5 T.C. 1239 (1945)

A residuary legatee who receives property from a prior estate but uses their own funds to pay the prior estate's debts is considered a purchaser of the property to the extent of the debts paid, reducing the allowable deduction for previously taxed property.

Summary

The Tax Court addressed the issue of determining the proper deduction for previously taxed property under Section 812(c) of the Internal Revenue Code. The decedent, Elizabeth Miller, received property as a residuary legatee from a prior estate. She then used her own funds to pay debts, taxes, and expenses of that prior estate. The court held that Miller was a purchaser of the property to the extent of the debts she paid, thus reducing the deduction for previously taxed property. The court reasoned that a residuary legatee is only entitled to what remains after the estate's debts are settled.

Facts

Elizabeth Miller received nineteen items of property from a prior estate, which were included in her own estate at a higher valuation. Miller paid $1,080,961.77 in debts, taxes, and expenses against the prior estate using her own funds. Miller's estate then claimed a deduction for previously taxed property in the amount of $2,477,631.67, representing the aggregate value of the nineteen items. The Commissioner argued that the deduction should be reduced by the $1,080,961.77 Miller paid in debts and expenses of the prior estate.

Procedural History

The case originated in the Tax Court of the United States. The Commissioner determined a deficiency in the estate tax, which the petitioner contested. The Tax Court reviewed the Commissioner's determination and the petitioner's arguments, ultimately upholding the Commissioner's calculation of the allowable deduction.

Issue(s)

Whether a legatee who receives property from a prior estate and subsequently pays the prior estate's debts out of their own funds is considered a purchaser of the property to the extent of the debts paid, thus reducing the deduction for previously taxed property under Section 812(c) of the Internal Revenue Code?

Holding

Yes, because under Connecticut law, a residuary legatee is entitled only to the residue of the estate after the payment of debts and expenses. To the extent the property obtained by the decedent exceeded what she was entitled to under the will

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of her benefactor, it cannot be considered as coming within the statute.

Court’s Reasoning

The court reasoned that under Connecticut law, a residuary legatee is only entitled to receive what remains of the estate after the payment of debts, funeral expenses, and testamentary expenses. The court cited Connecticut case law, including *First National Bank & Trust Co. v. Baker*, which defines the residue as that portion remaining after debts, administration expenses, legacies, and other proper charges are paid. Section 812(c) allows a deduction only for property received by “gift, bequest, devise, or inheritance.” The court emphasized that Miller received the property only after she paid the debts, and therefore, to the extent of those debts, she was considered to be a purchaser, not a beneficiary. The court distinguished cases cited by the petitioner, finding them not directly relevant to the issue at hand. It further noted that in *Commissioner v. Garland*, the taxpayer conceded a similar point.

Practical Implications

This case clarifies the scope of the previously taxed property deduction under Section 812(c) of the Internal Revenue Code. It establishes that when a beneficiary uses their own funds to pay debts of a prior estate from which they received property, the beneficiary is treated as a purchaser to that extent. This reduces the amount that can be deducted as previously taxed property in the beneficiary’s estate. Practitioners must carefully analyze the source of funds used to pay debts of prior estates when calculating the previously taxed property deduction. This case emphasizes the importance of proper estate administration and the distinction between inheriting a residue and purchasing assets to settle an estate’s liabilities.

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