Notre Dame Law Review

Volume 34 | Issue 2 Article 3

3-1-1959

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Arthur H. Northrup

THE MARITAL DEDUCTION: THE *STREET* CASE AND THE NEED FOR INDIANA LEGISLATION

*Arthur H. Northrup**

Introduction

Under the federal estate tax provisions,[1] a tax is imposed upon the value of the estates of decedents. Generally, the tax is computed by applying progressive rates to the net value of the estate, which is the gross value of the property less a complexity of possible expenses and allowable deductions. One of these is the "marital deduction"[2] by which the value of the property passing to the surviving spouse is deducted from the gross value of the estate in determining the net value for application of the tax rate. The operation of the tax can be demonstrated by means of an example. If the value of the estate is $200,000 and the amount passing to the spouse is $70,000, then the estate tax is computed by applying the rate to the net estate of $130,000. However, when under local probate law, the share passing to the wife is made to bear its proportion of the federal tax on the whole estate, the actual amount passing to the wife will be something less than the $70,000 assumed in the example. The computation of the tax in such a case results in a mathematical puzzle: the value of the property passing to the wife, and thus the allowable marital deduction, cannot be determined until her portion of the estate tax is computed, and the estate tax cannot be determined until the marital deduction is computed. The answer is given in formulae provided by the Internal Revenue Service.[3]

In any event, when the taxes are apportioned against the widow, the effect is to reduce the marital deduction and thereby increase the total estate tax. This article will deal with the treatment to be accorded the estate when a probate court has decreed that the widow's share is not to bear any part of the estate tax, and the federal taxing authorities later contend that the probate decree was wrong and is not binding on them in determining the amount of the marital deduction.

THE *Street* CASE

In the *Street* case,[4] a recent decision of the Federal Court of Appeals for the Seventh Circuit, the government was successful on this ground in reducing the marital deduction below the value of the fee-simple-absolute property actually distributed to the widow under a probate decree.[5]

* LL.B., Michigan, 1949; M.B.A., Harvard, 1946. Member of the Indiana Bar and member of the firm of Gregg, Fillion, Fillenwarth & Hughes of Indianapolis, Indiana.

1 INT. REV. CODE OF 1954, §§ 2001-2207.

2 INT. REV. CODE OF 1954, § 2056.

3 P-H (perm. ed. 1959) FED. TAX SERV. ¶¶ 120-564, 120-567.3—120-567.5.

4 Merchants Nat'l Bank and Trust Co. of Indianapolis, executor and trustee under the will of Guy E. Street v. United States, 246 F.2d 410, *cert. denied*, 355 U.S. 881 (1957).

5 Civil Probate #4621, in Probate Court of Marion County, Indiana (1951).

In this case, the testator's will gave his widow, in trust, the income of 40% of his residuary estate for life, gave the remainder of the estate to his grandchildren and directed the executor and trustee to pay all death taxes from the residuary trust. For the purpose of reducing federal estate taxes and to gain some control over her property, the widow followed the advice of counsel to renounce the will and elected to take under the law of descent, giving her one-third of the estate.[6] In a suit to construe the will, one of six issues presented to the Marion County Probate Court was: Should federal estate and Indiana inheritance taxes be apportioned against property qualifying for the marital deduction, thus reducing the net amount of the deduction and increasing the federal estate tax? The decision of the probate court was in favor of the widow. When the Internal Revenue Service assessed additional estate taxes on the theory that the taxes should be apportioned against the widow regardless of the probate court's decree, the United States District Court ordered the additional taxes refunded. Nevertheless, the Seventh Circuit found that the decision of the probate court was rendered in a non-adversary proceeding and therefore was not binding, and that $65,000 of the estate and inheritance taxes should have been paid out of the widow's share alone, thus reducing by $65,000 the original marital deduction taken in the estate tax return.

The decision establishes the supremacy of the federal government's views of what the law of Indiana and the distributions of property in an estate "should have been"[7] over the Indiana law of the case, applicable and applied,[8] and over the actual distribution of the estate in fact.[9] The end result is manifestly contrary to the language[10] and legislative history of the marital

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6 The value of a life estate interest passing to the spouse is not includable in the marital deduction, INT. REV. CODE OF 1954, § 2056(b), whereas a fee simple interest is included. As in other states, in Indiana, a surviving spouse may in general elect not to take under the provisions of the will and instead choose to share in the estate according to her rights of inheritance as if the spouse had died intestate. Ind. Acts 1907, ch. 48, §§ 1-4, IND. ANN. STAT. §§ 2332-2336 (Burns 1933) were the provisions in effect when Mrs. Street elected to take under the law. Present provisions are contained in IND. ANN. STAT. §§ 6-301—6-308 (Burns 1953 repl.).

7 This was stated by the government in oral argument before the Seventh Circuit Court of Appeals in May, 1957.

8 This conflicts directly with the income tax decision of Blair v. Comm'r, 300 U.S. 5, 9-10 (1937), involving the assignment of trust income: "The question of the validity of the assignments is a question of local law. . . . The decision of the state court upon these questions is final." This quoted rule was followed in estate tax cases in Brodrick v. Gore, 224 F.2d 892, 895 (10th Cir. 1955); Pitts v. Hamrick, 228 F.2d 486 (4th Cir. 1955); and Helvering v. Rhodes' Estate, 117 F.2d 509, 510 (8th Cir. 1941). There are exceptions to this rule in the case of fraud, consent or collusion, which are discussed in the text, *infra.*

9 In Freuler v. Helvering, 291 U.S. 35 (1934), which announced the basis of the rule in Blair v. Comm'r, *supra* note 8, a trustee had mistakenly over-paid the beneficiaries of a trust and a court decree issued that it be paid back, but factually it probably was not. The majority said that the court decree controlled, so that for tax purposes, the beneficiaries' income was reduced by the court decree. The dissent stated that the factual distribution controlled. The result in the *Street* case conflicts directly with both views, since the Seventh Circuit's finding was contrary to both the court decree and the factual distribution. Harrison v. Northern Trust Co., 317 U.S. 476 (1943), in holding that a deduction for a charitable bequest should be reduced by the amount of the estate taxes allocated to it, states that federal taxation is governed by what occurs in fact.

10 (E) Valuation of Interest Passing to Surviving Spouse.
In determining for the purpose of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection —

deduction statute. The statutory scheme contemplated was that in each case, the state court's determination of the distribution of the property would necessarily determine the amount of the marital deduction. Since its enactment, the policy of the federal estate tax law has been to leave the apportionment of the tax to state law also.[11]

FEDERAL-STATE JUDICIAL RELATIONSHIPS

An examination of the court's finding on the effect of the probate decree reflects the struggle between the Internal Revenue Service and the state courts for jurisdiction in settling issues of law determinative of federal tax questions. The issue of apportionment presented to the probate court, by its nature, is not one in which the interests of the heirs or legatees are typically united against the interests of the government. In the *Street* case, the probate court's decision not to apportion federal estate and Indiana inheritance taxes against the widow cost the residuary legatees $43,000, even though it reduced the federal estate taxes by some $22,000 because of the greater marital deduction.[12] As the case was finally determined, the full $65,000 of estate and inheritance taxes which the government argued should have been paid by the

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(i) there shall be taken into account *the effect* which a tax imposed by this chapter, or any estate, succession legacy, or inheritance tax, has upon the net value to the surviving spouse of such interest. . . .[12] (Emphasis added.)

Int. Rev. Code of 1939, § 812 (e)(1)(E), added by ch. 168, § 361(a), 62 Stat. 117, 118(1948) (now INT. REV. CODE OF 1954, § 2056(b)(4) as amended).

11 Its legislative history indicates clearly that Congress did not contemplate that the Government would be interested in the distribution of the estate after the tax was paid, and that Congress intended that state law should determine the ultimate thrust of the tax.* That Congress from 1916 onward has understood local law as governing the distribution of the estate after payment of the tax (with the limited exceptions created by § 826(c), (d) of the Internal Revenue Code, to be discussed presently) is confirmed by § 812(d) of the Code, 26 USCA 1940 ed. § 812(d), dealing with charitable deductions, which recognizes that estate taxes may be payable in whole or in part out of certain bequests, etc., 'by the law of the jurisdiction under which the estate is administered.' The administrative interpretation has been in accord, and that has been the understanding of the federal courts, and of some state courts.

Congressman Kitchin, Chairman of the House Ways and Means Committee stated: 'We levy an entirely different system of inheritance taxes. We levy the tax on the transfer of the flat or whole net estate. We do not follow the beneficiaries and see how much this one gets and how much that one gets, and what rate should be levied on lineal and what on collateral relations, but we simply levy on the net estate. *This also prevents the Federal Government, through the Treasury Department, going into the courts contesting and construing wills and statutes of distribution.* 53 CONG. REC. 1942 (1916).

* Congressman Cordell Hull, one of the supporters of the 1916 Act and its reputed draftsman, declared: 'Under the general laws of descent the proposed estate tax would be first taken out of the net estate before distribution, and the distribution made under the same rule that would otherwise govern it. *Where the decedent makes a will* he can allow the estate tax to fasten on his net estate in the same manner, or if he objects to this equitable method of imposing it upon the entire net estate before distribution *he can insert a residuary clause or other provision in his will, the effect of which would more or less change the incidence of the tax.*' 53 Cong. Rec. 10657 (1916). (Emphasis added.) Riggs v. Del Drago, 317 U.S. 95, 98 n.4 (1942).

12 In approximate figures, the original marital deduction taken was $345,000. The government successfully contended that it should be reduced to $280,000 (345,000 less $65,000) since under one apportionment theory, $65,000 more of state and federal taxes should be borne by the widow's share. The net deficiency asserted under this smaller marital deduction amounted to $22,000. Since the legatees had paid all the original taxes, the legatees had in effect assumed $43,000 ($65,000 less $22,000) of the taxes which according to the Circuit Court should have been borne by the widow.

widow alone were in fact paid by the residuary legatees.[13] Despite this factual distribution of the estate, the Seventh Circuit concluded that under the circumstances[14] the probate decree was not rendered in an adversary proceeding and therefore should not be binding on the federal government.

Consistent with the policy of the federal statute, the government is not bound by a state court's determination of the law of the case which was obtained by fraud, since such a determination is voidable by the innocent parties themselves.[15] And, of course, any decision which does not determine the facts upon which taxation depends, does not determine questions of federal taxation.[16] Because it is not a determination of the issues of law, a consent decree is not binding on the federal government.[17] Further, there is some dictum to the effect that a non-adversary proceeding will render any resulting decision not binding on the government,[18] but the term "non-adversary,"[19] is most often used in a context making it synonymous with collusion, which is a different ground.[20] In this connection, *Gallagher v. Smith*,[21] a recent

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13 Part of the estate taxes were originally paid by the widow, who received a share of the residuary trust set up for her in the will, since this passed by intestacy under the rule of Cassidy v. Padgett, 99 Ind. App. 234, 190 N.E. 133 (1934), (the wife's election to take by descent does not accelerate the legacies in the will that are payable upon her death, and she shares in the renounced life estate by intestacy). Since this share does not qualify for the marital deduction, the probate decree had already apportioned estate taxes to it. As to life estates, renunciation of the will, because of statutory change since Street's death, accelerates the estate ". . . as if such surviving spouse had predeceased the testator." IND. ANN. STAT. § 6-301(d) (Burns 1953 repl.). At the oral argument in the *Street* case, Judge Schnackenberg predicted that this provision would be difficult to interpret. He was right. See Salvation Army v. Hart, 149 N.E.2d 557, 565 (Ind. App. 1958) in which the majority held that the widow's renunciation destroyed the testatmentary trust set up for her benefit in the will, including the trust interests of two other beneficiaries, and accelerated the interests of the remaindermen finding ". . . a legislative intent to completely change the former statute."

14 In the probate court, the executor and the widow were represented by lawyers from the same firm, and the residuary legatees were represented through their father and guardian ad litem by another lawyer, who, after a first decree had been entered, filed a petition for a new trial and then withdrew on orders of the guardian. A second decree was then entered identical to the first with the addition of a default judgment against a daughter who had not put in an appearance.

15 See Helvering v. Rhodes' Estate, 117 F.2d 509, 510 (8th Cir. 1941) (dictum); Pitts v. Hamrick, 228 F.2d 486, 490-91 (4th Cir. 1955) (dictum). When a judgment is obtained by fraud, it is in the sense that a deliberate supression of the truth has prevented a judgment on the real merits. See Hilton v. Guyot, 42 Fed. 249, 252 (S.D.N.Y. 1890).

16 Saulsbury v. United States, 199 F.2d 578 (5th Cir. 1952)(court order allowing trustee to stop income payments so taxes could be paid did not determine issue of beneficiary's right to income). Sewell v. Comm'r, 154 F.2d 765 (5th Cir. 1945) (state determination of completed gift of stock did not prevent finding it was done only for tax purposes); Doll v. Comm'r, 149 F.2d 239 (8th Cir. 1945) (state determination of husband and wife partnership did not prevent taxation of all income as that of the husband alone).

17 Newman v. Comm'r, 222 F.2d 131 (9th Cir. 1955); Trapp v. United States, 177 F.2d 1 (10th Cir. 1949). A "consent" judgment is an agreement of the parties given sanction by entry on the court record, and is not a judicial determination of the rights of the parties and does not purport to be a court's judgment of the issues. See McRary v. McRary, 228 N.C. 714, 47 S.E.2d 31 (1948).

18 See Brodrick v. Gore, 224 F.2d 892, 896 (10th Cir. 1955)(dictum), and the reference in the *Street* case to the conflict, 246 F.2d 410, 417, n. 12. A probate proceeding is a proceeding in rem and is ex parte, and not an adversary suit among the parties, Callahan v. Hess, 348 Mo. 388, 153 S.W.2d 713, 717 (1941), but when conflicting claims are involved it becomes an adversary contest to a certain extent. O'Day v. Superior Court, 18 Cal. 2d 540, 116 P.2d 623, 624 (1941). The *Street* case being a suit to construe a will, was docketed as a "civil probate" matter. This classification is reserved for adversary proceedings.

19 Wolfsen v. Smyth, 223 F.2d 111 (9th Cir. 1955).

20 Pitts v. Hamrick, 228 F.2d 486, 490 (4th Cir. 1955)(dictum). A suit is collusive where brought by seemingly adverse parties under secret agreement and co-operation with a view to having some legal question decided which is not involved in a real controversy between them. See Texas & Pac. R.R. v. Gay, 86 Tex. 571, 26 S.W. 599, 612 (1894).

21 223 F.2d 218 (3d Cir. 1955).

Third Circuit decision, discussed the applicability of these principles in determinating the binding effect of a state court decree.

In *Gallagher v. Smith* the Commissioner contended that a widow should be liable for income tax on a greater amount of trust income than she was entitled to under a non-adversary orphan's court decree. The court, in a thoughtful opinion, held that whether the proceeding was adversary or not was relevant only as evidence, which, with other evidence, may tend to show collusion. In this particular type of inquiry, that is, a tax determination not requiring federal uniformity and which Congress has determined should be controlled by a local determination of property rights, a state court decision should be binding on the Commissioner regardless of its adversary character, not because it is res judicata, but because it finally determines the rights of the parties upon which the particular tax question depends. One year after *Gallagher,* the Third Circuit applied this ruling in *Babcock's Estate v. Commissioner,*[22] and reversed a district court for reducing the marital deduction below the amount actually received by the widow under an uncontested court decree.

The logic of this result and the precedent of the Third Circuit was avoided by the court in the *Street* case when it determined that the taxpayer had agreed that the state court proceeding had to be adversary in order to be binding,[23] and therefore that it would consider only that question. In view of the repeated quotations from, and express reliance on, the *Gallagher* and *Babcock* cases in the taxpayer's brief, oral argument and petition for rehearing, it would seem that the court misunderstood the taxpayer's position.[24]

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22 234 F.2d 837, 839 (3d Cir. 1956).

23 Merchants Nat'l Bank & Trust v. United States, 246 F.2d 410, 417 (7th Cir. 1957):

> . . . it is apparent that both sides agree that, if the probate court final decree was entered by consent of the parties or in a nonadversary proceeding, it is not binding upon the defendants in this federal estate tax litigation.

Later the Court seems to assume that a non-adversary proceeding is equivalent to consent decree by saying:

> The precise question before us is one of fact: Was the entry . . . the result of a genuine contest in an adversary proceeding . . . or was it the result of consent of the parties in a nonadversary proceeding?

24 The brief summary of argument on page 10 of taxpayer's brief said: "The evidence amply shows that the Probate Court proceeding was sharply adversary in form and in fact, and was clearly not collusive. Collusion is necessary if the Probate Court's decision is to be ignored." Taxpayer's brief on page 30 quoted and argued that the *Street* case came within the rules laid down in Gallagher v. Smith, 223 F.2d 218, 223, 225 (3d Cir. 1955):

> An adjudication of such a question of title by a court of the state must accordingly be given effect, not because it is res judicata against the United States, but because it is conclusive of the parties' property rights which alone are to be taxed. . . . It is for this reason that the federal court should not in a case of this kind make an independent examination and application of state law. For if it reaches a different conclusion from the state court as to what the parties' rights should be under the state law its decision will not change those rights which will necessarily remain what the state court has declared them to be.
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> . . . .
>
> But we think that the fact that the parties all favored the same result in the state court is relevant only so far as it is evidence of collusion and should not in and of itself vitiate in the federal court such conclusive effect as the state law gives to the judgment with respect to the property rights determined by it. For if in the absence of fraud such a judgment does determine the rights of the parties in the property they must thereafter live with it so far as their enjoyment of the property is concerned. . . .
>
> . . . .

At any rate, this avoidance of the issue of whether fraud, consent or collusion need be shown, or whether the showing of a non-adversary proceeding alone is sufficient, makes the *Street* case distinguishable as precedent in any future situations in which the Seventh Circuit must face the issue squarely.

Even on the basis of the Seventh Circuit's assumption that the proceeding had to be adversary, its conclusion that this proceeding was non-adversary is open to question. A definition of an adversary proceeding is necessarily implicit in the *Street* case, but the definition is not clear. The opinion acknowledges that as to the guardian ad litem for the ultimate beneficiaries of the residuary trust, the proceeding was genuinely contested.[25] After the first decree the attorney for the guardian ad litem filed a motion for a new trial, and thereafter, solely upon the orders of his own client, withdrew his appearance. The Court of Appeals held that at that point the proceeding ceased to be adversary. A second decree was later entered. It defaulted another beneficiary who had not appeared, but it was otherwise identical with the first decree. In effect, the Seventh Circuit treated the first decree as void and held that, since the lawyer for the guardian ad litem had withdrawn, the proceeding was not at the time of the final judgment of such an adversary nature as to be binding upon the Commissioner.

The court's position in this regard overlooked the binding effect of the first decree rendered as the result of an admittedly adversary proceeding. The only analytical basis for this view would be that the voluntary withdrawal of a motion for a new trial deprives the whole proceeding of what otherwise would be a valid adversary character. Since the purpose of the new-trial motion is to apprise the court and opposing counsel of trial errors forming the basis of appeal,[26] it is difficult to see how withdrawal of the appeal foundation destroys the already accomplished adversary determination of the law and facts in issue, much less converts it into a consent decree. The assumption that a later decree renders void the effect of the earlier decree when the two are addressed to different parties, but otherwise identical in terms, is unfounded. The court term having elapsed after the first decree was entered, the second decree, made on the judge's own initiative, could not modify the first in any way.[27] Finally, since the two decrees presented indentical de-

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> For it is quite common and highly commendable for all the members of a family group interested in a decedent's will to take a common view as to their rights under it, thus promoting family harmony and preventing that unseemly and disturbing spectacle, a family fight over a deceased relative's property.

It was also pointed out that the "disturbing spectacle" took place in the probate court in the *Street* case. The Court of Appeals seems to have penalized the taxpayer for his advocacy of the fact that it was adversary, by holding that he had agreed to a rule of law that it had to be adversary.

25 246 F.2d at 418. The Circuit Court brought out the facts that the lawyer for the guardian ad litem, failed to submit a brief and was not aware that the first decree had been rendered. These facts seem irrelevant when afterwards the court admits the proceeding was genuinely contested up to the time of the first decree. If anything, lack of advance knowledge of the terms or issuance of the first decree proves lack of consent to it.

26 Heekin Can Co. v. Porter, 221 Ind. 69, 46 N.E.2d 106 (1943); Smith v. Hill, 200 Ind. 616, 165 N.E. 911 (1929); H. C. Smith Coal Co. v. Finley, 190 Ind. 481, 131 N.E. 5 (1921); Edwards v. Weidenhaupt, 109 Ind. App. 507, 32 N.E.2d 106 (1941).

27 The first decree was entered February 21 and the motion for a new trial was made March 11, while the term for the probate court ends each month. IND. ANN. STAT. § 4-2907 (Burns 1946 repl.). State *ex rel.* Davis v. Achor, 225 Ind. 319, 75 N.E.2d 154 (1947); Irwin v. State, 220 Ind. 228, 41

terminations of the issues, the second did not in fact modify the first. In deciding "a question of fact," the Seventh Circuit made an error of law. If not, the rule of law laid down by the decision is: "When the losing party in an adversary proceeding fails to argue a motion for a new trial, the decree of the court becomes a consent decree and is not binding on the government for tax purposes." Since a motion for new trial is the first step toward appeal and follows final judgment, this proposition is contrary to those cases deciding that lower state court decisions are binding even though no appeal is taken.[28]

THE WIDOW'S RENUNCIATION OF THE WILL

Notwithstanding the rule of the cases discussed above,[29] establishing a probate court decision untainted by fraud, consent, or collusion as determinative of the same issues for federal-tax purposes, the Seventh Circuit in the *Street* case made an independent determination of the law of Indiana relative to a widow's renunciation of a will. The decision that her renunciation of the will precluded her right to receive any benefit from a direction in the will as to payment of taxes, appears to be erroneous.

Street's will directed that all estate taxes be paid out of the residuary trust estate.[30] The Court of Appeals apparently conceded that the directions were effective even as to the part of the estate passing by intestacy. That is, the "or" provisions in items I and V were disjunctive, so that the direction to pay estate taxes was not limited to benefiting "any beneficiary thereof on account of the provisions hereof made in their behalf . . .," or to "any beneficiary thereof by reason of the transfers herein. . . ."[31] The court apparently further conceded that the widow's election removed from the testamentary trust estate, prior to the payment of taxes, the property which she took by law, and that it would have made her property free of taxes which by the direction

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N.E.2d 809 (1942); Wagner v. McFadden, 218 Ind., 400, 31 N.E.2d 628 (1941); Hefton v. State, 206 Ind. 663, 190 N.E. 847 (1934); Rooker v. Fidelity Trust Co., 202 Ind. 641, 177 N.E. 454 (1931); Scheiring v. Baker, 202 Ind. 678, 177 N.E. 866 (1931); Bland v. State, 2 Ind. 608 (1851); Wakeman v. Jones, 1 Ind. 517 (1849); Blair v. Russell, 1 Ind. 516 (1849); Brackenridge v. McCulloch, 7 Blackf. 334 (Ind. 1845); Farmers & Merchants Nat'l Bank v. Elliott, 80 Ind. App. 596, 141 N.E. 652 (1923); Kruger v. Duckwall, 78 Ind. App. 577, 134 N.E. 895 (1922); Cauthorn v. Bierhaus, 44 Ind. App. 362, 88 N.E. 314 (1909). (The United States District Court for the Southern District of Indiana, Hon. Cale J. Holder, Judge, cited these authorities with approval in a learned memorandum of opinion dated June 18, 1958 partially denying a new trial after remand from the court of appeals).

28 Pitts v. Hamrick, 228 F.2d 486 (4th Cir. 1955); and see Frueler v. Helvering, 291 U.S. 35, 38, 45-47 (1934). See also, Oliver, *The Nature of the Compulsive Effect of State Law in Federal Tax Proceedings*, 41 CALIF. L. REV. 638, 664-66 (1953).

29 Smith v. Callagher, 223 F.2d 218 (3d Cir. 1955); Babcock's Estate v. Comm'r, 234 F.2d 837 (3d Cir. 1956).

30 These provisions were:

> Item I
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> I direct that all federal and state estate and inheritance taxes that may be assessed upon my estate or payable by any beneficiary thereof on account of the provisions hereof made in their behalf be paid from and out of my residuary estate.
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> . . . .
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> Item V
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> 10. My trustee is specifically authorized and empowered . . . to apply the principle of the trust estate to the payment of all inheritance taxes, State or Federal, levied against my estate or beneficiary thereof by reason of the transfers herein . . . . 246 F.2d at 411.

31 *Supra*, note 30. The will governs the administration of the entire estate, including interstate property. See Piersol v. Hayes, 113 Ind. App. 214, 47 N.E.2d 838 (1943).

in the will were to be borne by the trust estate. However, it held that any benefit the widow would have received under these directions in her intestate capacity, was forfeited by renouncing the will.

In its reliance on the Wisconsin case of *In re Uihlein's Will*[32] for this conclusion, the Seventh Circuit failed to distinguish between the Indiana and Wisconsin law on the subject. In the *Uihlein* case, the court admitted that a widow's share by renunciation is taken out before computation of the residue, but held that a direction to pay estate taxes from the residue simply could not operate in her favor after election against the will. The reasoning was that because under the will her share in the residuary estate would have been subject to taxes, she should not gain the benefit of the direction by electing to take outside the will. The decision on this point was without authority, controlled on its face by policy considerations. However, the policy of the Wisconsin law is to limit the widow solely to her statutory rights, as pointed out in the *Uihlein* case. The Indiana policy is contrary, and the Indiana widow may still receive benefits under the will she has renounced, as the following will demonstrate.

Without addressing itself to the argument that the renunciation by the widow, under the language of the Indiana statute should be interpreted to affect only bequests and devises to the widow,[33] and cannot change an administrative direction to the executor as to the payment of taxes,[34] the court assumed that the direction to pay estate taxes was one of "the provisions made for her" so that her renunciation deprived her of "the benefit that would have inured to her under Item I."[35] For authority in support of this proposition, the court relied upon *Clark v. Clark*[36] and *Rawley v. Sanns*.[37] These two cases were almost identical, arising under a peculiar statutory scheme which was in effect in Indiana from 1891 to 1907.[38] Under these statutes, for the husband to take under a will an election was necessary, otherwise it was presumed that the husband renounced the will and took his property as an heir. In both cases, a husband had occupied farm lands which had previously belonged to his wife and in which she had given him a life estate by her will. Thereafter, upon his death, the husband's heirs had sued for the one-third interest which he would have taken by law in the lands of his wife. In both

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32 264 Wis. 362, 59 N.W.2d 641, 648-49 (1953). It is interesting to note that on the issue of whether the widow's share should be taken free from taxes, a Wisconsin county court decision, decided prior to *Uihlein* and never appealed from, was contrary to *Uihlein*. However, the county court's decision was held to determine the law of Wisconsin for federal estate tax purposes, even though at the time of the tax decision, *Uihlein* had intervened and reversed the law on the point. Weyenberg v. United States, 135 F. Supp. 299 (D.C. Wis. 1955), cited with approval in Babcock's Estate v. Comm'r, 234 F.2d 837, 841 (3d Cir. 1956).

33 IND. ANN. STAT. § 6-2334 (Burns 1933) provided that the election of the widow should renounce "the provisions made for . . . her in such will." Compare with present law, IND. ANN. STAT. § 6-301 (Burns 1953 repl.).

34 Commerce Union Bank v. Albert, 301 S.W.2d 352 (Tenn. 1957).

35 246 F.2d at 414.

36 132 Ind. 25, 31 N.E. 461, 462 (1892).

37 141 Ind. 179, 40 N.E. 674, 676 (1895).

38 Ind. Acts 1852, § 22, and Ind. Acts 1853, ch. 38, § 5, as amended by Ind. Acts 1891, pp. 71, 72 (IND. ANN. STAT. §§ 2642, 2649 (Burns 1891) and partly repealed by implication in Acts 1901, ch. 78 (see Steirs v. Mundy, 174 Ind. 651, 92 N.E. 374 (1910)) and Ind. Acts 1907, §§ 2, 3 (see Studebaker Bros. Mfg. Co. v. DeMoss, 62 Ind. App. 635, 113 N.E. 417 (1916).

cases the court held against the husband's heirs, declaring that by estoppel the husband had elected to take under the will a life interest in the entire farm. These cases formulated the basic rule that a surviving spouse was not entitled directly to both the provisions of the law of descent and of the will at the same time, and then went on to theorize that a renunciation of the will would have prevented the husband taking any benefit which would have accrued to him under the will. The latter statements are dicta, since a converse factual situation was involved, that is, these cases involved an election to take under the will and not an election to take under the law. Also, the cases were concerned only with the general issue of title to particular real estate and not a surviving wife's total rights in a deceased husband's entire estate. These cases are of doubtful authority since the 1907 statute changed the law under which they were decided,[39] and the widow's and husband's rights have always been given separate statutory treatment.[40] The government no doubt considered these cases of less pursuasion and authority, since it failed to cite them to the court.

At any rate, contrary to the court's interpretation of these two cases, it is possible for the renouncing wife to retain some benefit under the will by sharing, in her intestate capacity, in the rights any intestate successor might have under the will, as the following example will demonstrate.

When the widow elects against the will, she destroys the provisions for her. An issue then arises as to the disposition of the property or the life estate originally bequeathed to her. A long line of Indiana cases take a minority view in providing that when a widow elects to take against a will, she gets, in addition to her express statutory interests, her full intestate share of any property which was bequeathed to her in the will and is not otherwise disposed of when the bequest lapses because of the renunciation.[41] The issue is present where either the will contains no residuary clause, or where the provisions for the widow, which she renounced, are in the residuary clause itself. The same principle applies directly to the *Street* case where the widow was entitled, as part of her intestate share, to the financial benefit of the testator's direction to the executor to pay estate taxes. Since this administrative directive to the executor on a matter affecting all legatees and heirs was not a singular provision for her, the widow's renunciation should not have altered this direction in any way.[42]

The Seventh Circuit concluded that because taxes are by statute made a superior claim on the estate before payment to any beneficiaries, this determines the issue that as among the various beneficiaries of the estate, there must be apportionment of the taxes. The court quoted from the Indiana case

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39 See note 38, *supra.*

40 At the time of the *Rawley* and *Clark* cases, the wife was already taking by the will unless she elected to take under the law. See Fosher v. Guilliams, 120 Ind. 172, 22 N.E. 118 (1889).

41 Tom v. Tom, 199 Ind. App. 599, 26 N.E.2d 410 (1940); Cassidy v. Padgett, 99 Ind. App. 239, 190 N.E. 133 (1934); Rocker v. Metzger, 171 Ind. 364, 86 N.E. 403 (1908); Garrison v. Day, 26 Ind. App. 543, 76 N.E. 188 (1905); Morris v. Morris, 119 Ind. 341, 21 N.E. 918 (1889); Hauk v. McComas, 98 Ind. 460, 464-65 (1884); Dale v. Bartley, 58 Ind. 101 (1877); Cool v. Cool, 54 Ind. 225 (1876); Rusing v. Rusing, 25 Ind. 63 (1865).

42 Commerce Union Bank v. Albert, 301 S.W.2d 352 (Tenn. 1957).

of *Cornet v. Guedelhoefer*[43] as establishing the superiority of estate taxes as a claim on the entire estate, but failed to point out that this case also indicated that the intent of the will governs as to its apportionment among the various beneficiaries. In the *Cornet* case, the question involved was the identity of the fund from which estate taxes should be paid in a testate estate when the personal property was insufficient to pay the taxes. The Indiana Supreme Court held that an agreement among the parties as to how the federal estate taxes should be paid was binding and enforceable, as not contrary to any law, observing:

> While the executor is required to pay such taxes before he may be discharged, he must, *in the absence of agreement or direction in the will,* deduct the tax payable by each beneficiary from his distributive share, or where tangible property is received, collect the tax from the beneficiary. (Emphasis added.)[44]

Thus in holding that taxes are a debt of the whole estate, but indicating their payment is subject to a direction in the will, *Cornet* seems to be authority, not for the Seventh Circuit position, but for the position that a direction in the will for the payment of taxes is an administrative provision, and not a provision for the benefit of any given beneficiary which would be renounced by electing to take under the law.[45]

Regardless of the validity of the court's determination on this point, and even assuming there had been no direction in the will at all, the court's decision disregarded the rule of equitable apportionment established in Indiana in 1951 by *Pearcy v. Citizen's Bank & Trust.*[46]

The Rule of Equitable Apportionment

Before the passing of the marital-deduction amendment to the federal estate tax statute in 1948, in some cases it had been successfully contended that by certain language in the estate tax statute, Congress had intended to make estate taxes payable solely out of the residue of the estate, so that states could neither by legislation nor court rulings apportion the burden of the tax among the beneficiaries of the estate as they saw fit. This theory was

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43 219 Ind. 200, 207, 36 N.E.2d 933, 935, *rehearing denied,* 37 N.E.2d 681 (1941).

44 36 N.E.2d at 938.

45 She could be responsible for no share of the taxes unless the fund was inadequate. Ind. Ann. Stat. § 6-1907 (Burns 1933) provided:

> Provisions of Will to be Complied With — If, by the will of the deceased, any part of his estate, or any one or more of the devisees or legatees, shall be made exclusively liable for the debt, in exoneration of the estate or of the devisees or legatees, the provisions of the will shall be complied with in that respect; and the real estate, and the persons so exempted by the will, shall be liable only for so much of the debt as cannot be recovered from those first chargeable therewith. (Acts 1881 (Spec. Sess.), ch. 45 § 222, p. 423).

No exactly similar provision appears in the 1953 Probate Code. A substantial amount of real estate was involved in the widow's renunciation. The Indiana statute, in explicit language, required that the widow receive one-third in fee simple, free from all demands of creditors, and was thus contrary to the computation of the Internal Revenue Service which assessed taxes against the widow's property on the basis of one-third of the total value, including real estate. Ind. Ann. Stat. § 6-2313 (Burns 1933). Provisions for real and personal property are now identical. Formerly, the widow received one-third of personal property under Ind. Ann. Stat. § 6-2319 (Burns 1933). Compare with present provisions, Ind. Ann. Stat. §§ 6-301, 6-402, 6-103 (Burns 1953 repl.).

46 121 Ind. App. 136, 96 N.E.2d 918, *rehearing denied,* 98 N.E.2d 231 (1951).

rejected by the Supreme Court in *Riggs v. Del Drago* in 1942, deciding that New York had the right to pass a statute providing for equitable apportionment:

> We are of the opinion that Congress intended that the federal estate tax should be paid out of the estate as a whole, and that the applicable state law as to the devolution of the property at death should govern the distribution of the remainder and the ultimate impact of the tax.[47]

Before the 1948 marital deduction had become applicable to estates, Indiana, on this ultimate authority, adopted the rule of equitable apportionment in *Pearcy v. Citizens Bank & Trust.*[48] The court quoted from the Kentucky case of *Martin v. Martin's Adm'r*[49] that,

> . . . in the absence of specific direction to the contrary justice requires that all classes of beneficiaries participating in the net value of the estate left after the federal tax is satisfied and deducted, should, as between themselves, bear their just proportion of it.[50]

So it followed after the case of *Riggs v. Del Drago* and before the marital deduction came into existence, that it was common sense justice and the better view[51] that in the absence of direction, the burden of taxes should be equitably borne by the various persons benefited. If we stopped here without consideration of the marital deduction, it would seem that equitable apportionment should operate to make the widow's share bear its portion of the tax, and thus that the Seventh Circuit was ultimately correct in its decision. However, this is to overlook the subsequent effect of the marital deduction upon the basic rule of equitable apportionment.

In the same year that the *Pearcy* case was being decided with heavy reliance on Kentucky views, Kentucky applied its rule of equitable apportionment in *Lincoln Bank & Trust v. Huber,*[52] in which, unlike the *Pearcy* case, the facts arose after the 1948 marital-deduction amendment. Kentucky, in applying its rule of equitable apportionment, held that since under operation of the new marital deduction, the property passing to the widow causes no tax to the estate, it is equitable that the widow's share should bear no proportionate part of the federal estate taxes. Many of the states have statutes providing for equitable apportionment, some merely providing that the taxes shall be "equitably prorated,"[53] while others specifically make reference to the marital deduction by saying, ". . . each such person shall have the benefit of any exemptions, deductions, and exclusions allowed by such [federal] law. . . ."[54] Of the sixteen states which have considered the problem, eight have found that either legislative or judicial equitable apportionment requires that estate taxes

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47 Riggs v. Del Drago, 317 U.S. 95 - 97,98 (1942).

48 121 Ind. App. 136, 96 N.E.2d 918, *rehearing denied,* 98 N.E.2d 231 (1951).

49 283 Ky. 513, 142 S.W.2d 164, 165 (1941) relying on Hampton's Adm'r v. Hampton, 188 Ky. 199, 221 S.W. 496 (1920).

50 96 N.E.2d at 926.

51 ANNOT., *Ultimate Burden of Estate Tax in Absence of Statute or Will Provision,* 37 A.L.R.2d 169, 171 (1951).

52 240 S.W.2d 89 (Ky. 1951).

53 CAL. PROBATE CODE § 970 (West 1956).

54 VA. CODE § 64-151 (1952).

should not reduce marital-deduction property,[55] while the others have rejected such a holding on the basis that statutory authority to do so was absent.[56]

Thus all of the equitable-apportionment states,[57] whether they are equitable-apportionment states by statute or pursuant to equity rulings in the absence of statute, have held that when a widow renounces a will, her property which qualifies for the marital-deduction exemption should not be subjected to any apportioned share of federal estate taxes. The *Street* case, when contrasted with *Pearcy*, makes Indiana the only exception to this division of states. There can be little doubt that had the Indiana Supreme Court been given the opportunity to rule definitively on the question, either in the *Street* case or in another decision, it would have logically developed its rule of equitable apportionment to exempt marital-deduction property from the payment of the estate tax. By the decision in the *Street* case, Indiana was deprived of the federal estate tax benefit which in all other states has accompanied the adoption of the rule of equitable apportionment.

Separate from, but related to the rule of equitable apportionment, is the general argument that the entire purpose of the federal marital deduction provision was to permit the common-law and code states to approach equality in federal estate tax treatment with community-property states.[58] In the *Uihlein* case, the Wisconsin Supreme Court rejected this argument as being a wholly untenable basis for interpreting the federal statute, since the federal statute expressly provides that the marital deduction shall be reduced by

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55 Cases decided without a statute are: N.J. — In re Burnett's Estate, 50 N.J. Super. 482, 142 A.2d 695 (1958); Ky. — Lincoln Bank & Trust v. Huber, 240 S.W.2d 89 (Ky. 1951); S.C. — Pitts v. Hamrick, 228 F.2d 486 (4th Cir. 1955), where the Fourth Circuit upheld a South Carolina probate court's reasoning that since South Carolina adopted the rule of equitable apportionment before the marital deduction, it should logically apply to relieve the widow of taxes on marital deduction property. Cases decided under general statutes requiring equitable apportionment but making no specific reference to exemptions in the federal law are: Conn. — Jerome v. Jerome, 139 Conn. 285, 93 A.2d 139 (1952); Cal. — In re Buckhantz' Estate, 120 Cal. App. 2d 92, 260 P.2d 794 (1953). Cases decided under statutes making reference to exemptions allowed by the estate tax law are: Fla. — In re Fuch's Estate, 60 So. 2d 536 (Fla. 1952); N.Y. — In re Wolf's Estate, 282 App. Div. 1018, 126 N.Y.S.2d 302 (1953); In re Peter's Will, 88 N.Y.S.2d 142 (Surrogate Ct.), *aff'd*, 275 App. Div. 950, 89 N.Y.S.2d 651 (1949); Pa. — In re Rosenfeld's Estate, 376 Pa. 42, 101 A.2d 684 (1954); Babcock's Estate v. Comm'r. 234 F.2d 837 (3d Cir. 1956).

56 *In re* Uihlein's Will, 264 Wis. 362, 59 N.W.2d 641 (1953) citing Wachovia Bank & Trust v. Green, 236 N.C. 654, 73 S.E.2d 879 (1953), held that the Wisconsin Supreme Court had no power to require equitable apportionment in the absence of statutory authority. Indiana has already adopted equitable apportionment without a statute in the *Pearcy* case. Other decisions holding that interpretation of their statutes defining the widow's share as part of the "surplus," "residue," or "net estate," or other such language, precluded them from computing the widow's share before deduction of taxes are: Northern Trust Co. v. Wilson, 344 Ill. App. 508, 101 N.E.2d 604 (1951); Campbell v. Lloyd, 162 Ohio St. 203, 122 N.E.2d 695 (1954), (overruling a case decided two years earlier that marital-deduction property should be free of estate taxes on the basis of equitable apportionment); Moorman v. Moorman, 340 Mich. 636, 66 N.W.2d 248 (1954); Weinberg v. Safe Deposit & Trust Co., 198 Md. 539, 85 A.2d 50 (1951); and see Thompson v. Wiseman, 233 F.2d 734 (10th Cir. 1956) (rejecting the equitable-apportionment theory on the ground that Oklahoma's law directed a certain fund to bear the tax, and therefore that the wife's share had to be computed after deducting the tax).

57 *But see* Williamson v. Williamson, 272 S.W.2d 73 (Ark. 1954) interpreting its statute providing for the apportionment of the "burden" of the estate taxes as not relieving the widow of taxes on marital deduction property. See also Weinberg v. Safe Deposit & Trust Co., 198 Md. 539, 85 A.2d 50 (1951).

58 Many of the Southwestern and Pacific states, from Louisiana to Washington, follow the Spanish community property law under which each spouse owns half of the real and personal property acquired (other than by separate gift or inheritance) during the marriage. Half of the property then is generally not included in the estate for estate tax purposes in these states.

whatever effect state inheritance and federal estate taxes have on the marital-deduction property. However, if a state does not relieve the widow's share of estate taxes, with the result that taxes do reduce the marital deduction, a state which limits the widow to fifty percent[59] or less of her husband's estate upon intestacy or renouncing his will, is not approaching equality of federal tax treatment with community-property states as closely as permitted by federal law. In short, to say that the federal law does not impose equality with community-property states is no argument for denying that the federal law was designed to permit as much equality in federal taxation as is possible under the state laws of inheritance. This is precisely what the Seventh Circuit's opinion in the *Street* case prevents Indiana probate courts from doing until the question is decided by the Indiana Supreme Court.[60]

THE NEED FOR INDIANA LEGISLATION

The problem in federal estate taxation created by the *Street* case goes beyond the narrow limits of cases in which the widow renounces the will. It affects the question of taxation of intestate Indiana estates as well. Moreover, the enactment of the 1953 Indiana Probate Code has removed much of the express statutory language relied upon by the taxpayer in the *Street* case. The effect of present Indiana statutes on the problem is doubtful.

Though the *Street* case arose because the testator failed to write a new will after the enactment of the marital deduction and directions may be put into wills to accomplish the purpose, clearly, legislation is desirable to insure that the Indiana rule of equitable apportionment has its natural consequences in federal estate tax savings. A bill would accomplish the main purpose by providing that no part of the federal estate taxes on an Indiana estate shall be apportioned against or collected from property qualifying, in the absence of apportionment, for the marital deduction allowed by the federal estate tax, unless the will expressly provides to the contrary. One additional aspect of the marital deduction should be noted. Apportionment of state inheritance taxes against marital-deduction property may increase the federal estate tax. Under present Indiana law, state inheritance taxes should be apportioned in an intestate or testate estate.[61] Under the *Cornet* case, when there is a will with a provision expressly providing for payment of inheritance and estate taxes, the terms of the will should govern, although the *Street* case casts some doubt on this proposition for federal estate tax purposes when a widow renounces. Accordingly, if the General Assembly of Indiana is desirous of having estates in Indiana receive the full benefit of the federal marital deduction statute,

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59 The marital deduction in any event is limited to 50% of the estate. INT. REV. CODE OF 1954, § 2056 (c).

60 The problem of a federal court's interpreting a state law in conflict with the ruling state court interpretation of its own law is not a new one. *Compare* the Seventh Circuit's construction of IND. ANN. STAT. § 2-606 (Burns 1933) in Vandevoir v. Southeastern Greyhound Lines, 152 F.2d 150 (7th Cir.) *cert. denied* 327 U.S. 789 (1945), *with* Mechanics Building Association v. Whitacre, 92 Ind. 547 (1883), and Wood v. Bissell, 108 Ind. 229, 9 N.E. 425 (1886).

61 Cornet v. Guedelhoefer, 219 Ind. 200, 36 N.E.2d 933, 938 (1941); Quirk v. Kirk, 64 Ind. App. 496, 114 N.E. 109 (1916).

legislation to achieve this result should provide that Indiana inheritance taxes are not to be apportioned against property qualifying for the federal marital deduction.

Such legislation would merely be a logical extension and application of the rule of equitable apportionment adopted in the *Pearcy* case. It would effect a tremendous tax saving for the citizens of Indiana without any change in their announced public policy on widow's rights. Such legislation, of course, would have to be limited to situations in which other property in the estate would be adequate to pay the federal estate and state inheritance taxes, which is likely to be the case in most estates where the problem is present in substantial form.

While legislation is an unwieldy remedy, it would operate to avoid an interpretation of Indiana law for federal-tax purposes different from that same law as interpreted and applied in controversies between Indiana citizens.