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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR G. MICHELLE FERREIRA
DISTRICT COUNSEL CC:WR:NCA:SF

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Industries) CC:PSI

SUBJECT: Section 2011 State Death Tax Credit for California Estate
Tax

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LEGEND

Decedent =
Estate =

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Date 1 =

ISSUE

To what extent should the credit for state death taxes under § 2011 of the Internal Revenue Code be allowed where Estate, approximately two years prior to the decision in Hoffman v. Connell, 73 Cal. App. 4th 1194, 87 Cal. Rptr. 2d 272 (1999), paid the entire California estate tax due and claimed a credit under § 2011 for that amount on the federal estate tax return?

CONCLUSION

The entire § 2011 credit claimed should be allowed where the Estate, approximately two years prior to the decision in Hoffman v. Connell, paid the entire California estate tax determined to be due under state law. Accordingly, a statutory notice of deficiency should not be issued in this case. However, if the Estate receives a refund of California estate tax, then in accordance with § 2016, the credit allowable under § 2011 should be redetermined to reflect the refund.

FACTS

Decedent, a resident of California, died on Date 1. As reported on a timely filed federal estate tax return, the Decedent's gross estate included, under § 2044, the value of a trust subject to a Qualified Terminable Interest Property (QTIP) election. In computing the federal estate tax, the executor claimed a credit for the amount of the California estate tax paid. California imposes a "pick-up" tax equal to the maximum federal state death tax credit allowable under § 2011. Approximately 2 years after the Decedent's executor filed both the federal and state estate tax returns, a California appeals court, in Hoffman v. Connell, *supra*, concluded that QTIP property subject to inclusion in the federal gross estate under § 2044 is not subject to California estate tax.

As a result of the Hoffman v. Connell decision, where the federal taxable estate includes QTIP property, the California "pick-up" estate tax will be less than the federal state death tax credit allowable under § 2011.

The examiner proposes to disallow a portion of the § 2011 credit on the basis that, in view of Hoffman v. Connell, the Estate overpaid the state estate tax liability and is entitled to a refund. The Estate has not filed a claim for refund of California estate tax based on the Hoffman v. Connell decision.

LAW AND ANALYSIS

Under § 2011(a) each estate is allowed as a credit, subject to certain limitations, an amount equal to any estate, inheritance, legacy, or succession taxes actually paid

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to any state. Under §2011(b), the allowable credit cannot exceed an amount determined using a table contained in that section.

Section 2016 provides as follows:

If any tax claimed as a credit under section 2011 . . . is recovered from any state . . . , the executor, or any other person or persons recovering such amount, shall give notice of such recovery to the Secretary at such time and in such manner as may be required by [the Secretary], and the Secretary shall (despite the provisions of Section 6501) redetermine the tax under this chapter and the amount, if any, of the tax due on such redetermination, shall be paid by the executor or such person or persons, as the case may be, on notice and demand.

In Rev. Rul. 56-230, 1956-1 C.B. 661, a state imposed a “pick-up” estate tax on intangible property situated outside the state. The tax contravened several Supreme Court decisions holding that a state had no power to tax the transfer of intangible property situated outside its jurisdiction. The revenue ruling concludes that the Service will disallow the credit to the extent attributable to the tax paid by the estate that the state has no power to impose. Accordingly, the allowable credit is limited to the proportion of the full federal credit allowable to the estate attributable to the part of the gross estate situated in the state.

Section 13302 of the California Revenue and Taxation Code imposes a “pick up” state estate tax equal to the federal § 2011 state death tax credit, as follows:

Imposition of estate tax equal to federal tax credit; Limitation

Notwithstanding the provisions of Section 13301, whenever a federal estate tax is payable to the United States, there is hereby imposed a California estate tax equal to the portion, if any, of the maximum allowable amount of the credit for state death taxes, allowable under the applicable federal estate tax law, which is attributable to property located in the State of California. However, in no event shall the estate tax hereby imposed result in a total death tax liability to the State of California and the United States in excess of the death tax liability to the United States which would result if this section were not in effect.

In Hoffman, supra, the court concluded that QTIP property subject to inclusion in the federal gross estate under § 2044 was not subject to California estate tax. The court reasoned that since the tax imposed under § 13302 of the California Revenue and Taxation Code is calculated based on property located in California, the definition of “property” controls. Since the term “property” is defined by the Revenue and Taxation Code to mean the real or personal property or interest therein of a decedent, two requirements are inherent in the § 13302 definition.

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First, to be taxable, the property must have been the decedent's property; i.e., he or she must have owned it. Second, the property must be located in California. The Court concluded that the decedent could not be said to have owned the property held in the QTIP trust, since the decedent's only interest in the trust was a life income interest. Accordingly, the QTIP property was not includible for California estate tax purposes and the state liability was determined without regard to the value of the QTIP property.

In the instant case, the Estate's payment of the California estate tax liability preceded Hoffman v. Connell. Thus, the amount paid by the Estate, which reflected the inclusion of the QTIP trust in the California tax base, was consistent with the California estate tax statute as it had been interpreted, with no judicial authority to the contrary, by the state taxing authority at the time payment was made. Under these circumstances, no portion of the credit should be disallowed at this time.

However, under § 2016, if any tax claimed as a credit under § 2011 is refunded by the state, then the Estate's executor (or any other person who receives the refund) is required to give notice of the refund to the Secretary, and any additional estate tax due as a result of the refund (because of the corresponding decrease in the allowable credit) can be assessed at any time. This provision will protect the Service if the Estate should ultimately receive a refund from the state. See Estate of Weisberger v. Commissioner, 29 T.C. 217 (1957), acq. 1958-2 C.B. 8. (concluding that under the predecessor to § 2016, the statute of limitation is not a bar to collecting additional federal estate taxes as a result of a refund of state estate or inheritance taxes). The situation presented here should be contrasted with that presented in Rev. Rul. 56-230, where under prevailing law at the time of payment, the property involved was not subject to tax by the state to which the tax was paid.

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