Estate of Sheldon C. Sommers, Deceased, Stephan C. Chait, Temporary Administrator, Petitioner, and Wendy Sommers, Julie Sommers Neuman, and Mary Lee Sommers-Gosz, Intervenors v. Commissioner of Internal Revenue, Respondent, 149 T. C. No. 8 (2017), United States Tax Court.

In Estate of Sommers, the U. S. Tax Court ruled that gift taxes paid on a decedent's gifts within three years of death are not deductible from the estate, and estate taxes cannot be apportioned to gift recipients under New Jersey law. This decision clarifies the tax treatment of estate and gift taxes, impacting estate planning strategies involving lifetime transfers.

Parties

The case involved the Estate of Sheldon C. Sommers as the petitioner, with Stephan C. Chait acting as the temporary administrator. Wendy Sommers, Julie Sommers Neuman, and Mary Lee Sommers-Gosz were intervenors, and the Commissioner of Internal Revenue was the respondent. Throughout the litigation, the estate was represented by David N. Narciso and Matthew E. Moloshok, the intervenors by Michael A. Guariglia and Vlad Frants, and the Commissioner by Robert W. Mopsick and Lydia A. Branche.

Facts

Sheldon C. Sommers made gifts of units in Sommers Art Investors, LLC to his three nieces in December 2001 and January 2002, shortly before his death in November 2002. These gifts were structured to minimize gift tax through valuation discounts and the use of the annual exclusion. The nieces agreed to pay any gift taxes on the 2002 transfers. Sommers also bequeathed all his remaining estate to his surviving spouse, Bernice Sommers, after settling debts and expenses. The IRS determined an estate tax deficiency due to the inclusion of the gift tax paid on the 2002 gifts under section 2035(b) of the Internal Revenue Code.

Procedural History

The estate filed motions for partial summary judgment to determine the deductibility of the gift tax under section 2053, the effect of debts and expenses on the marital deduction under section 2056, and the apportionment of any estate tax to the nieces. The intervenors filed a motion for partial summary judgment asserting that no estate tax should be apportioned to them. The Tax Court previously ruled in T. C. Memo 2013-8 that the gifts were valid and completed in 2001 and 2002, respectively, and thus not includable in the estate's value. The parties stipulated the gift tax liability, and the intervenors paid it.

Issue(s)

Whether the gift tax owed on the decedent's 2002 gifts is deductible under section 2053(a) of the Internal Revenue Code?

Whether the estate is entitled to a marital deduction under section 2056(a) that includes the value of the decedent's nonprobate property received by his surviving spouse, Bernice Sommers?

Whether any Federal estate tax due must be apportioned to the intervenors under the New Jersey estate tax apportionment statute?

Rule(s) of Law

Section 2035(b) of the Internal Revenue Code requires the gross estate to be increased by the amount of any gift tax paid by the decedent or his estate on gifts made within three years of death. Section 2053(a) allows a deduction from the gross estate for claims against the estate, but only to the extent that the estate would not be entitled to reimbursement if it paid the claim. Section 2056(a) allows a marital deduction for the value of any interest in property passing from the decedent to the surviving spouse. The New Jersey apportionment statute, N. J. Stat. Ann. sec. 3B:24-4, requires the apportionment of estate tax among transferees of nonprobate property included in the gross tax estate.

Holding

The gift tax owed on the 2002 gifts is not deductible under section 2053(a) because the estate's payment of the gift tax would give rise to a claim for reimbursement from the nieces, negating the deduction. The estate's entitlement to a marital deduction under section 2056(a) depends on factual questions regarding the use of exempt assets to pay debts and expenses. No portion of the estate tax due can be apportioned to the nieces under the New Jersey apportionment statute because the units they received were not included in the decedent's gross estate.

Reasoning

The court analyzed the deductibility of the gift tax under section 2053(a) by applying the principle from Parrott v. Commissioner that a claim against an estate is deductible only to the extent that it exceeds any right to reimbursement. Because the nieces agreed to pay the gift tax, the estate's payment of that tax would have given rise to a reimbursement claim, negating any deduction. The court also considered the policy underlying section 2035(b), which aims to prevent the avoidance of transfer taxes through lifetime gifts shortly before death. The court rejected the estate's argument that the gift tax should be deductible because it would effectively nullify the section 2035(b) gross-up rule.

Regarding the marital deduction, the court noted that the deduction is reduced by the value of property used to pay debts or expenses. The estate's claim to a marital deduction that includes only the value of nonprobate property suggests that the probate estate may have been entirely consumed by debts and expenses, but the record was insufficient to determine the impact of the estate tax on the marital deduction.

On the issue of estate tax apportionment, the court interpreted the New Jersey apportionment statute to require apportionment only to transferees who receive nonprobate property included in the decedent's gross estate. Because the units transferred to the nieces were not included in the gross estate, no estate tax could be apportioned to them. The court distinguished cases from other jurisdictions that had apportioned estate tax to recipients of lifetime gifts, noting that those cases did not involve the specific issue of section 2035(b) inclusions. The court also rejected the estate's argument that adjusted taxable gifts are part of the gross tax estate because they are included in the computation of estate tax liability.

Disposition

The court denied the estate's motions for partial summary judgment on the deductibility of the gift tax, the effect of debts and expenses on the marital deduction, and the apportionment of estate tax to the nieces. The court granted the intervenors' motion for partial summary judgment that no estate tax can be apportioned to them under applicable New Jersey law.

Significance/Impact

The decision in Estate of Sommers clarifies the deductibility of gift taxes paid on gifts made within three years of death and the apportionment of estate taxes under New Jersey law. It underscores the importance of considering the potential for reimbursement claims when claiming deductions under section 2053(a). The decision also highlights the limitations of state apportionment statutes in allocating estate tax to recipients of lifetime gifts not included in the gross estate, potentially affecting estate planning strategies that rely on such transfers to minimize transfer taxes. The case illustrates the interplay between Federal and state tax laws in determining the ultimate economic incidence of estate taxes.

