Grimm v. Commissioner, 89 T. C. 747 (1987)

A surviving spouse is taxable on their half of community income received by the decedent's estate during administration, based on the community property laws of the applicable jurisdiction.

Summary

Maxine T. Grimm contested the IRS's determination that she was taxable on half of the income from installment payments received by her deceased husband's estate. The couple, domiciled in the Philippines, had a "conjugal partnership" akin to Washington's community property system. Upon her husband's death, the estate received the remaining installments. The Tax Court held that under Ninth Circuit precedent, which treated Philippine community property similarly to Washington's, Grimm was taxable on her half of the income received by the estate, as her ownership interest continued despite the estate's administration. The court rejected the applicability of Fifth Circuit case law and found the IRS's notice timely under the extended statute of limitations due to significant income omission.

Facts

Maxine T. Grimm and her husband, Edward M. Grimm, were American citizens residing in the Philippines, where they were subject to the "conjugal partnership" property regime. Edward died in 1977, and Maxine moved back to Utah, where his estate was probated. Prior to his death, they had agreed to receive installment payments for the redemption of Everett Steamship Corp. stock, with the final three installments due after Edward's death. These were received by Edward's estate, which reported them as estate income. The IRS determined deficiencies in Maxine's income tax, asserting that half of these payments were taxable to her as community income.

Procedural History

Maxine filed a petition in the U. S. Tax Court challenging the IRS's deficiency notice for tax years 1978, 1979, and 1981. The Tax Court, applying Ninth Circuit precedent on community property laws, held that Maxine was taxable on half of the community income received by the estate. The court also ruled that the IRS's notice was timely under the extended six-year statute of limitations due to a significant omission of income in Maxine's 1978 tax return.

Issue(s)

1. Whether 50 percent of community income, all of which was received by the decedent's estate, is taxable to the surviving spouse when received by the estate?
2. Whether the statute of limitations on assessment of a deficiency has expired for the taxable year 1978?

Holding

1. Yes, because under the community property laws of the Ninth Circuit, which are analogous to the Philippine "conjugal partnership," the surviving spouse retains an immediate vested interest in half of the community income, and this interest remains taxable to the surviving spouse even when received by the decedent's estate during administration.
2. No, because the omission of the Everett payments from Maxine's 1978 tax return exceeded 25 percent of the reported gross income, triggering the six-year statute of limitations under IRC section 6501(e)(1)(A).

Court's Reasoning

The court relied on Ninth Circuit cases like *United States v. Merrill* and *Bishop v. Commissioner*, which clarified that in community property states, a surviving spouse's half interest in community property remains vested and taxable to them, even when income is collected by the estate during administration. The court dismissed the Fifth Circuit's *Barbour* decision as outdated and inapplicable, noting that the Ninth Circuit's approach was consistent with the Philippine community property laws applicable to the Grimms. The court emphasized that the estate's receipt of the income did not diminish Maxine's ownership interest, and the estate's role was limited to paying community debts. The court also found that the IRS's notice was timely because Maxine's omission of the Everett payments from her 1978 return triggered the extended statute of limitations.

Practical Implications

This decision clarifies that in community property jurisdictions, surviving spouses must report their share of community income received by a decedent's estate during administration. It aligns the tax treatment of Philippine "conjugal partnerships" with U. S. community property laws, particularly those of the Ninth Circuit. Practitioners should advise clients in similar situations to report their share of income received by the estate and consider the extended statute of limitations when dealing with significant omissions of income. This ruling also has implications for estate planning in community property states, as it emphasizes the continued ownership interest of the surviving spouse and the importance of accurate reporting to avoid extended IRS assessment periods.