Estate of Anne W. Morgens, Deceased, James H. Morgens, Executor v. Commissioner of Internal Revenue, 133 T. C. 402 (2009)

In Estate of Morgens v. Comm'r, the U. S. Tax Court ruled that gift taxes paid by trustees on behalf of a surviving spouse's deemed transfers of qualified terminable interest property (QTIP) within three years of her death must be included in her gross estate under I. R. C. § 2035(b). This decision upheld the application of the three-year rule to QTIP transfers, ensuring that such transfers made near death do not escape estate taxation, thereby aligning them with other gifts made in contemplation of death.

Parties

The plaintiff, Estate of Anne W. Morgens, was represented by James H. Morgens as the executor in the U. S. Tax Court. The defendant was the Commissioner of Internal Revenue. The case was initiated by the estate filing a petition against the Commissioner's determination of a deficiency in federal estate tax.

Facts

Anne W. Morgens and her husband, Howard J. Morgens, established a revocable inter vivos trust in 1991. Upon Howard's death in 2000, the trust was divided into a survivor's trust and a residual trust. The residual trust was funded with Howard's half of the community property and was subject to a QTIP election, which allowed Howard's estate to claim a marital deduction for the full value of the QTIP. Anne received an income interest for life from the residual trust. In 2000, the residual trust was further divided into two separate trusts, residual trust A and residual trust B. Anne made gifts of her qualifying income interests in both trusts, triggering deemed transfers of the QTIP remainders under I. R. C. § 2519. The trustees of these trusts paid the gift taxes on these deemed transfers. Anne died within three years of these transfers.

Procedural History

The executor of Anne's estate filed a timely federal estate tax return (Form 706) but did not include the gift taxes paid by the trustees in Anne's gross estate. The Commissioner audited the return and issued a notice of deficiency, asserting that the gift taxes paid by the trustees should be included in Anne's gross estate under I. R. C. § 2035(b). The estate petitioned the U. S. Tax Court, challenging the Commissioner's determination. The case was submitted fully stipulated under Tax Court Rule 122, and the court reviewed the case de novo.

Issue(s)

Whether the amounts of gift tax paid by the trustees with respect to Anne Morgens' deemed transfers of QTIP remainders under I. R. C. § 2519 are includable in her gross estate under I. R. C. § 2035(b).

Rule(s) of Law

I. R. C. § 2035(b) states that the amount of the gross estate shall be increased by the amount of any tax paid under Chapter 12 by the decedent or his estate on any gift made by the decedent or his spouse during the 3-year period ending on the date of the decedent's death. I. R. C. § 2519 treats any disposition of a qualifying income interest for life in QTIP as a transfer of all interests in QTIP other than the qualifying income interest. I. R. C. § 2207A(b) allows the surviving spouse to recover the gift tax attributable to the deemed transfer from the recipients of the QTIP.

Holding

The U. S. Tax Court held that the amounts of gift tax paid by the trustees of residual trusts A and B with respect to Anne Morgens' deemed transfers of QTIP remainders under I. R. C. § 2519 are includable in her gross estate under I. R. C. § 2035(b).

Reasoning

The court reasoned that despite the trustees paying the gift taxes, Anne was the deemed donor of the QTIP under the QTIP regime. The court relied on I. R. C. § 2502(c), which imposes gift tax liability on the donor, and I. R. C. § 6324(b), which imposes liability on the donee if the donor fails to pay. The court analogized the situation to net gifts, where the donee pays the gift tax, yet the tax is still considered paid by the donor for purposes of I. R. C. § 2035(b). The court also noted that the legislative history of I. R. C. § 2035(b) indicated that Congress intended to eliminate incentives for deathbed transfers. Excluding gift taxes paid on QTIP transfers from I. R. C. § 2035(b) would undermine this purpose by allowing such transfers to escape estate taxation. The court rejected the estate's arguments that the language of I. R. C. § 2207A(b) and the QTIP regime's intent to leave the surviving spouse in the same economic position as if the QTIP never existed should exempt these gift taxes from I. R. C. § 2035(b).

Disposition

The U. S. Tax Court entered a decision under Tax Court Rule 155, upholding the Commissioner's determination that the gift taxes paid by the trustees on the deemed QTIP transfers should be included in Anne Morgens' gross estate.

Significance/Impact

The decision in Estate of Morgens v. Comm'r clarifies that gift taxes paid by trustees on behalf of a surviving spouse's deemed transfers of QTIP remainders within three years of death are subject to I. R. C. § 2035(b). This ruling aligns QTIP transfers with other gifts made in contemplation of death, preventing the use of QTIP transfers to circumvent estate taxation. The case reinforces the principle that the donor's liability for gift tax, even when paid by another party, must be included in the gross estate under the three-year rule. This decision may impact estate planning strategies involving QTIP trusts, particularly in ensuring that the estate tax implications of such transfers are considered.

