No. 03-86

In the Supreme Court of the United States

ESTATE OF MELVINE B. ATKINSON, DECEASED, AND CHRISTOPHER J. MACQUARRIE, EXECUTOR, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the trust established by Melvine B. Atkinson failed to qualify as a charitable remainder annuity trust under 26 U.S.C. 664(d)(1), with the result that Atkinson's estate was not entitled to a charitable deduction under 26 U.S.C. 2055(e)(2) for the value of the remainder interest.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-11a) is reported at 309 F.3d 1290. The opinion of the Tax Court (Pet. App. 12a-23a) is reported at 115 T.C. 26.

JURISDICTION

The judgment of the court of appeals was entered on October 16, 2002. The petition for rehearing was denied on February 3, 2003 (Pet. App. 24a-25a). The petition for a writ of certiorari was filed on May 5, 2003 (a Monday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On August 9, 1991, Melvine B. Atkinson (whose estate is the taxpayer in this estate tax case) created and funded an irrevocable annuity trust. Pet. App. 1a–2a, 12a–13a. The document creating the trust stated that Atkinson desired to establish a charitable remainder annuity trust (CRAT). *Id.* at 2a, 13a. A CRAT is a trust that pays an annuity to noncharitable beneficiaries during their life and pays the remainder interest to charity. The federal estate tax allows the settlor of a valid CRAT a charitable deduction for the value of the charitable remainder interest. 26 U.S.C. 664(d)(1), 2055(e)(2).

The annuity trust established by Atkinson first provided her with an annuity for life. Pet. App. 2a, 13a. Upon her death, the trust was to pay the same annuity to several secondary beneficiaries, contingent upon their paying the estate and death taxes attributable to their shares. *Id.* at 2a–3a, 13a–14a. Upon the deaths of the secondary beneficiaries, the remainder was to be paid to charity. *Id.* at 2a.

The annuity trust did not, however, make the required annuity payments to Atkinson from its creation through Atkinson's death on June 7, 1993. Pet. App. 3a, 10a, 13a, 19a. This breached the requirements of 26 C.F.R. 1.664-1(a)(4), which specify that CRATs must comply with CRAT rules from formation through final disposition of assets. Christopher J. MacQuarrie (the trustee of the trust and executor of the estate) claimed that he sent Atkinson checks written on another trust but that Atkinson did not cash them. Pet. App. 3a, 10a, 13a, 19a; Tr. 427–428. Petitioners, however, introduced no documentary evidence (such as photocopies of checks or bank records) to support that assertion, and

the annuity trust was not reduced by annuity checks or by any transfers into the other trust. *Ibid.*

After Atkinson's death, the secondary beneficiaries were unwilling to pay the estate and death taxes due on their respective shares of the annuity. Pet. App. 3a–4a, 13a–15a. One of the secondary beneficiaries (Mary Birchfield, Atkinson's care giver) demanded that she be paid her share of the annuity free of tax. *Ibid.* After a dispute, and in exchange for relinquishing any claims she might have against the estate, Birchfield received payments from MacQuarrie out of the annuity trust equal to her share of the annuity unreduced by the taxes. *Ibid.* The payments to Birchfield made it necessary to invade the annuity trust to pay the estate's debts. *Id.* at 4a, 15a. This invasion of corpus breached the requirement of 26 U.S.C. 664(d)(1)(B) that a CRAT may not make noncharitable payments other than the required annuity payments.

On its estate tax return, the estate claimed a charitable deduction for the present value of the remainder interest in the annuity trust. Pet. App. 3a–4a, 13a. The Commissioner disallowed the deduction and asserted an estate tax deficiency, explaining that "it has not been established that the estate is entitled to a charitable deduction in any amount." *Id.* at 4a, 15a–16a, 35a.

2. Petitioners sought review of the asserted deficiency in the Tax Court. In his pretrial memorandum, the Commissioner maintained that the annuity trust violated the CRAT rules because it did not make annuity payments to Atkinson and because the Birchfield payments exposed the trust to liability for noncharitable obligations other than annuity payments. Pet. App. 15a–16a, 34a, 36a. Petitioners responded that the matter of Atkinson's not receiving payments was a new issue and that they lacked sufficient time to locate

documents regarding the payments. *Id.* at 33a–39a. At trial, the court rejected petitioners' attempt to shift the burden of proof to the Commissioner. Tr. 18–25. Although the court left the record open for other matters, petitioners did not ask the court to leave the record open for documents concerning the payment issue. See, *e.g.*, Tr. 486–492.

The Tax Court agreed with the Commissioner that the estate was not entitled to a charitable deduction for the remainder interest in the annuity trust. Although the annuity trust document was consistent with the CRAT rules, the trust did not function as a CRAT. Pet. App. 16a–23a. It did not make the required annuity payments to Atkinson (*id.* at 18a–21a), and the payments to Birchfield made it necessary to invade the trust to satisfy the estate's noncharitable obligations, including the estate and death taxes due with respect to those payments (*id.* at 21a–22a).

3. The court of appeals affirmed. Pet. App. 1a-11a. The court rejected petitioners' argument that there was never an interest conveyed to noncharitable beneficiaries (a "split interest") to trigger the CRAT rules because none of those beneficiaries agreed to pay the taxes due, and thus none qualified under the terms of the trust. Pet. App. 8a–10a. The court noted that, under the Treasury Regulations, property interests transferred during the life of a decedent, including contingent interests, are deemed to pass immediately unless the possibility of the occurrence of the contingency is so remote as to be negligible. *Id.* at 9a. The court further observed that, at the time of the creation of the annuity trust, the possibility that at least one of the secondary beneficiaries would agree to the tax payment, and thus satisfy the contingency, was not remote. *Id.* at 9a–10a. At the creation of the trust, there was

thus a split interest between the secondary annuity beneficiaries and the charitable remaindermen and, "[f]rom that moment on, the trust was required to operate as a CRAT in order to preserve its ability to qualify for a deduction of the charitable remainder." *Id.* at 10a. The court held that, because the trust failed to make the required annuity payments to Atkinson, her estate was not entitled to a deduction for the charitable remainder. *Id.* at 10a–11a. In light of that conclusion, the court did not address whether the payments to Birchfield also violated the CRAT rules. *Id.* at 5a n.2.

The court concluded that petitioners' other arguments, including their arguments regarding the notice of deficiency, "are without merit and deserve no substantial discussion." Pet. App. 5a n.2. The petition for rehearing was thereafter denied without comment.[1] *Id.* at 24a–25a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Section 2055(a) of the Internal Revenue Code allows an estate tax deduction for amounts donated to charity by a decedent. 26 U.S.C. 2055(a). Section 2055(e)(2) imposes limits on such deductions, however, that apply when an interest in the same property "passes or has passed" from a decedent for *both* charitable and noncharitable uses. 26 U.S.C. 2055(e)(2).

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[1] In their rehearing petition, petitioners proffered what purport to be copies of Atkinson's 1991, 1992, and 1993 income tax returns. Pet. App. 41a–67a. Those returns were not introduced in the Tax Court and are not part of the record on appeal. Fed. R. App. P. 10(a), 14.

Under that statute, if the charitable interest in the property is a remainder interest, an estate tax deduction is not allowed unless the charitable remainder meets one of several specified requirements, such as qualifying as a CRAT, as defined by 26 U.S.C. 664(d)(1). In 1991, when Atkinson created and funded the annuity trust, CRATs were required to pay the noncharitable beneficiaries at least annually a sum certain of at least 5 percent of the initial net fair market value of the property placed in trust, were prohibited from making any other noncharitable payments and were required to donate the remainder to charity. 26 U.S.C. 664(d)(1)(1988).[2]

Congress enacted these provisions as part of the Tax Reform Act of 1969, Pub. L. No. 91-172, §§ 201(d), (e), 83 Stat. 560–564. Their purpose was to combat abuses under prior law by matching the amounts of charitable deductions in the present with the present value of the amounts to be donated to charity in the future. Congress required CRATs to pay an annuity so that they could not be used to avoid the income-distribution requirements imposed upon private foundations and other tax-exempt organizations. S. Rep. No. 552, 91st Cong., 1st Sess. 89–90 (1969); H.R. Conf. Rep. No. 782, 91st Cong., 1st Sess. 295–296 (1969); see Pet. App. 18a-19a. Congress limited the amount of the annuity to prevent CRATs from claiming charitable deductions in excess of the amounts that would ultimately reach charity. S. Rep. No. 552, *supra*, at 86–90.

Consistent with that intent, Treasury regulations require that the trust's governing instrument comply with the CRAT rules and that the trust must function

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[2] The 1997 amendments to 26 U.S.C. 664(d)(1) are not applicable to the annuity trust. See Pet. App. 7a n.3.

exclusively as a CRAT from its creation. 26 C.F.R. 1.664-1(a)(4). Courts have consistently held that a trust's violation of the CRAT rules results in the complete disallowance of any deduction for the charitable remainder. *Burdick* v. *Commissioner*, 979 F.2d 1369 (9th Cir. 1992); *Estate of Johnson* v. *United States*, 941 F.2d 1318 (5th Cir. 1991); *Estate of Gillespie* v. *Commissioner*, 75 T.C. 374 (1980); *Estate of Sorenson* v. *Commissioner*, 72 T.C. 1180, 1185–1186, 1191, 1195 (1979); see Richard B. Stephens et al., *Federal Estate and Gift Taxation* ¶ 5.05[4][b] (8th ed. 2002).

2. The courts below correctly concluded that the annuity trust created by Atkinson as a CRAT on August 9, 1991, failed to comply with the CRAT rules and that the estate was therefore not entitled to a charitable deduction for the remainder.

Section 2055(e)(2) applies to situations in which an interest in property "passes or *has passed*" (emphasis added) from the decedent to both charitable and noncharitable recipients. The regulations under this statute look to 26 U.S.C. 2056(c) and its regulations to determine whether an interest in property "passes or has passed" at the formation of a trust. 26 C.F.R. 20.2055-2(e)(1)(i). That statute and its regulations specify that property interests transferred during a decedent's life are considered as having passed from the decedent to the recipient. 26 U.S.C. 2056(c)(4); 26 C.F.R. 20.2056(c)-1(a)(5) (formerly 26 C.F.R. 20.2056(e)-1(a)(5) (1991)). Even if an interest created during a decedent's life is subject to a date-of-death contingency in order to become effective, that contingency prevents the property interest from having "passed" during the decedent's life only when the possibility of the

contingency occurring is so remote as to be negligible.[3] 26 C.F.R. 20.2055-2(e)(1)(i).

In the instant case, when Atkinson created and funded the annuity trust, there was a non-remote chance that at least one of the secondary beneficiaries would pay the taxes due and accept the post-death annuity. Pet. App. 8a–10a, 18a–19a. The CRAT rules were thus triggered at the creation of the annuity trust because interests in the same property passed from Atkinson to the secondary annuity beneficiaries and to the charitable remaindermen. *Ibid.* To maintain its CRAT status, the annuity trust had to "function

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[3] Throughout their petition, petitioners argue that the annuity trust did not have to make annuity payments to Atkinson because her annuity interest ended at her death. In essence, petitioners contend that an *inter vivos* CRAT can disregard the CRAT rules until the decedent dies and the post-death status of the split interest is ascertained. That argument, however, ignores the requirement in the Treasury Regulations that a CRAT "must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust." 26 C.F.R. 1.664-1(a)(4). It also ignores the legislative goal of preventing CRATs from being used to circumvent the income-distribution requirements imposed upon private foundations. S. Rep. No. 552, *supra*, at 89–90; H.R. Conf. Rep. No. 782, *supra*, at 295–296; see Pet. App. 18a-19a ("If there were no such requirement [that CRATs actually make annuity payments of at least 5 percent of initial fair market value], a charitable remainder trust could be used to accumulate trust income tax-free, while a private foundation would remain limited in the amount of income it might accumulate."). Although Atkinson could have avoided the CRAT rules by giving herself a lifetime interest in a trust with remainder to charity upon her death (see 26 U.S.C. 2055(e)(2)), once she created the annuity trust as a CRAT (and created in the trust a split interest between the secondary beneficiaries and the charitable remaindermen), the trust had to follow the CRAT rules by making the annuity payments to Atkinson.

exclusively" as a CRAT from the start. 26 C.F.R. 1.664-1(a)(4). The courts below correctly found that the annuity trust failed to function as a CRAT because it failed to make annuity payments to Atkinson during her lifetime. They therefore properly concluded that the estate was not entitled to a charitable deduction for the remainder interest. Pet. App. 3a, 10a–11a, 13a, 18a–21a. Further review of these factual determinations "concurred in by two lower courts" is not warranted. See *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317–318 n.5 (1985); *Rogers* v. *Lodge*, 458 U.S. 613, 623 (1982).

3. Petitioners err in claiming (Pet. 5, 19–22, 25–27) that the decision in this case conflicts with *Commissioner* v. *Citizens & Southern National Bank*, 147 F.2d 977 (5th Cir. 1945), aff'g, *Estate of Whitehead* v. *Commissioner*, 3 T.C. 40 (1944). Petitioners cite *Citizens & Southern* for the proposition that actual compliance with the CRAT rules is not required if the founding documents of the trust are in order. That case, however, is an income tax case that was decided approximately 25 years before the adoption of the CRAT rules. In *Citizens & Southern*, an estate formed a corporation to make both noncharitable and charitable payments. 3 T.C. at 41–42, 46–47. The estate deducted on its income tax returns for 1936 through 1939 the amounts that it gave to the corporation and directed it to pay to charities. *Id.* at 43–47. The Commissioner disallowed these deductions because the corporation was not exclusively charitable. *Id.* at 43–44, 46–48. The Tax Court allowed the deductions for the amounts given for charity, however, because the corporation, as the estate's agent, was required to follow the estate's instructions. *Id.* at 48–49. The court stated that, if the money given for charity was misused by the corporation, other

authorities could then correct the problem. *Id.* at 49. The Fifth Circuit affirmed, stating that it would not "further labor the points" in the lower court's opinion. 147 F.2d at 980–981.

Contrary to petitioners' argument, the decision in *Citizens & Southern* does not authorize fiduciaries to ignore the CRAT rules. *Citizens & Southern* was an income tax case that dealt with deductions for money presently set aside for, or given to, charity. It did not construe the estate tax provisions that are involved in this case, which were not even enacted until a quarter-century later. And, when Congress enacted the CRAT provisions, it was for the purpose of avoiding preexisting abuses, by more accurately matching the amounts of present estate tax deductions with the present value of future charitable donations. The 1944 decision cited by petitioners thus did not, and obviously could not, purport to interpret the 1969 statute involved in this case.[4]

4. Petitioners also err in asserting (Pet. 5, 7–11, 19–20) that there is a conflict between this case and the cases that have concluded that the settlement of bona fide probate disputes can eliminate the split interest

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[4] Petitioners similarly err in relying (Pet. 8, 19–20) on other pre-1969 cases, including *Hight* v. *United States*, 256 F.2d 795 (2d Cir. 1958) (allowing estate tax deduction for actual donations to qualified charities over IRS's objection that the will could be read as allowing donations to "benevolent" organizations that were not qualified charities); *Norris* v. *Commissioner*, 134 F.2d 796 (7th Cir.) (denying estate tax deduction for actual donations to charity because the instructions in the decedent's will were too contingent), cert. denied, 320 U.S. 756 (1943). Those cases do not conflict with the instant case and, in any event, were decided before Congress enacted the Code sections at issue here and therefore do not address them.

that triggers the CRAT rules. The cases cited by petitioners follow a similar pattern in which a decedent executed a will or other revocable testamentary document that would not create a split interest until the decedent died.[5] In these cases, after the decedent died, there was either a spousal election or a *bona fide* probate dispute that resulted in the division of property among the charitable and noncharitable beneficiaries, giving each its own specified share. Although the testamentary documents in these cases could have been interpreted or applied to create a date-of-death split interest in the property, the split never occurred due to valid elections or dispute settlements.[6] And, because no split interest existed to trigger the CRAT rules, the estate was entitled to a charitable deduction for the property that passed to charity.

The present case obviously does not fit that pattern. During her lifetime, Atkinson created and funded the irrevocable annuity trust as a CRAT on August 9, 1991. The annuity trust, and the split interests established therein, had been in existence for almost two years when Atkinson died on June 7, 1993. Because the an-

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[5] See, *e.g.*, *Flanagan* v. *United States*, 810 F.2d 930 (10th Cir. 1987); *First Nat'l Bank of Fayetteville* v. *United States*, 727 F.2d 741 (8th Cir. 1984); *Oetting* v. *United States*, 712 F.2d 358 (8th Cir. 1983); *Estate of Strock* v. *United States*, 655 F. Supp. 1334 (W.D. Pa. 1987); *Northern Trust Co.* v. *United States*, 41 A.F.T.R.2d 1523 (N.D. Ill. 1977); Rev. Rul. 89-31, 1989-1 C.B. 277; Rev. Rul. 83-20, 1983-1 C.B. 231; Rev. Rul. 78-152, 1978-1 C.B. 296.

[6] These cases are consistent with the policy established in 26 U.S.C. 2055(e)(3)(F), which specifies that the death of the income beneficiary or the termination of the trust before the due date of the estate tax return, which leaves the charitable entity as the sole beneficiary of the trust, is to be treated as a reformation of the governing documents that makes the charitable deduction allowable.

nuity trust began within the ambit of the CRAT rules, it had to obey those rules in order to maintain its CRAT status and to secure for the estate a deduction for the charitable remainder. 26 C.F.R. 1.664-1(a)(4). See *Burdick*, 979 F.2d at 1369–1371 (termination of split interest solely to obtain charitable deduction will not be honored); *Estate of Johnson*, 941 F.2d at 1319–1321 (deduction disallowed when trust could not be reformed to avoid split interest). The decisions cited by petitioners, by contrast, involve situations in which the property was never within the realm of the CRAT rules in the first place. They are not authority for allowing a split-interest trust to violate the governing rules. There is thus no conflict among the circuits to warrant further review of the decision in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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