IRB No. 2012-17
April 23, 2012

ACTION ON DECISION

Subject: Alan Baer Revocable Trust v. United States,
105 AFTR 2d 1544, 2010-1 USTC ¶ 60,590
(D. Neb. 2010)

Issue:

Whether the stock includible in Decedent's gross estate qualifies for the marital deduction under § 2056(b)(7) when the stock is subject to contingent bequests.

Discussion:

At his death, Decedent owned shares of non-publicly traded stock held in a revocable trust. The trust provided that if the trustee sold the stock for more than the Decedent's $4,814,798 cost basis during the surviving spouse's lifetime, the trustee is to distribute $1,346,000 in cash to 23 named beneficiaries. Upon Decedent's death, Decedent's personal representative transferred the stock to a marital trust and then made the qualified terminable interest property (QTIP) election under § 2056(b)(7).

The estate reported the fair market value of the stock as $10,955,984. Upon examination, the Service denied the marital deduction for the full value of the contingent bequests and determined a deficiency.

In 2006, the estate reappraised the stock at $851,114, instead of $10,955,984, and filed a claim for refund, arguing that as of Decedent's death there was no likelihood that the trust could have sold the stock for an amount greater than the Decedent's cost basis. The estate filed a claim and later filed suit for refund in the Nebraska District Court. The District Court found that the trust could satisfy the contingent bequests only from profit realized from the sale of the stock in excess of the $4,814,798 cost basis. The court then found that the stock had a date-of-death value of "essentially zero" and, as a result, the contingent bequests were "effectively extinguished." The court further found that "the possibility that the transfer to the contingent beneficiaries would ever come to fruition is so remote that it is negligible." Accordingly, the court concluded that Decedent's estate was entitled to a refund of the tax deficiency assessed on the contingent bequests.

The District Court erred as a matter of law because the contingent bequests rendered the value of the stock ineligible for QTIP treatment pursuant to § 2056(b)(7)(B)(ii)(II), which requires that no person has the power to appoint any part of the property to any person other than the surviving spouse. See Treas. Reg. § 20.2056(b)-7(d)(6) (providing that § 2056(b)(7)(B)(ii)(II) is not satisfied if the surviving spouse is legally bound to transfer the distributed property to another person without full and adequate consideration in money or money's worth). The "so remote as to be negligible" standard that the District Court used does not apply to § 2056(b)(7)(B)(ii)(II).

Section 2056(b)(7)(B)(ii)(II) is a bright-line test intended to ensure that property that is not subject to tax in the estate of the previously deceased spouse, because of the election under § 2056(b)(7), does not escape taxation in the surviving spouse's estate under § 2044, unless the surviving spouse receives adequate and full consideration in money or money's worth. See Rinaldi v. Commissioner, 38 Fed. Cl. 341 (1997) (finding that a contingency in a trust that stock be sold to son at a below-market price rendered the trust ineligible for QTIP treatment). While the court erred as a matter of law, its finding that the stock had negligible value rendered the legal error irrelevant to the extent it did not materially affect the amount of the refund.

Recommendation:
Acquiescence in result only

Reviewers:

/s/
Theresa Melchiorre
Attorney, Branch 4
(Passthroughs & Special Industries)

Approved:

/s/
Curt G. Wilson
Associate Chief Counsel
(Passthroughs & Special Industries)