Estate of Fried v. Commissioner, 54 T. C. 805 (1970)

The marital deduction is not allowed for a bequest to a surviving spouse if the interest may terminate or fail upon the spouse's death within a period longer than six months after the decedent's death, and estate inclusions may be required for transfers made by the decedent prior to death that take effect at death.

Summary

Estate of Fried v. Commissioner involved the estate tax treatment of several assets and deductions. The court denied the marital deduction for personal property due to a will provision that would pass the estate to the daughter if the wife died before probate, exceeding the six-month period allowed under IRC § 2056. The court also included in the estate a $5,000 payment from the decedent's corporation to his widow under IRC § 2037, as it was part of a transfer made by the decedent in exchange for partnership assets. Additionally, the value of an automobile paid for by the decedent but registered to his corporation, U. S. Treasury bonds at par value, and certain tax deductions were addressed, with the court affirming the Commissioner's determinations.

Facts

Harry Fried died testate in 1963, leaving a will that bequeathed his residuary estate to his wife Ethel, but with a provision that if she died before the probate of the will, the estate would pass to their daughter. Harry and his brother had transferred their partnership assets to Brake Laboratories, Inc. , in 1957, with an agreement providing for lifetime employment and a $5,000 death benefit to the widow of either shareholder. Harry purchased a Chrysler automobile with his own funds, but it was registered in the corporation's name. At his death, Harry owned U. S. Treasury bonds that could be used to pay estate taxes. The estate claimed deductions for taxes and rent on Harry's apartment.

Procedural History

The estate filed a tax return in 1964 and the Commissioner determined a deficiency, which the estate contested. The Tax Court heard the case and addressed six issues: the marital deduction, inclusion of the $5,000 corporate payment, inclusion of the automobile, valuation of the Treasury bonds, deductions for taxes, and rent on the apartment.

Issue(s)

1. Whether the estate is entitled to a marital deduction under IRC § 2056 for personal property passing under a will provision that would pass the estate to the daughter if the wife died before probate?
2. Whether the $5,000 payment from Brake Laboratories, Inc. to the decedent's widow is includable in the estate under IRC § 2037?

3. Whether the value of an automobile, paid for by the decedent but registered to the corporation, is includable in the estate?
4. Whether the claimed deductions for taxes are properly deductible by the estate?
5. Whether the U. S. Treasury bonds, which could be used to pay estate taxes, should be included in the gross estate at par value or fair market value?
6. Whether the estate is entitled to a deduction for three months' rent on the decedent's apartment?

Holding

1. No, because the will provision created a terminable interest that could fail if the wife died more than six months after the decedent, before probate, which is not allowed under IRC § 2056(b)(3).
2. Yes, because the payment was a transfer by the decedent to the corporation in exchange for partnership assets, taking effect at his death and meeting the reversionary interest requirement of IRC § 2037.
3. Yes, because the estate failed to prove the automobile was not an asset of the decedent, despite being registered to the corporation.
4. Partially, as the estate was allowed a deduction for $125. 44 of taxes, but the remainder was disallowed due to insufficient evidence.
5. Yes, because the bonds were includable at par value since they could be used to pay estate taxes, which were due under the court's decision.
6. No, because there was no evidence that the decedent had a continuing lease obligation at the time of his death, as the original lease had expired.

Court's Reasoning

The court found that the will's provision for the daughter to inherit if the wife died before probate created a terminable interest under New York law, as probate could take longer than six months. The $5,000 payment was considered a transfer by the decedent because it was part of the consideration for transferring partnership assets to the corporation, and the decedent had a reversionary interest exceeding 5%. The automobile was included in the estate as the estate failed to prove it was not an asset of the decedent. The Treasury bonds were valued at par because they could be used to pay estate taxes, which were due. Tax deductions were partially allowed based on evidence provided, and the rent deduction was disallowed due to lack of evidence of a continuing lease obligation. The court relied on cases like *In re Johnston's Estate* for will interpretation and *Worthen v. United States* for estate inclusion principles.

Practical Implications

This case underscores the importance of precise will drafting to ensure estate tax benefits like the marital deduction are not lost due to conditions that could terminate the surviving spouse's interest. It also highlights that estate planners must consider the tax implications of corporate agreements, as payments to beneficiaries can be includable in the estate if linked to transfers by the decedent. Practitioners should be cautious about the classification of assets like automobiles, especially when registered to entities other than the decedent. The valuation of assets like Treasury bonds at par value when used for tax payments is a reminder of the need to consider all potential uses of assets in estate planning. Finally, the case illustrates the need for clear documentation of obligations like rent to support deductions, and the necessity of understanding state law regarding probate timing when drafting wills.

