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ACTION ON DECISION

Subject: Estate of Mellinger v. Commissioner, 112 T.C. 4 (1999)

Issue: Whether, for estate tax valuation purposes, a minority interest in a closely-held corporation held in a Qualified Terminable Interest Property (QTIP) trust, which is includible in the gross estate under I.R.C. § 2044, is aggregated with a minority interest in the same corporation that is includible in a decedent's gross estate under other provisions of the Code.

Discussion: Harriet R. Mellinger (decedent) died on April 18, 1993. Decedent's predeceased spouse, Frederick N. Mellinger, died on June 20, 1990. Under the terms of Mr. Mellinger's inter vivos revocable trust, shares comprising 27.861 percent of Fredericks of Hollywood (FOH) passed to a QTIP trust for the benefit of decedent. Mr. Mellinger's estate elected to claim a marital deduction under section 2056(b)(7) for this bequest. Accordingly, on decedent's death, the QTIP trust was includible in decedent's gross estate under section 2044.

Decedent's revocable inter vivos trust also held 27.861 percent of the outstanding shares of FOH. This property was otherwise includible in decedent's gross estate. In a statutory notice of deficiency, the Service determined that the FOH shares held by the QTIP trust and the revocable trust should be aggregated and valued as a controlling interest. In the Tax Court, the Service argued that, under section 2044(a) and (c), the decedent should be treated as the owner of the QTIP trust for valuation purposes. Therefore, the FOH shares held in the QTIP trust should be aggregated with the FOH shares held in the revocable trust and valued as a single block of stock for estate tax purposes.

Under section 2056(b)(7), a decedent's estate is entitled to a marital deduction for transfers of QTIP to the surviving spouse. In order to qualify as QTIP, the surviving spouse must receive a qualifying income interest for life in the property. Upon the death of the surviving spouse, the property usually passes to beneficiaries designated by the decedent or by the spouse pursuant to a limited power of appointment. Accordingly, the first spouse to die can postpone federal estate tax that would otherwise be due on the QTIP trust while also retaining partial or total control over the ultimate disposition of that property.

Under section 2044, the gross estate includes the value of property in which the decedent had a qualifying income interest for life and for which a deduction was allowed under section 2056(b)(7). Section 2044(c) provides that, for purposes of chapters 11 and 13, property includible in the gross estate of the decedent under section 2044(a) will be treated as property passing from the decedent.

The Tax Court rejected the Service's position that the FOH shares includible in the gross estate under section 2044(a) should be aggregated with the FOH shares includible in the gross estate held in the revocable trust. The Tax Court noted that an analysis of section 2044, and the regulations thereunder, does not indicate that Congress intended that property interests includible under section 2044 should be aggregated with interests includible under other Code sections for purposes of determining federal estate tax value. Although section 2044(c) treats QTIP as "passing from the decedent," the court noted that the statute does not provide that the decedent should be treated as the owner of such property for valuation purposes.

Upon further consideration, we agree with the Tax Court's opinion that closely-held stock held in a QTIP trust should not be aggregated, for valuation purposes, with stock in the same corporation held in a revocable trust and includible in the decedent's gross estate. The Tax Court's decision in this case is consistent with the Service's position regarding the valuation of minority interests passing to QTIP trusts. The proper funding of the QTIP trust should reflect, for example, the value of minority interests in closely-held entities or fractional interests in real estate that are used in satisfying the marital bequest. Cf. Estate of Chenoweth v. Commissioner, 88 T.C. 1577 (1987); see also Rev. Rul. 84 -105, 1984-2 C.B. 197.

Recommendation: Acquiescence.

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