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Estate of Valeria M. Miller, Deceased, Virgil G. Miller, Executor, Petitioner vs. Commissioner of Internal Revenue, Respondent, T. C. Memo 2009-119, May 27, 2009.

The Facts:

Valeria M. Miller married her husband Mr. Miller in 1938 and they remained married until his death on February 2, 2000. Mr. and Mrs. Miller had four children; Virgil G., Gordon, Donald and Marcia. Mr. Miller had worked as an architect until the time he retired in 1974 at the age of 60. After his retirement, Mr. Miller spent a significant amount of time managing his family's investments using his own personally developed method for charting stocks. Mr. Miller kept handwritten records of all of his investment activity over the course of 26 years until his death at the age of 86.

In October of 1991, Mr. Miller established the Virgil J. Miller Living Trust (the revocable trust). At the same time, the agreement that established the trust also established a life estate marital trust for Mrs. Miller ("QTIP trust"). When Mr. Miller passed away in 2000, his gross estate was valued at $7,667,939 and approximately 99.6% of his gross estate consisted of securities held by his revocable trust. As executor, Mr. Miller's son, Virgil G., elected to treat the QTIP trust property as qualified terminable interest property and Mr. Miller's estate claimed a marital deduction of $1,060,000 for assets funding the QTIP trust. The QTIP trust was made up of five accounts with Merrill Lynch and was funded on October 6, 2000.

The QTIP trust provided that all income from the QTIP trust was to be distributed to Mrs. Miller at least annually and that income was not to accumulate in the QTIP trust. Mrs. Miller never received any distributions from the QTIP trust and all income from the QTIP trust was reported on its own Forms 1041, U.S. Income Tax Return for Estates and Trusts.

At the age of 86, in November of 2001, Mrs. Miller established the V/V Miller Family Limited Partnership ("MFLP"). Virgil G. was General Partner and Mrs. Miller's Trust, Donald, Marcia and Gordon were the Limited Partners. Mrs. Miller was in good health at the time of formation. Although MFLP had not yet been funded, a valuation was performed as of December 31, 2001, showing the fair market value per unit of a limited partnership interest in MFLP for gift tax purposes based on statements provided by Virgil G. that detailed the assets that were going to be used to fund MFLP. This valuation

indicated that MFLP had marketable securities of $4,336,380, a margin account payable of $499,573, and a net asset value of $3,836,807. The valuation also applied a 35% lack of marketability discount to the purported net asset value of MFLP and concluded that as of December 31, 2001, MFLP had a fair market value per unit of $2,264.73.

The Partnership agreement was not formally signed by the partners until February of 2002. Furthermore, when the unit certificates were initially issued, they were signed by Virgil G. signed and dated November 27, 2001. MFLP issued 1,000 units; with Mrs. Miller's trust receiving 920 limited partner units, Virgil G. receiving 10 general partner and 10 limited partner units, and Donald, Gordon and Marsha each receiving 20 limited partner units. This ownership remained constant until Mrs. Miller's death. Mrs. Miller ended up making the asset contributions to MFLP in April of 2002, and the total assets transferred constituted about 77% of her total net assets.

Virgil G., through his company VGM Enterprises, received a monthly fee to manage MFLP's securities. Virgil G. was the only employee of VGM Enterprises and spent approximately 40 hours per week managing the stock portfolio by utilizing his father's personally developed stock charting methodology, subscribing to trade publications and purchasing computer software to assist in securities and trading research.

In April and May of 2003, Mrs. Miller suffered a series of health setbacks that initially began with a broken hip from a fall at her residence. On May 9, 2003, which was after her broken hip but before her head bruise was discovered on May 19th, she signed a letter requesting Fidelity to transfer all of her remaining assets except for the cash in her money market account over to MFLP. She died on May 28, 2003.

The estate timely filed Form 706 in February of 2004. The gross estate was shown as $2,637,024 with tax due of $994,299. The gross estate included 920 MFLP units valued at $2,589,118. The Form 706 did not include the value of the securities used to fund the QTIP trust in the value of the gross estate. Instead, Mrs. Miller's Form 706 indicted that she was the beneficiary of a trust for which a deduction was claimed by the estate of a predeceased spouse under section 2056(b)(7) and which was not reported on Mrs. Miller's Form 706.

The IRS timely filed a deficiency notice of $1,019,399 that, in part, increased the value of decedent's gross estate by the purported fair market value of the securities in the QTIP trust and by the amount of decedent's transfers to MFLP.

The Arguments:

The issues for determination by the IRS were; (i) whether Mrs. Miller was required to include in her estate the securities used to fund the QTIP trust; (ii) whether cash and securities transferred by Mrs. Miller in April of 2002, and May of 2003 must be included in the value of the gross estate at their full value or whether they are entitled to a

discount; and (iii) if they are entitled to a discount, is a 35% discount for lack of marketability appropriate?

The estate contended that the value of the assets funding the QTIP trust should not be included in the value of decedent's gross estate because decedent did not receive an interest in the trust or retain it at her death. Also, the decedent never received income or distributions from the trust and was never considered to have an interest in the trust, and to the extent she had an interest in the trust, effectively refuted it before her death. Secondly, the estate contended that the 35% discount for lack of marketability taken by the estate on MFLP contributions made in April of 2002 and May of 2003 was appropriate.

The IRS opposed both claims stating that the estate was required to include the value of the assets in the QTIP trust because a QTIP deduction under section 2056(b)(7) was allowed for assets funding a QTIP trust, a QTIP election was made, Mrs. Miller had the right to receive income from the trust annually, and Mrs. Miller did not dispose of her income interest in the trust prior to her death. Secondly, the IRS did not dispute the application of a 35% discount to MFLP securities, rather they argued that the estate was not entitled to any discount and must include the full value of the transferred assets in the value of the gross estate.

<u>The Findings:</u>

The Court reviewed each argument and made the following determinations. First, with respect to including the fair market value of the QTIP trust in the gross estate, the Court determined that the full fair market value must be included in the gross estate because the trust agreement provided that all income of the trust was to be distributed to Mrs. Miller at least annually and that income was not to accumulate in the trust, Mr. Miller's estate made a valid QTIP election, and his estate claimed a $1,060,000 marital deduction under section 2056(b)(7).

Secondly, the Court reviewed the 2002 and 2003 transfers separately. After review of all relevant facts, the Court determined that Mrs. Miller's transfers in April of 2002 satisfied the bona fide sale exception and were entitled to the claimed discount in valuing Mrs. Miller's gross estate. The Court then determined that Mrs. Miller's transfers made in May of 2003 did not have legitimate and substantial nontax business reasons for the transfers. The Court determined that there was no driving force behind the transfers except the declining health of Mrs. Miller and Virgil G.'s wish to reduce the value of Mrs. Miller's gross estate.

The Court's final determination was such that the estate was to be increased by the amounts used to fund the QTIP trust, the estate was entitled to the claimed discount for the securities transferred to MFLP in April of 2002, but the estate was not entitled to the claimed discount for the securities transferred to MFLP in May of 2003.

Parting Thoughts:

An interesting "split decision" by the Court. I was surprised that there wasn't more discussion or concern shown by the Court regarding the sloppy chronology of the MFLP formation, gifts, and capital contributions between November 2001 and April 2002.

I was also surprised that (1) there was no discussion of why the appraiser only applied a lack of marketability discount; (2) there was no discussion of why a minority interest discount was not applied to the limited partner units; and (3) the IRS did not dispute the application of a 35% marketability discount.