INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

March 23, 2005

Third Party Communication: None
Date of Communication: Not Applicable

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Index (UIL) No.: 2036.01-00, 2053.07-00, 2041.03-00
CASE-MIS No.: TAM-146767-04/CC:PSI:B4

Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Decedent =
Spouse =
Daughter =
Attorney =
Residence =

Deed 1 =

Deed 2 =

Year 1 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =

Date 6 =
Date 7 =
$X =
$Y =
$Z =

ISSUES:

(1) What portion of Residence is includible in Decedent's gross estate?

(2) Are the attorney's fees and litigation expenses incurred as a result of the malpractice suit that was filed against Attorney by Decedent's estate deductible as administration expenses under section 2053?

CONCLUSIONS:

(1) The entire value of Residence is includible in Decedent's gross estate.

(2) The attorney's fees and litigation expenses incurred as a result of the malpractice suit are deductible as administration expenses under section 2053.

FACTS:

In Year 1, Daughter conveyed Residence to her parents, Decedent and Spouse, residents of Maryland. The terms of the deed (Deed 1) provide that the property (Residence) is conveyed to:

> [Decedent] and [Spouse], his wife, their assigns, the survivor of them, his and her heirs and assigns, in fee simple . . . . [t]o have and to hold the said lots of ground and premises…, and hereby intended to be conveyed, together with the rights, privileges, appurtenances and advantages thereto belonging or appertaining unto and to the proper use and benefit of the said [Decedent] and [Spouse], his wife, their heirs, the survivor of them, his or her heirs and assigns, in fee simple.

(emphasis added)

On Date 1, eleven years after Year 1, Decedent and Spouse as Grantors executed Deed 2 in which they conveyed Residence to Daughter, as grantee. The terms of Deed 2 provide for the conveyance of Residence as follows:

> . . . to the Grantee, who is the daughter of the Grantors, her personal representatives, heirs and assigns, in fee simple the lot of ground located in . . . [t]ogether with all improvements, thereon and the rights, alleys, ways, waters, easements, privileges, appurtenances and advantages belonging or appertaining thereto. To have and to hold the property hereby conveyed unto the Grantee,

> her personal representatives, heirs and assigns, in fee simple, forever, but reserving unto the Grantors a life estate in the property for their own lives without liability for waste, and also reserving unto the Grantors the full power and authority during their lifetime to sell, convey, and dispose of the property (but not to devise the property) in fee simple, and to retain absolutely as their own all of the proceeds thereof, thereby divesting the remainder granted by this deed. The Grantors also reserve the right to mortgage the entire fee simple estate in the property, including the remainder granted herein, and to retain, absolutely as their own, all of the proceeds thereof.

(emphasis added.)

The facts presented indicate that Residence constituted the residence of Decedent and Spouse. Spouse died on Date 2. After Spouse's death, Decedent continued to reside in Residence. Subsequently, Decedent died on Date 3, approximately 3 months after Spouse's death.

Daughter was appointed as the personal representative of Decedent's estate. Daughter, as personal representative, retained Attorney prior to filing Decedent's federal estate tax return (Form 706). It is represented that Daughter, as personal representative, instructed Attorney to prepare a disclaimer pursuant to which Daughter, as personal representative, would disclaim, on behalf of Decedent, one-half of the value of Residence that purportedly passed from Spouse to Decedent on Spouse's death.

It is represented that if this disclaimer had been properly and timely executed, no estate tax would have been imposed on Decedent's estate.[1] However, this disclaimer was never executed. Decedent's estate tax return (Form 706) was filed on Date 5, indicating an estate tax liability of $X. On the estate tax return the entire value of Residence was included in Decedent's gross estate.

On or about Date 6, Daughter, as personal representative of Decedent's estate, commenced an action against Attorney alleging malpractice in Attorney's representation of Daughter, as personal representative. The estate ultimately recovered $Z. This amount was approximately equal to the additional federal and state estate tax, interest and penalties that were paid by the estate attributable to Attorney's alleged malpractice.

Subsequently**,** on Date 7**,** Decedent's estate filed a claim for refund of estate taxes. The estate contends that only one-half the value of Residence is properly included in Decedent's gross estate. In addition, the estate claimed a deduction under section 2053(a)(2) for $Y representing attorney's fees and litigation costs arising from the malpractice suit that was filed against Attorney.

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[1] It is also represented that Spouse's estate would have been nontaxable, even if the disclaimer had been executed.

LAW AND ANALYSIS:

Issue 1: Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States. Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which decedent has retained for life or for any period not ascertainable without reference to death or for any period which does not in fact end before death, (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income from the property.

Revenue Ruling 69-577, 1969-2 C.B. 173, considers a situation where a Husband and Wife hold property as tenants by the entireties. The property is transferred to a trust pursuant to which one-half of the trust income is to be paid to each spouse during their joint lives and the entire trust income is to be paid to the survivor for life. The revenue ruling concludes that each co-tenant made a transfer of a one-half interest in the property to the trust, reflecting the interest each owned under state law prior to the transfer. Accordingly, the revenue ruling concludes, relying on United States v. Heasty, 370 F.2d 525 (10th Cir. 1966), that for purposes section 2036(a)(1), the value of the one-half interest in the trust property each transferred to the trust will be includible in each cotenant's gross estate under section 2036(a)(1).

Section 2041(a)(2) provides that the value of the gross estate includes the value of all property to the extent of any property with respect to which the decedent has at the time of decedent's death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038 inclusive.

Section 2041(b)(1) provides that the term "general power of appointment" means a power which is exercisable in favor of the decedent, the decedent's estate, decedent's creditors, or the creditors of the estate. Section 20.2041-1(b)(1) of the Estate Tax Regulations provides, in part, that the term "power of appointment" includes all powers which are in substance and effect powers of appointment regardless of the nomenclature used in creating the power and regardless of local property law connotations. For example, if a trust instrument provides that the beneficiary may appropriate or consume the principal of a trust, the power to appropriate or consume is a power of appointment. Similarly, a power given to a decedent to affect the beneficial

enjoyment of trust property or its income by altering, amending, or revoking the trust instrument or terminating the trust is a power of appointment.

Section 20.2041-1(b)(2) provides that for purposes of sections 20.2041-1 to 20.2041-3, the "term power of appointment" does not include powers reserved by the decedent to himself or herself within the concepts of section 2036 to 2038. However, no provision of section 2041 or the applicable regulations is to be construed as in any way limiting the application of any other section of the Code.

In Rev. Rul. 69-342, 1969-1 C.B. 221, the Decedent's spouse bequeathed the estate residue to the Decedent for life "with power to mortgage, sell, assign, and convey the same, and use and dispose of the proceeds thereof to all intents and purposes as if she were the absolute owner thereof." Upon Decedent's death, the unconsumed portion of the residuary estate if any, was to be distributed in fee to their daughter. Under the laws of the state in which the spouse's will was probated, the quoted language is not construed to include a power to dispose of the property by gift. The revenue ruling concludes that the Decedent's lifetime power to consume or appropriate the residuary estate constituted a general power of appointment under section 2041(b)(1) notwithstanding that Decedent lacked testamentary control over the property, and could not make an inter vivos gift with respect to the property.

In the instant case, Deed 1 conveyed Residence to "[Decedent] and [Spouse], . . . , [or] the survivor of them, . . . in fee simple ". Thus, immediately prior to Spouse and Decedent's conveyance of Residence pursuant to Deed 2, Spouse and Decedent each held an undivided one-half interest in Residence (with right of survivorship) that each transferred in accordance with Deed 2. Regarding Decedent's transfer, pursuant to Deed 2, Decedent transferred his one-half interest in Residence while retaining with respect to his transferred one-half interest, a life estate in the property (including the power to dispose of the property and retain the proceeds). In accordance with Rev. Rul. 69-577, the date of death value of that undivided one-half interest in Residence that Decedent owned and conveyed pursuant to Deed 2 is includible in Decedent's gross estate under section 2036(a)(1) and (a)(2).

Regarding the other one-half interest in residence that Spouse conveyed pursuant to Deed 2, as discussed below, we believe that under the terms of the Deed, after Spouse's death, Decedent succeeded to a life estate in the entire property. In addition, under the terms of Deed 2, Decedent and Spouse reserved "the full power and authority during their lifetime to sell, convey, and dispose of the property . . . in fee simple, and to retain absolutely as their own all of the proceeds thereof, thereby divesting the remainder granted by this deed." Decedent and Spouse also reserved the right to mortgage the property, including Daughter's remainder interest, and to retain all of the proceeds. As is the case in Rev. Rul. 69-342, Decedent possessed, at the time of his death, the unrestricted power to appropriate the entire value of Residence for his own benefit. Accordingly, as is the case in Rev. Rul. 69-342, at the time of his death, Decedent possessed a general power of appointment, exercisable during his life, with respect to the one-half interest in Residence that Spouse conveyed pursuant to Deed 2.

The value of that one-half interest is includible in Decedent's gross estate under section 2041(a)(2).

In summary we conclude that 100% of the value of Residence is includible in Decedent's gross estate; fifty percent is includible under section 2036(a)(1) and (2) and fifty percent is includible under section 2041(a)(2).

Decedent's estate argues, however, that only the value of the one-half interest in Residence that Decedent conveyed under Deed 2 is includible in Decedent's gross estate. Specifically, the estate argues that it was the intent of Decedent and Spouse that the life estate and broad powers of disposition were reserved to them only during their joint lives, i.e., only during the period both were alive. Thus, when Spouse died, the one-half interest Spouse conveyed under Deed 2 passed immediately in fee simple to Daughter, the remainder beneficiary, and thereafter, Decedent and Daughter held the property as tenants in common. Thus, Decedent's interest and power over Spouse's one-half interest terminated on Spouse's death.

The estate discusses the requirements for creating tenancies by the entireties and joint tenancies, two forms of concurrent ownership that provide a survivorship interest in the entire property to the survivor of the co-tenants. Maryland courts have recognized that a joint tenancy or tenancy by the entirety can be created in an estate less than a fee interest, such as a reserved life estate. Register of Wills for Kent County v. Blackway, 217 Md. 1(Ct. of Appeals 1958). See also, Downing v. Downing, 326 Md. 468, 478-479 (Ct. of Appeals 1991) ("A joint estate is valid even though an estate less than a fee is conveyed to the tenants," citing 2 A. Casner, American Law of Property, § 6.1 at 6 (1952)).

The estate argues that, the interest retained by Spouse and Decedent in the property can not be viewed as a tenancy by the entirety, since under State law, a tenancy by the entirety can only exist between a husband and wife. In this case, Daughter is also granted a remainder interest in the property. Further, in the case of a joint tenancy, although the words "joint tenancy" need not be used in the instrument of transfer to create such an interest, a specific expression in the deed of a right of survivorship would constitute a clear indication of an intention to create a joint tenancy. The estate further argues that, there is no specific language in Deed 2 referencing joint tenancies, tenancies by the entirety, or any right of survivorship. Rather, the terms of Deed 2 reserve a life estate in the property "unto the Grantors" for "their own lives". Further, under the terms of Deed 2, the power to sell, convey, dispose, mortgage, etc. is reserved to the "Grantors". The estate argues that the use of the plural "Grantors" indicates that Decedent's and Spouse's reserved rights were to continue only during their joint lives.

However, we disagree. There is no indication in the deed that Daughter is to succeed to any interest or right in Residence on the death of the first to die of Spouse and Decedent. Rather, the language of Deed 2 specifically provides that Decedent and

Spouse reserved for their "own lives" a life estate and dispositive powers with respect to the "property". This language clearly indicates that these interests and powers were to continue for the life of Spouse and the life of Decedent; i.e., for Decedent's and Spouse's "own lives". Further, these powers are reserved with respect to the "property", i.e., the entirety of Residence. Thus, there is no intent expressed in the deed that on the death of the first to die of Decedent and Spouse, the survivor's interest is in any way terminated or restricted with respect to any portion of the property. Since Residence was Decedent's and Spouse's home, it is reasonable to assume that they intended to retain these interests and powers over the entire property while either was still living, thus, ensuring that either could continue to possess and occupy Residence without fear of eviction. It would seem improbable that a husband and wife would reserve a life estate in their own residence "for their own lives" and yet upon the death of the first to die, intend that the survivor share dominion and control of the residence with other family members. Further, this result is consistent with the interests Decedent and Spouse held in Residence prior to the conveyance under Deed 2. Under the terms of Deed 1, on the death of the first to die of Decedent and Spouse, the entire residence was to pass to the survivor. There is no indication that Decedent and Spouse desired to change the nature of their ownership interest other than to provide Daughter with a remainder in Residence.

In response to the estate's argument regarding joint tenancy, under Maryland law, in order to create a joint tenancy or survivorship interest the words "joint tenants" or "joint tenancy" need not be used. For example, in Gardner v. Gardner, 25 Md.App. 638 (Ct of Special Appeals, 1975), the court stated "[w]hile [Md Code Ann., Real Prop. § 2-117 (1974)] specifies that to create an estate in joint tenancy the instrument should expressly so provide, the words 'joint tenants' or ' joint tenancy' need not be used; the statutory requirement is only one of clear manifestation of intention and not of particular words." See also, Downing v. Downing, 326 Md. at p.477. Thus, Maryland courts have held that a survivorship interest was created, notwithstanding that the instrument of transfer did not contain specific language referencing a joint tenancy or right of survivorship. In Marburg v. Cole, 49 Md. 402 (Ct. of App. 1878) cited in Downing v Downing, Id. at 476 fn. 5, a conveyance to two named married individuals "their heirs and assigns in fee" was held to establish a tenancy by the entirety with a right of survivorship. See also, W.E. Shipley, Annotation, Disposition of Decedent's Share of Income or Property During Interval Between Deaths of Life beneficiaries Sharing Therein, Where Remainder was Given Over After Death of all Life Beneficiaries, 71 A.L.R. 2d 1332 (1960).

In the present case, as discussed above, although Deed 2 did not contain words such as "right of survivorship", the language used by Decedent and Spouse clearly indicates that they intended that their reserved interests and powers continue for their joint lives as well as the life of the survivor, i.e., "for their own lives". This is consistent with the language of the deed, as well as the nature of the property subject to the deed, the couples' residence. Thus, as the cited cases provide, although Deed 2 did not contain particular technical words, there was a "clear manifestation of intention" that the

reserved interests and powers continue until the death of the survivor of Spouse and Decedent.

Accordingly, we conclude that one-half the value of Residence is includible in Decedent's gross estate under section 2036. See Rev. Rul. 69-577. The other one-half is includible in Decedent's gross estate under section 2041(a)(2). See Rev. Rul. 69-342.

Issue 2:

Under section 2053(a)(2), the value of the taxable estate is determined by deducting from the value of the gross estate amounts incurred for "administration expenses" that are allowable by the laws of the jurisdiction under which the estate is being administered.

Section 20.2053-3(a) provides that:

> [t]he amounts deductible from a decedent's gross estate as "administration expenses" . . . are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payments of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries. . . Expenditures that are not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. Administration expenses include: (1) executor's commissions; (2) attorney's fees; and (3) miscellaneous expenses. . . .

Section 20.2053-3(c)(2) provides generally that a deduction for attorneys' fees incurred in contesting an asserted deficiency or in prosecuting a claim for refund will generally be allowed as prescribed in the regulation. Section 20.2053-3(c)(3) provides that attorney's fees incurred by beneficiaries incident to litigation as to their respective interests are not deductible if the litigation is not essential to the proper settlement of the estate within the meaning of § 20.2053-3(a). An attorney's fee not meeting this test is not deductible as an administration expense under section 2053 even if it is approved by a probate court as an expense payable or reimbursable by the estate.

In general, in order for a claimed administration expense to be deductible under section 2053, the expense must be allowable under applicable state law. In addition, the expense must satisfy the regulatory requirements contained in section 20.2053-3. Thus, among other requirements, the expense must be actually and necessarily incurred in the administration of the estate, and incurred for the benefit of the estate rather than for the beneficiaries. Estate of Grant v. Commissioner, 294 F.3rd 352, 354(2nd Cir. 2002), and the cases cited therein.

Under Maryland law, an attorney is entitled to reasonable compensation for legal services rendered by the attorney to the estate and/or the personal representative. Md. Code Ann., Est. & Trusts §7-602(2005). Maryland courts have approved the allowance of attorney's fees where the fee is incurred to protect or enhance the assets of the estate, avoid dissipation of estate assets, or to recover estate assets. See, Clark v. Rolfe, 279 Md. 301(Ct. of App. 1977) (allowing attorneys fees incurred by residuary beneficiaries in successfully contesting the allowance of excessive executors commissions and excessive attorneys fees.) See also, Mudge v, Mudge, 155 Md. 1(1928) (court disallowed attorneys fees incurred by beneficiaries where as a result of the attorney's services, "the estate was in no way enlarged or protected…The purpose and effort of the appellee 'was not to recover the estate or to protect it from spoliation,' but to determine the amount that should be distributed to her.")

Regarding satisfaction of the federal standard for deduction of administration expenses, in Estate of Glover v. Commissioner, TCM 2002 -186, attorneys fees incurred by the estate beneficiaries that resulted in the discovery of misappropriation of estate funds and malpractice on the part of the attorneys hired by the executrix, as well as fees incurred by the administrator pro tem in prosecuting the malpractice claim, were allowed as deductions under section 2053(a)(3).

In this case, Daughter, acting as personal representative of Decedent's estate, sued Attorney, in order to recover the loss incurred by the estate during administration resulting from Attorney's malpractice. The litigation resulted in a recovery for the estate in the amount of $Z, which amount largely approximated the additional estate tax Decedent's estate paid resulting from the alleged malpractice. Thus, as a result of the litigation, the estate was made whole for the financial loss incurred by the estate during administration. We believe the fees paid satisfy the criteria for allowance of attorney's fees outlined in Clark v. Rolfe, supra; that is, the fees were incurred to recover estate assets, and avoided dissipation of estate assets. Therefore we believe the fees would be allowable as an administration expense under Maryland law.

For the same reasons, we believe the fees were necessarily incurred in the administration of the Decedent's estate for purposes of section 20.2053-3(a) and 3(c). The fees were paid in order to recover a loss incurred by the estate during administration. Therefore, we do not believe the fees can be viewed as incurred for the individual benefit of the heirs, legatees, etc. See, Estate of Glover v. Commissioner, supra.

Accordingly, we conclude that the attorney's fees and expenses of litigation arising from the malpractice suit filed against Attorney are deductible administration expenses under section 2053.

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.