accrued both gift tax liability and potential estate tax liability. When the donees assumed the gift tax liability, the decedent's assets were relieved of the gift tax liability and so were replenished. Likewise, when the donees assumed the potential estate tax liability, the decedent's assets may have been relieved of the potential estate tax liability.

While noting that transactions within a family group are subject to special scrutiny, and that there is a presumption that a transfer between family members is a gift, the Tax Court rejected the IRS's claim that a transfer between family members was necessarily a gift unless it was in the ordinary course of business. The Court found that a transfer between family members even if it was not in the ordinary course of business could still avoid gift tax to the extent it was made for consideration in money or money's worth.

Further, the Court determined that the donees' assumption of potential estate tax liability could be quantifiable and reducible to monetary value. Nothing in the record indicates that the net gift agreement between the decedent and her daughters was not bona fide or made at arm's length. The donor and the donees were represented by separate counsel, and the net gift agreement was the result of months of negotiation.

Conclusion:

The Court found that the IRS was not entitled to summary judgment as the IRS had failed to show as a matter of law that the donees' assumption of the taxpayer's potential Code Section 2035(b) estate tax liability could not be consideration in money or money's worth under Code Section 2512(b). In addition, there were genuine disputes of material fact as to whether the donees' assumption of the taxpayer's potential estate tax liability constituted consideration in money or money's worth.

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1 In *McCord*, (2003) 120 TC 358, the Tax Court held that the value of a gift could not be reduced on account of the donees' agreement to pay any increased estate tax that would occur under Code Section 2035(b) if the donors were to die within three years of the gifts. The Tax Court found the assumption of the taxpayers' potential estate tax liability was too speculative to be reduced to a monetary value. However, the Fifth Circuit reversed and remanded this decision. (*McCord v. Commissioner* (CA5 2006) 98 AFTR 2d 2006-6147).