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## RECENT DEVELOPMENTS IN MARITAL DEDUCTIONS\*

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### I. INTRODUCTION

The estate tax marital deduction, introduced in the Revenue Act of 1948,<sup>1</sup> is of practical value to an attorney probating the estate of a decedent whose gross estate for Federal estate tax purposes (and this may include much more than the probate estate<sup>2</sup>) will exceed \$60,000 plus claims against the estate and expenses of administration.<sup>3</sup> The marital deduction should also be considered when drafting the will, or otherwise planning the estate, of a client whose gross estate at death is likely to exceed the aforementioned amount.<sup>4</sup> In order to qualify for the marital deduction, several legal requirements must be satisfied. The decedent whose estate is being probated must have been at the time of his death either a citizen of the United States or a resident alien,<sup>5</sup> and he must be survived by a spouse.<sup>6</sup> Only an "interest

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<sup>1</sup> §361 (a) added §812 (e) to the Internal Revenue Code of 1939. 62 STAT. 117 (1948). The section number has been changed to 2056 in the 1954 Code. 68A STAT. 392 (1954).

<sup>2</sup> E.g., jointly held property and life insurance proceeds includible in the gross estate under I.R.C. §§2040 and 2042.

<sup>3</sup> I.R.C. §2052 allows every decedent's estate an exemption of \$60,000 and §2053 authorizes deductions for funeral expenses, administration expenses, claims against the estate, and unpaid mortgages on decedent's assets where the latter are included in the gross estate at their unencumbered value. In addition, deductions for uncompensated casualty and theft losses during the settlement of the estate are allowable under §2054 and charitable bequests and devises are deductible subject to the limitations of §2055.

<sup>4</sup> It has been suggested that existing and potential assets of a husband and wife should be combined in order to determine whether there is a "marital deduction problem." Sargent, *A.B.C. and D. of Marital Deduction*, 92 TRUSTS AND ESTATES 746, 748 (1953).

<sup>5</sup> I.R.C. §2056, which authorizes a marital deduction, is contained in Subchapter A of Chapter 11. This subchapter applies only to the estates of U.S. citizens or resident aliens. Subchapter B deals with estates of non-resident aliens and contains no marital deduction provision. "However, if the decedent was a citizen or resident, his estate is not deprived of the right to the marital deduction by reason of the fact that his surviving spouse was a non-resident not a citizen." Treas. Regs. 105, §81.47a (a).

<sup>6</sup> I.R.C. §2056 (a). In this paper it will ordinarily be assumed that the husband

in property which passes or has passed from the decedent to his surviving spouse" can qualify for the marital deduction<sup>7</sup> and then only if such interest is included in decedent's gross estate,<sup>8</sup> is not deductible under section 2053,<sup>9</sup> does not exceed one-half of the adjusted gross estate,<sup>10</sup> and is not an objectionable terminable interest.<sup>11</sup>

This paper reviews recent decisions, rulings, and 1954 Code amendments involving these limitations.

## II. NECESSITY OF INTEREST IN PROPERTY "PASSING" FROM DECEDENT TO THE SURVIVING SPOUSE

An attorney drafting a will, or otherwise planning the estate, of a client should ordinarily have no difficulty in complying with the requirement that an interest in property pass from the decedent to the surviving spouse. Code section 2056(e) expressly provides that interests received by will or as surviving joint owner satisfy this condition, along with "proceeds of insurance on the life of the decedent receivable" by the surviving spouse.<sup>12</sup> And in the administration of an

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is the decedent and the wife is the surviving spouse, but §2056 (a) refers to a deceased man or woman who is survived by a spouse.

"The status of an individual as the decedent's surviving spouse is determined at the time of the decedent's death. A legal separation which has not (at the time of the decedent's death) terminated the marriage does not affect such status for the purposes of section [2056 (a)]. A transfer by the decedent during his lifetime to an individual to whom he was not married at the time of the transfer but to whom he is married at the time of his death and who survives him is a transfer by the decedent to his surviving spouse. If an interest in property passes from the decedent to a person who was his spouse but is not married to him at the time of death, the interest is not considered as passing to the decedent's surviving spouse even though such person survives the decedent." Sen. Rep. No. 1013, Part 2, 80th Cong., 2d Sess. (1948), as reported in 1948-1 Cum. Bull. 335.

<sup>7</sup> I.R.C. §2056 (a).

<sup>8</sup> *Id.* E.g., an inter vivos gift to the wife not includible in the deceased husband's gross estate cannot be claimed as a marital deduction.

<sup>9</sup> *Supra* note 3. "An interest in property does not pass to the surviving spouse from the decedent . . . by reason of a claim against the estate, or any indebtedness in favor of the surviving spouse for which a deduction is allowed by section [2053] . . . the payments made in satisfaction of such a claim or debt . . . [do not] pass to such surviving spouse from the decedent . . ." Sen. Rep., *supra* note 6, at 333.

<sup>10</sup> I.R.C. §2056 (c). This section defines the adjusted gross estate as the gross estate less deductions allowed under §§2053 and 2054, *supra* note 3. Thus, if the decedent's adjusted gross estate is valued at \$120,000 and all of it passes to the surviving spouse, not more than \$60,000 can qualify for the marital deduction. However, the \$60,000 exemption allowed by section 2052 could be set off against the portion of the adjusted gross estate not qualifying for the marital deduction. *Cf.* the example in Treas. Regs. 105, §81.47d (a).

<sup>11</sup> I.R.C. §2056 (b) (1). This section is discussed in detail at pp. 12-13, *infra*.

In valuing interests which meet all of the requirements, reductions must be made under §2056 (b) (4) for any death taxes payable out of such interests and for any encumbrances upon them. See Estate of Edward V. Babcock, 23 T.C. No. 111 (1955) and Estate of Fielder J. Coffin, Par. 54, 245 P-H Memo TC.

<sup>12</sup> This section also provides that inter vivos transfers and interests received through the exercise or non-exercise of a power of appointment held by the decedent pass from him.

intestate's estate, interests received by the surviving spouse through inheritance or as dower or curtesy pass from the intestate.

*A. Election by Widow to Take Against Deceased Husband's Will*

A question arises, however, on the probate of a will containing specific provisions for a wife who refuses them and elects to take against the will. The Senate Finance Committee Report on the bill which became the Revenue Act of 1948 stated that "if the surviving spouse elects to take her share of the decedent's estate under the local law instead of taking an interest under the will, the interest she takes under the local law is by the definition in section [2056(e)] considered as passing from the decedent to the surviving spouse."<sup>13</sup> So the Treasury Regulations rather grudgingly admit that an interest received by electing to take against the will passes to the widow from the decedent, but only if such interest meets the other requirements for the marital deduction.<sup>14</sup>

Since interests received by a widow who elects to take against her deceased husband's will are considered as passing to her from the decedent if such interests satisfy the other requirements for the marital deduction, a post-mortem tax-saving opportunity may be available when a will is probated. In *Will of Uihlein*<sup>15</sup> the husband had executed a will prior to the passage of the Revenue Act of 1948.<sup>16</sup> The will might have been designed to avoid a second death tax when the wife died since most of the estate was placed in a trust under which the wife was entitled to a life income plus a very limited power to appoint the corpus at her death. As explained later,<sup>17</sup> the wife's interest under such a trust would not qualify for the marital deduction when the husband died, but although his death did not occur until May 20, 1950, the will was never changed so as to give the wife an interest in the trust which would qualify for the marital deduction.<sup>18</sup> On the hus-

<sup>13</sup> Sen. Rep., *supra* note 6, at 334.

<sup>14</sup> "The following rules are applicable where the surviving spouse may elect between a property interest offered to her under the decedent's will or other instrument and a property interest to which she is otherwise entitled (such as dower, a right in the decedent's estate, or her interest under community property laws) of which adverse disposition was attempted under such will or other instrument. If the surviving spouse elects to take against the will or other instrument, then (1) the property interest offered thereunder is not considered as having 'passed from the decedent to his surviving spouse' and (2) the dower or other property interest retained by her is considered as having so passed only if it otherwise so qualifies under this section." Treas. Regs. 105, §81.47a (f).

<sup>15</sup> 264 Wis. 362, 59 N.W.2d 641 (1953).

<sup>16</sup> The original will was executed November 23, 1946, and a codicil on March 20, 1948. Brief of Appellant Guardian ad Litem, p. 10. The Revenue Act of 1948 became effective April 2, 1948, although section 361, containing the marital deduction provision, was made applicable to estates of decedents dying after December 31, 1947. 62 STAT. 121 (1948).

<sup>17</sup> See p. 27.

<sup>18</sup> Opinion No. 210 of the Professional Ethics Committee of the American Bar Association, reported in 27 A.B.A.J. 319 (1941), states:

band's death the widow elected to take against the will. A widow who so elects is entitled to three different types of interest in the probate estate under Wisconsin law.<sup>19</sup> In the unusual situation where title to the family residence was in the husband alone, rather than in the husband and wife as joint tenants, the widow is entitled to the same homestead rights as if the husband had died intestate leaving lawful issue. Since these rights consist of a life estate terminable upon remarriage,<sup>20</sup> they amount to an objectionable terminable interest and do not qualify for the marital deduction.<sup>21</sup> The second interest is the dower rights which the widow would have if her husband had died intestate leaving lawful issue. In Wisconsin, this is an estate in fee simple in one-third of "all the lands whereof her husband was seized of an estate of inheritance at any time during the marriage" except the family residence.<sup>22</sup> Such an interest qualifies for the marital deduction.<sup>23</sup> The third interest embraces one-third of the "net personal estate."<sup>24</sup> Unless the probate estate includes any "tainted assets,"<sup>25</sup>

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"Many events transpire between the date of making the will and the death of the testator. The legal significance of such occurrences are often of serious consequence, of which the testator may not be aware, and so the importance of calling the attention of the testator thereto is manifest.

"It is our opinion that where the lawyer has no reason to believe that he has been supplanted by another lawyer, it is not only his right, but it might even be his duty to advise his client of any change of fact or law which might defeat the client's testamentary purpose as expressed in the will.

"Periodic notices might be sent to the client for whom a lawyer has drawn a will, suggesting that it might be wise for the client to re-examine his will to determine whether or not there has been any change in his situation requiring a modification of his will."

<sup>19</sup> WIS. STATS. (1953) §233.14. This section requires that the election be made by filing in the court having jurisdiction over the settlement of the deceased husband's estate a "notice in writing" within one year after the filing of a petition for the appointment of an administrator or for the probate of the husband's will. But §233.15 (2) allows an extension of time in the event of a will contest or will construction proceeding.

<sup>20</sup> WIS. STATS. (1953) §237.02 (2).

<sup>21</sup> See p. 19, *infra*. In the more common situation where the family residence was held by the husband and wife as joint tenants, the widow's estate in fee simple as surviving joint tenant would qualify for the marital deduction. See p. 20, *infra*.

<sup>22</sup> WIS. STATS. (1953) §233.01.

<sup>23</sup> See p. 19, *infra*.

<sup>24</sup> *Supra* note 19.

<sup>25</sup> I.R.C. §2056 (b) (2) provides that if an interest passing to the surviving spouse may be satisfied out of assets which would not qualify for the marital deduction if such assets passed directly to such spouse then it is assumed that such "tainted assets" are used to satisfy the spouse's interest and to that extent the marital deduction is denied. "This rule is addressed generally to situations in which the surviving spouse is a pecuniary or residuary legatee or is a beneficiary of a trust created by the decedent during life or by will, or is the heir of an intestate decedent. In such cases there has passed to the surviving spouse an interest in property represented by all the assets included in the decedent's general estate (which does not include assets named by the decedent to pass under specific bequests) or included in the trust. However, under the rule of [section 2056 (b) (2)], if any such assets (in the general estate or trust) would, if specifically passing to the surviving spouse, not be deductible, the

this interest should likewise qualify for the marital deduction.<sup>26</sup> In the *Uihlein* case<sup>27</sup> the decedent's gross estate amounted to more than \$7,000,000 and Federal estate taxes were reduced by over \$1,000,000 by the widow's election to take against the will.<sup>28</sup> Presumably a smaller tax saving would be important to persons interested in lesser estates.<sup>29</sup> To the extent that the widow who elects to take against her husband's will thereby increases the taxable estate<sup>30</sup> at her death, there is in part only a postponement of the tax otherwise payable when the husband died.<sup>31</sup> Since there is nothing comparable to the marital deduction under the Wisconsin inheritance tax,<sup>32</sup> a widow who elects to take against the will is not likely to reduce inheritance taxes payable when the husband dies, but may instead increase the inheritance taxes payable upon her death.<sup>33</sup> The possibility of tax savings being offset by increased probate expenses should also be considered before advising a widow to elect to take against her husband's will. Unless the other

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value of such assets shall be applied in reduction of the amount otherwise deductible for the general or residuary bequest or transfer in trust . . . .

"Example (1). The decedent bequeaths \$50,000 to his surviving spouse. The general estate includes a term for years (valued at \$60,000 in determining the value of the decedent's gross estate) in Blackacre—an interest retained by the decedent after a gift of Blackacre to his son. Accordingly, the marital deduction with respect to the bequest of \$50,000 is reduced to zero. It is immaterial whether the surviving spouse actually receives the term for years . . . .

"In determining the assets out of which the interest passing to the surviving spouse may be satisfied, such assets are determined prior to payment of any general claims, but without including named property specifically bequeathed or devised." Sen. Rep., *supra* note 6, at 340-341.

Where a decedent has made inter vivos gifts it is possible that his estate may contain "tainted assets," but it is more probable that any interest retained in connection with such transfers would be only a life interest.

<sup>26</sup> See p. 12, *infra*.

<sup>27</sup> *Supra* note 15.

<sup>28</sup> Reply Brief of Widow, p. 3.

<sup>29</sup> See Rogers and Sterling, *Post Mortem Estate Planning*, 14 U. PITT. L. REV. 224, 228 (1953).

<sup>30</sup> Defined in I.R.C. §2051 as the gross estate less the \$60,000 exemption and any other allowable deductions.

<sup>31</sup> Assuming the wife's taxable estate is taxed at lower rates than those which would have been imposed on the husband's taxable estate had the wife taken under his will, there is always some tax saving, but to the extent that the tax on the widow's death is greater, payment of that amount of tax at the husband's death has been merely postponed. However, postponement of payment offers an economic advantage where assets which would otherwise have been used to pay the tax at the husband's death produce income or other benefit to the wife until her death. See Mannheimer *et al.*, *The Use of a Formula Clause for the Marital Deduction*, 32 TAXES 381, 382 (1954).

<sup>32</sup> WIS. STATS. (1953) §72.045 allows an exemption of \$15,000 out of the first \$25,000 transferred to the wife and \$5,000 from the first \$25,000 transferred to a husband. The tax rates under §§72.02 and 72.03, while lower than on transfers to uncles, aunts, and their issue, are the same as the rates on transfers to decedent's issue, ancestors, brothers and sisters.

<sup>33</sup> Since inheritance tax rates cannot exceed 19.5 percent, while Federal estate tax rates are 22 percent on the part of a taxable estate exceeding \$40,000 but not exceeding \$50,000 and step up for the larger estates until ultimately a rate of 77 percent is reached, increased inheritance taxes may not completely offset Federal estate tax savings. WIS. STATS. (1953) §§72.035, 72.74; I.R.C. §2001.

beneficiaries under the husband's will can agree upon the distribution of assets remaining after the widow's statutory share has been carved out of the estate, additional court proceedings can be expected.<sup>34</sup> Also, if the widow is given interests under her husband's will which would not require a second administration at her death, electing to take against the will is likely to change this.

A rather ingenious extension of the idea of saving Federal estate taxes by having the widow elect to take against the will is illustrated in *Moore v. Brodrick*.<sup>35</sup> There the husband's will also appears to have been executed prior to the Revenue Act of 1948. Presumably he had made inter vivos gifts to his wife, since assets retained until his death passed under his will to his daughter rather than to the wife.<sup>36</sup> On the husband's death none of the probate assets would qualify for the marital deduction unless the widow elected to take against the will, which she did. Prior to his death, the decedent had purchased government bonds and registered them in his and the daughter's names as co-owners. Since the decedent had furnished the entire consideration for the bonds, they were includible in his gross estate for Federal estate tax purposes;<sup>37</sup> but unless they were also a part of the probate estate, they could not be considered in computing the widow's statutory share. One possible theory which could have been used is that since the decedent retained possession of the bonds until his death and could have redeemed them at any time prior to death without the consent of the daughter, there was no completed inter vivos gift to the daughter because of lack of delivery.<sup>38</sup> Instead, the widow contended in probate court proceedings that the bonds purchased by the decedent constituted an advancement to the daughter which should be charged against the latter's interest in the probate estate and that other assets should be distributed to the widow to equalize the advancement to the daughter. The probate court agreed with this contention and gave the widow, in addition to what she would otherwise receive, assets equal in value to the bonds.<sup>39</sup> The executors filed a Federal estate tax return in which these additional assets were considered eligible for the marital

<sup>34</sup> Distribution problems that can arise when the widow elects to take her statutory share are discussed in Gigure, *The Widow's Election to Take Against a Will*, 38 MARQ. L. REV. 36 (1954).

<sup>35</sup> 123 F.Supp. 108 (D. Kan., 1954). Findings of fact and conclusions of law are reported in 1954 *Prentice-Hall Federal Tax Service*, Par. 132,751.

<sup>36</sup> Except for a \$5,000 legacy to a granddaughter.

<sup>37</sup> I.R.C. §2040.

<sup>38</sup> See Note, 1947 WIS. L. REV. 447, especially cases cited in note 5.

<sup>39</sup> Under Wisconsin law if an advancement has been made by a person who subsequently dies intestate, the hotchpot concept is applied so as to equalize the shares received by the other heirs. WIS. STATS. (1953) §§318.24-318.28. Assuming these statutes can apply where a decedent dies testate and his widow elects against the will, it may be difficult to find that an advancement has been made unless it was so designated in the will. See *Estate of Pardee*, 240 Wis. 19, 1 N.W.2d 803 (1942).

deduction. On audit no deduction was allowed for these assets and a deficiency in excess of \$14,000 was assessed. After payment of this amount a suit for its refund was brought in the Federal District Court. The Government contended that it was not bound by the probate court decree, seemingly on the ground that the proceedings in which it was rendered were not adversary.<sup>40</sup> But the Federal District Court granted a refund, finding that the proceedings were "adversary throughout," the daughter and her husband as executors and the daughter individually having "opposed and resisted" the widow's assertion that the bonds were an advancement, irrespective of the fact that the widow might have elected to take against the will in order to save taxes and that after receiving her statutory share she gave it to the daughter. In addition, the court held that the bonds should have been included in the probate estate even if they were not decreed to be an advancement, since under local law there had been no completed inter vivos gift of the bonds prior to decedent's death. The Government has authorized an appeal from this decision<sup>41</sup> so it is not yet certain that the taxpayer is the victor.

#### B. *Settlement of Surviving Spouse's Will Contest*

Since a widow who elects to take against her deceased husband's will is, apart from homestead rights, entitled to only one-third of the probate estate, under Wisconsin law this would not use up the maximum marital deduction<sup>42</sup> unless she also received a substantial amount of non-probate assets.<sup>43</sup> There are three situations where a widow would receive more of the probate estate by contesting the will and having it denied probate than by electing to take against it.<sup>44</sup> When no issue survive and a denial of probate requires the estate to be distributed as intestate property, the widow would receive the entire net estate as sole heir.<sup>45</sup> If one child also survives, the widow is entitled to one-half of the net personal estate instead of the one-third that she would receive by electing to take against the will.<sup>46</sup> The third situation is where denial of probate for a later will means a prior will is then

<sup>40</sup> Cf. Findings of Fact Nos. 13 and 16, *supra* note 35.

<sup>41</sup> 1955 *Prentice-Hall Federal Tax Service*, Par. 132,105.

<sup>42</sup> *Supra* note 10.

<sup>43</sup> Or she claimed in addition a widow's allowance which could qualify for the marital deduction. See pp. 13-17, *infra*.

<sup>44</sup> Advising a widow to contest her deceased husband's will on a ground such as lack of testamentary capacity in order to have tax dollars seems clearly improper, but gentler issues, such as revocation, might be raised.

<sup>45</sup> Wis. STATS. (1953) §§237.01, 237.02 and 318.01. Since not more than half of the adjusted gross estate could possibly qualify for the marital deduction, if this estate amounts to more than \$120,000, there would be some tax payable after the husband's death. Also see notes 31-33 *supra* and accompanying text. The additional expense resulting from will contest proceedings would, of course, reduce any tax savings.

<sup>46</sup> Wis. STATS. (1953) §318.01.



entitled to probate<sup>47</sup> and the prior will gives the widow more than one-third of the probate estate. Since a surviving husband has no right to elect to take against his deceased wife's will,<sup>48</sup> his only recourse is to contest the will.<sup>49</sup>

Assuming the contest is carried through to the point where the will is denied probate and the estate is distributed under the intestacy statutes or a prior will, the requirement that an interest in property pass from the decedent to a surviving spouse is clearly satisfied.<sup>50</sup> But suppose that the other beneficiaries under the contested will negotiate a settlement of the controversy with the surviving spouse by giving up to the latter part of their shares.<sup>51</sup> Does this property pass from the decedent to the surviving spouse? A recent Wisconsin Supreme Court decision held that, so far as computation of the Wisconsin Inheritance Tax is concerned, it does not.<sup>52</sup> The issue raised was whether the tax should be assessed on the disposition of the estate contained in the original will or under the compromise agreement.<sup>53</sup> The court held that the tax should be based on the distribution provided in the original will, since under the compromise the beneficiary gave up part of what he had received under the will to the contestants.<sup>54</sup>

Code section 2056 (d) provides that an interest "disclaimed" by someone other than the surviving spouse, to which the latter is then entitled, shall not be considered as passing from the decedent to the surviving spouse. Yet the Senate Report on the bill which became the Revenue Act of 1948 stated:

<sup>47</sup> This would necessarily be restricted to situations where the prior will was not revoked by execution of the later will. Cf. *Estate of Svendsen*, 257 Wis. 335, 43 N.W.2d 343 (1950) with *In re Noon's Will*, 115 Wis. 299, 91 N.W. 670 (1902).

<sup>48</sup> WIS. STATS. (1953) §233.14 limits election rights to "a widow."

<sup>49</sup> Even curtesy rights give way to a contrary testamentary disposition. WIS. STATS. (1953) §233.23.

<sup>50</sup> *Supra* pp. 2-3. It is unlikely that the Government could successfully contend that such proceedings were collusive in view of the strong public policy in Wisconsin which favors the admission to probate of all valid wills. See note 54 *infra*.

<sup>51</sup> WIS. STATS. (1953) §316.31 provides that such agreements shall be "valid and binding" when approved by the probate court.

<sup>52</sup> *Estate of Jorgenson*, 267 Wis. 1, 64 N.W.2d 430 (1954).

<sup>53</sup> Since the sole beneficiary under the will was not a relative of the testatrix, but the contestants were, a lower tax would result from a computation based on the settlement because of the lower rates and higher exemptions on transfers to relatives. WIS. STATS. (1953) §§72.02, 72.045.

<sup>54</sup> Construing the statute on compromises, *supra* note 51, "as authorizing the admission of a will to probate, not as executed by the testator, but as judicially amended, would require us to hold the statute unconstitutional, because such a construction would be against the fundamental constitutional right to dispose of property by will as discussed above, and no one—the beneficiaries, the heirs, the courts, or the legislature, or all of them together—can rewrite a will so as to effect a distribution other than that provided by the testator." 267 Wis. 7-8, 64 N.W.2d at 434. See Scheller, *The Right to Dispose of Property by Will*, 37 MARQ. L. REV. 92 (1953).

"If the surviving spouse takes under the decedent's will, the interest passing to her is determined from the will. In this connection proper regard should be given to interpretations of the will rendered by a court in a bona fide adversary proceeding. If, as a result of a controversy involving a bequest or devise to the surviving spouse, such spouse *assigns or surrenders* an interest in property pursuant to a compromise agreement in settlement of such controversy, the amount so assigned or surrendered is not deductible as an interest passing to such spouse. Moreover, any interest received by the surviving spouse under a settlement which does not reflect her rights under the local law does not pass to the surviving spouse from the decedent."<sup>55</sup> (italics added)

Hence, the Treasury Regulations provide:

"If as a result of a controversy involving the will, or involving any bequest or devise thereunder, a property interest is *assigned or surrendered* to the surviving spouse, the interest so acquired will be regarded as having 'passed from the decedent to his surviving spouse' only if such assignment or surrender was a bona fide recognition of enforceable rights of the surviving spouse in the decedent's estate."<sup>56</sup> (italics added)

It seems quite reasonable to conclude from these pronouncements that both the Senate Finance Committee and the Treasury considered an interest which technically passed from the decedent to beneficiaries other than the surviving spouse and then from them to such spouse, for Federal estate tax purposes, as passing directly from the decedent to the surviving spouse, *if* such interest represented a good faith satisfaction of the spouse's rights under local law.

The question of whether such a good faith settlement had taken place was presented to the Tax Court in *Estate of Gertrude P. Barrett*.<sup>57</sup> There a surviving husband, who was actually, though not legally, separated from his wife prior to her death, retained counsel who advised him that he had a valid claim against the estate of his deceased wife. The Tax Court found that the surviving husband "in good faith made claim" to the executor for the share of personal property, including that in an inter vivos trust,<sup>58</sup> to which a husband is entitled under Missouri law in the event of intestacy. He alleged that the trust had been executed under the influence of decedent's executor, who was

<sup>55</sup> *Supra* note 6, at 334. Norman A. Sugarman (then attorney in the Office of Chief Counsel and more recently Assistant Commissioner, Technical) interpreted this as requiring a settlement made in good faith rather than a gift to the spouse or "the creation of a secret trust." *Estate and Gift Tax Equalization—The Marital Deduction*, 36 CALIF. L. REV. 223, 262-263 (1948).

<sup>56</sup> Treas. Regs. 105, §81.47a (g).

<sup>57</sup> 22 T.C. No. 78 (1954).

<sup>58</sup> Prior to marriage, the parties had signed an antenuptial agreement under which each renounced all rights in the estate of the other. At the same time the decedent created a trust, in favor of herself and children by a prior marriage, over the major part of her personal estate.

also her brother and lawyer, "in order to keep the decedent's property away from him," the husband.<sup>59</sup> Although no proceedings were started in the probate court, the husband's attorney conferred with the executor and submitted a memorandum of authorities supporting the husband's position. The Tax Court then found that the executor, "recognizing the substantial nature of Barrett's claim," negotiated a settlement under which \$10,250 was paid the husband in return for a release of all claims and a promise not to contest the will. The executor subsequently obtained approval of the settlement by the probate court and, because of deductions taken elsewhere, \$9,813.08 was claimed on the estate tax return as a marital deduction. The Commissioner disallowed all except \$420 of this amount, taking the position that "the surviving husband had no valid or enforceable claims against the decedent's estate under Missouri law." The Treasury Regulation quoted above<sup>60</sup> also provides:

"Such a bona fide recognition will be presumed where such assignment or surrender was pursuant to a decision of a local court upon the merits in an adversary proceeding following a genuine and active contest. However, such a decree will be accepted only to the extent that the court passed upon the facts upon which deductibility of the property interest depends. If such assignment or surrender was pursuant to an agreement not to contest the will or not to probate the will, it will not necessarily be accepted as a bona fide evaluation of the rights of the spouse."

Since the settlement in the *Barrett* case was not pursuant to court decree after "a genuine and active contest" in adversary court proceedings, the Commissioner was unwilling to presume the settlement was a good faith satisfaction of the husband's rights in the estate of his deceased wife. The executor contended that the settlement was in recognition of the husband's rights and passed to the latter by inheritance under the rationale of *Lyeth v. Hoey*.<sup>61</sup> In that case the contestant had filed a protest with the probate court, but a settlement was reached prior to trial on the issues; and the Supreme Court held that a settlement received by the contestant, because of his standing as an heir, should be treated the same tax-wise as property received under a judgment following a successfully litigated contest. The Commissioner attempted to distinguish *Lyeth v. Hoey*, since in the

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<sup>59</sup> Subsequent to its execution, the decedent had modified the trust so as to give the husband a life interest, after her death, in one-fourth of the trust income. Decedent later eliminated this provision, but the husband also contended that this change was invalid.

<sup>60</sup> *Supra* note 56.

<sup>61</sup> 305 U.S. 188 (1938), where the Supreme Court held that a settlement received by a contesting heir passed to him by inheritance for purposes of the Federal income tax exclusion.

*Barrett* case the husband had not filed any protest in the county court; but the Tax Court held that this was due to the settlement made with the executor which occurred while the husband still had time to challenge the will. Since the settlement was "made in good faith as a result of arm's length bargainings" in advance of a formal court contest, and there was "sufficient basis for a reasonable belief that only such payment would avoid a serious and substantial threat to the testamentary plan provided by the decedent," the entire amount claimed by the executor qualified for the marital deduction. The Commissioner has acquiesced in this decision.<sup>62</sup>

The Wisconsin statute authorizing the compromise of will contests apparently does not require a genuine and active contest in adversary court proceedings prior to the settlement,<sup>63</sup> but "all facts relating to the claims of the various parties" must be presented by verified petition;<sup>64</sup> and the compromise is binding only "if found by the court to be just and reasonable."<sup>65</sup> Hence, it is arguable that in Wisconsin there never can be a purely "consent decree" approving a compromise. If the ground or grounds for contest satisfy the statutory test in the probate court,<sup>66</sup> the interest received under a compromise agreement, assuming it is not and could not be satisfied out of an objectionable terminable interest,<sup>67</sup> should qualify for the marital deduction.

### C. *Bequest in Satisfaction of Rights Under an Antenuptial Agreement*

In *Revenue Ruling 54-446*<sup>68</sup> advice was sought on the tax treatment of a bequest in the will of a deceased husband intended to satisfy the rights of the widow under an antenuptial agreement. As illustrated above,<sup>69</sup> double deductions are avoided by construing the requirement that an interest in property pass from decedent to surviving spouse as missing if the interest received is deductible under Code section 2053. Hence, the first problem raised by a bequest or devise in satisfaction of contract rights<sup>70</sup> is whether it is deductible under that section. The *Ruling* stated that a relinquishment of marital rights was not consideration "in money or money's worth" so as to qualify the widow's claim under the antenuptial contract for deduction under

<sup>62</sup> I.R.B. 1954-50, 6.

<sup>63</sup> In *Estate of Jorgenson*, *supra* note 52, there was a "hearing" prior to the compromise.

<sup>64</sup> WIS. STATS. (1953) §318.31 (6).

<sup>65</sup> WIS. STATS. (1953) §318.31 (5).

<sup>66</sup> *E.g.*, because of the presumption that a will was revoked when last known to have been in the possession of the testator but not found after his death. See *Will of Donigan*, 265 Wis. 147, 60 N.W.2d 732 (1953).

<sup>67</sup> See notes 11 and 25 *supra*.

<sup>68</sup> I.R.B. 1954-41, 14.

<sup>69</sup> *Supra* note 9.

<sup>70</sup> Presumably the same problem would be raised by a bequest to a wife named in the will as executrix in lieu of statutory fees.

section 2053. This cleared the way then for the conclusion that an interest given in satisfaction of such a claim<sup>71</sup> passed from the deceased husband to the surviving widow so that, if the other statutory requirements were satisfied,<sup>72</sup> it qualified for the marital deduction.

### III. THE OBJECTIONABLE TERMINABLE INTEREST RULE

Probably the most intricate requirement for the marital deduction is the one which specifies that the surviving spouse must not receive an objectionable terminable interest.<sup>73</sup> The Code contains two alternative definitions of such interests.<sup>74</sup> The first definition consists of three parts: (1) the interest in property passing to the surviving spouse must terminate or fail in some way;<sup>75</sup> (2) there must be a possibility that someone else, other than the spouse or her estate, may enjoy at least part of the property when the spouse's interest ends, (3) because of a gift of an interest to that person by the decedent.<sup>76</sup> Unless all three parts of the definition are satisfied, the spouse does not have an objectionable terminable interest.<sup>77</sup> The alternative statutory defi-

<sup>71</sup> Under the antenuptial agreement the decedent had promised to leave the widow specific property in his will. Instead, he left her other property of greater value than that promised in the agreement, the will specifically providing that this bequest was in lieu of any right under the agreement.

<sup>72</sup> An interest transferred when the antenuptial agreement was executed, or at any time prior to the husband's death, would not qualify unless it was includible in the husband's gross estate at death. *Supra* note 8.

<sup>73</sup> According to Sugarman, *supra* note 55, since the general purpose of the marital deduction is to equalize the tax impact on estates of decedents in common law and community property states, and a decedent generally could not give his spouse and other persons successive interests in community property, equality is promoted by denying any deduction where such interests have been created by a decedent in a common law jurisdiction. *Id.* at 235-237.

<sup>74</sup> I.R.C. §2056 (b) (1). The "tainted assets" provision, *supra* note 25, could be classified as a third definition since it covers assets or their proceeds which could, but not necessarily, pass to the surviving spouse.

<sup>75</sup> "However, the interest of the surviving spouse is not considered a terminable interest merely because her possession or enjoyment may be affected by events not provided for by the terms of the bequest. Thus, a fee-simple interest is not a terminable interest merely because the physical possession and enjoyment of the property by the surviving spouse will terminate at her death. Nor is such an interest, or any other interest, considered as a terminable interest merely because the surviving spouse may lose it by a fire or earthquake or it may be taken by condemnation or for nonpayment of taxes. An interest in property is not a terminable interest merely because it may be consumed. Thus, a bequest of \$50,000 or of a herd of 50 cattle is not a bequest of a terminable interest.

"On the other hand, an interest may be a terminable interest . . . even though such interest is the entire property. Thus, if the property in which the surviving spouse has an interest, or all of the interest, is terminable, the interest of the surviving spouse is a terminable interest. Example of such terminable interests are patents, copyrights and annuity contracts." Sen. Rep., *supra* note 6, at 336.

<sup>76</sup> The word "gift" is used here in the tax law sense of a transfer for less than an adequate and full consideration in money or money's worth.

<sup>77</sup> Thus, an absolute bequest to a spouse of a patent expiring two years after decedent's death gives the spouse a terminable interest, but since no one else has an interest in the patent entitling him to enjoy it after the spouse's interest ends, she does not have an objectionable terminable interest. *Cf.* Treas. Regs. 105, §81.47b (d) (viii). Likewise, if a decedent purchased a term for years

inition of a non-deductible interest also has three parts: (1) The surviving spouse must receive a terminable interest, (2) which was acquired for her by decedent's executor or trustee, (3) and pursuant to decedent's directions.<sup>78</sup> Unless a conversion after decedent's death fits this definition, it is immaterial so far as the marital deduction is concerned.<sup>79</sup> Hence, the Treasury Regulations distinguish a direction by the decedent from "a general authorization to reinvest property" under which terminable or non-terminable interest may be acquired.<sup>80</sup>

*A. Widow's Allowance for Support Pending Distribution of the Estate*

The first officially published *Ruling* on marital deductions was in response to a request for advice on the deductibility of a widow's allowance during the period preceding distribution of the deceased husband's estate.<sup>81</sup> Prior to the Revenue Act of 1948, section 812 (b) (5) of the 1939 Code allowed a deduction for amounts "reasonably required and actually expended for the support during the settlement of the estate of those dependent upon the decedent."<sup>82</sup> Hence, the Senate Finance Committee Report on the bill which became the Revenue Act of 1948 assumed the only problem in connection with widows' allowances was avoiding a double deduction and stated:

"Neither the payments made in satisfaction of [a claim or debt owed the surviving spouse which was deductible under section 812 (b) (3)<sup>83</sup>] nor the amounts expended in accordance with the local law for support of such surviving spouse during the settlement of the estate pass to such surviving spouse from the decedent . . . ."<sup>84</sup>

No serious problem arose under this approach until the Revenue Act

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and bequeathed absolutely the unexpired portion to his spouse, the owner of the reversionary interest may enjoy the property when the lease terminates but, since he did not receive the reversionary interest from the decedent, the bequest is not an objectionable terminable interest. Sen. Rep., *supra* note 6, at 337.

<sup>78</sup> Sugarman, *supra* note 51, suggests that this definition can also be justified "on grounds of equalization" since generally a decedent could not direct the conversion of the surviving spouse's interest in community property. But he considers this rationale an inadequate explanation of the differing tax treatment of a terminable interest purchased for the spouse by the decedent (and includible in his gross estate) and a terminable interest purchased by an executor or trustee pursuant to decedent's directions. *Id.* at 252-253.

<sup>79</sup> "The deduction is determined with respect to interests which the decedent specifically directed the surviving spouse to have out of estate assets or is determined with respect to the interest of the surviving spouse in the property represented by assets in the general estate out of which, or the proceeds of which, the interest passing to her may be satisfied. Therefore, except as provided in [§2056 (b) (1) (C)] conversions of property after the decedent's death are immaterial to the deduction." Sen. Rep., *supra* note 6, at 338.

<sup>80</sup> Treas. Regs. 105, §81.47c (e).

<sup>81</sup> Rev. Rul. 83, 1953-1 Cum. Bull. 395.

<sup>82</sup> 53 STAT. 123 (1939).

<sup>83</sup> *Supra* note 9.

<sup>84</sup> Sen. Rep., *supra* note 6, at 333.

of 1950 repealed section 812 (b) (5).<sup>85</sup> The Senate Finance Committee Report on the bill effectuating this change stated:

"Under existing law amounts expended in accordance with the local law for support of the surviving spouse of the decedent are, by reason of their deductibility under section 812 (b), not allowable as a marital deduction . . . . However, as a result of the amendment made by this [bill], such amounts heretofore deductible under section 812 (b) will be allowable as a marital deduction subject to the conditions and limitations of section 812 (e)."<sup>86</sup>

One of the "conditions and limitations of section 812 (e)"<sup>87</sup> is that an interest in property must pass from the decedent to the surviving spouse.<sup>88</sup> Support for the position that a widow's allowance does not so pass under Wisconsin law is found in a Supreme Court decision<sup>89</sup> involving the Wisconsin inheritance tax statutes as they existed in 1915.<sup>90</sup> In that case the court held that a widow's allowance was not subject to an inheritance tax since it did not pass by will or under intestate laws to the widow but rather by order of the probate court acting under statutory authorization. Strangely enough, the *Ruling* referred to above<sup>91</sup> did not raise the issue of whether, for Federal estate tax purposes, a widow's allowance passes from the decedent to the surviving spouse.<sup>92</sup> This may have been due to an inference from the legislative history set forth above<sup>93</sup> that the "passing" requirement was satisfied if there was no danger of a double deduction. The legislative history of the 1954 Code strengthens this inference.<sup>94</sup>

<sup>85</sup> 64 STAT. 962 (1950).

<sup>86</sup> Sen. Rep. No. 2375, 81st Cong., 2d Sess. (1950), as reported in 1950-2 Cum. Bull. 576. Identical language is contained in the House Report. *Id.* at 478.

<sup>87</sup> The marital deduction section of the 1939 Code, now section 2056. *Supra* note 1.

<sup>88</sup> *Supra* note 7.

<sup>89</sup> Estate of Smith, 161 Wis. 588, 155 N.W. 109 (1915).

<sup>90</sup> These statutes were subsequently amended so as to expressly cover widows' allowances. Ch. 369, LAWS OF 1943.

<sup>91</sup> *Supra* note 81.

<sup>92</sup> It does first state: "Under the general rule of subparagraph (A) of section 812 (e) (1) of the Code, the marital deduction will be allowed with respect to any interest in property included in the gross estate *which passes from a decedent to his surviving spouse as absolute owner.*" But it concludes: "In view of the foregoing, it is held that the interest in an estate *which passes to a surviving spouse pursuant to State law* in the form of an allowance for support during the period of settlement of the deceased spouse's estate must constitute a vested right of property such as will, in the event of her death as of any moment or time following the decedent's death, survive as an asset of her estate, in order to qualify under section 812 (e) (1) (A) of the Internal Revenue Code for the estate tax marital deduction." (italics added)

<sup>93</sup> *Supra* notes 84 and 86.

<sup>94</sup> H. R. 8300 originally contained an amendment creating an exception to the objectionable terminable interest rule for amounts paid a widow within one year of her husband's death. The Report of the Ways and Means Committee assumed the only problem concerning widows' allowances was whether they constituted objectionable terminable interests. H. R. Rep. No. 1337, 83rd Cong., 2d Session (1954), pp. 92, A319. Although the Senate Finance Committee re-

In any event, the *Revenue Ruling* stresses only the requirement that a widow's allowance must not be an objectionable terminable interest. Since a widow's right to an allowance will normally terminate when she receives her distributive share of the estate,<sup>95</sup> the Internal Revenue Service could have taken the position that this made it a terminable interest. But assuming the allowance was not acquired for the widow by an executor pursuant to decedent's direction, it would not be an objectionable terminable interest unless someone else, by reason of a gift from the decedent, could possibly enjoy the *property* when the right to an allowance terminated.<sup>96</sup> Such a possibility would exist only if the *property* in which the widow had an interest was not the allowance itself.<sup>97</sup> Instead, the allowance would have to be considered an interest in *underlying property*.<sup>98</sup> Under Wisconsin law the allowance is "out of the personal estate or the real estate, or both, of the deceased."<sup>99</sup> If a widow were awarded a sum payable monthly out of the income from estate assets, the allowance could be considered an interest in those assets producing the income. Unless it were feasible for the probate court to restrict the widow's allowance to income from assets which would ultimately be included in her distributive share, the Government might have assumed, in situations

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jected this amendment, its Report gave the following reason: "Under present law many widows' allowances qualify for the marital deduction without regard to the time of payment. It is believed that the House bill might raise some question as to the treatment under the marital deduction of these widows' allowances to the extent not received within 1 year of the decedent's death." Sen. Rep. No. 1635, 83rd Cong., 2d Sess. (1954), p. 125. The Conference Report, after quoting from the legislative history of the Revenue Act of 1950, *supra* note 86, stated: "Many of these 'widows' allowances' should qualify for the marital deduction under present law without regard to the time of payment. Therefore, the added complications of [the provision in the original bill] are largely unnecessary. The House recedes." H. R. Rep. No. 2543, 83rd Cong., 2d Sess. (1954), p. 75.

<sup>95</sup> E.g., WIS. STATS. (1953) §313.15 (2).

<sup>96</sup> See p. 12, *supra*.

<sup>97</sup> Otherwise, the allowance would be comparable to a patent in which no one but the widow held an interest. See note 77 *supra*.

<sup>98</sup> "The terms 'interest' and 'property,' as used in section [2056] have separate and distinct meanings. The term 'property' is used in a comprehensive sense and includes all objects or rights which are susceptible of ownership. The term 'interest' refers to the extent of ownership, that is, to the estate or the quality or quantum of ownership by the surviving spouse or other person, of particular property. For example, if the surviving spouse is specifically devised an estate for life in a farm, the 'interest' passing to her is the life estate, and the 'property' in which such interest exists is the farm. Generally, the property in which any person is considered as having an interest is the property out of which, or the proceeds of which, such interest may be satisfied. Thus, in the case of a bequest, devise, or transfer of an interest which may be satisfied out of, or with the proceeds of, any property of the decedent's general estate or of a trust, the interest so bequeathed, devised, or transferred is an interest in any or all of such property. If the decedent's general estate or the trust consists of assets which are themselves interests in property (such as leases), the interest so bequeathed, devised, or transferred is an interest in such property." Sen. Rep., *supra* note 6, at 333.

<sup>99</sup> *Supra* note 95.



where the widow was not the sole beneficiary or heir,<sup>100</sup> that these income-producing assets would, on distribution of the estate, pass to persons other than the surviving spouse or her estate.<sup>101</sup> However, a widow's allowance in the form of specific assets owned by the decedent,<sup>102</sup> plus any income earned from them, would avoid this difficulty since no one other than the widow would have a possibility of enjoying these assets by reason of a gift from the decedent.

This may explain why the *Revenue Ruling* exhibits no concern that someone other than the widow may subsequently enjoy *property* which produced her income allowance *if* the widow has an indefeasible right to the allowance "for the full period of settlement of the estate." This right must arise immediately upon the death of the decedent. If the right is terminable upon her death, remarriage, or other contingency occurring after the husband's death but before the estate is settled, it is an objectionable terminable interest.<sup>103</sup> Unfortunately, the *Ruling* does not elaborate on why termination of the right to an allowance prior to settlement of the estate places it in this category.<sup>104</sup> It seems

<sup>100</sup> If the assets were used to satisfy creditors, it would not be because of a gift to them from decedent. *Supra* note 76.

<sup>101</sup> I.R.C. §2056 (e), after defining various types of transfers where an interest is considered as passing from decedent to another, states that "where at the time of the decedent's death it is not possible to ascertain the particular person or persons to whom an interest in property may pass from the decedent, such interest shall, for purposes of [the objectionable terminable interest rule], be considered as passing from the decedent to a person other than the surviving spouse." The specific illustrations given in the Treasury Regulations are of possible beneficiaries who are unknown at the time of the decedent's death, but they are followed by this general statement: "Whether there is a possibility that the 'person other than his surviving spouse' (or the heirs or assigns of such person) may possess or enjoy the property following termination or failure of the interest therein which passed from the decedent to his surviving spouse is to be determined as the time of the decedent's death." Treas. Regs. 105, §81.47b (d). Except for specific bequests and devises, it would seem impossible to determine "as of the time of the decedent's death" which beneficiaries would receive particular assets. The same difficulty would exist where decedent died intestate.

<sup>102</sup> Wis. STATS. (1953) §313.15 (1) allows the widow certain personal items plus "other personal property to be selected by her, not exceeding in value \$400." This is in addition to the support allowance under section 313.15 (2). The latter is not specifically restricted to an income allowance, but section 313.15 (4) authorizes an assignment of "a sum or value not exceeding \$2,000" from the residue of the estate.

<sup>103</sup> *Supra* note 81. According to Wis. STATS. (1953) §313.15 (2) the widow "shall have such reasonable allowance . . . as the county court shall judge necessary for [her] maintenance" until a final lump sum award is made or refused or her distributive share is assigned. *Baker v. Baker*, 51 Wis. 538, 8 N.W. 289 (1881), held that the county court has the power to change an allowance order previously made "upon a showing that the condition of the estate has changed or that situations and circumstances of the family have changed." And *Estate of Hemphill*, 157 Wis. 331, 147 N.W. 1089 (1914), held a widow's estate was not entitled to the personal property allowance under Section 313.15 (1), *supra* note 102, as a matter of right where she had neither selected nor claimed it prior to her death.

<sup>104</sup> "In many States local courts have held that such allowances, or any rights thereto, terminate *ipso facto* upon remarriage and that death also terminates any rights to subsequent allowances. Under such circumstance, the interest

due to an assumption on the part of the Internal Revenue Service that the right to an allowance is itself the *property*<sup>105</sup> in which a widow has an objectionable terminable interest, if all or part of the income or assets which would have constituted the allowance for the "full period of settlement" can possibly pass to someone other than the widow or her estate.<sup>106</sup> If, for example, a probate court ordered a monthly allowance paid a widow out of estate income, and she received some payments but died before the estate was distributed, the Service seems to conclusively presume that, if under local law the payments then stop as such,<sup>107</sup> the estate income to which the widow would have been entitled in the form of a widow's allowance had she lived is not later included in her distributive share of the deceased husband's estate, nor used to pay claims or expenses of administration, but passes instead to other beneficiaries or heirs.<sup>108</sup> If an attempt were made to avoid this result through a probate court decree providing that, in the event the allowance terminated prior to distribution, the balance otherwise due should be included in the widow's distributive share, or a decree allowing only a single lump sum payment instead of a monthly allowance, the Service would undoubtedly contend that, if the widow had died before obtaining such an allowance order, none would have been granted her estate.<sup>109</sup> The major weakness in the Service's position seems to be the lack of statutory authority for the presumption that the "allowance" then passes to someone other than the widow's estate.<sup>110</sup>

### B. Dower, Curtesy and Homestead Interests

Although a dower or curtesy interest passes to the surviving spouse from the decedent,<sup>111</sup> the Senate Report on the bill which became the Revenue Act of 1948 stated: "If such interest is a terminable interest, such as a life estate, the marital deduction would nevertheless be dis-

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passing to the surviving spouses of decedents in the forms of allowances made for their support, pursuant to local law, amount to no more than annuities payable out of the assets of the estates during the periods of settlement or until prior death or remarriage of the surviving spouses and, as such, constitute terminable interests within the meaning of section [2056 (b)] of the Code, no portion of the values of which qualify for the marital deduction." *Supra* note 81.

<sup>105</sup> See note 98 *supra*.

<sup>106</sup> "Therefore, if a widow's allowance for the full period of settlement of the estate is such that the allowance, or any unpaid balance thereof, will survive as an asset of her estate in case she dies at any time following the decedent's death, the interest thus taken by the widow would clearly constitute a deductible interest . . ." *Supra* note 81.

<sup>107</sup> *Supra* note 103.

<sup>108</sup> This assumes, of course, a situation where the widow is not the sole beneficiary or heir.

<sup>109</sup> The ruling refers to "the allowance, or any unpaid balance thereof," *supra* note 106, and again to "such allowances or any rights thereto," *supra* note 104.

<sup>110</sup> See note 101 *supra*.

<sup>111</sup> *Supra* pp. 2-3.

allowed under [section 2056 (b) (1)].<sup>112</sup> In *Revenue Ruling 279*<sup>113</sup> it appeared that under Alabama law the widow of an intestate was entitled to a life estate in one-third of her deceased husband's real estate when there were surviving lineal descendants. While this interest was free from the claims of creditors, if land was to be sold by the administrator for the payment of debts or because it could not be equitably divided among the heirs, the widow could consent to inclusion of her dower interest in the sale. The probate court must then order the administrator to pay the widow, out of the purchase money collected, the fair equivalent of her dower interest, computed with regard to her age and health, but not more than one-third of the purchase money. In the case presented for a ruling, land had been sold and the court awarded the widow one-third of the purchase price.

The administrators contended that this amount qualified for the marital deduction since it constituted the widow's statutory interest in lieu of dower and thus passed to her from the decedent,<sup>114</sup> and since she received the amount as absolute owner it was not an objectionable terminable interest. But the Service refused to accept the first contention. Instead it ruled that the Alabama statute giving the widow a share of the sale proceeds was not a statutory substitute for dower within the Code definition<sup>115</sup> since dower had not been abolished in Alabama. Nor did this statute give the widow any interest in property which could be considered as passing to her from the decedent. The only interest so passing was her dower interest in the form of a life estate; and, since the remainder passed from the decedent to children who might enjoy the property upon the widow's death, her dower was an objectionable terminable interest. The fact that her terminable interest had been, through the subsequent sale, converted into a non-terminable interest was irrelevant, since the first statutory definition of an objectionable terminable interest<sup>116</sup> must be applied to the interest passing to the widow at decedent's death.<sup>117</sup>

<sup>112</sup> Sen. Rep., *supra* note 6, at 337.

<sup>113</sup> 1953-2 Cum. Bull. 275.

<sup>114</sup> I.R.C. §2056 (e) provides: "For purposes of this section, an interest in property shall be considered as passing from the decedent to any person if and only if . . . such interest is the dower or curtesy interest (or statutory interest in lieu thereof) of such person as surviving spouse of the decedent; . . ."

<sup>115</sup> *Id.*

<sup>116</sup> *Supra* p. 12.

<sup>117</sup> The Ruling cited Treas. Regs. 105, §81.47b (d) which states that the test "is to be applied with respect to the property interests which actually passed from the decedent. Subsequent conversions of the property are immaterial for this purpose. Thus, where a decedent bequeathed his estate to his wife for life with remainder to his children, the interest which passed to his wife is a 'non-deductible interest,' even though the wife agrees with the children to take a fractional share of the estate in lieu thereof, or sells the life estate for cash, or acquires the remainder interest of the children either by purchase or gift." This follows Sen Rep., *supra* note 79.

Unlike Alabama, Wisconsin statutes provide that when an intestate is survived by a widow and lineal descendants, the widow "shall be entitled to a dower defined to be a one-third part of all the lands whereof her husband was seized of an estate of inheritance at any time during the marriage" except the homestead.<sup>118</sup> Where a husband and lineal descendants survive, the husband "shall be entitled to curtesy defined to be a one-third part of all the lands of which [the wife] died seized of an estate of inheritance" except the homestead.<sup>119</sup> If the word "seized" was used in these definitions in the traditional common law sense of possession or the right to possession of a freehold estate,<sup>120</sup> dower and curtesy interests would exist only in lands which the decedent owned in fee simple.<sup>121</sup> At least, a one-third interest in land owned by the decedent in fee simple absolute would not be a terminable interest.<sup>122</sup>

However, the surviving spouse's homestead rights under Wisconsin intestacy statutes consist of an estate for life or remarriage with a remainder to decedent's issue<sup>123</sup> and, since comparable to the dower interest of an Alabama widow, are an objectionable terminable interest. Converting these homestead rights into a dower or curtesy interest by a sale of the homestead after decedent's death<sup>124</sup> might be more successful tax-wise than the conversion involved in *Revenue Ruling 279*.<sup>125</sup>

<sup>118</sup> WIS. STATS. (1953) §233.01.

<sup>119</sup> WIS. STATS. (1953) §233.23.

<sup>120</sup> Cf. Will of Prasser, 140 Wis. 92, 121 N.W. 643 (1909) with *Inglis v. Fohey*, 136 Wis. 28, 116 N.W. 857 (1908) and *Olsen v. Ortell*, 264 Wis. 468, 59 N.W. 2d 473 (1953).

<sup>121</sup> The only freehold estates at common law were the fee simple, fee tail, and life estate. 2 POWELL, REAL PROPERTY 8 (1950). Since a life estate is not also "an estate of inheritance" there can be, of course, no dower or curtesy interest in it after the life tenant dies; and an estate for the life of another descends as a chattel real under WIS. STATS. (1953) §230.06. Fee tails are converted into fee simples under section 230.02.

<sup>122</sup> *Supra* note 75. If decedent owned a defeasible estate, such as a fee simple subject to an executory limitation, and the widow's dower interest were also subject to this limitation [See 1 AMERICAN LAW OF PROPERTY, §5.29 (1952)], the widow would receive a terminable interest. But it would not be an objectionable terminable interest unless decedent had himself created the executory limitation in favor of a third party by gift. *Supra* note 77.

<sup>123</sup> WIS. STATS. (1953) §237.02, which also provides that if no "lawful issue" survive, the spouse takes the entire interest.

<sup>124</sup> The dower statute, *supra* note 118, provides: "But such widow shall have no dower in any homestead of which her husband died seized, except in the proceeds thereof in lieu of her homestead rights in case of sale of the premises while she has homestead rights therein." The curtesy statute, *supra* note 118, contains a similar provision.

<sup>125</sup> A Wisconsin taxpayer would not have to show a statutory substitute but rather that dower (or curtesy) rights in the sale proceeds passed from the decedent to the surviving spouse. The Service might interpret the statute quoted above as passing only homestead rights from the decedent at his death, the dower (or curtesy) rights arising only after a conversion by sale of the homestead rights. But I.R.C. §2056 (e), *supra* note 114, merely requires a "dower or curtesy interest . . . of such person as surviving spouse of the decedent."

### C. *The Equivalent of a Legal Life Estate*

It is obvious from the preceding discussion of dower, curtesy, and homestead interests that any legal life estate<sup>126</sup> passing from a decedent to a surviving spouse is a terminable interest; and, if a remainder interest in the same property passed as a gift from the decedent to someone other than the spouse or her estate, it is also an objectionable terminable interest.<sup>127</sup> The first case decided by the Tax Court involving the marital deduction<sup>128</sup> illustrates how the equivalent of a legal life estate may have been unintentionally created and undoubtedly surprised tax practitioners unacquainted with the vagaries of property law. There an Iowa couple owned real estate as joint tenants, government bonds as co-owners, and a joint bank account. They executed a joint and mutual will which contained the following clauses:

"Article Two. Whatever property we own, real or personal, we jointly own whether or not so recorded,<sup>129</sup> and we have agreed and hereby agree that the survivor of us shall have the full use and income and control of all our property as long as the survivor of us shall live.

Article Three. After the death of the survivor of us all our property real and personal, shall be sold by our trustees hereinafter named and the net proceeds shall be divided into two equal parts to be distributed amongst our nephews and nieces hereafter named . . . ."

After the husband's death this will was admitted to probate, the widow qualified as executrix, and she also elected to take under the will. Since decedent furnished all the consideration for the jointly held assets their entire value was included in his gross estate,<sup>130</sup> but the widow contended that since she received an absolute interest in these assets as surviving joint owner her interest qualified for the marital deduction. The Commissioner maintained that these assets passed to the widow under the joint and mutual will which gave her the equivalent of a legal life estate and, since an interest also passed under the will from decedent to the nephews and nieces which entitled them to enjoy the property underlying the widow's interest after her death, she had an objectionable terminable interest. A substantial majority

<sup>126</sup> The adjective "legal" refers here to common law life estates as distinguished from equitable life interests in trust property.

<sup>127</sup> "H (the decedent) devised real property to W (his surviving wife) for life, with remainder to A and his heirs. The interest which passed from H to W is a 'non-deductible' interest since it will terminate upon her death and A (or his heirs or assigns) will thereafter possess or enjoy the property." Treas. Regs. 105, §81.47b (d) (i).

<sup>128</sup> Estate of Emmet Awtry, 22 T.C. No. 14 (1954), [reversed by U.S. Court of Appeals for the Eighth Circuit, 4 TAX FORTNIGHTER 460 (1955) Ed.].

<sup>129</sup> Under Wisconsin law this will would not be sufficient to convert property owned separately into joint ownership. Estate of Gabler, 265 Wis. 126, 60 N.W. 2d 720 (1953).

<sup>130</sup> *Supra* note 37.

of the Tax Court judges accepted the Commissioner's argument, finding that under Iowa law the rights of a surviving spouse who elects to take under a joint and mutual will are fixed by its terms and the will in the case at bar was intended to cover jointly held property.<sup>131</sup> Where such a will expressly covers jointly held property or insurance payable to the surviving spouse<sup>132</sup> it would probably have the same effect under Wisconsin Law.<sup>133</sup> It is not clear, however, whether this result can be avoided by a surviving widow electing to take against the will<sup>134</sup>

*Estate of Thomas J. White*<sup>135</sup> illustrates the ease with which the Tax Court finds the equivalent of a legal life estate in life insurance settlements. There the husband owned several policies on his life. In 1936 he made an agreement with the insurer under which his wife, as primary beneficiary, was to receive payments under an interest option with the privilege of changing to a life income option with installments certain. The agreement also provided that in the event of the wife's death the children, as contingent beneficiaries, should have interest payments plus a right to withdraw principal upon attaining a certain age. But if the wife had elected the installment option prior to her death, the children were to continue to receive the remaining payments under this option with the right of commutation upon reaching a certain age. In addition, the husband assigned all rights under the policies, including the right to change beneficiaries and settlement options, to his wife, but if he survived her, the rights were to revert in him. In 1941 the wife executed, with the husband's consent, an instrument directing the insurer to pay the proceeds to her estate if she, the contingent beneficiaries, and no children of the latter survived the husband. It further provided that in the event of her death prior to her husband's the rights under the policies should vest in her personal

<sup>131</sup> In *Estate of Gust Marion Peterson*, 23 T.C. No. 126 (1955), the Tax Court reached a similar result under Nebraska law, not only as to jointly held property, but also with respect to the proceeds of insurance policies payable in lump sums to the surviving widow.

<sup>132</sup> Cf. *Hutson v. Jenson*, 110 Wis. 26, 85 N.W. 689 (1901).

<sup>133</sup> Cf. *Doyle v. Fisher*, 183 Wis. 599, 198 N.W. 763 (1924) and *Estate of Schefe*, 261 Wis. 113, 52 N.W.2d 375 (1952) with *Will of Schaech*, 252 Wis. 299, 31 N.W.2d 614 (1948).

<sup>134</sup> If a joint and mutual will creates an ordinary contract, it should be binding irrespective of whether the surviving spouse elects to accept benefits under the will. See generally Sparks, *Legal Effect of Contracts to Devise or Bequeath Prior to the Death of the Promisor*, 53 MICH. L. REV. 1 (1954). Under this approach, assets received by a widow electing to take against the will would not qualify for the marital deduction to the extent that such assets are "subject to a binding agreement by such spouse to dispose of such interest in favor of a third person." Treas. Regs. 105 §81.47a (2). But the contract involved here may not be an ordinary one under Wisconsin law. The Doyle and Schefe cases cited in the preceding note, held the agreement enforceable in equity when the surviving joint testator accepted benefits under the will from the decedent.

<sup>135</sup> 22 T.C. No. 83 (1954).

representative rather than in her husband. On his death in 1948 the husband was survived by his wife and children. The Commissioner having included the insurance proceeds in the deceased husband's gross estate,<sup>136</sup> his executors contended that the widow's interest qualified for the marital deduction. Since the husband had only assigned his rights under the policies, the widow's power to change their terms ended with his death, except as to her privilege to change to the installment option described above.<sup>137</sup> Hence, the executors urged that, since under her right to change beneficiaries during her husband's lifetime the widow could have named herself sole beneficiary, any interest of the contingent beneficiaries passed to them from her rather than decedent.<sup>138</sup> But the Tax Court considered this reasoning inconsistent with the failure of the executors to resist inclusion of the proceeds in the gross estate, which could only occur if the proceeds passed from the decedent to the beneficiaries named in the policies. Since the widow's interest would terminate at her death and, if at that time the insurer still held any of the proceeds, the contingent beneficiaries would enjoy them because of an interest passing to them from the decedent, she held an objectionable terminable interest.<sup>139</sup>

#### D. *Legal Life Estate Plus Power Over Remainder*

The legal life estate has been characterized as "a very inflexible interest" unless the life tenant is given a power of sale.<sup>140</sup> For this and other reasons eminent authorities have stated that legal life estates infrequently occur in modern practice.<sup>141</sup> If this were true, Congress was perhaps justified in not inserting in the Revenue Act of 1948 any exception to the objectionable terminable interest rule for even those legal life estates accompanied by broad powers over the re-

<sup>136</sup> Under the payment-of-premiums test of the 1939 Code as amended by the Revenue Act of 1942. 56 STAT. 944 (1942). Since the test under section 2042 of the 1954 Code is now restricted to "incidents of ownership," the proceeds would not now be includible in the gross estate unless decedent retained a reversionary interest of sufficient value. If he did not, the proceeds could not qualify for the marital deduction. *Supra* note 8.

<sup>137</sup> If an unfettered power to change beneficiaries or settlement options had survived the husband's death, the executors would probably have relied on the exception to the objectionable terminable interest rule contained in I.R.C. §2056 (b) (6), discussed at pp. 31-32, *infra*.

<sup>138</sup> If this theory had been accepted, the third part of the first statutory definition of an objectionable terminable interest (*supra* p. 12) would have been lacking. It would still have been necessary for the executors to show that the widow's interest passed to her from decedent, but I.R.C. §2056 (e) (7) merely requires for this that the proceeds be "receivable" by her without stating when; and the broad language of §2056 (e) (4) sanctions the transfer of an interest "at any time."

<sup>139</sup> Her power to change from the interest option to the life income option was not a power to appoint all amounts payable under the policies as required by I.R.C. §2056 (b) (6), discussed at pp. 31-32, *infra*.

<sup>140</sup> CASNER AND LEACH, *CASES AND TEXT ON PROPERTY* 281 (1950).

<sup>141</sup> *Id.* But compare the recent survey of the frequency of legal life estates as a property arrangement in Iowa. Note, 40 IOWA L. REV. 182, 193-194 (1954).

remainder interest.<sup>142</sup> The Senate Report stated: "Generally, a power of appointment is not an 'interest in property.' Accordingly, no deduction is allowed with respect to a power to appoint given to a surviving spouse, except as provided in the special rules in subparagraphs (F) and (G) of section 812 (e) (1), in the case of certain trust and insurance proceeds where the surviving spouse is given a power to appoint."<sup>143</sup> Following this approach, the Treasury Regulations issued in 1949<sup>144</sup> gave the following illustration:

"H devised real property to W for life, and created in W a power, exercisable by will, to appoint the remainder interest to any person. In default of appointment by W, the remainder interest was to go to A and his heirs. Assuming that under the local law W did not take the real property as absolute owner, nor as trustee of a trust meeting the requirements of section 81.47a (c), the interest which passed from H to W is a 'non-deductible interest.'"<sup>145</sup>

Since the widow's power was not an interest in property, she received only a terminable interest from the decedent; and, since there was a chance that the power might not be exercised, it was an objectionable terminable interest because A would take in default of appointment. But the assumptions made in the Regulation suggested two different possibilities for qualifying a life estate accompanied by a power over the remainder.

One possibility was any local property law rule which could be used to give the life tenant a non-terminable interest. *Estate of Michael Melamid*<sup>146</sup> illustrates an unsuccessful attempt to use this approach. There a New York decedent had willed to his widow a legal life estate plus "the power to use my estate during her lifetime as she may deem advisable for the best interest of my estate, and to use so much of it as she may need for the way of life to which she and I have been accustomed." The widow, as executrix, contended that the right to invade corpus converted her life estate into absolute ownership, but the Tax Court held that under New York law no conversion occurred when, as here, the decedent had named a remainderman to take the unconsumed corpus.<sup>147</sup> But where a remainder fol-

<sup>142</sup> Sugarman, *supra* note 55, at 254-255.

<sup>143</sup> Sen. Rep., *supra* note 6, at 333.

<sup>144</sup> T.D. 5699, 1949-1 Cum. Bull. 181.

<sup>145</sup> Treas. Regs. 105, §81.47b (d).

<sup>146</sup> 22 T.C. No. 116 (1954).

<sup>147</sup> In Wisconsin, conversion into absolute ownership occurs under Wis. STARS. (1953) §232.10 when no remainder is limited on the life estate of the widow if she has in addition an absolute power of disposition as defined in §§232.11-232.12. The combination of a life estate plus such a power followed by a remainder interest to another apparently gives the widow absolute ownership only as to her creditors and purchasers according to §232.08. If liability for taxes as a transferee under I.R.C. §6901 makes the Federal Government a



lowed a widow's life estate in personal property the Tax Court agreed that the widow took an absolute interest in any personal property necessarily consumable by use.<sup>148</sup>

The second possibility was any local law rule which converted the life tenant into a trustee of a trust qualifying under an exception to the objectionable terminable interest rule.<sup>149</sup> An argument along these lines was attempted in *Estate of Edward F. Pipe*.<sup>150</sup> There a New York decedent had willed his widow a life estate "with full power to use, enjoy, sell or dispose of the income and principal thereof, or any part thereof, for such purposes or in such manner as she in her uncontrolled discretion may choose, it being my desire to place no restraint on her in any respect concerning the absolute right of full disposition and use of the whole or any part of said income or principal of my residuary estate, except that she shall have no power over the disposition of such part thereof as remains unexpended at the time of her death." The "unexpended part" was to go on the wife's death to certain named beneficiaries. It was contended that under New York law the widow took the property as trustee but the Tax Court held that at most the trust consisted not of the property received by the life tenant but only of that remaining at her death. Since the subject matter of such a trust could not be identified at decedent's death, this was "an adequate reason for presuming that it was not the congressional intent to include this type of 'trust' in the marital deduction provisions" excepting certain trusts from the objectionable terminable interest rule.<sup>151</sup>

Both the House Ways and Means Committee and the Senate Finance Committee of the Eighty-Third Congress recognized that "because of doubt under the law of the various States as to what constitutes a 'trust' it is not clear when a legal life estate will qualify as a trust."<sup>152</sup> Hence the 1954 Code, applicable to estates of decedents dying on or after August 17, 1954,<sup>153</sup> now provides:

"In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific por-

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creditor of the widow, \$232.08 would probably still not apply unless the property were actually used to satisfy her liability.

<sup>148</sup> *Estate of Frank E. Tingley*, 22 T.C. No. 54 (1954), applying a Rhode Island statute to that effect. Although Wisconsin has no similar statute, this is the common law rule. 1 AMERICAN LAW OF PROPERTY, §4.4 (1952).

<sup>149</sup> This exception is discussed at pp. 27-31, *infra*.

<sup>150</sup> 23 T.C. No. 14 (1954).

<sup>151</sup> It appears that under Wisconsin law the trust would consist of the property received by the life tenant. See *Estate of Lenahan*, 258 Wis. 404, 46 N.W.2d 352 (1951) and *Estate of Larson*, 261 Wis. 206, 52 N.W.2d 141 (1952).

<sup>152</sup> H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 92 (1954); Sen. Rep. No. 1622, 83rd Cong., 2d Sess. 125 (1954).

<sup>153</sup> I.R.C. §7851 (a) (2) (A).

tion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—

(A) the interest or such portion thereof so passing shall, for purposes of subsection (a),<sup>154</sup> be considered as passing to the surviving spouse, and

(B) no part of the interest so passing shall, for purposes of paragraph (1) (A),<sup>155</sup> be considered as passing to any person other than the surviving spouse. This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events."<sup>156</sup>

The House and Senate Reports state that this language is designed "to make it clear that property in a legal life estate as well as property in trust qualifies for the marital deduction."<sup>157</sup>

Attorneys engaged in estate planning under the new Code are now faced with the problem of determining what type of legal life estate a wife must receive in order to qualify the transfer for the marital deduction. The first general requirement is that the wife must be "entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals." In Wisconsin this would presumably mean that the wife must receive an "absolute life estate" as distinguished from a "life support estate."<sup>158</sup> Fear has been expressed that, since statutory and case law deal with only a few of the problems of apportioning benefits and burdens between a legal life tenant and remainderman, "[t]he rest have to be resolved by negotiation or provision in the instrument—the net effect of which may well be to shift to the life tenant a larger share of the burden and place in jeopardy the marital deduction requirements of full beneficial enjoyment."<sup>159</sup> But it seems unlikely that the new Treasury Regulations when issued will be more stringent than those dealing with power-of-appointment trusts under the old Code<sup>160</sup> or that apportionment rules developed in the law of trusts cannot be applied by analogy to legal life tenants and remainder-

<sup>154</sup> *Supra* note 7.

<sup>155</sup> *Supra* note 74.

<sup>156</sup> I.R.C. §2056 (b) (5).

<sup>157</sup> *Supra* note 152.

<sup>158</sup> See Estate of Larson, 261 Wis. 206, 52 N.W.2d 141 (1952).

<sup>159</sup> Fleming, *Present Status of the Marital Deduction*, 33 TAXES 167-168 (1955).

<sup>160</sup> Treas. Regs. 105, §81.47a (c).

men. The second general requirement necessitates giving the wife a power to appoint the property in which the wife has the life estate to herself or to her estate. An unlimited power of invasion should satisfy this requirement<sup>161</sup> but a power to invade when necessary for support would not qualify the transfer<sup>162</sup> unless the life tenant had in addition a power to appoint assets remaining at her death to her estate.

Once it has been determined what type of life estate must pass to a surviving spouse in order to qualify for the marital deduction, the next problem is deciding whether such a transfer is preferable to other types, particularly an outright gift and a trust. Professor Casner has suggested four possible advantages of a legal life estate over an outright gift.<sup>163</sup> The first two are that in many jurisdictions appointive assets would not be subject to claims of the wife's creditors at her death unless she exercised the power, nor would these assets be part of her probate estate and subject to the delays and expenses of administration. Wisconsin does not appear to be one of these jurisdictions. If the wife has an absolute power of disposition<sup>164</sup> she is considered the owner of an outright interest as to her creditors<sup>165</sup> and such property would then have to be considered part of her probate estate.<sup>166</sup> The third advantage existing in many jurisdictions is the freedom of the appointive assets from state inheritance taxes at the wife's death. Here again Wisconsin law is to the contrary. Upon the husband's death the wife is taxed as though she had received an absolute interest<sup>167</sup> and on her death the property is taxed a second time, whether the power was exercised or not.<sup>168</sup> The fourth advantage is the freedom of the appointive assets from the marital claims of the wife's second husband where she dies without having appointed to him. There appear to be no Wisconsin cases in point but, considering the limited statutory rights of a surviving husband,<sup>169</sup> Wisconsin would probably follow the general rule here. A fifth advantage might possibly appeal to some husbands, namely, controlling the devolution of the property through a gift in default if the wife failed to exercise her power of appointment.<sup>170</sup>

<sup>161</sup> Cf. Treas. Regs. 105, §81.47a (c) (i). Care should be taken to spell out the lack of any limitations on this power. See Fleming, *supra* note 159, at 168.

<sup>162</sup> This does not appear to be a power to appoint a sufficiently "specific portion." Cf. the Tax Court's reasoning in the Pipe case, *supra* note 150.

<sup>163</sup> Casner, *The Internal Revenue Code of 1954: Estate Planning*, 68 HARV. L. REV. 222, 433, 477-478 (1954-55).

<sup>164</sup> As defined in WIS. STATS. (1953) §§232.11-232.12.

<sup>165</sup> WIS. STATS. (1953) §232.08.

<sup>166</sup> See generally ATKINSON, WILLS, §116 (1953).

<sup>167</sup> WIS. STATS. (1953) §72.15 (8m).

<sup>168</sup> WIS. STATS. (1953) §72.01 (5).

<sup>169</sup> *Supra* notes 48 and 49.

<sup>170</sup> With reference to power-of-appointment trusts, the following observations have been made: "In his effort to have the provisions of his will govern, the husband need not rely entirely on the wife's inertia, but can throw obstacles

A legal life estate may have three possible advantages over a gift in trust. Particularly in small estates, there would be the saving of trustee's fees in those situations where use of a trust would require a professional fiduciary rather than a relative or friend who would waive compensation.<sup>171</sup> The second arises where a testamentary trust is not feasible since a testamentary trust always entails the expense and delay resulting from court supervision.<sup>172</sup> The third exists "where the testator, for personal reasons, does not desire the intrusion of the impersonal services of a bank's trust department"<sup>173</sup> and no relative or close friend is available to act as trustee.

#### E. Power-of-Appointment Trusts

Although the Revenue Act of 1948 contained no express exception to the objectionable terminable interest rule for a legal life estate accompanied by a general power of appointment, it did allow a transfer in trust to qualify for the marital deduction if the surviving spouse was entitled for life to all of the income, payable at least annually, plus a power, exercisable by the surviving spouse alone and in all events, to appoint the entire corpus to herself or her estate.<sup>174</sup>

The Treasury Regulations issued in 1949<sup>175</sup> listed five requirements for coming within this exception. The first was that the surviving spouse "must be entitled for life to all the income from the corpus" and the third that she "must have the power, exercisable in favor of herself or her estate, to appoint the entire corpus free of the trust

into her path in the form of 'formal limitations' on the exercise of the power. Without disqualifying the trust, he can in his will provide that (1) to exercise her power the wife must make specific reference to it in her will and (2) she must do so in a will made by her after his death." Mannheimer, *et al.*, *The Use of a Formula Clause for the Marital Deduction*, 32 TAXES 381, 385 (1954). Presumably the new Regulations on legal life estates will allow similar limitations.

<sup>171</sup> Whether a real rather than an apparent saving would result depends, of course, on the type of assets involved, the ability of the widow to manage them, and, if expert assistance is needed, the relative cost of professional property management and investment counsel services compared with charges ordinarily made by a professional trustee.

<sup>172</sup> WIS. STATS. (1953) §323.01 requires testamentary trustees to file an inventory, render an annual accounting, and a final accounting at the termination of the trust. Where personal property which may be difficult to identify or trace at the widow's death is involved, some husbands may prefer court supervision. But if the latter is to be avoided in connection with a legal life estate, because of the Wisconsin practice of forcing a life tenant receiving property by will to hold it as trustee, *supra* note 151, the husband should expressly relieve the wife from any duty of protecting the remaindermen. The will in the Pipe case, *supra* note 150, provided: "I direct that my wife shall not be required to file any bond or other security for the protection of any remainderman interested in my said residuary estate . . ."

<sup>173</sup> Note, 28 IND. L. J. 409, 413 (1953).

<sup>174</sup> §812 (e) (1) (F) of the 1939 Code as amended by the Revenue Act of 1948. 62 STAT. 118 (1948).

Sugarman has suggested the liability of the surviving spouse for estate and gift taxes, because of her power over the appointive assets, as justification for this exception. *Op. cit. supra* note 54, at 254.

<sup>175</sup> *Supra* note 144.

. . . . If the surviving spouse is entitled to only a portion of the trust income, or has power to appoint only a portion of the corpus, the trust fails to satisfy conditions (1) and (3), respectively. However, such conditions may be satisfied by one or more of several separate trusts created by the decedent. An undivided interest in property may constitute the corpus of a trust."<sup>176</sup> In *Revenue Ruling 54-20*<sup>177</sup> decedent had created an inter vivos trust under which the widow was entitled to the entire net income during her lifetime plus a general power to appoint a portion of the trust corpus equal in value to fifty percent of the decedent's adjusted gross estate, reduced by the value of any property passing to the widow outside the trust and qualifying for the marital deduction. Decedent's will poured his residuary estate into this trust. Advice was requested as to whether the power to appoint by itself created a separate trust over the assets subject to the power. The Commissioner ruled that this power was insufficient to create a separate trust and, since none was otherwise created by the trust or the will, the widow merely had a power to appoint only a portion of the corpus of a single trust. Hence, none of the trust assets qualified for the marital deduction. A similar trust was under consideration in *Estate of Louis B. Hoffenberg*,<sup>178</sup> the widow being entitled to all the net income for life plus a power to appoint two-thirds of the corpus by will. The executors first contended that the words "entire corpus" in the statute<sup>179</sup> should be construed to mean only the corpus subject to the power of appointment. The Tax Court held that the plain language of the statute was to the contrary and that the legislative history of the Revenue Act of 1948 showed that the phrase "entire corpus" was not intended to be synonymous with a part of the corpus,<sup>180</sup> The alternative contention then urged was that this will created two separate trusts consisting of undivided interests in the same property. The Tax Court held that whether a single instrument created two or more trusts depended on whether the creator had expressed such an intent in the instrument and that there was nothing in this instrument to indicate an intent to create more than a single trust.<sup>181</sup>

The House Ways and Means Committee Report on H.R. 8300 states:

"Nor is it clear [under present law] where property is placed in trust and the surviving spouse has an income interest in and

<sup>176</sup> Treas. Regs. 105, §81.47a (c).

<sup>177</sup> I.R.B. 1954-2, 23.

<sup>178</sup> 22 T.C. No. 146 (1954).

<sup>179</sup> *Supra* note 174.

<sup>180</sup> The executors also urged that the 1954 Code merely clarified rather than changed pre-existing law. *Infra* note 182.

<sup>181</sup> The same conclusion was reached in *Estate of Harrison P. Shedd*, 23 T.C. No. 8 (1954), where the widow was entitled to two-thirds of the income for life plus a power to appoint one-half of the corpus.

power of appointment over part of the property, when the interests given the surviving spouse constitute a transfer in trust qualifying for the marital deduction. The House and your committee's bill make it clear that . . . a right to income plus a general power of appointment over only an undivided part of the property will qualify that part of the property for the marital deduction."<sup>182</sup>

Hence, the 1954 Code now allows either a right to "all the income from the entire interest, or all the income from a specific portion thereof," plus a power to appoint "the entire interest, or such specific portion."<sup>183</sup>

The new language raises several questions for the attorney who desires to draft a "portion" trust. First, there is the problem of deciding what is a "specific portion." The House Report gives the following example ". . . if the decedent in his will provided for the creation of a trust under the terms of which the income from one-half of the trust property is payable to this [sic] surviving spouse with uncontrolled power in the spouse to appoint such one-half of the trust property by will, such interest will qualify as an exception from the terminable interest rule."<sup>184</sup> This seems sufficient assurance that an undivided fractional share of the corpus of a single trust constitutes a specific portion. However, doubt has been expressed as to whether setting up a fixed dollar amount of the corpus as the specific portion would qualify.<sup>185</sup> The second problem is drafting the wife's right to income so that it will meet the statutory requirement of "all the income from a specific portion." It will be observed that the example in the House Report does not give the wife one-half of all the trust income but rather all the income from one-half of the corpus.<sup>186</sup> Thirdly, must the wife receive income only from the portion over

<sup>182</sup> H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 92 (1954). Similar language appears in Sen. Rep. No. 1622, 83rd Cong., 2d Sess. 125 (1954).

Attempts were made in both the Hoffenberg and Shedd cases, *supra* notes 178 and 181, to convince the Tax Court that the 1954 Code merely clarified rather than changed prior law. In the Hoffenberg case the court said: "We find only that the [Committee] reports carefully avoid any characterization of the meaning of prior law." And in the Shedd case: "Perhaps the Committee was referring to the not infrequent difficulty of determining whether or not a separate trust was created for the surviving spouse" but that in any event the prior statute was not ambiguous and the Committee reports do not change its plain meaning. The Hoffenberg decision has been appealed. 1955 *Prentice-Hall Federal Tax Service* Par. 132,101.

<sup>183</sup> *Supra* note 156.

<sup>184</sup> H.R. Rep. No. 1337, 83rd Cong., 2d Sess. a319 (1954).

<sup>185</sup> Since this amount would not increase despite appreciation in trust assets, the wife might not have a sufficient degree of ownership. Lovell, *Marital Deduction Simplified*, 93 TRUSTS AND ESTATES 760, 761-762 (1954).

<sup>186</sup> "The common formula of 'one-half the income for life and a power to appoint one-half the corpus at death' should, however, be avoided in favor of 'the income from an undivided one-half of the corpus for life and a power to appoint such undivided one-half at death.'" Toll, *Provisions of the 1954 Internal Revenue Code Affecting Trustees*, 34 TRUST BULL. (Sept., 1954) 7, 11.

which she has a power of appointment or may she, for example, be entitled to two-thirds or all of the trust income though her power is restricted to one-half of the corpus? A literal reading of the statutory language supports the conclusion that the right to income and the power to appoint must be coextensive, but it has been suggested that a more liberal construction would be "in keeping with the intention of Congress."<sup>187</sup>

Assuming a "portion" trust can be drafted which would qualify for the marital deduction, the question of using it rather than a separate trust seems to hinge upon whether the former is really simpler and less expensive to administer. At present there seems to be a divergence of opinion on this point among trust officers.<sup>188</sup>

Whether a portion or separate trust is used, the wife still must be entitled to all of the income, from whichever type is created, for life and she alone must have a power of appointment exercisable in all events.<sup>189</sup> *Estate of Frank E. Tingley*,<sup>190</sup> illustrates how a trust which attempts to provide for possible future incompetency of the wife may fail to satisfy these requirements. There the widow was given a right to income plus a power to appoint to herself, but both were to cease "in case of her legal incapacity from any cause or upon the appointment of a guardian, conservator, or other custodian of her person or estate," and the trustee then had "full power and discretion" to either pay out the income to or for the benefit of the widow or accumulate it. The Commissioner contended that, although the specified events never happened, the widow could have lost her right to income and power to appoint, so she was not entitled to all the income for life nor did she have a power to appoint in all events. The executor asserted that since the widow had the right at her husband's death to withdraw the corpus she was "the substantial owner" of both the income and corpus. The Tax Court held:

"If [decedent] had referred to legal incapacity alone, the situation might well be different for any surviving spouse with a power to appoint by will could later lose the power by becoming legally incapable of writing a will exercising the power, and Congress may not have intended that such an event by operation of law would deny the marital deduction wherever the power was to be by will. But this testator intentionally made the right to enjoy the income for life and the power to take down the corpus depend on events not synonymous with legal incapacity.

<sup>187</sup> Young, *Estate and Gift Tax Changes*, 93 TRUSTS AND ESTATES 858, 860 (1954). Also see Casner, *supra* note 163, at 481-482.

<sup>188</sup> Compare Lovell, *Marital Deduction Simplified*, 93 TRUSTS AND ESTATES 760 (1954) with Fleming, *Present Status of the Marital Deduction*, 33 TAXES 167, 168-169 (1955). Also see Dicus, *Some Implications of the 1954 Code for Estate Planning*, 32 TAXES 938, 945 (1954).

<sup>189</sup> *Supra* note 156.

<sup>190</sup> 22 T.C. No. 54 (1954).

Conditions short of legal incapacity could bring about the appointment of a guardian, conservator, or other custodian of the estate of the widow and the decedent chose to cut off his wife's rights should any such event occur. Thus, he named events under which she could not exercise the power and it was not exercisable 'in all events'. . . ."<sup>190a</sup>

*F. Life Insurance Payments with Power of Appointment*

The Revenue Act of 1948 also contained an exception to the objectionable terminable interest rule for proceeds under a life insurance contract<sup>191</sup> naming beneficiaries in addition to the surviving spouse or her estate<sup>192</sup> if "all amounts payable during the life of the surviving spouse are payable only to such spouse, and such spouse has the power to appoint all amounts payable under such contract" to herself or her estate.<sup>193</sup> The Treasury Regulations issued in 1949<sup>194</sup> listed five conditions for coming within this exception and then stated:

"If the interest of the surviving spouse under a life insurance, endowment, or annuity contract is in proceeds held by the insurer which do not, however, represent the entire amount payable under such contract, the provisions of section 812 (e) (1) (G) nevertheless apply to such proceeds so held to which all five of the above conditions apply. For example, an insurance contract on the decedent's life may provide for payment of the proceeds into two funds to be held by the insurer. In such case, if all five of the above conditions are satisfied with respect to all amounts payable into one such fund, then the special rule of section 812 (e) (1) (G) is applicable to the proceeds held in such fund."<sup>195</sup>

In *Revenue Ruling 54-554*<sup>196</sup> advice was sought on the proper treatment of proceeds under an insurance contract which provided that they be retained by the insurer in a single fund with monthly interest to be paid to the widow for life and up to one-half of the proceeds subject to withdrawal by her, the amount remaining at her

<sup>190a</sup> The taxpayer has appealed from this decision. 1955 *Prentice-Hall Federal Tax Service* Par. 132,101.

<sup>191</sup> This was later amended to include endowment and annuity contracts. Pub. L. No. 869, 62 STAT. 1214 (1948).

<sup>192</sup> Cf. Treas. Regs. 105, §81.47b (d) (iv): "H during his lifetime purchased an annuity contract providing for payments to himself for life and then to W for life if she should survive him. Upon the death of the survivor of H and W, the excess, if any, of the cost of the contract over the annuity payments theretofore made was to be refunded to A. The interest which passed from H to W is a 'nondeductible interest' since A may possess or enjoy a part of the property following the termination of the interest to W. If, however, the contract provided for no refund upon the death of the survivor of H and W, or provided that any refund was to go to the estate of the survivor, then the interest which passed from H to W is (to the extent it is included in H's gross estate) a 'deductible interest'."

<sup>193</sup> §812 (e) (1) (G) of the 1939 Code as amended by the Revenue Act of 1948 and Pub. L. No. 869. 62 STAT. 118 and 1214 (1948).

<sup>194</sup> *Supra* note 144.

<sup>195</sup> Treas. Regs. 105, §81.47a (d).

<sup>196</sup> I.R.B. 1954-48, 27.



death to go to decedent's children. The Commissioner ruled that none of the proceeds qualified for the marital deduction since under the terms of the contract "there was no segregation of the portion or interest in the proceeds subject to the widow's power to appoint such as would constitute a separate or single fund in respect of such portion or interest."

The House and Senate Committee Reports on the 1954 Code indicate that changes were made in the statutory exception for life insurance proceeds to bring the section into conformity with the changed power-of-appointment trust provision.<sup>197</sup> Section 2056 (b) (6) now provides that either all amounts payable during the widow's life "or a specific portion of all such amounts" must be payable only to her and she must have a power to appoint "all amounts, or such specific portion." Since an undivided fractional share is a "specific portion" for a power-of-appointment trust,<sup>198</sup> it should be the same for insurance proceeds. It has been suggested that a fixed dollar amount of insurance proceeds should also qualify as a specific portion.<sup>199</sup> A specific portion would appear preferable to a separate fund in estate planning if insurance companies consider the former less expensive to administer and offer some inducement, such as increased interest, to encourage the choice of this form of settlement.

#### G. *Death in a Common Disaster and Six-Months Exceptions*

The Revenue Act of 1948 provided yet another exception to the objectionable terminable interest rule for a surviving spouse's interest "which will terminate or fail upon the death of such spouse if (i) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding six months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and (ii) such termination or failure does not in fact occur."<sup>200</sup> Because this was phrased

<sup>197</sup> H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 92, a319 (1954). Sen Rep. No. 1622, 83rd Cong., 2d Sess. 125, 475 (1954).

<sup>198</sup> *Supra* note 184.

<sup>199</sup> Because of the lack of any fluctuation in value problem. Lovell, *supra* note 185, at 762.

<sup>200</sup> §812 (e) (1) (D) of the 1939 Code as amended by the Revenue Act of 1948. 62 STAT. 117 (1948).

"An example of the application of subparagraph (D) is a case in which the decedent's will provides that all his property shall pass to his spouse if she survives him by three months; but if she does not survive him such property shall pass to X charity. In this case the interest of the surviving spouse will terminate or fail only if she dies within three months following the date of the decedent's death. If in fact she does not die before the expiration of such period (and accordingly the property passes to her under the terms of the decedent's will), the marital deduction is allowable . . . . The rule of such subparagraph (D) does not apply to an ordinary life estate, such as under a devise of Blackacre to the wife for her life with remainder to X. While it is

as an exception to the definition of an objectionable terminable interest, it did not appear to apply to any of the other exceptions to this definition, particularly those concerning trust assets and life insurance proceeds subject to a power of appointment. The power required under both of those exceptions had to be exercisable in all events<sup>201</sup> and conditioning the power upon surviving the decedent by six months, or a common disaster in which decedent died, seemed contrary to this requirement. However, in 1951 the Treasury Regulations were amended to allow this type of condition with respect to a power to appoint trust assets or life insurance proceeds.<sup>202</sup> Congress in the 1954 Code ratified this interpretation by providing that the exception for an interest conditioned upon surviving six months or a common disaster should apply not merely to the definition of an objectionable terminable interest but to the entire subsection which contained not only this definition but also the other exceptions to it.<sup>203</sup>

Two recent developments illustrate how easily, and perhaps inadvertently, the surviving spouse's interest can be conditioned on survival for a period after decedent's death and how difficult it is to bring such conditions within the limited statutory exception. *Revenue Ruling 54-121*<sup>204</sup> was concerned with a life insurance policy which named the wife as primary beneficiary provided she was living when the insurance company received due proof of the death of the insured husband, otherwise the proceeds were to go to certain designated contingent beneficiaries. The Commissioner ruled that since proof of death might be submitted more than six months after the husband's death and the wife's interest would terminate if she were not then alive, she held an objectionable interest which was not within the statutory exception even though "the spouse does in fact survive the condition stated and take the property." In *Kasper v. Kellar*<sup>205</sup> a South Dakota decedent had willed certain property to his widow "if living at the time of the distribution of my estate," with a gift over to others if she "dies prior to the distribution of my estate." The estate was administered and the assets were distributed to the widow within six months of decedent's death, but the Commissioner refused to allow any marital deduction since South Dakota law did not require the distribution of a decedent's estate within six months after his death

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true that death of the wife within the 6-month period will cause a termination or failure of her interest, it is also true that her death at any time will also cause such termination or failure and accordingly the case does not meet the test of clause (i) of subparagraph (D)." Sen. Rep., *supra* note 6, at 341-342. Also see Treas. Regs. 105, §81.47b (d).

<sup>201</sup> *Supra* notes 174 and 193.

<sup>202</sup> T.D. 5857, 1951-2 Cum. Bull. 159.

<sup>203</sup> I.R.C. §2056 (b).

<sup>204</sup> I.R.B. 1954-14, 8.

<sup>205</sup> 217 F.2d 744 (8th Cir. 1954).

and, hence, "[a]s of the date of the decedent's death there was no certainty that within the six-months' period the spouse's interests would become absolute inasmuch as it was possible that distribution might not have been made within six months of death." The Court of Appeals agreed with this interpretation of the statutory exception and that no marital deduction should be allowed unless under South Dakota law the language in the will gave the widow an indefeasible interest as of decedent's death.<sup>206</sup>

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<sup>206</sup> The executors contended that the phrase in the will should be read as meaning "if living at the time of my death." The case was remanded to the lower court for a determination of "whether, under wills-and-property law of South Dakota, the language used and the intention and the circumstances involved would be regarded as having had the legal effect of vesting and make indefeasible in the widow, as of the time of the testator's death, the property devised and bequeathed to her."