14 T.C. 445 (1950)

A taxpayer's payment of a deceased spouse's estate tax deficiency, as a transferee to protect annuity contracts, is a capital expenditure amortizable over the taxpayer's life expectancy.

Summary

Irene Moffett, the surviving annuitant of annuity contracts purchased by her deceased husband, Franklyn Hutton, for $730,000, paid an estate tax deficiency to prevent a transferee assessment and lien on the annuities. The Tax Court addressed whether Moffett was taxable on annuity payments received in 1944 and whether she could deduct the estate tax payment. The court held that 3% of the annuity's cost was taxable income under Section 22(b)(2)(A) of the Internal Revenue Code, and that the estate tax payment was a capital expenditure to be amortized over Moffett's life expectancy.

Facts

Franklyn Hutton's daughter gave him $730,000 to purchase annuity contracts. These contracts provided annual payments to Hutton and his wife, Irene Moffett, jointly or to the survivor. Hutton died in 1940, and Moffett continued to receive the annuity payments. The annuity contracts were not initially included in Hutton's estate tax return. The IRS later determined a deficiency, including the contracts at a compromise valuation of $424,873.03. To protect her annuity interest, Moffett paid the estate tax deficiency.

Procedural History

The IRS assessed an estate tax deficiency against Hutton's estate, including the annuity contracts. Moffett, as executrix and transferee, initially contested the deficiency but eventually signed a waiver consenting to the assessment. Facing a transferee assessment and potential seizure of the annuities, Moffett paid the deficiency. She then contested the inclusion of the 3% of the annuity's cost in her gross income for the tax year 1944. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether the Commissioner properly included 3% of the annuity contract's cost in Moffett's gross income under Section 22(b)(2)(A) of the Internal Revenue Code.

2. Whether Moffett's payment of the estate tax deficiency, as a transferee, constitutes a deductible expense; and if so, how should it be treated for tax purposes?

Holding

1. Yes, because Moffett was the annuitant during the tax year, and Section 22(b)(2)(A) mandates including 3% of the annuity's cost in her gross income, irrespective of her transferee status.

2. Yes, because the payment constitutes a capital expenditure for the protection and preservation of her rights as an annuitant, amortizable over her life expectancy.

Court's Reasoning

The court reasoned that Moffett's payment of the estate tax deficiency, while perhaps made under duress, was a legal exaction that did not alter her status as an annuitant. Therefore, she was subject to the 3% rule under Section 22(b)(2)(A), citing *Title Guarantee & Trust Co., Executor, 40 B.T.A. 475*. The court acknowledged that Moffett received no other property from the estate and that the annuity contracts were included in the gross estate. Her payment of the estate tax deficiency was deemed a capital expenditure to protect her annuity rights. The court determined amortization over her life expectancy was the fairest method for recovering this expenditure, referencing *William Ziegler, Jr., 1 B.T.A. 186*; *Christensen Machine Co., 18 B.T.A. 256*; and *Ida Wolf Schick, 22 B.T.A. 1067*. The court held, "The payment was made for the protection and preservation of her rights as annuitant, and constitutes a capital expenditure."

Practical Implications

This case establishes that payments made by a transferee to satisfy estate tax liabilities, when those payments protect the transferee's beneficial interest in an asset included in the estate, are capital expenditures, not currently deductible expenses. Such expenditures must be amortized over the asset's useful life, which, in the case of an annuity, is the annuitant's life expectancy. The Moffett case highlights the importance of considering the transferee's interest and the nature of the payment when determining its tax treatment. It influences how tax advisors structure settlements involving estate tax liabilities and transferee liability, emphasizing the long-term amortization rather than immediate deduction of such payments.