

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
October 17, 2000

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Index (UIL) No.: 2040.00-00, 2053.00-00, 2056.00-00
CASE MIS No.: TAM-114145-00/CC:PSI:B4

District Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Date of Death:
Date of Conference:

LEGEND:

Decedent =

Spouse =

Property =

\$A =

\$B =

\$C =

\$D =

\$E =

Date 1 =

Date 2 =

State Statute =

Cite 1 =

Cite 2 =

Cite 3 =

Cite 4 =

Cite 5 =

Cite 6 =

State =

ISSUE: What amount is deductible under § 2053(a)(3) or § 2053(a)(4) and what amount is deductible under § 2056(a) where the Decedent and Spouse held property as tenants by the entirety, and at the time of Decedent's death, Property was subject to a mortgage with respect to which Decedent and Spouse were jointly and severally liable?

CONCLUSIONS: (1) Under § 2040(b) and § 20.2053-7, one-half the value of Property, (\$C) without reduction for the mortgage balance, is includible in the gross estate; (2) As stated in Rev. Rul. 79-302, one half of the mortgage balance (\$D) is deductible under §§ 2053(a)(3) or (a)(4); and (3) The marital deduction allowed with respect to Property is \$E which amount is equal to \$C (the amount includible in the gross estate with respect to Property) less \$D (one-half the outstanding balance due on the mortgage on the date of death).

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FACTS: Decedent died on Date 1, a resident of State. At the time of his death, Decedent and Spouse owned their residence (Property), located in State, as tenants by the entirety. The fair market value of Property on Date 1 was \$A. The outstanding mortgage on Property on this date was \$B. Decedent and Spouse were jointly and severally liable for the balance due on the mortgage.

Decedent's estate filed Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return on Date 2. On Schedule E of Form 706, Decedent's estate included one-half of the fair market value of Property in the amount of \$C. On Schedule K of Form 706, Decedent's estate deducted one-half of the outstanding mortgage on Property in the amount of \$D. On Schedule M of Form 706, Decedent's estate claimed a marital deduction with respect to Property of \$C, the amount included with respect to Property on Schedule E. Decedent's estate did not reduce the amount deducted on Schedule M by the portion of the outstanding mortgage deducted on Schedule K.

In the alternative, Decedent's estate argued that the entire amount of the mortgage is deductible on Schedule K under § 2053(a)(3), and that the amount allowable as a marital deduction is limited to one-half the value of Property reduced by one half the outstanding balance on the mortgage.

LAW AND ANALYSIS:

Section 2040(a) of the Code provides that, in general, the entire value of property in which the decedent had an interest as a joint tenant with rights of survivorship is includible in the decedent's gross estate, except for that portion of the value of the property that is attributable to the surviving joint owner's contributions toward the purchase of the property.

Section 2040(b)(1) provides that, notwithstanding § 2040(a), only one-half of the value of any qualified joint interest is included in a decedent's gross estate. A "qualified joint interest" is defined in § 2040(b)(2) as any interest in property held by the decedent and the decedent's spouse as tenants by the entirety or joint tenants with right of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants.

Section 2053(a)(3) provides that the value of the taxable estate is to be determined by deducting from the value of the gross estate such amounts for claims against the decedent's estate as are allowable by the laws of the jurisdiction under which the estate is being administered. Section 2053(a)(4) provides that the value of the taxable estate is to be determined by deducting from the value of the gross estate amounts for unpaid mortgages on property where the value of decedent's interest in the property, undiminished by the amount of the mortgage is included in the decedent's gross estate. The deduction for mortgages under § 2053 (a)(4) is also limited to such amounts as are allowable under the laws of the jurisdiction where the estate is being administered. Further § 2053(c)(1) provides that these deductions are limited to the extent that the obligations are contracted bona fide and for adequate and full consideration in money or money's worth.

Section 20.2053-7 of the Estate Tax Regulations provides that a deduction is allowed from a decedent's gross estate for the full unpaid amount of a mortgage upon any property provided the value of the property, undiminished by the amount of the mortgage, is included in

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the value of the gross estate. If the decedent's estate is liable for the amount of the mortgage, the full value of the property subject to the mortgage must be included as part of the value of the gross estate and the amount of the mortgage is allowed as a deduction. But if the decedent's estate is not so liable, only the value of the equity of redemption (or the value of the property, less the mortgage or indebtedness) need be returned as part of the value of the gross estate.

Section 2056(a) provides that, in general, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

Section 20.2056(b)-4(a) provides that the marital deduction may be taken only with respect to the net value of any deductible interest which passes from the decedent to his surviving spouse, the same principles being applicable as if the amount of a gift to the spouse were being determined. Section 20.2056(b)-4(b) provides that if a property interest passes from the decedent to the surviving spouse subject to a mortgage or other encumbrance, or if an obligation is imposed on the surviving spouse by the decedent in connection with the passing of a property interest, the value of the property interest is to be reduced by the amount of the mortgage, other encumbrance, or obligation.

Section 2056(b)(9) provides that nothing in § 2056 or any other provision of chapter 12 of the Internal Revenue Code (regarding the estate tax) shall allow the value of any interest in property to be deducted for estate tax purposes more than once with respect to the same decedent.

Rev. Rul. 79-302, 1979-2 C.B. 328, considers a situation where the decedent, A, and the decedent's spouse, B, owned a residence as joint tenants with rights of survivorship. A portion of the purchase price was obtained through a mortgage on which the spouses were jointly and severally liable. The revenue ruling discusses the co-tenants liability under the mortgage as follows:

Under the law of State X, A and B were jointly and severally liable on the mortgage debt and thus, each co-tenant was personally and primarily liable for the entire debt. Under State X law, if either co-tenant was required to satisfy more than one-half of the debt, the co-tenant paying more than one-half the debt would be entitled to contribution from the other co-tenant to the extent of the excess of the amount paid over one-half of the amount of the debt. Upon A's death, B succeeded to the sole ownership of the residence and under local law, A's estate and B became jointly and severally liable for the mortgage debt.

The revenue ruling concludes that, in view of State X law, the amount deductible from the decedent's gross estate, under either § 2053(a)(3), as a claim against the estate, or under § 2053(a)(4), as a mortgage on property included in the gross estate, is one-half the mortgage balance, the amount representing the extent to which A's estate is ultimately liable for payment

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of the mortgage.

Under applicable State statutory law, where property owned by a decedent that is subject to a lien passes to a distributee at his or her death, the encumbrance on the property is not chargeable at first instance against the assets of the estate. Rather, any encumbrance is first chargeable against the property subject to the encumbrance. State Statute. If there is a deficiency after any mortgage foreclosure sale, the decedent's estate would generally be liable for the deficiency. Cite 1. State courts have applied this statutory rule where property subject to the mortgage is held by the decedent and his spouse as tenants by the entirety, and the property passes to the surviving spouse on the decedent's death. Thus, several state courts have held that where property is held by the decedent and spouse as tenants by the entireties, on the decedent's death, the spouse succeeds to ownership of the property subject to any existing mortgage. Cite 2. See also, Cite 3 involving a predecessor statute. As is the case where the mortgaged property is owned by the decedent outright, the mortgaged property is the primary fund for payment of the debt and the decedent's estate is only secondarily liable. If the mortgage is in default and the foreclosure sale results in a deficiency, the estate would be liable for the deficiency, to the extent of the decedent's personal liability under the mortgage. Cite 2, supra.

Under State law, if two or more persons sign as indorsers as part of the same transaction, they are jointly and severally liable and the holder of the instrument may proceed against any and all indorsers. Cite 4. Where parties are jointly and severally liable, each co-owner is principal to the extent of his or her proportionate part of the debt and surety as to the rest of the debt. Cite 5. Upon the death of one of two or more joint obligors in contract, the estate becomes jointly and severally liable with the surviving obligors. Cite 6.

In the present case, under applicable State law outlined above, we believe the rights and obligations of Decedent, Spouse, and Decedent's estate with respect to the mortgage are essentially the same as described in Rev. Rul. 79-302. Therefore, we conclude as follows:

(1) Under § 2040(b) and § 20.2053-7, one-half the value of Property, (\$C) without reduction for the mortgage balance, is includible in the gross estate;

(2) As stated in Rev. Rul. 79-302, one half of the mortgage balance (\$C) is deductible under §§ 2053(a)(3) or (a)(4); and

(3) The marital deduction allowed with respect to Property is \$E which amount is equal to \$C (the amount includible in the gross estate with respect to Property) less \$D (one-half the outstanding balance due on the mortgage on the date of death). Under § 20.2056(b)-4(a) and (b), this amount reflects the net value of the portion of Property included in the gross estate that passes to Spouse. See also, § 2056(b)(9).

CAVEAT:

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