PERKINS & CO

FCG VALUATION CASE E-FLASH

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Issue 13:3

Estate of Sylvia Riese, Deceased, Ellen C. Grimes and Judith A. Zipp, Executors, Petitioner, v. Commissioner of Internal Revenue, Respondent
T.C. Memo 2011-60, March 15, 2011

Although the Decedent's qualified personal residence trust terminated six months before her death, the Tax Court determined that her personal residence was not includable in her estate under IRC § 2036. In addition, because the Court determined that the residence had transferred to trusts that benefited the decedent's daughters, the estate was able to take a deduction for accrued rent expense for the decedent, even though no lease agreement had been signed. However, the estate itself was not entitled to a deduction for rent expense because the estate had no need to occupy the residence and no lease agreement was entered into even though all parties were capable of doing so. Finally, the estate failed to explain how it was entitled to $125,000 in investment management fees, and the claimed deduction was disallowed.

TAKEAWAY
Proper documentation of legal and financial advice can assist estates in receiving deductions, even if the official paperwork for the transactions and deductions is not complete at the time of death.

THE FACTS
Ms. Sylvia Riese ("Ms. Riese" or the "Decedent") owned an expensive home and substantial fortune, which she inherited upon her husband's death in 1990. Mrs. Ellen Grimes ("Mrs. Grimes") and Ms. Judith Zipp ("Ms. Zipp") were Ms. Riese's daughters and co-executors of the Decedent's estate. Ms. Zipp spent much of her time taking care of Ms. Riese in the latter's last few years of life, while Mrs. Grimes was entrusted with the Decedent's financial affairs. Ms. Riese received significant financial planning toward the end of her life from Mr. Stefan F. Tucker ("Mr. Tucker").

Beginning in 1999, Mr. Tucker and Mrs. Grimes began discussing the establishment of a qualified personal residence trust ("QPRT"). In September of that year, Mr. Tucker sent Mrs. Grimes a letter outlining the benefits and costs associated with a QPRT. Upon discussing the matter with the Decedent, Ms. Riese liked the idea and instructed Mrs. Grimes and Mr. Tucker to proceed.

In February 2000, Mr. Tucker met with Mrs. Grimes and her husband ("Mr. Grimes", who provided financial advice to Mrs. Grimes for the Decedent) to discuss the QPRT and other estate planning options for Ms. Riese. They agreed the QPRT was the best option for the Decedent's residence. Mr. Tucker called Ms. Riese to inform her of their agreement. After explaining the costs and benefits to Ms. Riese during this telephone call, the Decedent agreed to establish the QPRT.

Two weeks after the meeting with Mrs. Grimes, Mr. Tucker sent a letter to the Decedent informing her that she would have to pay fair market rent to her daughters (as trustees of trusts to which the residence would transfer after the QPRT's termination) if she continued to live in the residence after the termination of the QPRT. Mrs. Grimes and Ms. Riese discussed the contents of the letter, and, after the discussion, the Decedent decided on a three-year term for the QPRT.

The QPRT was established on April 19, 2000. Ms. Riese executed a deed that transferred the residence and reported the transfer on Form 709 for the 2000 Tax Year.

The QPRT agreement required that, if Ms. Riese survived the termination date of the QPRT, the QPRT would terminate and the residence would be distributed 50 percent to two trusts, each established for the benefit of the Decedent's daughters. The QPRT terminated on April 19, 2003.

Although Mrs. Grimes never directly discussed rent with the Decedent after the QPRT expired, she did call Mr. Tucker to ask how fair market rent could be determined. Mr. Tucker instructed Mrs. Grimes to contact local real estate brokers, and, as long as she had done so by December 31, 2003, she should be fine from a legal standpoint. Mr. Tucker made a note in his calendar to check in with Mrs. Grimes around Thanksgiving to ensure she taken care of all of the details before the end of the year.

Ms. Riese died from a stroke on October 26, 2003, before Mrs. Grimes had determined fair market rent and before Mr. Tucker was to call her. After the Decedent passed away, the estate continued to pay property taxes, maintenance, and upkeep on the residence until it was sold on October 6, 2004. The trusts to which the residence was transferred did not maintain homeowners' insurance for the residence, nor did the trusts directly pay any of the aforementioned expenses.

On its January 24, 2005, Form 706, the estate did not include the residence, claimed a deduction of more than $46,000 for fair market value rent (estimated at $7,500 per month) owed from Ms. Riese to the trusts from the termination of the QPRT to the date of death, claimed another deduction of more than $46,000 for fair market value rent for the estate from the date of death to April 30, 2004, and investment management fees of $125,000 to Mr. Grimes' financial firm.

DISCUSSION

The IRS argued that the Decedent retained an interest in the residence due to an implied agreement. The IRS' argument rested on its assertion that nothing changed in Ms. Riese's relationship to the home after the expiration of the QPRT. The Decedent did not execute a lease, did not pay rent, and still lived in the home. The estate argued that no such agreement existed, that there was evidence Ms. Riese intended to pay rent, and that the trustees of the trusts which owned the residence intended to collect rent. The estate argued that rent was never collected due to Ms. Riese's unexpected death before the establishment of fair market value for such rent.

Due to the credible testimony of Mrs. Grimes and Mr. Tucker, the Court accepted that the Decedent intended to pay fair market value rent, that no agreement existed for the Decedent to retain an interest in the property, and that the residence was not includable in Ms. Riese's estate.

Although the Decedent had not entered into a lease agreement with the trustees of the trusts, the Tax Court determined that her occupancy at the residence (which was owned by the trusts from the time of expiration of the QPRT to her date of death) constituted a tenancy-at-will under New York state law. Accordingly, rent due to the trusts constituted a liability to the trusts, which the estate was required to pay on Ms. Riese's behalf. Because the liability existed, the estate was entitled to deduct the amount of fair market value rent from April 19, 2003, through October 26, 2003.

In contrast, the Court denied the estate's ability to deduct fair market value rent after Ms. Riese's death. The estate did not require the residence as a place to conduct its affairs and was not obligated to pay rent to the trusts. The tenancy-at-will obligation died with the Decedent.

The Tax Court also disallowed the investment management fee deduction. The disallowance was based primarily on the estate's failure to introduce evidence indicating services were provided by Mr. Grimes' company to the estate. Mr. Grimes did not testify for the estate and Mr. Tucker indicated he was unsure of the services provided by Mr. Grimes' firm. Accordingly, the Court did not permit the deduction.

CONCLUSION
Based on the facts as presented, the Tax Court determined that Ms. Riese intended to pay fair market value rent which was evidence of her no longer owning or retaining an interest in her personal residence. As a result, the residence was not includable in her estate under IRC § 2036. In addition, because Ms. Riese intended to pay fair market value rent, the value of such rent payments was deductible from her estate tax burden as a debt of the Decedent. However, Ms. Riese's tenancy-at-will status died with her, and the estate was not entitled to deduct accrued rent after the Decedent's date of death. The estate's failure to introduce evidence as to services provided by its investment manager caused the Tax Court to disallow the claimed investment management deduction, as well.

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