***138 T.C. 306 (2012)***

When assets are included in a decedent's gross estate under Section 2036 due to a retained interest in a family limited partnership, the estate cannot claim a marital deduction for assets underlying partnership interests previously gifted to individuals other than the surviving spouse.

**Summary**

The Estate of Clyde W. Turner, Sr. petitioned for reconsideration of a prior ruling that included assets transferred to a family limited partnership (FLP) in the gross estate under Section 2036. The estate argued that even if Section 2036 applied, a marital deduction should offset any estate tax deficiency due to a clause in Clyde Sr.'s will. The Tax Court held that the estate could not claim a marital deduction for assets underlying partnership interests gifted before death, as these assets did not pass to the surviving spouse as a beneficial owner. This decision reinforces the principle that the marital deduction is intended to defer, not eliminate, estate tax and that gifted assets are not eligible for the marital deduction.

**Facts**

Clyde Sr. and his wife, Jewell, formed Turner & Co., a family limited partnership (FLP), contributing significant assets in exchange for partnership interests. Clyde Sr. gifted a portion of his limited partnership interest to family members during his lifetime. Upon his death, the IRS included the assets he transferred to the FLP in his gross estate under Section 2036, arguing that he retained an interest in those assets. The estate argued for an increased marital deduction to offset the increased estate value.

**Procedural History**

The Tax Court initially ruled that Section 2036 applied to include the FLP assets in Clyde Sr.'s gross estate (*Estate of Turner I, T.C. Memo. 2011-209*). The estate then filed a motion for reconsideration, arguing that the marital deduction should offset the increased estate tax. The Tax Court denied the motion, issuing a supplemental opinion clarifying the marital deduction issue.

**Issue(s)**

Whether the estate can claim a marital deduction for assets included in the gross estate under Section 2036 that underlie partnership interests previously gifted to individuals other than the surviving spouse.

**Holding**

No, because the gifted assets and partnership interests did not pass to the surviving spouse as a beneficial owner and therefore do not qualify for the marital deduction

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under Section 2056.

**Court's Reasoning**

The court reasoned that Section 2056(a) allows a marital deduction only for property "which passes or has passed from the decedent to his surviving spouse." The court emphasized that under Treasury Regulations Section 20.2056(c)-2(a), "a property interest is considered as passing to the surviving spouse *only if it passes to the spouse as beneficial owner*." Since Clyde Sr. had already gifted the partnership interests (and the underlying assets) to other family members, those assets could not pass to Jewell as a beneficial owner. The court further explained that allowing a marital deduction for these assets would violate the fundamental principle that marital assets should be included in the surviving spouse's estate (or be subject to gift tax if transferred during life). The court noted the consistency of this approach with the QTIP rules under Sections 2056(b)(7), 2044, and 2519, which ensure that assets for which a marital deduction is taken are ultimately subject to transfer tax. The court stated, "Although the formula of Clyde Sr.'s will directs what assets should pass to the surviving spouse, the assets attributable to the transferred partnership interest or the partnership interest itself are not available to fund the marital bequest…Because the property in question did not pass to Jewell as beneficial owner, we reject the estate's position and hold that the estate may not rely on the formula of Clyde Sr.'s will to increase the marital deduction."

**Practical Implications**

This case clarifies the interaction between Section 2036 and the marital deduction, particularly in the context of family limited partnerships. It serves as a warning to estate planners that including assets in the gross estate under Section 2036 does not automatically entitle the estate to a corresponding increase in the marital deduction. Specifically, assets underlying partnership interests gifted before death cannot be used to increase the marital deduction. This decision reinforces the IRS's position that the marital deduction is limited to assets actually passing to the surviving spouse as a beneficial owner and prevents the avoidance of estate tax on gifted assets. It highlights the importance of carefully considering the implications of family limited partnerships and retained interests when planning for estate tax purposes. This case has been cited in subsequent cases involving similar issues, reinforcing its precedential value.

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