

Estate tax application ruled unconstitutional

Decedent's shares in Paris apartment not taxable in Mass.

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BIERWIRTH
'Tremendously widespread' issue

The Department of Revenue unconstitutionally applied the Massachusetts estate tax to a state resident's ownership interest in a Paris apartment, a Probate & Family Court judge has determined.

The apartment was technically owned by a "societe civile immobiliere," or SCI — a creature of French law in which the owner transfers property to a newly created corporation in exchange for shares. The decedent had created the SCI to facilitate a more orderly disposition of the apartment upon her death.

The Department of Revenue refused to grant an abatement to the estate after it included the apartment's value in the gross estate for purposes of calculating the estate tax. That increased the estate's state tax liability by more than \$175,000.

The estate's personal representative argued that the DOR's action constituted a due-process violation under the 14th Amendment, citing a long line of authority holding that states have no power to tax the transfer of out-of-state real property following a resident's death.

Judge Maureen H. Monks agreed, rejecting the DOR's argument that the decedent's interest in the apartment was taxable as intangible personal property.

"Under Massachusetts law, the apartment within the SCI is real estate," Monks wrote, awarding summary judgment to the plaintiff. "While the SCI that holds the apartment is not recognized in Massachusetts, it is similar to a nominee trust, which is recognized. Nominee trusts are used to hold legal title to real estate. ... Thus under Massachusetts and French law the apartment is real estate."

The seven-page decision is *Dassori v. Commissioner of Revenue*, Lawyers Weekly No. 15-002-16. The full text of the ruling can be ordered at masslawyersweekly.com.

'Frequent occurrence'

Joseph L. Bierwirth Jr., litigation counsel for the estate's administrator, said he thought it was the first time a Massachusetts court had taken up the constitutionality of the inclusion of real estate located outside Massachusetts within the Massachusetts estate tax system.

"This court held that it was unconstitutional," Bierwirth said. "There wasn't much analysis in the actual decision, but the underlying premise — and what we argued — is that the only grounds for excluding non-Massachusetts real estate is this constitutional basis."

Bierwirth said the case is particularly important because it deals with a "tremendously widespread" situation.

"Whenever a Massachusetts resident owns a vacation home or other real estate outside the commonwealth, whether it's in Florida, New Hampshire or overseas, that real estate is currently included in the taxable base according to DOR forms, and they regularly collect Massachusetts estate tax on account of that real estate," the Boston lawyer said. "This isn't constitutional, and when faced with a challenge on a constitutional basis, the DOR didn't really argue against it. Instead, they focused on the issue of whether this was real estate or shares in a corporation that would be considered intangible personal property. That's how they made their pitch to the judge."

Boston lawyer Andree Saulnier, who handled tax and administration matters as general counsel for the estate but did not represent it in the litigation before Monks, said the issue had been confounding estate planning attorneys since the repeal of the federal "Credit for State Death Taxes" in the early 2000s.

Up to that point, the federal government had allowed a credit for any state taxes an estate had paid, as long as that state had a law expressing that it was basing its tax on the amount the federal government

permitted as a credit.

Once the federal credit was eliminated, Massachusetts and a number of other states passed legislation requiring estate taxes to be paid in the amount that would have been due had the federal credit still existed.

As a result, the base of property upon which the amount payable to the DOR is calculated includes property situated both within and outside Massachusetts. If the out-of-state property is located somewhere like Maine, which has a scheme similar to Massachusetts, there is a mechanism to pro-rate shares of the gross estate attributable to real property located in the two respective states. But no pro-rating mechanism exists when the out-of-state property is located overseas or in a state like New Hampshire or Florida that has no state-level estate tax.

"So if I have a house in Florida or New Hampshire and I die, does [the Massachusetts statutory scheme] effectively operate to tax my non-Massachusetts real estate?" Saulnier asked. "This was the question we've all had as estate tax practitioners: Is this constitutional, and what do we do?"

While the ruling does not change the statutory scheme, it does provide attorneys more direction in counseling clients, she added.

"I'd advise anyone that the most conservative option would be to disclose the existence of the out-of-state listing [on the Massachusetts form], but perhaps list it at zero value, specifically explaining your position [that it's not subject to the Massachusetts estate tax] and citing the relevant legal authorities," Saulnier said. "The open question going forward, that only the DOR is in a position to comment on, is whether Massachusetts will seek to revise its estate tax statute and forms to comport with this decision."

Andrew D. Rothstein of Boston, who practices trusts and estates law, said he has faced situations in which the DOR took a similar position on real property located outside Massachusetts, but there was not enough at stake to actually litigate the issue. It is useful to finally have a

ruling on point, he said.

Rothstein also noted that the Massachusetts estate tax statute for non-resident decedents does not produce the same unconstitutional outcome that the statute for Massachusetts residents creates because it applies only to the decedent's real and tangible personal property located in the commonwealth.

"In this regard, the ruling focuses attention on the need to update the Massachusetts estate tax statute to eliminate the constitutional concern," Rothstein said, adding that other states, such as New York, have similar estate tax statutes but have written those laws in a way that does not create constitutional issues.

Garrett M. Quinn Jr., communications director at the Executive Office for Administration and Finance, said the DOR would not comment on whether it plans to update its forms or push for statutory changes in the wake of the ruling.

Paris apartment

The decedent, Anita Curtis, a Massachusetts resident, had owned an apartment in Paris since 1960.

In 2010, on the advice of an attorney, Curtis transferred ownership of the apartment into an SCI in exchange for 15,000 shares in the corporation. Curtis also appointed her son, John McClellan, as general manager of the corporation. He paid 100 Euros to the SCI in exchange for a single share.

Curtis arranged the transaction so that her son could control the apartment's disposition after her death. Otherwise, under French inheritance law, the apartment would transfer equally to McClellan and his sister, and any sale of the property would need the consent of both siblings.

Curtis died in October 2012. The SCI sold the apartment to a third party for \$2.2 million. Curtis' heirs paid more than \$400,000 in taxes under French inheritance law, which treated the apartment as real estate.

Dassori v. Commissioner of Revenue

THE ISSUE	Was it constitutional for the Department of Revenue to apply the Massachusetts estate tax to a state resident's ownership interest in a Paris apartment owned by a French corporation that she had created for probate purposes?
DECISION	No (Probate & Family Court)
LAWYERS	Joseph L. Bierwirth Jr. of Hemenway & Barnes, Boston (plaintiff) John J. Connors Jr. of the Department of Revenue, Boston (defense)

In September 2013, the estate filed a Massachusetts estate tax return, listing the apartment as real estate with a gross value of \$2.2 million. Curtis' gross estate was valued at \$3.4 million, which resulted in the estate paying \$204,000 in taxes.

The following year, the estate asked the DOR for \$176,000 as an abatement, reflecting the portion of the estate tax attributable to the apartment. The estate also filed an amended return, listing the apartment as real estate, but stating its value at \$0 with an explanation that non-Massachusetts real estate, taxable under French law, should not be subject to the Massachusetts estate tax.

The DOR denied the request. The estate's administrator then filed an equity complaint in Probate Court asking the court to compel the DOR to refund the \$176,000 and moved for summary judgment.

Real property

The plaintiff argued in a memo supporting its motion that states lack constitutional authority under the 14th Amendment due process clause to impose estate taxes on out-of-state real property.

As support, the plaintiff pointed to a line of U.S. Supreme Court cases beginning with the 1925 *Frick v. Pennsylvania* decision, as well as Supreme Judicial Court decisions in the 1970s and 1980s, acknowledging that authority.

"Despite those acknowledgements by

the SJC, subsequent amendments to the Massachusetts estate tax regime have resulted in precisely the sort of extraterritorial reach that the Constitution forbids," the plaintiff stated.

Monks implicitly accepted those arguments and focused on the DOR's contention that the decedent's asset was not, in fact, real estate at all, but taxable, intangible personal property in the form of shares in the corporation that owned the real estate.

Monks rejected the DOR's argument, finding instead that the SCI is similar to a nominee trust, an entity recognized in Massachusetts that is used to hold legal title to real estate.

"One of the hallmarks of a nominee trust is that the trustees do not possess any power, but must act at the direction of the beneficiaries," the judge observed, likening the decedent's son to a trust beneficiary and noting that he could manage the apartment only at her direction while she was still alive.

Meanwhile, the apartment constituted real estate under French law, resulting in the decedent's heirs paying more than \$400,000 in French inheritance taxes.

"Thus, under Massachusetts and French law the apartment is real estate," Monks concluded, ordering the DOR to refund \$176,000 in estate taxes plus interest. **MLW**



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