Estate of Babbitt v. Commissioner, 87 T. C. 1270 (1986)

Gifts of future interests made within three years of death are includable in the decedent's gross estate under IRC § 2035(a), even if valid under state law, and do not qualify for the annual exclusion under IRC § 2503(b).

Summary

Nona H. Babbitt attempted to gift $3,000 interests in her residence to 16 family members shortly before her death. The Tax Court ruled these were future interests, not qualifying for the annual gift tax exclusion, and thus includable in her estate under IRC § 2035(a). The court assumed the validity of the gifts under Texas law but found they did not grant immediate use or enjoyment, defining them as future interests. The full value of Babbitt's residence, $62,259, was included in her estate without discount, as the entire property was considered part of her estate at death.

Facts

Nona H. Babbitt owned a residence in Houston, Texas. Diagnosed with terminal cancer in August 1980, she moved out of her home and into her daughter's residence. On September 11, 1980, Babbitt executed a will and an instrument purporting to gift a $3,000 interest in her residence to each of her 16 children and grandchildren. The residence was listed for sale around the same time. Babbitt died on December 15, 1980, and the residence was sold in February 1983. None of the donees took possession or control of the residence before Babbitt's death, and each received $3,000 from the estate after her death.

Procedural History

The estate filed a Federal estate tax return claiming the gifted interests were not includable in the gross estate. The Commissioner determined a deficiency, arguing the gifts were future interests and thus includable under IRC § 2035(a). The case was heard by the U. S. Tax Court, which issued its decision on December 4, 1986, affirming the inclusion of the gifts in the gross estate and determining the value of the residence.

Issue(s)

1. Whether the interests transferred by Babbitt to her children and grandchildren on September 11, 1980, were present or future interests under IRC § 2503(b).

2. Whether the value of the residence should be included in Babbitt's gross estate at its full fair market value or discounted due to the purported gifts.

Holding

1. No, because the interests transferred were future interests, not qualifying for the

annual exclusion under IRC § 2503(b), and were therefore includable in Babbitt's gross estate under IRC § 2035(a).

2. No, because the entire value of the residence, $62,259, should be included in Babbitt's gross estate without discount, as the gifts did not create a cloud on the title and did not affect the property's value.

Court's Reasoning

The court determined that the gifts were future interests because they did not grant immediate use, possession, or enjoyment of the property. The court cited IRC § 2503(b) and related regulations, which define future interests as those limited to commence at some future date. The court noted that the donees did not possess or enjoy the residence before its sale, and the instrument was not recorded or delivered to the donees, indicating an intent to convey interests in the proceeds from the sale rather than immediate rights to the property. The court also analogized the gifts to oil payments under Texas law, which are nonpossessory interests, further supporting the classification as future interests. Regarding valuation, the court rejected the estate's arguments for discounting the property's value, stating that the entire residence, including the gifted interests, should be valued at its fair market value as if Babbitt had retained it until her death.

Practical Implications

This decision clarifies that gifts of future interests made within three years of death are includable in the decedent's gross estate under IRC § 2035(a), even if valid under state law. Attorneys should advise clients that attempts to reduce estate taxes through such gifts will fail if the gifts do not grant immediate use or enjoyment. This ruling affects estate planning strategies, particularly those involving real property, as it underscores the importance of structuring gifts to qualify for the annual exclusion. The decision also impacts how similar cases should be analyzed, emphasizing the need to distinguish between present and future interests based on the timing of enjoyment. Subsequent cases, such as *Estate of Iacono v. Commissioner*, have applied similar reasoning in determining estate tax valuations.