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Shapiro: Palimony and the Estate Tax

Wendy G. Gerzog
University of Baltimore School of Law, wgerzog@ubalt.edu

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By Wendy C. Gerzog

Wendy C. Gerzog is a professor at the University of Baltimore School of Law.

In *Estate of Shapiro*, the Ninth Circuit held that an individual had a valid palimony claim under Nevada state law. However, the issue was whether the decedent's estate qualified for a deduction for that claim under federal estate tax law.

For over two decades, Ms. Chenchark and Mr. Shapiro lived together. She took care of the household and he paid her living expenses, including a weekly allowance. When he cheated on her, the relationship ended with Chenchark suing Shapiro for palimony.[1] The following year, Shapiro died.

The executor of Shapiro's estate filed an estate tax return in May 2001. In September 2001 a jury found there was no express or implied contract between the parties. Chenchark appealed, and the estate settled that claim plus Chenchark's will-contest lawsuit for a total of approximately $1 million.[2] In 2003 the estate filed an amended return, valuing the palimony claim at $8 million at decedent's date of death. In 2006 the estate filed a claim in federal district court, valuing that claim at $5 million. On cross-motions for summary judgment, the district court granted the government summary judgment, finding there was insufficient consideration to support a contract claim that was deductible under section 2053.

On appeal the Ninth Circuit held that the lower court erroneously concluded as a matter of law that "love, support, and homemaking services" are insufficient consideration to support a state contract claim. Writing for the majority, Circuit Judge Barry G. Silverman elaborated on the contract law changes beginning with *Marvin v. Marvin*[3] that expanded the rights of cohabitants and what the circuit court viewed as the lower court's misreading of *Western States Construction Inc. v. Michoff*.[4] According to the appeals court, *Western States* did not conclude that love, support, and homemaking services "*cannot*, as a matter of law, constitute consideration for a promise to share property under Nevada law."[5] While acknowledging that Nevada courts had not addressed the issue, the circuit court proceeded to discuss California law on the subject, which is that "a promise to perform homemaking services is adequate to support such a contract," and Arizona law, which held that such a promise may constitute consideration.[6]

The Ninth Circuit stated that the lower court never addressed the adequacy of consideration and that its "point is simply that these services are not of *zero* value as a matter of law."[7] The court held that summary judgment was improper. Finding that the value of Chenchark's claim at the decedent's death is an issue of fact,[8] the court remanded the case on that issue.

The district court also had held that the estate was estopped from claiming that an employment contract existed between the decedent and Chenchark because the estate defended against her claim on the basis of the nonexistence of an employment contract. The circuit court, however, again held for the estate on the basis that the estate's positions were not inconsistent with its position in the instant case, which was to claim a deduction for the value of Chenchark's claim against the estate.[9]

Senior Circuit Judge A. Wallace Tashima dissented on one issue — the court's decision about the estate's deduction under section 2053. He disagreed with the majority about the value of Chenchark's

[1] *Estate of Shapiro v. United States*, No. 08-17491 at 2725 (9th Cir. Feb. 22, 2011), *Doc 2011-3741*, *2011 TNT 36-12* (all pinpoint citations are to page numbers in the PDF of the Ninth Circuit opinion in the *Tax Notes Today* database). Chenchark sued on "breach of express and implied contract, breach of fiduciary duty, and quantum meruit." *Id.*

[2] *Id.* at 2726.

[3] 557 P.2d 106 (Cal. 1976).

[4] 840 P.2d 1220 (Nev. 1992).

[5] No. 08-17491 at 2729 (emphasis added).

[6] *Id.* at 2729-2730 (emphasis added).

[7] *Id.* at 2730.

[8] *Id.* at 2731.

[9] On the grounds that the estate earlier abandoned its claim, the Ninth Circuit affirmed the district court's grant of summary judgment against the estate relating to the property value reductions based on the notices of *lis pendens* filed by Chenchark on a specific property. *Id.* at 2732.

claim for federal estate tax purposes.[10] Although the majority was concerned about a possible misreading of Nevada law on contracts between cohabitants, the case is not dependent on state contract law interpretation, but on federal tax law: whether ''the claim underlying [the estate's] deduction [is] supported by full consideration in money's worth.''[11]

As Judge Tashima explained, although ''a valid state law claim is a necessary condition for the deduction, [it is] not necessarily a sufficient one.''[12] That someone has an enforceable claim against the estate under state law is not enough to constitute a claim deductible under the federal tax statute. He cited the circuit's own precedent explaining that legal consideration for state law purposes ''is immaterial'' for federal estate tax law purposes.[13]

The purpose of the estate tax rule is to prevent the depletion of the decedent's estate by easily recharacterizing what should be bequests into allowable deductions.[14] As a co-executor expressed in his letter to Shapiro, despite there being no legitimate claim, ''it would be a nice gesture . . . to make some arrangement to put money in an account or trust [for Chenchark] to pay for support during her lifetime.''[15] Judge Tashima noted that code references to ''money or money's worth'' consideration routinely exclude ''love and affection.''[16] Essentially, ''the Estate has presented no evidence here that would create a genuine issue of material fact that Chenchark enhanced the value of the Estate in money's worth.''[17] Indeed, the estate acknowledged that she ''gave nothing of monetary value to the relationship.''[18]

Wemyss

Commissioner v. Wemyss[19] is a classic gift tax case in which the taxpayer wanted to marry a widow who was reluctant to marry him because she would lose income from her deceased husband's trusts upon her remarriage. So he transferred stock to her to offset that financial loss, and they married.[20] The issue was whether marriage or a financial detriment to the widow, which constituted adequate consideration to support a contract under state law, represented ''full and adequate consideration in money's worth'' for gift tax purposes. Justice Felix Frankfurter, writing for the Supreme Court, agreed with the Tax Court: ''And so, while recognizing that marriage was of course a valuable consideration to support a contract, the Tax Court did not deem marriage to satisfy the requirement of [the statute] in that it was not a consideration reducible to money value.''[21]

Likewise, agreeing with the Tax Court and emphasizing that ''common law considerations were not embodied in the gift tax,''[22] the Supreme Court stated that ''if Mrs. More's loss of her trust income rather than the marriage was consideration for the taxpayer's transfer of his stock to her, [the taxpayer] is not relieved from the tax because he did not receive any money's worth from Mrs. More's relinquishment of her trust income.''[23]

The Court approved the lower court's finding that the stock transfer was not ''at arm's length in the ordinary course of business.'' It noted that the inducement was marriage, took account of the discrepancy between what the widow got and what she gave up, and also of the benefit that her marriage settlement brought to her son.'' Examining the legislative intent of the gift tax, the Court held that the reason the gift tax applies to any transfer not for ''adequate and full (money) consideration'' is to tax transfers that would otherwise have been part of the donor's estate. ''To allow detriment to the donee to satisfy the requirement of 'adequate and full consideration' would violate the purpose of the statute and open wide the door for evasion of the gift tax.''[24]

Merrill v. Fahs

In this companion case to *Wemyss*, with an opinion also written by Justice Frankfurter, the taxpayer agreed to transfer a considerable sum of money after his marriage and to provide additional sums to his wife and their children in his will.[25] In consideration of those transfers, his fiancée agreed to release her marital property rights. ''The inducements for this agreement were stated to be the contemplated marriage, desire to make fair requital for the release of marital rights, freedom for the

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[10]Judge Tashima concurred in the *lis pendens* and administrative expense issues. Because of his dissent on the section 2053 issue, he found it unnecessary to decide the estate's judicial estoppel claim. *Id.* at 2733.

[11]*Id.* at 2734.

[12]*Id.*

[13]*Id.* at 2735, citing *Giannini v. Commissioner,* 148 F.2d 285, 287 (9th Cir. 1945).

[14]*Id.* at 2736.

[15]*Id.* at 2737, n.8.

[16]*Id.* at 2737-2738.

[17]*Id.* at 2739.

[18]*Id.*

[19]324 U.S. 303 (1945).

[20]*Id.* at 303-304.

[21]*Id.* at 305.

[22]*Id.* at 306.

[23]*Id.* at 305. ''If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct.'' *Id.* at 307.

[24]*Id.* at 307-308.

[25]324 U.S. 308 (1945).

taxpayer to make appropriate provisions for his children and other dependents, the uncertainty surrounding his financial future and marital tranquility.''[26] The agreement was enforceable under state law, and under state law, wives had inchoate marital property rights. The couple married and carried out the terms of the agreement.

The issue in *Merrill* was whether there was a taxable gift for a transfer for full and adequate consideration in money or money's worth.[27] To answer that question, the Court looked to *Estate of Sanford v. Commissioner*,[28] which explained the root of the phrase in the context of the estate tax deduction for claims against an estate:

> The gift tax was supplementary to the estate tax. The two are *in pari materia* and must be construed together. The phrase on the meaning of which decision must largely turn — that is, transfers for other than ''an adequate and full consideration in money or money's worth'' — came into the gift tax by way of estate tax provisions. It first appeared in the Revenue Act of 1926. Section 303(a)(1) of that Act allowed deductions from the value of the gross estate of claims against the estate to the extent that they were bona fide and incurred ''for an adequate and full consideration in money or money's worth.'' It is important to note that the language of previous Acts which made the test ''fair consideration'' was thus changed after courts had given ''fair consideration'' an expansive construction. The first modern estate tax law had included in the gross estate transfers in contemplation of, or intended to take effect in possession or enjoyment at, death, except ''a bona fide sale for a fair consideration in money or money's worth.'' Dower rights and other marital property rights were intended to be included in the gross estate since they were considered merely an expectation, and in 1918 Congress specifically included them. This provision was for the purpose of clarifying the existing law. In 1924 Congress limited deductible claims against an estate to those supported by ''a fair consideration in money or money's worth'' . . . Congress was thus led as we have indicated to substitute in the 1926 Revenue Act the words ''adequate and full consideration'' in order to narrow the scope of tax exemptions.[29]

To prevent tax avoidance, the Court affirmed the lower court's decision against the taxpayer.

Analysis and Conclusion

Although the Ninth Circuit sporadically mentioned the legal precepts that control whether an expense is deductible as a claim against the estate under section 2053, the court focused on what constitutes consideration under state law. Unfortunately, that is not the applicable law or precedent to decide *Shapiro.*

While spending a lot of time discussing consideration for state law contract purposes, the court, for federal transfer tax purposes, peculiarly differentiated state law contract consideration from consideration in money or money's worth. Although the claim must be allowable under local law, that was not central to the controversy and, indeed, was not the basis for the government's denial of the deduction here. Rather, the focus is on whether there is adequate consideration in money or money's worth to support the deduction under section 2053. The majority not only lost sight of the pertinent issue in the case but also never seemed to understand that it was the pivotal source of the controversy.

Judge Tashima's excellent dissent had it right in every respect. It properly analyzes the applicable estate tax principles and arrives at the correct conclusion. The lower court decision should have been affirmed.[30]

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[26]*Id.* at 309.
[27]*Id.* at 310.
[28]308 U.S. 39, 44 (1939).

[29]324 U.S. at 311-312 (citations omitted).
[30]What also troubles me is that this is not the only case in which the Ninth Circuit has confused the application of state law in a federal transfer tax case. Its reversal in *Linton v. United States*, 630 F.3d 1211 (9th Cir. 2011), *Doc 2011-1458, 2011 TNT 15-27*, is likewise problematic. *See* Wendy C. Gerzog, ''*Linton* Reversed: Indirect Gifts and the Step Transaction Doctrine,'' *Tax Notes*, Mar. 28, 2011, p. 1607, *Doc 2011-4779*, or *2011 TNT 62-8*.