Estate of David Davis IV, Deceased, David Davis V, Executor v. Commissioner of Internal Revenue, 86 T. C. 1156 (1986)

Successive interests in trusts can qualify for special use valuation under Section 2032A even if remote contingent beneficiaries are not qualified heirs.

Summary

The U. S. Tax Court ruled that the Estate of David Davis IV could elect special use valuation under Section 2032A for farm property held in a trust despite the remote possibility that non-qualified heirs might eventually receive the property. The court invalidated a Treasury regulation requiring all successive interest holders to be qualified heirs, as it conflicted with the statute's purpose to preserve family farms. Additionally, the court held that a trust for the decedent's widow qualified for the marital deduction under Section 2056, despite broad trustee powers and provisions affecting distribution to other heirs.

Facts

David Davis IV died in 1978, leaving a will that established two trusts: one for his widow, Nancy, and another for his three children. The farm property was placed in the children's trust, which would terminate upon the death of the last surviving child, with the remainder to go to the decedent's descendants. If no descendants survived, the property would pass to three non-qualified charitable institutions. The estate elected special use valuation for the farm property under Section 2032A. The IRS disallowed the election because the ultimate remainder beneficiaries were not qualified heirs.

Procedural History

The executor of the estate filed a petition with the U. S. Tax Court challenging the IRS's determination of a $1,332,388. 48 estate tax deficiency. The IRS had disallowed the special use valuation election and the marital deduction for the trust for Nancy. The Tax Court heard the case and issued a majority opinion allowing the special use valuation and the marital deduction.

Issue(s)

1. Whether the estate can elect special use valuation under Section 2032A for farm property when the ultimate remainder beneficiaries of the trust are not qualified heirs.
2. Whether the trust for the widow qualifies for the marital deduction under Section 2056(b)(5) given the terms of the trust and the powers granted to the trustees.

Holding

1. Yes, because the Treasury regulation requiring all successive interest holders to

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be qualified heirs is invalid as it conflicts with the statutory purpose of preserving family farms.
2. Yes, because the trust terms satisfy the requirements of Section 2056(b)(5), and the broad powers granted to the trustees do not evidence an intent to deprive the widow of the required beneficial enjoyment.

Court's Reasoning

The court reasoned that the Treasury regulation requiring all successive interest holders to be qualified heirs for special use valuation was inconsistent with the legislative intent of Section 2032A. The statute aims to preserve family farms and businesses, and the court adopted a "wait and see" approach, allowing the election despite the remote possibility of non-qualified heirs receiving the property. The court emphasized the decedent's clear intent to comply with the statute and the minimal risk of the contingency occurring. For the marital deduction, the court found that the widow was entitled to the "entire net income" of the trust, which satisfied the statutory requirement of receiving "all the income. " The court also held that the broad powers granted to the trustees did not indicate an intent to deprive the widow of her beneficial enjoyment, and her power of appointment was not limited by the terms of the children's trust.

Practical Implications

This decision has significant implications for estate planning involving family farms and trusts with successive interests. It allows estates to elect special use valuation even when remote contingent beneficiaries are not qualified heirs, provided the primary beneficiaries are family members and the risk of the contingency occurring is minimal. Estate planners can now design trusts that preserve family farms while providing for non-qualified heirs in the event of unforeseen circumstances without jeopardizing the special use valuation election. The ruling also clarifies that broad trustee powers do not necessarily disqualify a trust from the marital deduction, as long as the surviving spouse's beneficial enjoyment is not impaired. Subsequent cases, such as *Estate of Clinard v. Commissioner*, have applied this ruling, though the dissent in *Davis* raised concerns about potential abuse and the need for clearer statutory guidelines.

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