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Rev. Rul. 78-409

ISSUE

Whether, under the circumstances described below, any portion of the value of a residence transferred by a decedent to his son and daughter-in-law is includible in decedent's gross estate under section 2036 of the Internal Revenue Code of 1954.

FACTS

The decedent was the owner of a residence in State X. In 1965, after the death of the decedent's spouse, the decedent's child A, and A's spouse, moved into the residence and lived with the decedent. In 1970, the decedent gratuitously conveyed the residence to A in fee simple. At the time of the transfer it was assumed by the decedent and A, although not expressly agreed, that the decedent would continue to live in the residence. After the conveyance A paid for the upkeep of the property. The decedent died in 1975 while still occupying the residence.

Under the law of State X, A was the absolute owner of the residence at the time of the decedent's death. The decedent had not retained any interest in the property that was recognized by state law.

LAW AND ANALYSIS

Section 2036(a)(1) provides that the gross estate shall include the value of property transferred by the decedent in which the decedent retained the possession, enjoyment or right to income from the property. Section 20.2036-1(a) of the regulations states that the gross estate of the decedent shall include the value of property to the extent of the interest retained or reserved by the deceased transferor. Thus, if the decedent retained an interest only with respect to a portion of the property, it is includible in the gross estate to that extent.

An interest retained pursuant to an understanding or arrangement comes within section 2036. *Skinner v. United States*, 316 F.2d 517 (3d Cir. 1963). The arrangement may be express, or it may be implied from the circumstances surrounding the transfer. *Estate of Linderme v. Commissioner*, 52 T.C. 305 (1969); *Estate of Kerdolff v. Commissioner*, 57 T.C. 643 (1972); Rev. Rul. 70-155, 1970-1 C.B. 189.

In the present case, the evidence supports a conclusion that the decedent retained a right pursuant to an implied understanding with A, to share possession and enjoyment of the residence for life. Consequently, whatever portion of the residence was subject to this retained interest is now includible in the decedent's gross estate.

In *Diehl v. United States*, Civil No. C-67-74 (W.D. Tenn., Oct. 18, 1967), the decedent transferred his home to his son and daughter-in-law. Prior to the transfer the decedent had an addition constructed onto the house, wherein he resided after the transfer. After the transfer, the decedent contributed toward the household expenses and utilities, while the son paid the taxes on the residence. The court concluded under these facts that there was no "understanding" between

transferor and transferee that the decedent would live at the residence although it was "assumed" by both transferor and transferee that the transferor would continue to reside there after the transfer.

The Internal Revenue Service will not follow *Diehl v. United States* because the court erred in concluding that there was no implied agreement or "understanding" that the decedent would continue to reside there. The fact that a special addition was constructed onto the house and the fact that the court found that it was assumed that the decedent would reside in the home, clearly shows that after the transfer, the decedent retained an interest in the home.

Under the principal facts, the extent of the decedent's interest will not be considered limited for purposes of section 2036 solely because the residence was shared with A and A's spouse until the decedent's death. For example, where a decedent gratuitously transferred realty and retained a portion of the income from the land, <Page 235> and the decedent's share equaled the fair rental value of the entire tract, the entire value of the realty has been held includible in the decedent's gross estate. *Estate of Nicol v. Commissioner*, 56 T.C. 179 (1971). Similarly, where a decedent gratuitously transferred land to his spouse, which they subsequently jointly occupied until the decedent's death, pursuant to an agreement that the decedent's continued control and enjoyment of all the property and income would remain unlimited, the entire value of the property was included in the decedent's gross estate. *Estate of Hendry v. Commissioner*, 62 T.C. 861 (1974).

HOLDING

Here, it was assumed by both the decedent and A that the decedent would reside at the home after the transfer. No evidence exists that the decedent's enjoyment of the residence was restricted in any manner. Under these circumstances, where the decedent's possession and enjoyment of the residence continue without limitation, the retained rights extend to all the property.

Accordingly, the entire value of the residence is includible in the decedent's gross estate under section 2036(a)(1).