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Moore v. Commissioner Highlights Risk of Denial of Estate Tax Charitable Deduction

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The recent case of *Estate of Moore v. Commissioner*,¹ highlights the risk of the denial of an estate tax charitable deduction where the amount contributed to charity by an estate is either not ascertainable at the decedent's death or is not required to be made under the applicable testamentary documents.

BACKGROUND

The decedent in this case created a living trust over which he retained complete power and control during his lifetime as trustee and, as a result, the assets of the trust were fully included in his gross estate upon his death. The living trust provided that upon the death of the decedent, the remaining trust property, after the payment of expenses, claims, taxes, and specific distributions of personal property and real estate, was to be divided between two separate trusts: (i) a charitable lead annuity trust (CLAT), and (ii) a trust for the benefit of his children. The CLAT was designed to make distributions to a family private foundation, which would then contribute funds to a local community foundation to be split among several designated charities. The amount to be distributed from the living

trust to the CLAT was based upon a formula clause, whereby instead of a fixed dollar amount, the CLAT was to be funded with an amount intended to minimize the federal estate tax to the extent possible. The specific language in the living trust document provided for a transfer to the CLAT equal to “the smallest amount which, when transferred to the [CLAT] will result in the least possible federal estate tax being payable . . . after allowing for the applicable exclusion amount (after taking into account adjusted taxable gifts, if any) as finally determined for federal estate tax purposes, and the credit for state death taxes.” This amount was intended to produce an estate tax charitable deduction to minimize any estate tax.

In addition to establishing a living trust during his lifetime, the decedent also established an irrevocable trust under which the decedent's children were the beneficiaries. Under the trust document, the decedent did not have a reversionary or any other interest in the irrevocable trust and otherwise had no control over it, such that no asset held by the irrevocable trust was reported as part of the decedent's gross estate on the federal estate tax return filed with the IRS. Interestingly, however, and presumably as a precautionary measure, the decedent included a provision in his irrevocable trust requiring the trustee to distribute to the living trust “**an amount equal to the value of any asset of [the irrevocable] trust which is includible in my gross estate for federal estate tax purposes.**”²

Both the IRS and the estate agreed that the only possible way this provision could ever be triggered was by an IRS examination that resulted in the inclusion in the decedent's gross estate of any asset held by the irrevocable trust. In the event the provision ultimately did come into effect, then the assets required to be distributed from the irrevocable trust to the living trust would then have been distributed to the CLAT to the extent provided under the formula clause contained in the living trust, thereby resulting in an additional estate tax charitable deduction that would minimize the federal estate tax due.

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¹ No. 20-73013, 2021 BL 428171 (9th Cir. 2021), *aff'g* T.C. Memo 2020-40.

² *Estate of Moore v. Commissioner*, T.C. Memo 2020-40 (emphasis added).

During his lifetime, the decedent transferred a 1000-acre farm, known as Moore Farms, to his living trust and continued to live on the property which was his principal residence. The living trust subsequently contributed four-fifths of Moore Farms to a newly formed family limited partnership, in which the decedent's living trust held a 95% limited partnership interest, his children collectively held a 4% limited partnership interest and a management trust, with respect to which the decedent was not a trustee and otherwise had no control, held the remaining 1% general partner interest. Although the decedent had no control over the limited partnership and no ownership interest in any of its assets, including Moore Farms, the Tax Court determined that even though the farm was owned by the limited partnership, the decedent, prior to his death, continued to live on and control Moore Farms, made a determination to sell the farm and then negotiated the terms of the sale of the farm to a third-party buyer. The partnership then sold the farm to the buyer for the \$16,512,000 sales price negotiated by the decedent, with the sale proceeds paid entirely to the limited partnership.

Even after the sale of Moore Farms, the decedent continued to live on the farm for the remaining years of his life, apparently a common practice whereby the new owner of the farm allows the original owner to continue to live on his homestead. What took the situation out of the ordinary, however, was that the deal with the buyer of the farm not only allowed the decedent live out his days in his own house but also let him operate the farm as well. And he did so, as he lived on and managed the property and continued farming on it until the day he died.

ISSUE OF ALLOWANCE OF ADDITIONAL ESTATE TAX CHARITABLE DEDUCTION ON ACCOUNT OF INCLUSION OF MOORE FARMS IN DECEDENT'S ESTATE

In a subsequent audit, the IRS determined that because the decedent kept possession and enjoyment of Moore Farms until his death, then, under §2036,³ the decedent's gross estate should be increased by the over \$7 million value of Moore Farms. The relevant issue at that point was whether the estate was entitled to an additional estate tax charitable deduction under the operative terms of the living and irrevocable trusts intended to minimize any additional estate tax resulting from the inclusion of Moore Farms in the decedent's estate.

³ All section references herein are to the Internal Revenue Code of 1986, as amended (the "Code"), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

The estate argued that an additional charitable deduction should be available to the estate because as a result of the inclusion of Moore Farms in the decedent's gross estate, the irrevocable trust was required to transfer to the living trust "an amount equal to the value of any asset of [the irrevocable] trust which is includible in my gross estate for federal estate tax purposes"⁴ and the living trust was then required to transfer such amount to the CLAT to the extent necessary to produce an estate tax charitable deduction in order to minimize any estate tax. Contrary to the position of the estate, the IRS asserted that no additional charitable deduction was allowable on account of any amount transferred to the CLAT because such a transfer was "contingent on the IRS's examination of the estate's return," as a result of which the transfer to the CLAT was not ascertainable upon the decedent's death.

DETERMINATION BY TAX COURT

The Tax Court first upheld the IRS determination that Moore Farms should be included in the decedent's gross estate under §2036. The court also upheld the IRS determination that the estate was not entitled to an additional estate tax charitable deduction on account of the provision in the irrevocable trust requiring it to make a transfer to the living trust of "an amount equal to the value of any asset of [the irrevocable] trust which is includible in my gross estate for federal estate tax purposes."⁵ The court found that there were two separate grounds for the denial of an additional estate tax charitable deduction the estate asserted it could validly claim.

The first was the very specific language of the irrevocable trust, which speaks of a distribution to the living trust of "an amount equal to the value of *any asset of this trust* which is includible in my gross estate for federal estate tax purposes."⁶ Although Moore Farms was determined to be includible in the decedent's gross estate for estate tax purposes, the court pointed out that the farm was not an asset of the irrevocable trust at the time of the decedent's death. Instead, the court noted, the farm was owned at that time by the third-party buyer of the farm and that even when the farm was owned by the family limited partnership, the living trust only held an interest in the partnership and not an interest in any of the partnership's assets, including Moore Farms. On this basis, the court held that under the specific language of the irrevocable trust, there was no requirement for it to make any transfer to the living trust and, as a conse-

⁴ *Estate of Moore*, T.C. Memo 2020-40.

⁵ *Estate of Moore*, T.C. Memo 2020-40.

⁶ *Estate of Moore*, T.C. Memo 2020-40 (emphasis added).

quence, there was no requirement for the living trust to make any additional distribution to the CLAT. Therefore, even if additional funds were actually transferred from the irrevocable trust to the living trust and then from the living trust to the CLAT, no estate charitable deduction would be allowable because there was no requirement under the applicable testamentary documents that such a transfer be made in the first instance.

The second reason in support of the Tax Court determination in this case went to the issue of whether the transfer to the CLAT was ascertainable upon the decedent's death. In this regard, the court pointed to case law specifically holding that for a charitable deduction to be claimed for estate tax purposes, the transfer to charity "must be ascertainable at the decedent's date of death."⁷ The Tax Court also noted the following language set forth in Reg. §20.2055-2(b)(1):⁸

If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.

The court then observed that under the terms of the irrevocable trust, any transfer of additional funds from the irrevocable trust to the living trust, which would then be transferred to the CLAT, "was not ascertainable at Moore's death but only after an audit by the Commissioner, followed by a determination that additional property should be included in Moore's estate, followed by either the successful defense of that position or the estate's acquiescence to his determinations. For the exception to apply, it would have to have been almost certain that the Commissioner would not only challenge, but also successfully challenge the value of the estate. We do not think that's a reasonable conclusion."⁹

Interestingly, in support of its position that it should be entitled to an additional estate tax charitable deduction, the estate sought to rely on the charitable lid formula clause cases of *Estate of Christiansen v.*

⁷ See *Ithaca Tr. Co. v. United States*, 279 U.S. 151, 154 (1929) (transfers to a charity must be "fixed in fact and capable of being stated in definite terms of money"); *Estate of Marine v. Commissioner*, 97 T.C. 368 (1991).

⁸ *Estate of Moore v. Commissioner*, T.C. Memo 2020-40 (citations omitted).

⁹ *Estate of Moore*, T.C. Memo 2020-40.

*Commissioner*¹⁰ and *Estate of Petter v. Commissioner*.¹¹ The amount the property to be received by the charities in those case was subject to change based on a formula clause tied to the value of the property transferred as finally determined for federal estate and gift tax purposes. The Tax Court found those cases to be distinguishable because in the estate in *Moore*, the language of irrevocable trust did not provide that the living trust "will receive a transfer of assets of unknown value."¹² Instead, the court stated that whether the living trust would ever receive "a transfer of assets is unknown — contingent upon an examination by the Commissioner."¹³ Thus, the transfer to charity was contingent upon an event occurring following the decedent's death. In contrast, the court stated that in *Estate of Christiansen and Estate of Petter*, there was only a question as to how much the charities would receive.

DETERMINATION BY NINTH CIRCUIT COURT OF APPEALS

In upholding the Tax Court decision, the Ninth Circuit Court of Appeals confined its determination to whether any additional transfer of funds from the living trust to the CLAT "were required by the Moore documents."¹⁴ In this regard, the court stated that the provision of the irrevocable trust requiring a distribution to the living trust was only triggered by a determination that "any asset of this trust" is also an asset of the gross estate of the decedent.¹⁵

Here, the court noted, neither Moore Farms nor the proceeds of the sale were assets of the irrevocable trust at the time of the decedent's death. Instead, the court noted that the proceeds of the farm sale were an asset of the limited partnership and that although the irrevocable trust had a significant interest in limited partnership, the partnership agreement specifically provided that "no Partner shall have any interest in any of the assets of the partnership."¹⁶ In the end, therefore, the court concluded that irrevocable trust was not required to transfer the farm's sale proceeds to the living trust and then from the living trust to the CLAT and that "the Commissioner therefore correctly denied the Estate's claimed charitable deductions."¹⁷

CONCLUSION

Although the estate planning in this case contained formula clauses intended to minimize the estate tax by

¹⁰ 586 F.3d 1061 (8th Cir. 2009), *aff'g* 130 T.C. 1 (2008).

¹¹ 653 F.3d 1012 (9th Cir. 2011), *aff'g* T.C. Memo 2009-280.

¹² *Estate of Moore*, T.C. Memo 2020-40.

¹³ *Estate of Moore*, T.C. Memo 2020-40.

¹⁴ *Estate of Moore*, 2021 BL 428171 at *1.

¹⁵ *Estate of Moore*, 2021 BL 428171 at *1.

¹⁶ *Estate of Moore*, 2021 BL 428171 at *2.

¹⁷ *Estate of Moore*, 2021 BL 428171 at *2.

increasing the charitable deduction should there be any unanticipated additions to the decedent's gross estate, the planning ultimately failed because, in the end, any additional transfer to charity was contingent upon an IRS audit, thereby making any such transfer

not ascertainable at the decedent's death. In addition, under the specific language used in the testamentary documents, there was no actual requirement for any transfer to be made to charity.