Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **201745012**
Release Date: 11/9/2017

CC:PSI:B04:JDMacEachen
POSTF-114042-17

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 2512.13-01, 2053.09-09

date: August 04, 2017

to: Associate Area Counsel (Manhattan, Group 1)
(Small Business/Self-Employed)
Attn: Jane J. Kim

from: Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

---

subject: Deathbed Purchase of Remainder Interest in a Grantor Retained Annuity Trust

This Chief Counsel Advice responds to your request for assistance dated May 5, 2017. This advice may not be used or cited as precedent.

LEGEND

Donor =
Spouse =
Trust 1 =
Trust 2 =

Trust 3 =

Date 1 =
Date 2 =
Date 3 =
Date 4 =

ISSUES

(1) Whether the remainder interest in transferred property in which the donor has retained an annuity replenishes the donor's taxable estate so as to constitute adequate and full consideration in money or money's worth for gift tax purposes where the purchase of the remainder occurs on the donor's deathbed during the term of the annuity.
(2) Whether a note given in exchange for property that does not constitute adequate and full consideration in money or money's worth for gift tax purposes is deductible as a claim against the estate.

CONCLUSIONS

(1) Where the purchase of the remainder occurs on the donor's deathbed during the term of the annuity, the remainder does not replenish the donor's taxable estate. Accordingly, the remainder does not constitute adequate and full consideration in money or money's worth for gift tax purposes. Merrill v. Fahs, 324 U.S. 308 (1945).

(2) A note given in exchange for property that does not constitute adequate and full consideration in money or money's worth for gift tax purposes is not deductible as a claim against the estate.

FACTS

On Date 1, Donor formed Trust 1, an irrevocable discretionary trust for the benefit of Donor's first spouse and issue. Trust 1 terminates on the later of the death of Donor or his first spouse, at which time the principal and any accumulated income are distributed outright to Donor's issue per stirpes. Donor's first spouse predeceased him; Donor then married Spouse.

On Date 2, Donor formed Trust 2, an irrevocable trust for the benefit of Donor and his issue. Under the terms of Trust 2, an annuity is payable to Donor for the term of the trust, and the remainder is payable under the terms of Trust 1.

On Date 3, Donor formed Trust 3, an irrevocable trust for the benefit of Donor and his issue. Under the terms of Trust 3, an annuity is payable to Donor for the term of the trust, and the remainder is payable under the terms of Trust 1.

On Date 4, a date before the expiration of the respective terms of Trusts 2 and 3, Donor purchased the remainder interests in Trusts 2 and 3 from the trustees of Trust 1. Donor paid the purchase price with two unsecured promissory notes. Donor died the following day.

Donor's executor filed Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, and reported the purchases of the remainder interests as non-gift transfers,

asserting that Donor received adequate and full consideration in money or money's worth in the form of the remainder interests in Trusts 2 and 3. Spouse elected to split gifts with Donor.

Donor's death occurred prior to the expiration of the respective terms of the annuities payable from the assets transferred to Trusts 2 and 3. Donor's executor filed Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, and included the corpus of Trusts 2 and 3 in the gross estate. I.R.C. § 2036(a)(1); Treas. Reg. § 20.2036-1(c)(2). Donor's executor deducted the value of the outstanding promissory notes payable to the trustees of Trust 1 as claims against the estate.

LAW AND ANALYSIS

Adequate and Full Consideration for Purposes of § 2512(b)

I.R.C. § 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511(a) provides that the tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(a) provides that, if the gift is made in property, the value of the property at the date of the gift is considered the amount of the gift.

Treas. Reg. § 25.2511-1(c)(1) provides, in part, that the gift tax also applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax. See Treas. Reg. § 25.2512-8 (relating to transfers for insufficient consideration).

Treas. Reg. § 25.2511-1(g)(1) provides, in part, that donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor.

Section 25.2511-2(a) provides that the gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.

Treas. Reg. § 25.2511-2(b) provides, in part, that as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave

in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete.

Section 2512(b) provides that the amount of the gift is the value of the property transferred for less than an adequate and full consideration in money or money's worth on the date of the gift.

Treas. Reg. § 25.2512-8 provides, in part, that transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. A consideration not reducible to a value in money or money's worth, as love and affection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift. Similarly, a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the spouse's property or estate, shall not be considered to any extent a consideration "in money or money's worth."

In Commissioner v. Wemyss, 324 U.S. 303 (1945), the Supreme Court considered the meaning of the term "adequate and full consideration in money or money's worth" for gift tax purposes. There, the donor transferred assets to his fiancé to compensate her for the loss of an income interest that would terminate upon her marriage to him. There was no dispute that both a promise of marriage and detriment to a contracting party constituted valuable consideration for purposes of the law of contracts. The Tax Court had held that if the promise of marriage was the consideration, it was not one reducible to a money value and if the fiancé's loss of the income interest was the consideration, it did not constitute consideration in the hands of the donor.

> If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. . . . The section taxing as gifts transfers that are not made for 'adequate and full (money) consideration' aims to reach those transfers which are withdrawn from the donor's estate. To allow detriment to the donee to satisfy the requirement of 'adequate and full consideration' would violate the purpose of the statute and open wide the door for evasion of the gift tax.

Wemyss, 324 U.S. at 307-08. In other words, valuable contractual consideration in the hands of the donor is not sufficient; adequate and full consideration is that which replenishes, or augments, the donor's taxable estate.

Wemyss had a companion case, Merrill v. Fahs, 324 U.S. 308 (1945), which was also a gift tax case. Merrill and its predecessors likewise involved situations where A transferred property to B, A's fiancé or spouse, in exchange for B's relinquishment of marital rights in A's remaining property. Both Wemyss and Merrill have come to stand for the general proposition that "adequate and full consideration in money or money's worth" for gift tax purposes is that which replenishes, or augments, the donor's taxable estate. See Steinberg v. Commissioner, 141 T.C. 258, 266 (2013) (noting that under the estate depletion theory, a donor receives consideration in money or money's worth only to the extent that the donor's estate has been replenished), citing Wemyss, at 307-08, and Randolph E. Paul, Federal Estate and Gift Taxation, para. 16.14, at 1114-15 (1942).[1] See also I.R.C. § 2043(b)(1) ("Transfers for Insufficient Consideration"). Thus, B's relinquishment of marital rights in A's property will have no effect on the includible value of that property in A's gross estate. Accordingly, the relinquishment of marital rights cannot replenish a donor's gross estate for estate tax purposes, and thus cannot constitute adequate and full consideration for gift tax purposes. See also Commissioner v. Bristol, 121 F.2d 129, 136 (1st Cir. 1941).

It is important to keep in mind that in each of the above cases, the relinquishment of the marital rights in the donor's remaining assets did constitute valuable contractual consideration in the hands of the donor, and did benefit the donor. It enabled the donor to dispose of that property free of the spousal claims of the second marriage. See Merrill v. Fahs, 324 U.S. at 309. For instance, Bristol involved the waiver of spousal claims against a family business that the donor wished to bequeath to the children of his first marriage. Bristol, 121 F.2d at 131. Indeed, in each of these cases, it was the prospective husband's desire to dispose of his property as he chose that was the basis of the ante-nuptial agreement. This freedom did not constitute adequate and full consideration, however, because it did not augment the husband's taxable estate.

Here, it cannot be disputed that Donor's liability on the promissory notes depleted Donor's taxable estate. However, in the context of a deathbed purchase of a remainder interest in transferred property in which a donor has retained a § 2036 "string," the receipt of the remainder does not increase the value of the donor's taxable estate, because the value of the entire property, including that of the remainder, will be includible in the donor's gross estate pursuant to § 2036(a)(1). Thus, Donor's receipt of the remainder interests cannot constitute adequate and full consideration within the meaning of § 2512(b). Commissioner v. Wemyss, 324 U.S., at 307-08. Cf. Rev. Rul. 98-8, 1998-1 C.B. 541 (reaching a similar conclusion for gift tax purposes in the context

[1] The Steinberg court relied upon Wemyss for the general proposition that consideration is that which replenishes the donor's estate for transfer tax purposes, and found as a factual matter that the donees' assumption of the donor's potential liability constituted adequate and full consideration in money or money's worth. Steinberg v. Commissioner, 145 T.C. 184,196 (2015) (supp. op.).

of §§ 2519 and 2044.) Accordingly, Donor has made a completed gift to the beneficiaries of Trust 1 in the amount of the value of the promissory notes transferred to Trust 1.

Adequate and Full Consideration for Purposes of § 2053(c)(1)(A)

Section 2053(a) provides, in part, that the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts for funeral expenses, administration expenses, claims against the estate, and unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate, as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

Section 2053(c)(1)(A) provides, in part, that the deduction allowed in the case of claims against the estate, unpaid mortgages, or any indebtedness shall, when founded on a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth.

Treas. Reg. § 20.2053-1(b)(2)(i) provides, in part, that amounts allowed as deductions under § 2053 must be expenses and claims that are bona fide in nature. No deduction is permissible to the extent it is founded on a transfer that is essentially donative in character (a mere cloak for a gift or bequest).

Treas. Reg. § 20.2053-1(b)(2)(ii) provides, in part, that factors indicative (but not necessarily determinative) of the bona fide nature of a claim or expense involving a family member of a decedent, or a beneficiary of a decedent's estate or revocable trust, may include, but are not limited to: (A) the transaction underlying the claim or expense occurs in the ordinary course of business, is negotiated at arm's length, and is free from donative intent; (B) the claim or expense is not related to an expectation or claim of inheritance; (C) the claim or expense originates pursuant to an agreement between the decedent and the family member or beneficiary, and the agreement is substantiated with contemporaneous evidence; (D) performance by the claimant is pursuant to the terms of an agreement between the decedent and the family member or beneficiary and the performance and the agreement can be substantiated; (E) all amounts paid in satisfaction or settlement of a claim or expense are reported by each party for Federal income and employment tax purposes, to the extent appropriate, in a manner that is consistent with the reported nature of the claim or expense.

Treas. Reg. § 20.2053-1(b)(2)(iii) provides, in part, that for purposes of the foregoing, family members include the spouse of the decedent; the grandparents, parents, siblings, and lineal descendants of the decedent or of the decedent's spouse; and the spouse and lineal descendants of any such grandparent, parent, and sibling. Family

members include adopted individuals. Beneficiaries of a decedent's estate include beneficiaries of a trust of the decedent.

Treas. Reg. § 20.2053-4(a)(1) provides, in part, that a claim against a decedent's estate must represent a personal obligation of the decedent existing at the time of the decedent's death.

Treas. Reg. § 20.2053-4(d)(5) provides in part, that the deduction for a claim founded upon a promise or agreement is limited to the extent that the promise or agreement was bona fide and in exchange for adequate and full consideration in money or money's worth; that is, the promise or agreement must have been bargained for at arm's length and the price must have been an adequate and full equivalent reducible to a money value.

As discussed above in Merrill v. Fahs, supra, the Court considered the correlation of the estate tax and the gift tax, finding that the estate and gift tax statutes should be interpreted "harmoniously." Id. at 313. The Court held that the phrase "adequate and full consideration" should be deemed to have the same meaning in both statutes. Consideration is that which replenishes the donor's taxable estate for transfer tax purposes. Commissioner v. Wemyss, 324 U.S., at 307-08.

In Estate of Goetchius v. Commissioner, 17 T.C. 495, 503 (1951), the Tax Court considered the meaning of the phrase "adequate and full consideration" in the context of the estate tax:

> This Court and other courts, and the Treasury in its estate and gift tax regulations, had taken the view that the phrase 'a bona fide sale for an adequate and full consideration in money or money's worth' means that there must be the kind of consideration which in an arm's length business transaction provides the transferor of property with the full value thereof, in exchange; and that if the consideration is not paid in money, property, or services, but is represented by some benefit, then the benefit must be of the equivalent money value in order to constitute the required 'adequate and full consideration.' The Supreme Court approved that view in Commissioner v. Wemyss, supra. Accordingly, the exemption from tax is limited to those transfers of property where the transferor or donor has received benefit in full consideration in a genuine arm's length transaction; and the exemption is not to be allowed in a case where there is only contractual consideration but not 'adequate and full consideration in money or money's worth.' (Citations and footnotes omitted).

Cf. U.S. v. Stapf, 375 U.S. 118 (1963) (noting that a deduction should not be predicated solely on the finding that a promise or claim is legally enforceable under the state laws governing the validity of contracts and wills).

Where the purchase of the remainder occurs on the donor's deathbed while he is holding a § 2036 "string" to the transferred property, the remainder does not increase the value of the donor's taxable estate. That is because the entire value of the transferred property, including that of the remainder, will be includible in the donor's gross estate pursuant to § 2036(a)(1). Estate of Goetchius v. Commissioner, supra. For the same reason, Donor's deathbed receipt of the remainder interests cannot constitute adequate and full consideration within the meaning of § 2053(c)(1)(A). On these facts, the promissory notes are a mere cloak for a gift. Treas. Reg. § 20.2053-1(b)(2)(i); Estate of Tiffany v. Commissioner, 47 T.C. 491 (1967); Estate of Davis v. Commissioner, 57 T.C. 833 (1972). Accordingly, no deduction is allowable for Donor's liability on the outstanding promissory notes.

Please call (202) 317-6859 if you have any further questions.