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The Effect of Estate Taxes upon the Right of Election

COMMENTS

THE EFFECT OF ESTATE TAXES UPON THE RIGHT OF ELECTION

The impact of estate taxes upon the surviving spouse's right to elect against a will was at issue in two cases affirmed by the New York Court of Appeals.[1] Since the basic issue in both cases was the same, a discussion of one will serve to illustrate the problem. In *Matter of Edwards*[2] the will contained a bequest to the widow of the income for life from a trust of one-third of the net estate after the deduction of debts, funeral and administrative expenses, and any estate or other taxes. The widow's share in intestacy would have been a one-third share subject to debts and funeral and administrative expenses, but not subject to estate taxes either federal or state.[3] The widow claimed that, since by the provisions of the will and the applicable tax laws the corpus of the trust would be reduced by estate taxes, whereas her share if she took by intestacy would not, the will failed to comply with the requirements of section eighteen of the Decedent Estate Law. She, therefore, claimed a limited right of election to take the amount of the estate taxes which would be assessed against the trust corpus.[4]

Paradoxically, the term "intestate share" has no relation to cases where decedent dies intestate. "Intestate share," as referred to in section eighteen of the New York Decedent Estate Law, is a term of art, meaning that amount which the widow would receive under an election against the will. Generally speaking, it is equivalent to the share she would have received in intestacy under section eighty-three of the Decedent Estate Law with the major exception that in no event can the intestate share exceed one half of the net estate. Within this limitation, however, the will must provide an amount equal to that which would have been received in intestacy. Thus "intestate share" and "share in intestacy" are generally equivalent terms.[5] The widow

1. Matter of Edwards, 2 Misc. 2d 564, 152 N.Y.S.2d 7 (Surr. Ct.), aff'd without opinion, 2 A.D.2d 838, 156 N.Y.S.2d 135 (1st Dep't 1956), aff'd without opinion, 3 N.Y.2d 739, 143 N.E.2d 520 (1957); Matter of Ruppert, 1 Misc. 2d 1072, 148 N.Y.S.2d 541 (Surr. Ct. 1955), aff'd without opinion, 2 A.D.2d 958, 157 N.Y.S.2d 902 (1st Dep't 1956), aff'd without opinion, 3 N.Y.2d 731, 143 N.E.2d 517 (1957).

2. Supra note 1.

3. See note 10 infra.

4. N.Y. Deced. Est. Law § 18(1)(b). Actually, the widow in Matter of Edwards had the limited right to elect to take $2,500 outright from the trust corpus but this had no bearing upon the right of election she was claiming in respect to the taxes. In Matter of Ruppert, 1 Misc. 2d 1072, 148 N.Y.S.2d 541 (Surr. Ct. 1955), aff'd without opinion, 2 A.D.2d 958, 157 N.Y.S.2d 902 (1st Dep't 1956), aff'd without opinion, 3 N.Y.2d 731, 143 N.E.2d 517 (1957), the section involved was N.Y. Deced. Est. Law § 18(1)(d) but, again, this had no bearing upon the right of election claimed in respect to the taxes.

5. N.Y. Deced. Est. Law § 18(1)(a). The section, as amended by L. 1955, c. 487, now reads: "In exercising the right of election herein granted . . . the words 'intestate share' . . . shall be construed to mean the surviving spouse's share of the estate as in intestacy

in the *Edwards* case argued that she should actually receive in trust the same amount that she would have taken outright had testator died intestate. Since that was not the case, the will failed to provide her with a trust equal to, or greater than, her intestate share and, therefore, she had a right to elect.

The surrogate, however, held that for the purposes of determining whether a right of election exists under section eighteen, it is enough to compare the amount provided in the will *before* taxes with the intestate share, which is to be computed before taxes, if any. In this case the will provided a one-third share and the intestate share was also one-third. Thus there was no right

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or one-half of such net estate, whichever is smaller. In computing such net estate all estate taxes shall be disregarded, but nothing herein contained shall be construed as relieving such surviving spouse from contributing to all such taxes the amounts apportioned against him or her pursuant to . . . section one hundred twenty-four . . . ." The court in Matter of Ruppert, supra note 4, cited the amendment as "further evidence of the legislative plan to harmonize sections 18 and 124 so that each is operative in its own sphere and the tax allocation does not begin until the share of each beneficiary is computed." 1 Misc. 2d at 1073, 148 N.Y.S.2d at 543. The difficulty with this proposition is that, in cases where the taxation of the share under the will and the share in intestacy is unequal, the result seems to conflict with earlier expressions of legislative intent in regard to § 18. See pp. 241-42 infra. In any event, § 18(1)(a) seems to have no bearing upon the problem for it merely states that the intestate share is to be computed before taxes. Certainly it is not a legislative mandate that the share under the will is also to be computed before taxes.

The amendment seems to have been designed to settle the apparent conflict between Matter of Ryan, 280 App. Div. 410, 114 N.Y.S.2d 21 (1st Dep't 1952), in which it was held that the intestate share was to be computed after the deduction of estate taxes both state and federal, and Matter of Peters, 204 Misc. 333, 88 N.Y.S.2d 142 (Surr. Ct.), aff'd mem., 275 App. Div. 950, 89 N.Y.S.2d 651 (2d Dep't 1949), which held that the intestate share, as such, was to be computed before the deduction of any estate taxes. Cf. Matter of Spencer, 145 N.Y.S.2d 397 (Surr. Ct. 1955); Matter of Vitale, 118 N.Y.S.2d 773 (Surr. Ct. 1952). The court of appeals in Matter of Wolf, 307 N.Y. 280, 287, 121 N.E.2d 224, 227 (1954), distinguished Matter of Ryan, supra, from Matter of Peters, supra, stating, in effect, that they represented two distinct rules for computing the intestate share based upon two distinct fact situations. Where taxes are not to be apportioned, as in Matter of Ryan, supra, where § 124 was not applicable because testator had shifted the entire tax burden to the residuary clause to the widow, the intestate share is to be computed after the deduction of estate taxes. Where, however, taxes are to be apportioned, as in Matter of Peters, supra, where testator failed to make any provision thus bringing § 124 into operation, the intestate share is to be computed before the deduction of taxes. The amendment, therefore, seems to have been aimed at removing this "dual" method of computing the intestate share by stating that it is to be computed before taxes. Here the legislature adopted that method of computation most beneficial to the surviving spouse as did the court of appeals in Matter of Wolf, supra.

The proviso in the statute that nothing contained in it should be construed as relieving the spouse from taxes under § 124 seems to be a codification of the holding in Matter of Peters, supra, that, while the widow could take free of federal taxes by reason of the marital deduction, she would still be liable for whatever state taxes were applicable under § 124. Here the court was determining what deductions should be made from the intestate share as already computed. 204 Misc. at 338-39, 88 N.Y.S.2d at 147.

of election to take more than was given by the will. Yet by reason of the applicable estate taxes the share under the will would, in fact, be less than the share in intestacy. The *Edwards* court, in the face of this argument, held that taxes are not to be considered in relation to section eighteen and, therefore, no right of election based upon a tax theory could exist. In reaching this conclusion the court relied in part upon *Matter of Wolf*[6] where the court of appeals held that, where the testator failed to provide for apportionment, the intestate share was to be computed before apportionment of taxes under section 124 of the Decedent Estate Law. The right of election in this case was conceded so that the only question before the court was the amount the widow should be allowed to take by election. No provision by will had been made in the *Wolf* case. Thus the court was not called upon to measure the provisions of a will, and compare it with the intestate share to determine whether a right of election existed. *Wolf*, therefore, is not authority for the manner in which a share under a will is to be computed for purposes of comparison with the intestate share. The surrogate in *Edwards*, therefore, having no authority directly in point, assumed that the share under the will was to be measured in the same way as the intestate share. It is important to note that the court of appeals in the *Wolf* case expressly stated that it had adopted that method of computing the intestate share which would be the most beneficial to the widow.[7] This has been the general rule of construction of section eighteen.[8] It seems odd, therefore, that it should be used to justify a method of computation which is detrimental to the widow. Nevertheless, this was done in the *Edwards* case. It is submitted that the result in *Edwards* is open to question.

The Marital Deduction

Under section 2056 of the Internal Revenue Code of 1954 and section 249-s of the New York Tax Law, the corpus of a trust for the benefit of the surviving spouse for life, wherein the spouse has the sole and exclusive power of appointment of the corpus, would be deducted from the value of the gross estate before the assessment of estate taxes.[9] This is the so-called marital deduction. The trust corpus, therefore, would not bear any of the burden of such taxes. In *Edwards*, however, no such power of appointment was given the widow and thus the marital deduction was not applicable to the trust in

6. 307 N.Y. 280, 121 N.E.2d 224 (1954).

7. Id. at 289, 121 N.E.2d at 228.

8. See e.g., Matter of Byrnes, 260 N.Y. 465, 472, 184 N.E. 56, 58 (1933).

9. The marital deduction was first introduced into estate taxation by the Int. Rev. Act of 1948, c. 168, § 361, 62 Stat. 117. It was intended to equalize the tax on estates in common law and community property states. Int. Rev. Code of 1954, § 2056, gives the gross estate a deduction not to exceed fifty percent of the "adjusted gross estate" for the value of any interest in property which passes or has passed from the decedent to his surviving spouse. There is no deduction, however, for interests which will terminate on the death of the surviving spouse unless such spouse has a power of appointment which is sufficiently broad to be a taxable power for estate tax and gift tax purposes. See Lowndes and Kramer, Federal Estate and Gift Taxes, cc. 16-18 (1956).

that case and the corpus would bear a portion of the estate taxes. Had the widow been taking by intestacy, however, the marital deduction would have applied to her share in intestacy and it would not have been burdened by estate taxes.[10]

Federal estate taxes are levied upon the gross estate and the marital deduction accrues to the gross estate not to the surviving spouse personally.[11] The individual states, therefore, are free to determine both the manner in which such taxes are to be apportioned[12] and also who is to receive the benefit of the marital deduction.[13] New York, in section 124 of the Decedent Estate Law, has provided that, except where the testator otherwise directs, the tax shall be equitably apportioned among the persons interested in the gross tax estate.[14] The statute also provides that, in the absence of directions to the contrary, the benefit of any deductions created by the tax law by reason of the relationship of any person to the deceased shall accrue to the benefit of the person bearing such relationship.[15] Since section 124 applies only where no other provision has been made,[16] the testator is given the power by section 124 to declare both the manner in which the tax is to be apportioned and also the person who is to receive the benefit of any applicable deductions which, as pointed out, accrue to the benefit of the gross estate under federal law. Thus, a testator may shift the entire burden of estate taxes to the widow's share under the will and may deprive that share of deductions to which it would otherwise have been entitled.[17]

Section 124 and Its Effect Upon the Right to Elect

Two situations arise as a result of section 124. First, the testator may, as was done in the *Edwards* case, provide that the trust to the widow is to bear its equitable share of the estate taxes. Thus, the testator simply provides expressly for the same manner of apportionment which section 124 would have brought into play had the testator failed to make any provision.[18] Second,

10. Int. Rev. Code of 1954, § 2056(a); N.Y. Tax Law § 249-s(4). It may be argued that all that was held in Matter of Edwards was that the testator is not obligated to draw his will so as to give his spouse the benefit of the marital deduction. It cannot be doubted that this is so. The testator, however, is obliged to draw his will in such a way that he leaves his spouse the enjoyment for life of a principal equal to her intestate share if he wishes to bar her from electing against his will. See notes 22, 24-28 infra and accompanying text. The fact that testator has no obligation in respect to the marital deduction should not be made the basis for relieving him of the obligation which he does have in respect to what he must provide in his will to satisfy § 18.

11. See note 9 supra.

12. Riggs v. Del Drago, 317 U.S. 95 (1942).

13. See e.g., Foerster v. Foerster, 122 N.E.2d 314 (Ohio Prob. Ct. 1954).

14. N.Y. Deced. Est. Law § 124(1).

15. Id. § 124(3).

16. Matter of Mills, 189 Misc. 136, 141, 64 N.Y.S.2d 105, 109 (Surr. Ct. 1946), aff'd, 272 App. Div. 229, 70 N.Y.S.2d 746 (1st Dep't 1947), aff'd, 297 N.Y. 1012, 80 N.E.2d 535 (1948); Matter of Durkee, 183 Misc. 382, 47 N.Y.S.2d 721 (Surr. Ct. 1944).

17. Matter of Pepper, 307 N.Y. 242, 120 N.E.2d 807 (1954).

18. Whether a valid distinction may be drawn between a case where the testator ex-

the testator may expressly provide for apportionment of taxes in a manner other than the equitable apportionment method of section 124. Both situations must be considered in relation to section eighteen.

In regard to the first situation the affirmance of the *Edwards* case by the court of appeals has apparently settled the law. No right of election will be created by the mere fact that a testator declares that a trust corpus for the benefit of his spouse shall bear its equitable portion of the estate taxes even though he thereby reduces the corpus below the share which such spouse would have taken in intestacy. It follows a fortiori that if an express declaration by the testator that taxes are to be apportioned equitably is not sufficient to create a right of election, mere silence, which permits section 124 to operate to the same effect, will not create such a right.[19] It may be urged in support of the *Edwards* rule that the legislature, in enacting section eighteen, intended only to protect the spouse from being deprived of that share in the estate which section eighty-three would give her if decedent died intestate, and not to protect her from the operation of tax laws not then in existence. Thus, if a later tax law should give the spouse a "windfall" by freeing her share in intestacy from estate taxes, it was not the intention of the legislature in section eighteen to protect her from being deprived of this "windfall" by a will.[20] The fatal defect of this position is that the legislature at the time it passed section eighteen made its intention quite clear: equality of amount actually received whether in trust by the will or outright in intestacy.[21] It is far more probable that the legislature assumed that both the share in the will and the share in intestacy would be equally burdened by estate taxes and, therefore, the desired equality of amount would be maintained automatically without the need to consider taxes when applying section eighteen. As the *Edwards* case demonstrates, equality of taxation is not always the situation.

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pressly declares that taxes be equitably apportioned and one in which an equitable apportionment is brought about by the operation of § 124 where the testator has made no provision is considered in note 19 infra.

19. In Matter of Noble, 2 A.D.2d 897, 157 N.Y.S.2d 201 (2d Dep't), modifying, 3 Misc. 2d 565, 155 N.Y.S.2d 152 (Surr. Ct. 1956), the appellate division, second department, granted the widow a limited right of election to take the estate taxes. In that case, as in the Edwards case, the testator had expressly stated that taxes were to be equitably apportioned. The basis of this decision was that the taxes were apportioned by act of the testator not by mere operation of law under § 124. This does not appear to be a sound distinction. Section 124 applies in the absence of express provisions to the contrary. A direction for a method of apportionment which is the same as the statutory method is, therefore, mere surplusage and should not be determinative of the widow's right to elect. It is submitted that it would have been sounder for the court to have held that, since the testator may control the tax burden, he has made a choice even where he does no more than permit the provisions of § 124 to take effect as a result of his silence.

In view of the conflict between Matter of Edwards and Matter of Noble, supra, it is indeed unfortunate that the court of appeals did not write an opinion when affirming Matter of Edwards.

20. The marital deduction was not made a part of estate tax law until 1948 almost twenty years after the passage of §§ 18 and 124. See note 9 supra.

21. See notes 25-29 infra.

A more compelling argument in support of *Edwards* is that to permit the widow to elect in such a case would be to require testators to anticipate the effect of present and future tax laws at the risk of creating a right of election where the intention was to bar such a right. This argument clearly demonstrates the need for a legislative clarification of sections 18 and 124 particularly with respect to the manner in which the share under the will is to be evaluated. Section eighteen states that the intestate share against which the bequest in the will is to be measured is to be computed before taxes. At the same time it requires that a testator who wishes to bar any right of election must provide his spouse with an absolute legacy or devise of at least $2,500 and a "trust for . . . her benefit for life of a principal equal to or more than the excess between said legacy or devise and . . . her intestate share."[22] If the net estate before taxes is $90,000 and section eighty-three gives the widow a one third share, then her intestate share is $30,000. If the will provides a legacy of $2,500 and a trust principal of $27,500 but, in fact, that principal is reduced by estate taxes to, for example, $26,500, does the will provide the widow with a trust for her *benefit for life* of a principal equal to the difference between her legacy and her intestate share? Clearly it does not.[23] Even if it be argued that she may not have actually received $30,000 in intestacy it would not seem that the will in such a case satisfies section eighteen. Certainly it does not satisfy section eighteen where a greater amount could be taken outright in intestacy than the will provides in trust. Equality of amount actually received either in trust or outright was clearly the legislative intent behind section eighteen.[24] To support this interpretation one need only look to the history of the statute. Section eighteen was intended to insure the surviving spouse of at least a certain minimum participation in the decedent's estate.[25] It is the well established rule that the statute is to be liberally construed in favor of that interpretation which is most beneficial to the surviving

22. N.Y. Deced. Est. Law § 18(1)(d).

23. See Matter of Byrnes, 260 N.Y. 465, 470, 184 N.E. 56, 57 (1933) where the court of appeals said, "In making these provisions [§ 18] it was the evident purpose of the Legislature that a surviving spouse should retain the right to claim his or her full intestate share, in spite of any will, unless the instrument should provide substantial equivalents."

24. See e.g., Matter of Ittelson, 197 Misc. 786, 94 N.Y.S.2d 786 (Surr. Ct. 1950); Matter of Goldsmith, 177 Misc. 298, 30 N.Y.S.2d 474 (Surr. Ct. 1941); Matter of Clark, 169 Misc. 202, 7 N.Y.S.2d 176 (Surr. Ct. 1938). In Matter of Ittelson, supra at 787, 94 N.Y.S.2d at 789, the court said: "Section 18 . . . grants to a surviving spouse . . . a personal right to elect to take his or her share of the estate . . . 'as in intestacy'. The primary measure . . . is the share in intestacy provided in section 83 . . . . It is against this measure that, in the first instance, the adequacy of any testamentary provision must be considered and the extent of any elective share must be determined."

25. Matter of Byrnes, 141 Misc. 346, 347, 252 N.Y. Supp. 587, 588 (Surr. Ct. 1931), aff'd, 253 App. Div. 782, 257 N.Y. Supp. 884 (1st Dep't 1932), aff'd, 260 N.Y. 465, 184 N.E. 56 (1933); Matter of Jackson, 176 Misc. 1020, 29 N.Y.S.2d 569 (Surr. Ct. 1941); Matter of Clark, 169 Misc. 202, 7 N.Y.S.2d 176 (Surr. Ct. 1938); N.Y. Legis. Doc. (1929) No. 62, pp. 20-21.

spouse.[26] The section was intended to safeguard the widow from having her share "whittled down by the ingenuity of the draftsman of a will."[27] To effectuate this purpose the legislature attempted "to assure a surviving spouse of the beneficial enjoyment of that portion of the estate of a decedent which he or she would have *received* in intestacy."[28] On the other hand, if a different standard is to be employed in measuring the share under the will than is employed to measure the intestate share, how may this intended equality of amount be maintained? It would seem that a more practical approach to section eighteen is required. The comparison between intestate share and share under the will should be made upon the basis of net amounts which would actually be received free and clear. This would require amendment of section eighteen and would undoubtedly create problems for the draftsmen of wills but it certainly would be more consistent with the legislative intent than is the *Edwards* rule or the present application of section 124. Is it not ingenuity to allow section 124 to "whittle down" the spouse's share in the will so that she does not receive the beneficial enjoyment of that portion of the estate which she would have received in intestacy?[29]

In regard to the second situation under section 124, where the testator expressly provides for an apportionment of taxes other than by the equitable apportionment method of section 124, the law is still unsettled as to the question of a right of election. In *Matter of Pepper*[30] the testator shifted the burden of estate taxes from the shares of his sisters to that of his widow. The result, however, was that the widow still actually received in trust an amount at least equal to the share she would actually have received in intestacy. The court said:

> [A]s long as he [the testator] makes such provision for his spouse as the law requires . . . the testator is privileged to cause a shift of the tax burden of his estate from

26. See note 8 supra.

27. Matter of Byrnes, 141 Misc. 346, 350, 252 N.Y. Supp. 587, 591 (Surr. Ct. 1931), aff'd mem., 235 App. Div. 782, 257 N.Y. Supp. 884 (1st Dep't 1932), aff'd, 260 N.Y. 465, 184 N.E. 56 (1933). That a similar motive was behind the enactment of § 124 can be seen by the remarks of the Decedent Estate Commission which drafted the statute: "The principal objection to an estate tax has been that where the decedent dies having a will, and makes no provision therein to the contrary, the entire burden of the tax must be borne by the residuary legatee or legatees. Experience has demonstrated that in most estates the residuary legatees are the widow, children, or nearer and more dependent relatives." Combined Reports of the Decedent Estate Commission 138 (1930).

28. N.Y. Legis. Doc. (1929) No. 62, pp. 20-21. (Emphasis added.)

29. See note 19 supra. From a practical point of view it may be assumed that the draftsmen of wills would consider it "ingenious" to allow § 124 to reduce the spouse's share below the intestate share. There is some indication that the testator in Matter of Edwards may have intentionally drawn his will in such a way as to achieve the result which occurred. There had been litigation involving some bitterness between testator and the widow. See Brief for Respondent Columbia University, p. 4, Matter of Edwards, 3 N.Y.2d 739, 143 N.E.2d 520 (1957).

30. 307 N.Y. 242, 120 N.E.2d 807 (1954).

the sisters to the widow, thus imposing a burden upon the widow which the law would not have imposed . . . .[31]

The problem which will eventually arise lies in the extension of cases such as the *Pepper* case to extreme situations.[32] Where a testator so shifts the tax burden as to reduce drastically the trust corpus below the intestate share the question of a right of election will become of paramount importance. In such a case it seems unlikely that the courts will refuse any right of election. The problem will be how to justify granting such a right and to what extent should it be granted. Section eighteen makes it clear that the legislature did not intend that the right of election should depend upon judicial discretion and questions of degree. The section was obviously intended to specify the situations in which the right of election would exist and to exclude all other situations. Certainly it would seem that the courts would not apply the *Edwards* rule to such a case. Yet, purely from a logical point of view, there is no reason why they should not.[33] The basic difference between the *Edwards* case and the hypothetical situation now being discussed is, in the final analysis, merely one of degree.[34] If it may be assumed, however, that the *Edwards* rule will not be applied and a right of election will be granted, upon what grounds may the giving of such a right be justified? Certainly no resort could be had to the legislative intent of equality of amount in section eighteen without thereby detracting from the validity of the *Edwards* holding. It is probable that the courts in such cases will fall back upon the *Pepper* case and the limitation implied therein that the testator must make such provisions for his spouse as the "law requires." On this reasoning the courts could grant a limited right to elect to take that amount of the taxes up to the amount which the share would have to bear under an equitable apportionment. *Edwards* is the law

31. Id. at 249, 120 N.E.2d at 810.

32. It is interesting to note in this connection that the surrogate in Matter of Edwards, citing Matter of Pepper, indicated that it would permit such extensions. Matter of Edwards, 2 Misc. 2d at 569, 152 N.Y.S.2d at 11.

33. It may be argued that there is a vast distinction between a case where the apportionment of taxes is by operation of law and one in which the testator himself expressly provides for an apportionment by other than the statutory method. Thus, it may be urged, the rule of Matter of Edwards could be limited to the former situation without logically conflicting with a possible right of election in the latter situation. As a practical matter it would seem to be just as much an exercise of power by the testator to permit a statute to operate as it would be to prevent it from operating. This appears, therefore, to be a distinction without meaning. See also note 19 supra.

34. The court in Matter of Clark, 169 Misc. 202, 206-207, 7 N.Y.S.2d 176, 180 (Surr. Ct. 1938), made the same point when it said: "It is obviously immaterial in evaluating the authority of a testator in this regard [apportionment of taxes] as to whether the invasion of the devolutionary rights of the surviving spouse is great or small. Any invasion, if it be such, is not permissible. If, however, any invasion, no matter how small, may pass unchallenged, the entire beneficent purpose of the enactment [§ 18] is undermined since if the principle be once established, its application would be possible of extension to a point which would destroy the utility of the statute as a safeguard against disinheritance of a surviving spouse."