Estate of Loren Doherty, Deceased, Dan A. Doherty, Personal Representative, Petitioner v. Commissioner of Internal Revenue, Respondent, 95 T. C. 446 (1990)

For special use valuation under IRC § 2032A, a written appraisal must be obtained before filing the estate tax return, and a surviving spouse must have an unconditional right to all income from a trust for it to qualify as a marital deduction under IRC § 2056(b)(7).

Summary

The Estate of Loren Doherty attempted to elect special use valuation and a marital deduction under IRC §§ 2032A and 2056(b)(7), respectively. The estate failed to attach a required written appraisal to its estate tax return, and the trust terms allowed the surviving spouse discretion over income distribution. The Tax Court ruled that the estate could not elect special use valuation due to the missing appraisal and denied the marital deduction because the surviving spouse was not unconditionally entitled to all trust income, emphasizing strict compliance with statutory and regulatory requirements.

Facts

Loren Doherty died in 1984, and her estate attempted to elect special use valuation for real property interests indirectly held through a partnership, Ganado, Inc. The estate tax return, filed in January 1985, included estimated market values but did not attach a formal written appraisal. Additionally, the estate sought a marital deduction for a trust established by Doherty's will, which gave the surviving spouse, Dan A. Doherty, discretion to distribute or accumulate income. The IRS challenged both elections due to non-compliance with statutory and regulatory requirements.

Procedural History

The estate timely filed its tax return in January 1985, electing special use valuation and a marital deduction. After an audit, the IRS issued a notice of deficiency in 1988. The estate petitioned the Tax Court, which heard the case and issued its opinion in October 1990, ruling against the estate on both issues.

Issue(s)

1. Whether the estate is entitled to value real property at its special use value under IRC § 2032A without attaching a formal written appraisal to the estate tax return.
2. Whether the surviving spouse has a "qualifying income interest for life" within the meaning of IRC § 2056(b)(7) to qualify for the marital deduction.

Holding

1. No, because the estate did not obtain a written appraisal prior to filing the return,

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as required by IRC § 2032A and the regulations.
2. No, because the surviving spouse was not entitled to all the income from the trust property and did not have a usufruct interest for life, as required by IRC § 2056(b)(7).

Court’s Reasoning

The court emphasized that strict compliance with IRC § 2032A and its regulations is necessary for special use valuation. The estate’s failure to attach a written appraisal to the return disqualified it from electing special use valuation, as the regulations require such an appraisal to be obtained before filing. The court rejected the estate’s argument that the personal representative’s estimates constituted an appraisal and found no substantial compliance with the regulations. Regarding the marital deduction, the court determined that the trust’s terms allowing the trustee discretion to accumulate income precluded the surviving spouse from having a qualifying income interest for life. The court also dismissed the estate’s argument that the surviving spouse’s role as trustee entitled him to all income, noting the possibility of a successor trustee exercising that discretion. The court found no evidence of a usufruct interest under New Mexico law to support the marital deduction.

Practical Implications

This decision underscores the importance of strict adherence to statutory and regulatory requirements for tax elections. Practitioners must ensure that a written appraisal is obtained and attached to the estate tax return before filing to qualify for special use valuation under IRC § 2032A. For marital deductions under IRC § 2056(b)(7), trusts must be structured to ensure the surviving spouse has an unconditional right to all income. This case has influenced subsequent cases, such as Estate of Merwin v. Commissioner, emphasizing the need for precise compliance with tax election rules. It serves as a reminder for estate planners to carefully draft trust provisions and ensure all necessary documentation is prepared before filing estate tax returns.

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