Estate of George D. Ellingson, Deceased, Douglas L. M. Ellingson and Lavedna M. Ellingson, Co-trustees of the George D. and Lavedna M. Ellingson Revocable Living Trust, Petitioner v. Commissioner of Internal Revenue, Respondent, 96 T. C. 760 (1991)

A surviving spouse must be entitled to all income from a marital deduction trust annually to qualify for a qualifying income interest for life under IRC section 2056(b)(7).

Summary

The Estate of George D. Ellingson sought a marital deduction under IRC section 2056(b)(7) for assets transferred to a marital deduction trust. The trust allowed trustees to accumulate income if it exceeded what they deemed necessary for the surviving spouse's needs, best interests, and welfare. The Tax Court held that this provision prevented the trust from qualifying for the marital deduction because the surviving spouse, Lavedna M. Ellingson, was not entitled to all income annually. The court's decision underscores the strict interpretation of the requirement for a qualifying income interest for life, emphasizing that any discretionary power to accumulate income by trustees disqualifies the trust from QTIP treatment.

Facts

George D. Ellingson and his wife, Lavedna M. Ellingson, established a revocable inter vivos trust as part of their estate plan. Upon George's death, the trust was to be divided into three separate trusts, one of which was a marital deduction trust for Lavedna's benefit. The trust allowed the trustees to accumulate income if it exceeded what was deemed necessary for Lavedna's needs, best interests, and welfare. The estate claimed a marital deduction for the assets transferred to this trust, but the IRS disallowed the deduction, asserting that the trust did not meet the requirements for a qualifying income interest for life under IRC section 2056(b)(7).

Procedural History

The estate filed a federal estate tax return claiming a marital deduction under IRC section 2056(b)(7) for assets transferred to the marital deduction trust. The IRS disallowed the deduction, leading the estate to file a petition with the U. S. Tax Court. The Tax Court, after considering the case fully stipulated, ruled in favor of the Commissioner of Internal Revenue.

Issue(s)

1. Whether Lavedna M. Ellingson has a qualifying income interest for life in the property passing to the marital deduction trust, thereby qualifying for a marital deduction under IRC section 2056(b)(7).

Holding

1. No, because the trust’s provision allowing the trustees to accumulate income if it exceeds what they deem necessary for the surviving spouse’s needs, best interests, and welfare prevents Lavedna M. Ellingson from being entitled to all income annually, which is required for a qualifying income interest for life under IRC section 2056(b)(7).

Court’s Reasoning

The court applied the strict requirements of IRC section 2056(b)(7), which mandates that the surviving spouse must be entitled to all income from the property payable annually or at more frequent intervals. The court noted that the trust’s language allowing the trustees to accumulate income in their discretion clearly violated this requirement. The court rejected the estate’s argument that the trust’s intent to qualify for the marital deduction should override the accumulation provision, emphasizing that the possibility of income accumulation by someone other than the surviving spouse disqualifies the trust. The court also distinguished this case from *Estate of Howard v. Commissioner*, where the accumulation was limited to between quarterly distributions, whereas here, the accumulation could extend over several years. The court’s interpretation was that the trust’s terms did not provide Lavedna with an absolute right to all income annually, thus failing to meet the statutory test for a qualifying income interest for life.

Practical Implications

This decision underscores the importance of precise drafting in estate planning to ensure compliance with the requirements for a qualifying income interest for life under IRC section 2056(b)(7). Estate planners must ensure that any trust intended to qualify for the marital deduction does not include provisions allowing for discretionary income accumulation by trustees. The ruling may lead to increased scrutiny of trust provisions by the IRS and could result in more challenges to marital deductions claimed under similar circumstances. Practitioners should be aware that even the possibility of income accumulation by someone other than the surviving spouse can disqualify a trust from QTIP treatment, regardless of the probability of such accumulation occurring. This case also highlights the need for estate planners to consider alternative estate planning strategies if they wish to retain some control over income distribution while still achieving tax benefits.

