Michigan Law Review

Volume 63 | Issue 5

1965

Marital Deduction Formula Clauses in Estate Planning-Estate and Income Tax Considerations

Alan N. Polasky
University of Michigan Law School

MARITAL DEDUCTION FORMULA CLAUSES IN ESTATE PLANNING—ESTATE AND INCOME TAX CONSIDERATIONS

*Alan N. Polasky**

TABLE OF CONTENTS

ONCE upon a time, and not so very long ago, a child was born, much to the delight of its lawyer-parents. As children will, it brought much joy and only occasional moments of dismay and concern during its early, formative years. But one day it entered the terrible teens, and at age sixteen it became, like many teen-agers, baffling, confusing, and frustrating, giving rise to frenzied attempts to cope with and control the complexities of its behavior. Its name? The Federal Estate Tax Marital Deduction.

Two rather startling developments during the past year focused attention on the federal estate tax marital deduction. Each in its own quite different way gave rise to a feeling that "the halcyon

* Professor of Law, The University of Michigan.—Ed. Parts of this article comprised portions of speeches for the 17th Univ. of Miami Tax Institute, the American Bankers Association 1964 Midwinter Trust Meeting, Corporate Fiduciaries' Association of Boston, Pennsylvania State Bar Association June 1964 meeting, and various estate planning council meetings.

days"[1] had passed and an era of stricter enforcement of the technical requirements for qualification was at hand.[2]

The first development involved the Supreme Court, which, during the October 1963 term (1963-1964), handed down opinions in five cases involving federal tax liability. Three dealt with procedural matters;[3] the other two, involving substantive interpretation of the Internal Revenue Code, were both concerned with the federal estate tax marital deduction. The first of these two cases, *United States v. Stapf*,[4] is an illustration of statutory interpretation in the light of the underlying purpose of legislation; it reached an expected[5] and sensible result.[6] The second, *Jackson v. United States*,[7] though it might be regarded as hyper-technical by some, is typical of the spate of decisions in the lower courts[8] illustrating situations which should not have arisen[9] and which should create no impediment to obtaining the marital deduction in well-planned estates.[10]

---

1. See, *e.g.*, Cantwell, *Ten Years of Experience With the Marital Deduction*, 36 DICTA 197, 201 (1959); Fleming, *Five Years' Experience With the Marital Deduction*, 34 CHICAGO B. RECORD 247 (1953); Golden, *A Decade With the Marital Deduction*, 97 TRUSTS & ESTATES 304, 361 (1958); Lovell, *Administering the Marital Deduction—A Summary of Five Years' Experience*, 92 TRUSTS & ESTATES 812 (1953). In varying degrees the articles suggest that the statute was being administered in the "spirit" in which it was enacted.

2. See Lloyd, *Revenue Procedure 64-19—Background of Drafting Problems*, 103 TRUSTS & ESTATES 898, 900 (1964): "Paul Sargent . . . characterized the tax laws as providing an interesting study in the triumph of intellect over common sense. I would say that the issuance of Revenue Procedure 64-19 proves the truth of this statement."

3. Reisman v. Caplin, 375 U.S. 440 (1964); Meyer v. United States, 375 U.S. 233 (1963); United States v. Zacks, 375 U.S. 59 (1963).

4. 375 U.S. 118 (1963).

5. See Bushman, *Thoughts From Stapf—The Widow's Election in Community Property States*, 103 TRUSTS & ESTATES 592 (1964).

6. Bushman, *supra* note 5; Polasky, *Panoramic View of Current Tax Developments*, 103 TRUSTS & ESTATES 253, 257 (1964); Polasky, *Current Developments in Taxation*, 43 TRUST BULL. 12, 38 (1964).

7. 376 U.S. 503 (1964), 63 MICH. L. REV. 924 (1965), discussing this case. In addition to the point there discussed, *Jackson* has created some concern because of inclusion of the statement that "Qualification for the marital deduction must be determined as of the time of death," *id.* at 508, and disqualification based on the fact that the interest was not "a vested right," *id.* at 506, which was "indefeasible" at that time. *Id.* at 507. This language may have given rise to certain recent statements of representatives of the Internal Revenue Service relative to the "vesting" requirement. See note 151 *infra*.

8. A recent unpublished study undertaken in connection with the American Bar Foundation's Federal Tax Procedure Project (Wright & Polasky, Co-Directors) indicates that of the thirty to thirty-five published estate tax opinions of the federal circuit courts of appeals, Court of Claims, and district courts during the past three years, one-third dealt with the marital deduction.

9. A number of the recent cases are collected and briefly discussed in Polasky, *Some Recent Federal Estate and Gift Tax Developments*, in Institute for Continuing Legal Education, Michigan Course Handbook No. 10, 1964, pp. 10, 18-22; and Polasky, *Some Recent Federal Estate and Gift Tax Developments*, in INSTITUTE FOR CONTINUING LEGAL EDUCATION, THIRD ANNUAL PROBATE SEMINAR 1, 6-13 (1963); Polasky, *supra* note 6; CASNER, ESTATE PLANNING, SUPPLEMENT 297-337 (1964).

10. Even the recent denial of the deduction in Estate of Pierpont v. Com-

The second development, which was far more unsettling to the toiler in the estate-planning vineyard, was the decision of the Internal Revenue Service to delay determination of estate taxes where the claimed marital deduction involved a certain, widespread type of pecuniary bequest to the surviving spouse.[11] On March 19, 1964, the Internal Revenue Service announced its position in this problem area,[12] and Rev. Proc. 64-19 was published in the April 13, 1964, Internal Revenue Bulletin.[13] Since its promulgation, a significant amount of the time and energy of trust men and attorneys has been focused upon the action required to conform with its provisions.

The analysis which follows is directed toward an exploration of the background and scope of the underlying controversy and the future feasibility of various types of formula clauses used to obtain the maximum allowable marital deduction for estate tax purposes.

I. Rev. Proc. 64-19

Revenue Procedure 64-19 sets forth the position of the Internal Revenue Service "relative to allowance of the marital deduction in cases where there is some uncertainty as to the ultimate distribution to be made in payment of a pecuniary bequest or transfer in trust where the governing instrument provides that the executor or trustee may satisfy bequests in kind with assets at their value as finally determined for Federal estate tax purposes."[14]

A. *Background*

A bit of background may be helpful in understanding the importance and scope of this statement of the Service's position and its implications for the draftsman of wills and trusts.

missioner, 336 F.2d 277 (4th Cir. 1964), *affirming* Estate of Melvin G. Pierpont, 21 CCH Tax Ct. Mem. 286 (1962) (holding that a gift to the wife of all income from the marital trust coupled with a power that "the entire remaining principal . . . shall be paid . . . as my said wife may designate and appoint in her last will . . ." did not qualify because, under Maryland law, the donee of such a general power of appointment may not appoint the property to her estate unless granted the right by *express* language of the will), can be finessed by careful drafting of the gift designed to qualify under I.R.C., § 2056(b)(5). The *Pierpont* decision is discussed in Newsletter of the ABA Section of Real Property, Probate and Trust Law, No. 1, 1965, p. 3. A similar result was reached in Estate of William C. Allen, 29 T.C. 465 (1957). These cases simply illustrate the importance of a knowledge of local law characterizing the nature of the gift. See, *e.g.*, First Nat'l Bank v. United States, 233 F. Supp. 19, 24 (D. Kan. 1964).

11. Peter, *Revenue Procedure 64-19—Instance of ABA-IRS Cooperation*, 103 Trusts & Estates 908 (1964).

12. Announced March 19, 1964, in T.I.R. 553.

13. Rev. Proc. 64-19, 1964-1 Cum. Bull. 682 (hereinafter cited as Rev. Proc. 64-19). At least one commentator suggests that the courts will uphold the validity of the Procedure. Colson, *The Marital Deduction and Revenue Procedure 64-19*, 10 The Practical Law. 69, 70 (1964).

14. Rev. Proc. 64-19, § 1.

The federal estate tax marital deduction,[15] enacted in 1948,[16] permits a deduction of up to one-half[17] of the decedent's adjusted gross estate[18] for "the value of any interest in property which passes or has passed from the decedent to his surviving spouse."[19] With its advent, the lawyer-draftsman was faced with the task of assuring qualification of sufficient property to secure the deduction where this was deemed desirable.

Obviously, a husband could leave all of his property outright to his surviving spouse and be assured of full qualification. Some, however, regard this as an undesirable overqualification, giving rise to unnecessary estate taxation; while only half of the husband's property would be taxed in his estate, the entire remaining property would be subject to estate tax again in the wife's estate, subject to allowance of a credit for previously taxed property[20] if she dies within ten years after her husband.[21] And, of course, there were

15. Now INT. REV. CODE OF 1954, § 2056. For a general discussion of the marital deduction, including the requirements and methods for qualifying assets, see Polasky, *Estate Tax Marital Deduction in Estate Planning*, Tax Counselor's Q., June 1959, p. 1; *Report of Subcommittee on Estate Planning and the Marital Deduction*, 102 TRUSTS & ESTATES 934 (1963). The report of subcommittees referred to in this article are reports of the Section of Real Property, Probate and Trust Law of the American Bar Association and are published in the *Annual Proceedings of the Section* as well as in *Trusts and Estates*.

16. For historical background and discussion of earlier legislation, see Pedrick, *The Revenue Act of 1948—Income, Estate and Gift Taxes—Divided They Fall*, 43 ILL. L. REV. 277 (1948); Polasky, *supra* note 15; Surrey, *Federal Taxation of the Family—The Revenue Act of 1948*, 61 HARV. L. REV. 1097 (1948).

17. INT. REV. CODE OF 1954, § 2056(c)(1) (hereinafter cited as I.R.C. by section).

18. I.R.C., § 2056(c)(1).

19. I.R.C., § 2056(a).

20. I.R.C., § 2013.

21. For example, consider a case where a husband had an estate of $200,000 (after deduction of expenses and debts other than taxes) and the wife had no property of her own; three of the many alternative methods of disposition are: (1) a gift of a life estate to the wife and remainder to the children, (2) an outright gift of the property to the wife, or (3) use of the familiar bifurcated gift whereby the wife receives a qualifying bequest equal to the maximum marital deduction ($100,000 here) and the residue, after bearing the burden of all taxes, provides income for the wife for life with the remainder to the children. Assuming the husband dies first and the unlikely proposition that corpus neither increases nor decreases prior to the subsequent death of the wife, the federal estate tax results, assuming no community property, might be expected to show the following:

	(1)	(2)	(3)
Husband's Estate	$200,000	$200,000	$200,000
Less: Marital Deduction	-0-	$100,000	$100,000
The $60,000 Exemption	$ 60,000	60,000	60,000
Taxable Estate	$140,000	$ 40,000	$ 40,000
Federal Estate Tax*	31,500	4,800	4,800
Wife's Estate**	-0-	$195,200	$100,000
Less: The $60,000 Exemption		60,000	60,000
Taxable Estate***	-0-	$135,200	$ 40,000

(and are) testators who desired to take full advantage of any available marital deduction minimizing estate taxes, but who were equally adamant that only the minimum amount of property necessary to secure such deduction should pass to the surviving spouse in such form as to be includable in her estate and subject to her control.[22] To satisfy this desire for qualifying sufficient property to secure the maximum marital deduction and "not one penny more," attorneys began to include a so-called "formula clause" in wills.

1. *Evolution of Formula Clauses*

The wisdom, or folly, of using a formula clause has been the subject of a continuing, often delightful, debate.[23] Suffice it to say for present purposes that formula clauses were rapidly and widely adopted.[24] Several basic types were devised, and the relative desirability of each (with innumerable variations of the basic patterns) has also been the subject of continuing discussion.[25]

Pecuniary Formulas. The first basic type, often referred to as a "pecuniary bequest," provides for a dollar amount bequest.[26] Its function is simply to measure the dollar amount or value of the gift, and early clauses hewing closely to the language of the Internal Revenue Code phrased the bequest in terms of "an amount equal to" one-half of the testator's adjusted gross estate.

Federal Estate Tax	-0-	30,137	4,800
Total Federal Estate Tax on Estates of Husband and Wife	$ 31,500	$ 34,937	$ 9,600

Notes: * After maximum credit taken for state death taxes.
** Taxes paid from non-marital share, if any, ignores payment of state succession taxes.
*** Assumes no credit for tax on prior transfers (I.R.C., § 2013).

22. See Durbin, *Marital Deduction Formula Revisited*, 102 TRUSTS & ESTATES 545 (1963); Golden, *Rev. Proc. 64-19*, 103 TRUSTS & ESTATES 536 (1964).

23. *Compare* Trachtman, *Leaping in the Dark*, 93 TRUSTS & ESTATES 922 (1954), *with* Sargent, *To Each His Own*, *id.* at 933.

24. *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 15, at 943.

25. *E.g.*, see Golden, *supra* note 22; Kiley & Golden, *The Residue Formula as an Aid to the Executor*, 90 TRUSTS & ESTATES 824 (1951); Kiley & Golden, *A Residue Formula for Maximum Marital Deduction*, 89 TRUSTS & ESTATES 744 (1950). *Cf.* Bolte, *Choosing a Marital Deduction Formula Clause*, 44 MARQ. L. REV. 532 (1961); Durbin, *supra* note 22. See generally Cox, *Types of Marital Deduction Formula Clauses*, N.Y.U. 15TH INST. ON FED. TAX. 909 (1957); Craven, *Marital Deduction Problems—Use of the Percentage Formula Clause*, N.Y.U. 19TH INST. ON FED. TAX. 613 (1961).

26. For examples of early types of pecuniary formula clauses, see Casner, *How To Use Fractional Share Marital Deduction Gifts*, 99 TRUSTS & ESTATES 190 (1960); Lauritzen, *Marital Deduction Bequests—Current Problems and Drafting Suggestions*, 8 TAX COUNSELOR'S Q. 247, 286 (1964); Polasky, *supra* note 15, at 44, 54. For an up-dated clause, see *Report of Subcommittee on Forms for Marital Deduction Planning*, 103 TRUSTS & ESTATES 961, 962 (1964). CASNER, ESTATE PLANNING, SUPPLEMENT 793 (1964).

The pecuniary bequest, carved out of the estate before disposition of the residue, was a distinct departure from the prior practice of providing for primary objects of bounty through a division of the residuary estate.[27] When drafted as a general legacy, the amount (once determined) [28] is fixed and is satisfiable before division of the residue among the residuary legatees. Thus, though the dollar amount of the widow's share was fixed, the fractional portion of the total estate assets actually received by the widow would vary with fluctuations in estate assets between the time of valuation and distribution, a relatively larger share being received by her if assets declined in value during administration and the converse being true when a general appreciation in asset values occurred.

Fractional Share Formulas. Concern over a number of additional, potentially troublesome administrative problems[29] foreseeable in connection with a pecuniary clause led to development of a second major species of formula—the "fractional share."[30] This quite different clause measures the gift in terms of a fractional share of the decedent's estate and was sometimes expressed as "that fractional share of my residuary estate which, together with all other property qualifying for the federal estate tax marital deduction, is equal to one-half of my adjusted gross estate as determined for purposes of the federal estate tax . . . ." Since the fraction, computed on the basis of federal estate tax values,[31] remains constant in relation to the residuary estate[32] (however defined) upon which it operates, the marital deduction gift shares ratably in any appreciation or depreciation of assets prior to distribution. Use of the fractional share clause does, however, require rather careful specification of the manner in which the fraction is to be determined.[33] Moreover, problems of determining the appropriate shares of income and principal to be distributed become complicated where partial distributions occur during administration.[34]

---

27. Durbin, *supra* note 22, at 545; Golden, *supra* note 22, at 537; Lauritzen, *The Marital Deduction*, 103 TRUSTS & ESTATES 318 (1964).

28. Bolte, *supra* note 25, at 535. The "amount" depends on the choice of valuation date.

29. See generally Part III of this article *infra*.

30. Lloyd, *supra* note 2, at 898.

31. See Golden, *supra* note 22, at 538. The rationale behind the use of federal estate tax values to *define* the fraction (and for that purpose *only*) is discussed *infra* note 116 and accompanying text. See also CASNER, *op. cit. supra* note 26, at 796.

32. See Durbin, *supra* note 22. The fraction may change, however, if non-pro-rata distributions occur during administration.

33. See Casner, *supra* note 26; see also text accompanying notes 110-21 *infra*.

34. See discussion in text accompanying notes 122-148 *infra*.

2. *"Problem-Pecuniary" Language*

Despite the administrative problems, real or imagined, which caused some counselors to prefer the fractional share disposition, others regarded the pecuniary formula as tending to be somewhat easier to express and to administer. Perhaps most importantly, it appeared to afford significant opportunities for minimizing the total estate taxes incurred by the estates of both spouses. Thus it became the favorite of a sizable minority of draftsmen.[35]

A number of problems, however, brought about the type of pecuniary bequest which triggered the recent "furor over formulas" and occasioned the issuance of Revenue Procedure 64-19. First, if the will directed the executor to pay the widow an amount of cash equal to the maximum available marital deduction, the conversion of assets into cash would normally incur expense and might well require recognition of gains or losses by the estate for income tax purposes (measured by the difference between the basis, ascertained by federal estate tax values,[36] and the net receipts from disposition).[37] For this and other reasons making it desirable to have the widow receive some or all of the distributable assets in kind, most draftsmen began to include in pecuniary formulas a clause empowering the executor to satisfy the bequest in kind as well as in cash. Further, to avoid any suggestion that distributions must include a fractional share of each asset, the executor was given discretion to select the assets to be distributed in satisfaction of the marital bequest.[38]

Absent further provision, however, distribution in kind would result in recognition of gain or loss by the estate where the value of the distributed assets at distribution date differed from their value for federal estate tax purposes.[39] The bequest to the widow, whether of a specified sum or determined by a formula provision, establishes a dollar-amount legacy due from the estate. Satisfaction by delivery

35. Many able commentators still express a preference for the pecuniary (*e.g.*, Covey, *The Marital Deduction and the Use of Formula Provisions*, P-H WILLS-TRUSTS-ESTATE PLANNING FORMS ¶ 121, at 287 (1962); Stevens, *How To Draft Marital Deduction Formula Clauses Under New Rev. Proc. 64-19*, 20 J. TAXATION 352 (1964)) as did others prior to the inception of the current controversy over pecuniary clauses. *E.g.*, McGorry, *Pecuniary or Fractional Formula?*, 98 TRUSTS & ESTATES 422 (1959).

36. I.R.C., § 1014.

37. I.R.C., § 1001.

38. See Golden, *supra* note 22; Lauritzen, *supra* note 27. Absent a provision to the contrary, property distributed in kind is valued at its value at date of distribution for distribution purposes. See, *e.g.*, Estate of Gauff, 27 Misc. 2d 407, 211 N.Y.S.2d 583 (1960).

39. *E.g.*, Suisman v. Eaton, 15 F. Supp. 113 (D. Conn. 1935), *aff'd*, 83 F.2d 1019 (2d Cir.), *cert. denied*, 299 U.S. 573 (1936); Rev. Rul. 56-270, 1956-1 CUM. BULL. 325. See discussion in text accompanying notes 163-76 *infra*.

of non-cash assets is treated as a sale of the property to the widow for the dollar amount due, and the widow is deemed to take the property by purchase, rather than by inheritance, thus receiving a basis for the property equivalent to its fair market value at the time of the distribution.[40]

Now, assume for the moment that the testator left an adjusted gross estate of one million dollars, composed of 5,000 shares of *A* stock worth 500,000 dollars and 5,000 shares of *B* stock worth 500,000 dollars. If the executor decided to satisfy the 500,000 dollar bequest with *A* stock and if it is assumed that the 5,000 shares of *A* stock, which had an estate tax value of 500,000 dollars, had now increased in value to 800,000 dollars, he might transfer to the widow 5/8 of the *A* stock (present value 500,000 dollars). Since the basis of the entire holding of *A* stock was 500,000 dollars, a transfer of 5/8 (with an aliquot basis of 312,500 dollars) would result in a gain to the estate of 187,500 dollars subject to income tax at capital gains rates.

To avoid incurring this tax, attorneys began to include a clause specifying that assets distributed in satisfaction of the marital bequest were to be valued at the values determined for federal estate tax purposes. Then, if the executor distributed *A* stock, he would distribute all of it (federal estate tax value *and*, thus, basis of 500,000 dollars) in satisfaction of the 500,000 dollars due the marital share, and the estate would recognize neither gain nor loss.[41]

At this stage of the development of the pecuniary formula, then, it became fairly common to find clauses granting the executor discretion to satisfy the marital bequest (1) in cash or in kind, (2) with assets selected by him, and (3) with assets valued at the values determined for federal estate tax purposes. The following is an example[42] typical of such dispositive provisions, but which might *not* presently qualify under Rev. Proc. 64-19:

> "If my wife, March Smith, shall survive me, I devise and bequeath to State National Bank of Zoneville, or its corporate successor, as Trustee, an amount equal to one-half (1/2) of the value of my adjusted gross estate as finally determined for fed-

40. Commissioner v. Brinckerhoff, 168 F.2d 436 (2d Cir. 1948). See discussion in text accompanying notes 167-73 *infra*.

41. See, *e.g.*, 1 CASNER, ESTATE PLANNING 816 (3d ed. 1961). See discussion in text following notes 192-95 *infra*.

42. This clause appeared in Polasky, *supra* note 15, at 54 and was reprinted in Lauritzen, *supra* note 26, at 286. Its use is *not* recommended in its present form; the clause is set forth for illustrative purposes only and should not be used unless it is amended to comply with the requirements of Rev. Proc. 64-19 or clearly meets the requirements of § 2.02 of the Rev. Proc. See note 55 *infra*.

eral estate tax purposes, less the aggregate amount of marital deductions, if any, allowed by reason of interests in property passing or which have passed to my wife otherwise than by the terms of this Article of my Will. My Executor shall have full authority and discretion to satisfy said bequest in cash or in kind, or partly in cash and partly in kind, and to select and designate, and to convey and assign to the Trustee of said Trust Estate the cash, securities, or other assets, including real estate or any interests therein, which shall constitute said Trust Estate; provided, however, that in no event shall there be included in said Trust Estate any asset or the proceeds of any asset with respect to which a marital deduction would not be allowable, if so included; and provided, further, that assets applied on said bequest in kind shall for such purposes be valued at the values thereof finally determined for the purposes of the federal estate tax on my estate. . . ."

Flexibility: Discretion To Distribute in Cash or in Kind and To Select Assets So Used

"Tainted Asset" Clause[43]

Avoidance of Capital Gain to Estate on Distribution

The discretion granted to the fiduciary appeared to offer delightful opportunities for minimizing total estate tax burdens on the estates of both spouses through a bit of post-mortem planning.[44] If the claim could be satisfied with assets which had appreciated, it would seem that it could also be satisfied with assets, having a basis equal to the claim, which had declined in value prior to distribution. For example, suppose that the 5,000 shares of *B* stock (with an estate tax value and basis of 500,000 dollars) had a distribution date value of 400,000 dollars. If the clause granting the executor full authority and discretion to satisfy the bequest in cash or in kind *and* to select the assets to be so used should be deemed broad enough to permit the executor to distribute either the *A* stock or the *B* stock, distribution of the *B* stock to the widow would tend to hold down the size of the widow's estate subject to estate tax at her death and to permit allocation of income (from increasing dividends on the *A* stock, perhaps accounting for its appreciation) to beneficiaries in lower income tax brackets. It is not unlikely that the prospect of an amicable arrangement between the widow, her devoted children (the residuary legatees), and the executor designed

43. See Polasky, *supra* note 15, at 25, for discussion of the "tainted assets" problem; HARRIS, HANDLING FEDERAL ESTATE AND GIFT TAXES § 231 (1959).

44. Lloyd, *supra* note 2, at 899.

to produce a full marital deduction for the decedent's estate while satisfying the marital bequest with assets having a distribution-date value less than the deduction allowed and not representative of the overall appreciation or depreciation of estate assets (indeed, carefully selected to channel the greatest appreciation to the residue and the maximum depreciation to the widow's share) proved disturbing to the Internal Revenue Service.[45]

B. *The Ruling*

In any event, rumors spread as early as 1961 that in some districts Service personnel had questioned the allowability of the marital deduction where clauses of this type had been used.[46] By early 1963, it became apparent that allowance of the marital deduction in audited estates in which the dispositive instrument contained such a clause was being delayed in a number of Internal Revenue Service Regions pending disposition of requests for technical advice from the National Office.[47] Quite naturally, in view of the number of such clauses in previously drawn wills, attorneys and professional fiduciaries became adamant, apprehensive, or both.

Some practitioners took the view that, despite the use of the clause, the fiduciary law of their states would require that the widow share equitably and ratably in any appreciation or depreciation prior to distribution.[48] Others, however, suggested that it was not at all clear that the executor could not exercise the broad discretion specifically granted by the testator, and they realistically recognized that where harmonious family situations existed the validity of such distributions, acquiesced in by the surviving spouse, residuary legatees, and fiduciary, would not be presented explicitly to a court. In that light, the Service's concern with the possibility of manipulation was at least understandable.

1. *Negotiation*

The situation existing during 1963 posed formidable practical problems for attorneys and corporate fiduciaries. This was not an issue involving an isolated, atypical set of facts. Tens of thousands of such clauses had been incorporated in previously drawn instru-

45. See Cohen, *Treasury Views on Current Questions*, 104 TRUSTS & ESTATES 9 (1965).
46. Peter, *supra* note 11.
47. *Ibid.*
48. Some regarded the Service's position as without foundation. See Lauritzen, *supra* note 27. The question of allowability of the marital deduction in such a case had, however, been raised many years earlier. Casner, *Estate Planning: Marital Deduction Provisions of Trusts*, 64 HARV. L. REV. 582, 593-96 (1951).

ments. In some cases the testator was dead, and in others, lack of testamentary capacity, inability to alter irrevocable inter vivos trusts, or lack of contact with the client rendered corrective amendment or substitution of a new dispositive clause impossible or unlikely. Thus, with respect to existing wills, there was widespread apprehension over the possible loss of the marital deduction (or at least protracted negotiation and potential litigation) where the suspect dispositive provision had been used. Further, those engaged in planning estates and drafting effective dispositive instruments are far less interested in speculation over the validity of a Treasury position than in the establishment of definite and workable guidelines assuring qualification for the deduction. The Treasury, too, faced distinct administrative problems as a result of the position taken by some field offices.

Wisely, the Bar recognized that this was not a situation calling for adamant opposition; and, happily, the Service did not select this occasion to press for draconic administrative edict, judicial decision, or legislation as a response to real or imagined attempts to shrewdly circumvent the intended limitations on the deduction. During 1963, representatives of the American Bar Association met at length with personnel in the National Office of the Service.[49] The need for both an expression of guidelines for future drafting and a fair administrative solution permitting qualification under existing clauses was emphasized. From this setting, Rev. Proc. 64-19 emerged as an example of the effectiveness of cooperative negotiation between representatives of the Bar and the Service to effectuate a rational accommodation between implementation of statutory purpose and protection of taxpayers through adequate notification of the Treasury position and opportunity for compliance. The chairman of the Estate and Gift Tax Committee of the American Bar Association's Section of Taxation phrased it well:

> "While Revenue Procedure 64-19 certainly has its limitations, it does carry out the primary goals sought by the members of the Tax and Probate Sections, namely, to alert lawyers across the country to the kind of pecuniary clause which causes the marital deduction clause to arise, to apprise them of means of curing the problem, and to provide a feasible administrative solution for presently existing wills containing the problem language."[50]

2. *Scope*

Rev. Proc. 64-19 (to use the current shorthand term) deals only with a very narrow segment of the marital deduction area. It is

49. Peter, *supra* note 11.
50. *Id.* at 909.

addressed solely to the issue of qualification of pecuniary bequests for the federal estate tax marital deduction where the dispositive instrument contains "problem-pecuniary" language: a bequest of an amount, measurable in dollars (whether specifically set forth or determined by formula), which (1) is satisfiable in kind, (2) is satisfiable with assets which may be selected by the executor in his discretion, and(3) where, in determining the amount to be transferred to the surviving spouse's share, such assets distributed in kind are to be valued at the value determined for federal estate purposes.[51] It is clear that the Procedure does *not* purport to deal with *income* tax problems arising in connection with such a bequest[52] and only obliquely treats gift tax considerations.[53] Further, it explicitly states that the problem under consideration does not arise where the bequest consists of (1) a bequest of specific assets, or (2) "a fractional share of the estate under which each beneficiary shares proportionately in the appreciation or depreciation in the value of assets" to the time of distribution, or (3) a pecuniary bequest (whether of a stated amount or determinable by formula) if it can be satisfied only in cash or if the fiduciary has no discretion in the selection of assets to be distributed in kind, or (4) if assets distributed in kind are to be valued at distribution date values in determining the quantum to be transferred in satisfaction of the bequest.[54]

II. The Pecuniary Formula in the Light of Rev. Proc. 64-19

A. *Dispositions Under the "Problem-Pecuniary" Language That Will Qualify*

Confining treatment to the "problem-pecuniary" dispositive provision, the Procedure first specifies those circumstances in which the pecuniary bequest or transfer will continue to qualify no matter when it was executed.[55] Specifically, the deduction will be allowed when it is "clear" under either (a) applicable state law *or* (b) an express or implied provision of the instrument that the fiduciary, in satisfying the bequest, *must* distribute assets according to *one and only one* of the two following tests:[56]

51. Rev. Proc. 64-19, §§ 1, 2.01.
52. Rev. Proc. 64-19, § 4.02.
53. Rev. Proc. 64-19, §§ 3.01, 3.02, 5.01; see Lauritzen, *supra* note 26, at 274.
54. Rev. Proc 64-19, § 4.01
55. Rev. Proc. 64-19, § 2.02.
56. It is essential to note that the dispositive instrument must *limit* the fiduciary to *one* of the alternative routes. If he might satisfy the bequest by a choice of either route, the pecuniary bequest will not be deemed to qualify under § 2.02 of Rev. Proc. 64-19. See Cohen, *supra* note 45.

(1) A quantum of assets having an aggregate fair market value at the date or dates of distribution amounting to no less than the amount of the pecuniary bequest or transfer as finally determined for federal estate tax purposes (hereinafter referred to as the *"minimum-value"* test).

(2) A quantum of assets fairly representative of appreciation or depreciation in the value of all property thus available for distribution in satisfaction of such pecuniary bequest (hereinafter referred to as the *"ratable-sharing"* test).

Assuming that the dispositive instrument does not specify use of either of the alternative requirements, under what circumstances will it be "clear" that applicable state law will require one *or* the other of the requirements so that the disposition will qualify? In a recent speech, a high-ranking representative of the Internal Revenue Service suggested that the disposition could qualify if an applicable statute so required or if there existed "a decision of the highest court in the state similar to that rendered in Estate of Kirchheimer, Ill. Probate Ct., Cook County, File No. 56 P 8017."[57] He also suggested that the deduction might be allowed if it could be established by the executor, "that the value of this interest can be determined as of the date of death and cannot subsequently be shifted by action of any other person. This might be done by showing that the right to make the selection was in the surviving spouse or her estate . . . or, as in one instance, by showing that the residue [presumably referring to the source of satisfying the bequest] consisted entirely of cash and insurance."[58]

If, however, it is not clear that this type of result must flow, what will be the effect of problem-pecuniary language and what should be done? Discussion may be facilitated by first considering dispositive instruments executed prior to October 1, 1964, and then turning attention to those executed after that date.

1. *Instruments Executed Prior to October 1, 1964*

a. *Where Re-execution Is Impracticable or Impossible*

Even if it is not clear that the problem-pecuniary language will require either distribution of the specified minimum value or a ratable sharing of appreciation or depreciation, the marital deduc-

57. Speech by Mr. John Sheets, Estate and Gift Tax Branch, National Office, Internal Revenue Service, before the Chicago Bar Association, Dec. 1, 1964, as reported in FED. EST. & GIFT TAX REP. ¶ 8147, at 7239 (1964). A slightly different version appears as Sheets, *Practical Solutions to 64-19*, 104 TRUSTS & ESTATES 71 (1965). The *Kirchheimer* case is discussed in Lauritzen, *Marital Deduction Bequests—Current Problems and Drafting Suggestions*, 8 TAX COUNSELOR'S Q. 125, 146 (1964).

58. Sheets, *supra* note 57.

tion may still be obtained with respect to documents executed prior to October 1, 1964. The price of allowance, absent litigation,[59] is the execution of appropriate agreements by both the fiduciary and the surviving spouse that assets available for distribution in satisfaction of the bequest "will be so distributed between the marital deduction bequest or transfer in trust and the balance of the estate . . . that the cash or other property distributed in satisfaction of the marital-deduction pecuniary bequest or transfer in trust will be fairly representative of the net appreciation or depreciation in the value of the available property on the date or dates of distribution."[60] Section 5 of the Revenue Procedure sets forth forms of the required agreements.[61]

It will be noted that the agreement requires that the marital gift must share ratably in appreciation and depreciation; it does not include the other alternative of provision of a "minimum amount" equal in value to the marital deduction claimed for the property so passing.[62] Firsthand hearsay suggests that originally representatives of the American Bar Association sought an agreement from the Service whereby the deduction would be allowed if agreements were signed specifying that the widow must receive property with a distribution date value at least equal to the marital deduction claimed. Opposition to this minimum-value approach, however, developed in the Chicago area, premised on the propositions (1) that this would require two valuations (a valuation at date of distribution as well as a valuation at date of death)[63] and (2) that the entire risk of appreciation and depreciation would be shifted to the residuary legatees, whose interests might be wiped out if asset values declined drastically during administration. The Service pointed out that the Rev. Proc. would have to prescribe one route or the other; allowing the executor to choose between the ratable sharing or min-

59. The one case noted involving this precise question is Estate of Walsh v. Commissioner, No. 3433-63, T.C., filed July 16, 1963. See Lauritzen, note 27 *supra*, at 396.

60. Rev. Proc. 64-19, § 3.01.

61. Rev. Proc. 64-19, § 5.01 sets forth the form of agreement to be executed by the surviving spouse; § 5.02 sets forth the form of agreement to be executed by the executor or trustee.

62. Rev. Proc. 64-19, § 5.

63. In the case of a ratable sharing provision that would permit distributions equal to the fractional share of the estate as determined for federal estate tax purposes, only one valuation is required (that being the valuation for federal estate tax purposes). In essence, this is the same as a fractional share of the residue type clause. As distinguished from a "true fractional share" disposition, however, the ratable-sharing pecuniary does not require distribution of a fractional share of each item; rather, it is required only that the *value* of assets distributed result in ratable sharing. However, if assets are to be chosen to make up the required amount, it is obvious that a second valuation as of date of distribution will be necessary.

imum value routes in the light of hindsight derived from many months of administration would obviously make available the very type of discretionary action the Rev. Proc. forbade.[64] In any event, the ultimate choice was the ratable-sharing pattern, and the agreements to be signed provide *only* this route.

The actual agreement required of the executor differs from that which the spouse must sign. The former must agree that he will make a distribution fitting the ratable-sharing pattern;[65] the latter must agree only that if the property "accepted in full satisfaction of this bequest . . . is not fairly representative of my proportionate share of any net appreciation in the value . . . the difference in value will be treated as a transfer . . . by gift . . . and a Federal gift tax return . . . filed if required."[66]

Questions have been raised regarding the authority of the executor to sign the required agreement and the feasibility of securing agreement from the surviving spouse. But, though an able commentator has expressed a contrary view,[67] it seems that neither problem should be insurmountable.[68] Surely the basic reason for including the pecuniary formula in the will was to secure the maximum

64. To illustrate the point, assume an adjusted gross estate of $1,000,000 at date of death with a maximum marital deduction of $500,000 to be provided. If the executor had a *choice* of routes and the property appreciated to $1,200,000, he might well satisfy the bequest with the "minimum value" of $500,000 (thus precluding the marital share from appreciation during administration); if, on the other hand, the estate declined to a value of $800,000, he might (absent fiduciary law doctrine to the contrary) satisfy the bequest with property worth $400,000, having chosen the ratable-sharing method in the light of hindsight.

65. Section 5.02. He also agrees that "within six months after the final distribution of cash and other property in satisfaction of the marital deduction . . . I will file with the District Director . . ." schedules showing assets available to satisfy the bequest and those actually so used. § 5.02.

66. Section 5.01.

67. Lauritzen, *supra* note 27, at 320, 396; Lauritzen, *supra* note 26, at 249, 281 (lack of authority in *executor* and need to resort to court), 266 (the problems in securing the widow's agreement). See also Colson, *The Marital Deduction and Revenue Procedure 64-19*, 10 THE PRACTICAL LAW. 69, 78 (1964), suggesting that, "The validity of such agreements, however, depends upon local law . . . [and] it could be argued that the requisite agreements are contrary to the terms of the will, and, therefore, unenforceable, because, in effect, they require the executor to surrender his power to satisfy the pecuniary bequest by a cash distribution in the exact amount of the bequest." It has been suggested that the execution of the agreement by the executor, to protect the marital deduction's availability affects the interests of beneficiaries and leads to a conflict of interest. New York and Illinois attorneys who subscribe to this view have recommended that a court order be obtained authorizing or disapproving execution of the agreement. A contrary view was expressed by distinguished Pennsylvania probate lawyers in sessions of the Pennsylvania State Bar Association meeting in Erie, in June 1964. Perhaps the mere existence of divergence of opinions suggests the presence of a "problem with agreements."

68. See, e.g., Straus, *Revenue Procedure 64-19—When Should Agreements Be Made?*, 103 TRUSTS & ESTATES 911 (1964); *Revenue Procedure 64-19—Panel Discussion*, 103 TRUSTS & ESTATES 917, 919 (1964) (a Straus-Lauritzen exchange of views).

marital deduction, and the testator's obvious intent (or that of his attorney) in granting the discretion to his executor was to minimize taxes. If the executor is required to distribute a marital share reflecting a pro rata allocation of appreciation and depreciation during administration, as the New York[69] and Oregon[70] cases have held, no agreement should be required. Only where he might be deemed to have discretion in this regard should the agreement be required,[71] and, in these instances, signing the agreement and distributing accordingly would appear to be no more than the grant of discretion permitted.

And what of the possibility that the widow might be unable or unwilling to sign the agreement? As to inability, a top official of the Service has expressed the opinion that "If the surviving spouse is incapable of signing an agreement, the Service will accept the signature of anyone who would be authorized to sign any other document requiring her signature when she or her estate would be bound by such agreement."[72]

As to unwillingness, it has been suggested that the decedent might be "survived by a second wife who is not the mother of his children and where the relationship between the wife and children is far from amicable. Suppose, after her husband's death, she is told that unless she executes the required agreement, substantial additional taxes must be paid from the shares passing to her stepchildren. In such case, her reply might well be, 'How wonderful.' "[73] This

69. *E.g., In re* Bush's Will, 2 App. Div. 2d 526, 156 N.Y.S.2d 897 (1956), *aff'd mem.*, 3 N.Y.2d 908, 145 N.E.2d 872 (1957); In the Matter of Estate of Inman, 22 Misc. 2d 573, 196 N.Y.S.2d 369 (Surr. Ct. 1959). The New York cases are collected and analyzed in a perceptive and excellent opinion by Surrogate Hildreth in *In re* Umpleby's Will, 252 N.Y.S.2d 674 (Surr. Ct. 1964). But may the testator specify that the executor may distribute assets so as to allocate appreciation to the nonmarital share, as under a "minimum-value" tax value clause? It has been suggested that the requirement of impartial allocation of appreciation "may be avoided by the testator indicating his desire that any distributions in kind be made with assets whose market value on the date of distribution does not exceed or exceeds by the smallest amount possible their income tax bases. Such language constitutes a clear waiver of the executor's duty to act impartially as between the beneficiaries." Covey, *The Marital Deduction: Revenue Procedure 64-19 and Formula Provisions*, 36 N.Y.S.B.J. 317, 324 (1964); Covey discusses the statement in *Bush, supra*, suggesting that such a provision violates section 125(2) of the Decedent Estate Law, but argues that subsequent cases have held to the contrary, citing *Inman, supra*, and Matter of Nickelsburg, 34 Misc. 2d 82, 224 N.Y.S.2d 90 (1961). See Matter of McDonnell, 153 N.Y.L.J. No. 27, 18 (Nassau Co. Surr.) Feb. 9, 1965, where the duty of impartiality was held to require allocation of a pro rata share of appreciation to the marital share "in the absence of some indication by the testator that he intended to vest in his executives such far-reaching power to seriously affect, as in this case, the share of the widow."

70. Nicolai v. Hoffman, 232 Ore. 105, 373 P.2d 967 (1962).

71. Straus, *supra* note 68, at 913, 914.

72. Sheets, *supra* note 57; *cf.* Lauritzen, *supra* note 26, at 271.

73. Golden, *Rev. Proc. 64-19*, 103 TRUSTS & ESTATES 536, 539 (1964); *Panel Discussion, supra* note 68, at 917.

assumes that the marital share bears no estate taxes, a proposition which is not universally true absent an appropriate tax allocation clause in the dispositive instrument.[74] (If her share bore an aliquot share of the estate tax, she would surely have an incentive to sign.[75]) In any event, it will be recalled that this discussion relates only to the "saving" of irremediable wills of pre-October 1, 1964, vintage; such situations should not arise where prophylactic redrafting is possible and assuredly will not arise under wills drawn since October 1, 1964.

One further suggestion may be in order. Although the statute of limitations has not run on some estates in which the full marital deduction has been granted despite the dependence on problem-pecuniary language, there has been no indication that the Service has been seeking to reopen such audited and cleared estates. If, perchance, a potential claim for refund in such an estate should come to light, it would seem but the better part of valor to consider the potential risks of raising the ghost of the problem-pecuniary language before filing any refund claim which might result in a deficiency rather than a recovery.

b. *Where Re-execution Is Possible*

In a great many cases, it will be possible to re-execute documents containing the problem-pecuniary language. This will not be necessary where state law requires ratable sharing, as in New York.[76]

74. A significant number of states (twenty-four) provide for apportionment of estate taxes absent any specific direction to the contrary in the dispositive instrument. See, *e.g.*, MICH. PUB. ACTS No. 144 (1963), applicable to estates of decedents dying after Nov. 9, 1963, or after ninety days after adjournment of the legislature, whichever occurred later; New York: N.Y. DECED. EST. LAW § 124. The Michigan statute is discussed in 2 MICHIGAN PROBATE GUIDE FOR THE GENERAL PRACTITIONER 436 (1964). A recent case involving a Michigan estate of earlier vintage, and discussing the Michigan situation is Old Kent Bank and Trust Co. v. United States, 232 F. Supp. 970 (W.D. Mich. 1964), (*on appeal* to 6th Cir.). The statutes are collected in FED. EST. & GIFT TAX REP. ¶ 2490.16 (1964). Other states have no applicable statutory treatment, though in many of these states the courts have established relevant local law. For an earlier comprehensive treatment, see Lauritzen, *Apportionment of Federal Estate Taxes*, Tax Counselor's Q., June 1957, p. 55. For a recent case illustrating the necessity for careful drafting of tax allocation clauses and a pitfall to avoid, see Estate of Albert L. Rice, 41 T.C. 344 (1963) (discretion to pay all taxes from the nonmarital share). The case is on appeal to the Court of Appeals for the First Circuit. Recent cases are discussed in CASNER, ESTATE PLANNING, SUPPLEMENT 316-19 (1964).

75. But, even granting the premise, it may be suggested again that the agreement is required only where the executor is not precluded from exercising discretion. Under these circumstances and again assuming the somewhat unlikely attitude of the widow, might not the executor exercise discretion so as to allocate the additional tax burden to the widow through judicious selection of distributable assets? And would a probate court be likely to upset the restoration of excess taxes to the residue? Perhaps gentle suasion, in the form of reflective suggestion of this possibility, would have a salutary effect on the spiteful widow posited by the example.

76. See Private Ruling, Letter from Lester H. Wallace, Acting Chief, Estate and

However, in states where the law is not clear, at least two choices are available.

On the one hand, the counselor may feel it appropriate to rely on the execution of agreements, preferring not to disturb the existing will. This will be particularly appealing where the mental condition of the testator has declined since the document was executed.

In most cases, however, the balance seems to weigh in favor of executing an amendment, codicil, or new instrument.[77] The mere fact that competent practitioners have raised questions concerning the authority of the fiduciary to execute the required agreement should give pause where alternative, safer corridors are available. Furthermore, there is authority for the proposition that a will and its codicils are construed as having been executed on the date of the last codicil.[78] Thus, execution of any codicil after October 1, 1964, to a pre-October 1, 1964, dispositive instrument without modification of the problem-pecuniary language might bring the instrument squarely within the thrust of section 2.03 of the Rev. Proc., which disqualifies post-September 30, 1964, problem-pecuniary dispositions that are not clearly subject to the minimum-value *or* ratable-sharing requirements.

2. *Instruments Executed Subsequent to September 30, 1964*

The stated position of the Service is that a pecuniary bequest that specifies the use of federal estate tax values in determining the quantum of assets to be selected by the executor to satisfy the bequest will qualify for the marital deduction only if it satisfies the minimum-value or ratable-sharing test. Both new instruments executed after September 30, 1964, and amendments of existing instruments after that date must conform to these requirements if tax-value clauses of the type specified are to qualify for the deduction. Comparison of the various types of tax-value clauses may be useful in determining which, if any, to use.

Gift Tax Branch, I.R.S., to Fiduciary Trust Co. of N.Y., P-H FEDERAL TAXES ¶ 142051, at 7242 (1965).

77. This does not overlook the "practical problems" of determining what the "appropriate" approach to the client is and whether to charge him for redrafting the instrument. As to the former, the Canons of Ethics impose no barrier. See Opinion 210 (1942), approving the propriety of contacting the client where there has been a change in fact or in law which makes a change in the will, drawn by the lawyer, desirable. See also Opinion 213 (1941). OPINIONS OF THE COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES. (1957 ed.)

78. *E.g.*, Estate of Challman, 127 Cal. App. 2d 736, 274 P.2d 439 (1954); Jackman v. Kasper, 393 Ill. 496, 66 N.E.2d 678 (1946); Spangenberg Estate, 359 Pa. 353, 59 A.2d 103 (1948).

For purposes of illustration, consider the earlier example of the estate subject to a dispositive clause containing the problem-pecuniary language, with an adjusted gross estate for federal estate tax purposes of 1,000,000 dollars composed of 5,000 shares of *A* stock and 5,000 shares of *B* stock, each with a federal estate tax value and basis of 500,000 dollars and all included in the probate estate. At distribution date, the *A* stock has a fair market value of 800,000 dollars and the *B* stock is worth 400,000 dollars.

a. *Operation of Minimum-Value Clauses*

If the governing instrument specifically provides (and a number of draftsmen have so provided in recent years) that assets distributed in satisfaction of the marital bequest shall have a distribution date value of not less than the marital deduction allowable, the transfer should qualify for the marital deduction. Absent a local law requirement of ratable sharing in appreciation of assets during administration, the executor may distribute all of the *A* stock, thus complying with the donor's direction, qualifying for the marital deduction, and, presumably, incurring no capital gain to be reported on the estate's income tax return.[79] A tax-oriented executor might distribute one-fourth of the *A* stock (basis 125,000 dollars and fair market value 200,000 dollars) and three-fourths of the *B* stock (basis 375,000 dollars and current value 300,000 dollars).[80]

In similar manner, the minimum-value clause described above will qualify and implementation will follow similar principles when there is an overall diminution in the value of assets during administration. For example, assume that the *A* stock appreciated to 550,000 dollars while the *B* stock declined to 300,000 dollars. In complying with the bequest, the executor might distribute four-fifths of the *A*

79. Such an exercise of discretion might, however, be deemed a violation of the normal fiduciary duty of impartiality if such a duty is deemed imposed despite the terms of the will. See Carrier v. Carrier, 226 N.Y. 114, 123 N.E. 135 (1919). Certainly, he would be ill-advised to make such a distribution unless the will clearly indicated that he had the authority to prefer one or the other of the several beneficiaries. When the surviving spouse is both a fiduciary and the preferred legatee, courts may be expected to take a rather dim view of the proceeding. See *In re* Bush's Will, 2 App. Div. 2d 526, 156 N.Y.S.2d 897 (1956).

80. The mathematics for the "ratio" distribution are as follows: The ratio of the appreciation of *A* stock values ($300,000) to *B* stock diminution ($100,000) is three to one; therefore, the executor distributes ¼ of the *A* stock and ¾ of the *B* stock to the marital share. To further illustrate the principle, assume that the ratio of the *A* stock's appreciated value ($800,000) to the *B* stock's decline ($200,000) is eight to two; therefore, the executor will distribute 2/10 of the *A* stock (basis of $100,000 and fair market value of $260,000) and 8/10 of the *B* stock (basis $400,000 and fair market value $240,000) to the marital trust. The assets distributed have an *aggregate* basis of $500,000 and an *aggregate* distribution date value of $500,000.

stock (basis 400,000 dollars and fair market value of 440,000 dollars) and one-fifth of the *B* stock (basis 100,000 dollars and current value of 60,000 dollars), satisfying both the testamentary instruction and the requirement set forth in the Procedure. Again there should be no recognized gain or loss to either the spouse or the estate.

b. *Operation of Ratable-Sharing Clauses*

If either the governing instrument or applicable local law clearly requires that the share allocated to the surviving spouse be fairly representative of appreciation or depreciation in the value of property available for distribution in satisfaction of the marital bequest, the share similarly will qualify for the marital deduction.[81] In carrying out such a direction (using our original hypothetical estate), the executor presumably should distribute property having an aggregate value at distribution date of at least 600,000 dollars. He might distribute one-half of the *A* stock (basis 250,000 dollars and current value 400,000 dollars) and one-half of the *B* stock (basis 250,000 dollars and current value 200,000 dollars).

Could the executor transfer all of the *A* stock (fair market value of 800,000 dollars) to the widow in satisfaction of the marital bequest under a clause qualifying under the appreciation-depreciation provision of the Procedure? Under the problem-pecuniary language, the executor had the right to satisfy the bequest in kind with selected assets having a basis equal to the marital deduction claimed; choice of the *A* stock would meet these specifications. (This would also be true where the dispositive language or local law simply required that the distribution date value of assets distributed be at least equal to the marital deduction allowable with respect to them, absent any requirement of the instrument or local law that beneficiaries share ratably in appreciation and depreciation during administration.) It will be recalled, however, that absent a minimum-value requirement, qualification must follow the appreciation-depreciation pattern, and the traditional problem-pecuniary language must have been augmented either by an additional provision reading, for example, "The assets to be distributed in satisfaction of said bequest shall be selected in such manner that the cash and other property distributed shall have an aggregate fair market value fairly representative of the distributee's proportionate share of the appreciation or depreciation in the value to the date, or dates, of distribution of all property then available for distribution,"[82] or by a clear local

81. Rev. Proc. 64-19, § 2.02.

82. The language closely follows that used in Rev. Proc. 64-19.

law requirement of such result. This ratable-sharing requirement would seem to limit the assets chosen to a distribution date value of 600,000 dollars.[83]

The question may now be posed as to whether there is any real difference between the new "ratable-sharing pecuniary" and a straight fractional share formula clause. Economically, each results in a marital share of 600,000 dollars. Theoretically, however, there are several differences.

The pecuniary sets no requirement that the marital share include a ratable share of each asset; conceivably, the marital share can be carved out, as a bequest, utilizing selected assets. Yet the new pecuniary clause imposes concurrent requirements which may tax the ingenuity of the executor. The marital deduction is fixed at 500,000 dollars, and the dispositive clause specifies that the marital bequest shall be satisfied with assets having an aggregate estate tax value or other basis equal to that amount. The newly added ratable-sharing requirement sets the distribution date value at 600,000 dollars. Thus the executor apparently must select assets with an aggregate estate tax value of 500,000 dollars and an aggregate distribution date value of 600,000 dollars—a challenging matching job to say the least if selection of individual assets, rather than an allocation of a fractional share of each, is sought.[84]

In the example which has been used, no combination of distributions other than an equal splitting of the *A* and *B* stock will fit the specifications. This does not mean, however, that a selection of assets is impossible in other situations. Suppose, for example, that the adjusted gross estate had been 1,000,000 dollars and that available assets had been 2,500 shares of *W*, 2,500 shares of *X*, 2,500 shares of *Y*, and 2,500 shares of *Z*, each having a federal estate tax value of 100 dollars per share. Further assume that the *W* and *X* shares were each worth 160 dollars per share at the distribution date while the *Y* and *Z* shares had a fair market value of 80 dollars each at that time. Clearly, the executor could comply by distributing all of the *W* and *Z* shares or all of the *X* and *Y* shares to the surviving spouse.

83. For illustrative purposes, it is assumed in the text that the distribution carries a proportionate share of appreciation or depreciation. The language used, "fairly representative," would not seem to require precise allocation; yet the words are not free from ambiguity, and the executor will probably be well-advised to come as close as possible within the limits of practicality. If there is to be deviation from exact allocation of appreciation or depreciation, it probably should be in favor of the marital share.

84. To the extent that "fairly representative" permits modest deviation in the interest of practical administration, the "challenge" is eased. The same is true where modest overfunding of the marital share seems appropriate and the acquiescence of other interested beneficiaries can be secured.

Realistically, however, neatly designed hypothetical situations of this type will rarely occur and, as a practical matter, a distribution of a fractional share of each class of stock will be required.[85]

A further possibility arises. Might not the executor meet the requirements by selling sufficient shares to produce 600,000 dollars in cash?[86] The quoted will provision and the requirements of Rev. Proc. 64-19 would not seem to inhibit such a course of action, the rationale underlying the requirement of ratable sharing would seem to be satisfied, and opportunity for manipulation would appear to be nonexistent. However, one of the purposes of the pecuniary clause permitting distribution in kind, namely, the transfer of specific assets without the necessity of liquidation and without concomitant expense and possible gain and loss to the estate on disposition, would be lost. In short, the executor will often be faced, at best, with a choice between distributing a pro-rata share of each asset similar to the operation of the fractional share clause or making distribution in cash subject to the provision that the widow's portion share in appreciation and depreciation of estate assets prior to distribution with an economic result similar to a distribution of a fractional share.

c. *Minimum-Value Versus Ratable-Sharing as a Means of Qualifying Tax-Value Clauses Under Rev. Proc. 64-19*

If local law neither requires the fiduciary to give the surviving spouse a minimum amount equivalent to the allowable marital deduction nor requires that her distributive share be "fairly representative" of appreciation and depreciation during administration *and if* the draftsman should decide to utilize a pecuniary clause embodying the problem-pecuniary language, *then*, which of the two alternatives set forth in Rev. Proc. 64-19 would appear to be preferable? (Obviously, if local law clearly requires that the widow share ratably in appreciation or depreciation, despite a grant of discretion to the trustee subject only to a requirement of a *minimum* distribution date value, the minimum value route will not be chosen.)

In essence, the basic choice is between assuring the widow of a

85. Other possibilities may arise. For example, the estate may contain corporate stock plus equal amounts of municipal bonds and high-yielding corporate bonds. If bond values do not change, it may be possible to assign the municipals to the marital share, an appropriate amount of the industrials to the nonmarital share, and then to split the stock and remaining assets fractionally in order to comply with the twin requirements of the ratable-sharing route.

86. In New York, absent authority to distribute in kind, he apparently must distribute in cash. See *In re* Umpleby's Will, 252 N.Y.S.2d 674 (Surr. Ct. 1964). The result does not follow in all states. See note 167 *infra*.

"fixed amount" (limiting the legatee's participation in appreciation or depreciation occurring prior to distribution) and qualifying a marital portion which shares ratably in appreciation and depreciation in a manner similar to that of the traditional fractional share of the residue clause.

It will be recalled that, during the negotiations leading to Rev. Proc. 64-19, one group of practitioners opposed establishment of the assured minimum-value method on the ground that it was unfair, undesirable, and perhaps a violation of local law to prefer the widow's share, particularly when drastic depreciation of assets during administration might virtually wipe out the interest of other residuary beneficiaries. On the other hand, it seems logical that the testator would normally and naturally prefer the surviving spouse to residuary legatees and, absent a very large estate in which overqualification was clearly undesirable, would prefer that the widow's share be protected. Thus, if some minimum for both the widow and other legatees is desirable, these should be provided for by fixed amount pecuniary bequests to each, antecedent to the formula clause.[87] In the more likely situation of overall appreciation during administration (and economic history seems to suggest that inflation, whether slow or galloping, seems to have become a way of life), the minimum-value clause does permit the executor to choose those assets less likely to appreciate (or to produce maximal income) and to allocate them in satisfaction of the marital bequest. The only new requirement under Rev. Proc. 64-19 is that the distribution have a fair market value equivalent to the marital deduction allowable with respect to such assets—a fair condition to avoid the possible manipulation which triggered the promulgation of the Procedure.

This discretion granted to the trustee—to determine the nature and value of assets allocable to the marital share (subject only to the minimum bench mark)—will have much of the appeal which led to the widespread use of the pecuniary clause. But, for those who look upon this discretion to vary the widow's share as an undesirable potential source of administration problems stemming from competing interests of the widow and the residuary legatees, the considerations are quite similar to those which led to avoidance of the pecuniary formula clause before the emergence of the problems which gave rise to Rev. Proc. 64-19.

87. The bequest might either be an outright general pecuniary legacy (carrying no share in income during the normal period required for distribution) or a legacy in trust (entitled to a share of income, usually). The right to income should be considered and specifically provided. See *Report of Committee on Probate and Estate Administration*, 102 TRUSTS & ESTATES 916 (1963).

From an administrative standpoint, the minimum-value type clause appears to present fewer undesirable features, such as mechanical problems and potential expense stemming from liquidation to satisfy the bequest in cash, than does the ratable-sharing alternative. The latter, at best, seems likely in normal circumstances to present the same type of distribution and administration problems inherent in the traditional fractional share clause.[88] This ratable-sharing pecuniary, as a newly developed hybrid (to use a more polite term than another which comes readily to mind), simply presents a new form of clause for local courts to interpret;[89] though pecuniary in appearance, it apparently will be treated by the Service as a fractional share which it so closely resembles.[90] In short, the appreciation-depreciation formula appears to offer few, if any, attractions when compared to the fractional share formula—and a voyage of exploration seems somewhat inappropriate.[91]

While this analysis would seem to suggest the relative desirability of the minimum-value clause vis-à-vis the ratable sharing alternative, the choice is obviously, and happily, not limited to the two. As will be suggested, the "true pecuniary" (a pecuniary bequest which will be satisfied with assets valued as of distribution date) will often be preferable to either, when potential recognition of gain is not of controlling importance.

Beyond this, it is possible to speculate on alternatives imaginative scriveners may devise. In addition, it seems reasonable to consider whether some selected species of fractional share clause might not be preferable. Pursued further, it would be appropriate to consider whether any form of formula bequest is really worth the candle and, if so, how the dangers and problems which seem to arise can be minimized by an appropriate specific allocation of certain assets to the marital and nonmarital shares, respectively, with the formula merely performing the function of a "back-up" clause and probably affecting a relatively small quantum of the estate absent

88. These problems are considered in the discussion of fractional share clauses. See Part III of this article *infra*.

89. The difficulties of coping with formula clauses and appropriately classifying them are collected and analyzed in Straus, *supra* note 68, at 912; see Durand, *Planning Lessons From Marital Deduction Litigation*, 101 TRUSTS & ESTATES 8 (1962).

90. See Sheets, *supra* note 57, at 72: "The construction adopted by Rev. Proc. 64-19 treats bequests covered by its provisions as bequests of fractional shares. Therefore, any intermediate, disproportionate distribution of any significance would require a revaluation of the property and an adjustment of the fraction."

91. "In working out an estate plan a lawyer should not try to skate successfully over thin ice but should confine himself to places where the ice is abundantly thick. . . ." TWEED & PARSONS, LIFETIME AND TESTAMENTARY ESTATE PLANNING 2 (1959 rev. ed.).

significant change in the makeup and value of estate assets. These latter questions are considered in the closing portion of this article.

B. *Possible New Pecuniary Tax-Value Formulas To Avoid the Problems Involved in Rev. Proc. 64-19*

The imagination and ingenuity of the American will draftsman in developing new formula approaches is legendary.

One such formula that appeared even before issuance of Rev. Proc. 64-19 utilizes the traditional problem-pecuniary language, but adds that values used shall be the lower of (1) federal estate tax values *or* (2) fair market value at the time of distribution. A typical clause reads: "Allocations of property to the marital trust may be made in the executor's discretion wholly or partly in kind, by allocating specific assets, or undivided interests therein, *at values as finally determined for Federal estate tax purposes OR the values current at the time of distribution, whichever shall be LOWER.*"[92]

Such a clause "should" avoid the problems which gave rise to Rev. Proc. 64-19, since it is clear from the instrument that the distribution date value of the assets so distributed cannot be less than the marital deduction allowed with respect to such assets. Yet it would appear to have distinct disadvantages. While setting the allowable marital deduction as the minimum quantum for distribution to the marital share, it makes possible a sharing of appreciation, but not depreciation, by the marital share.

Again returning to the example of *A* and *B* stock, the executor might, absent imposition of specific dispositive direction or local law requirement of ratable sharing of appreciation and depreciation, distribute all of the *A* stock, thus passing all appreciation to the widow. If he chose to fund the bequest with *B* stock, however, its value for distribution purposes would be 400,000 dollars (fair market value being lower than the federal estate tax value of 500,000 dollars) and some distribution of *A* stock would be required.

At this point, an interpretative problem arises in connection with the language used in the illustrative clause. If the direction is deemed to require that *each* asset distributed shall, for purposes of computing the required distribution, be valued at the lower of the two specified values, then an additional 1,000 shares of *A* stock

92. This clause is taken from a form of a well-known bank. Suggestions for this type of clause have appeared elsewhere; references are set forth in *Report of Subcommittee on Estate Planning and the Marital Deduction*, 102 TRUSTS & ESTATES 934, 944 n.70 (1963). See also Covey, *The Marital Deduction and the Use of Formula Provisions*, P-H WILLS-TRUSTS-ESTATE PLANNING FORMS ¶ 121, at 291 (1962). This type of clause is criticized in Dane, *Marital Deduction Questions*, 103 TRUSTS & ESTATE 112, 114 (1964).

(federal estate tax value of 100,000 dollars being lower than the fair market value of 160,000 dollars) would also be distributed to the marital share.

If the executor were inclined toward a ratable distribution of shares, he would encounter difficulties when a clause is so interpreted. A distribution of one-half of the *A* stock (2,500 shares) would be valued at 250,000 dollars (the federal estate tax value of 250,000 dollars being lower than the fair market value of 500,000 dollars), while a distribution of the *B* stock would be valued at 200,000 dollars (the fair market value of 200,000 dollars being lower than the federal estate tax value of 250,000 dollars). Since the bequest calls for 500,000 dollars, additional assets would have to be transferred.[93]

If the clause were revised to make clear that it referred to the lower of the *aggregate* federal estate tax value or fair market value at distribution, the result would be somewhat different in the second and third examples. In the second case, use of all of the *B* stock would require only 625 additional shares of *A* stock (basis of 62,500 dollars and fair market value of 100,000 dollars) since the aggregate fair market value (400,000 dollars for *B* and 100,000 dollars for *A*) was lower than the aggregate federal estate tax value of the assets distributed (500,000 dollars for *B* and 62,500 dollars for *A*). In the third case, a distribution of half of the *A* shares and half of the *B* shares would be appropriate, since the aggregate federal estate tax value (250,000 dollars each for *A* and *B* shares) would be less than the aggregate fair market value (400,000 dollars for the *A* shares and 200,000 dollars for the *B* shares).

A fourth case will illustrate the built-in requirement that assets distributed must have a fair market value at least equal to the allowable marital deduction and that the full brunt of any decline

93. The mathematics and fraction of shares distributed might prove a bit discouraging. For example, in the hypothetical case, strict adherence to the formula would suggest distribution of 2,777.80 shares of *A* stock with a basis of $277,780 (which is lower than fair market value) and 2,777.80 shares of *B* stock with a distribution date value of $222,220 (actually $222,224) which is lower than the basis of $277,780. Where numerous assets are involved, a bit of thought should suggest the desirability of revising the clause to make clear that only the lower of *aggregate* fair market value or federal estate tax value is intended. In Matter of McDonnell, 153 N.Y.L.J. No. 27, 18 (Nassau Co. Surr. Ct.) Feb. 9, 1965, the formula clause provided, ". . . each item of property . . . distributed in kind shall be valued at the date or dates of such distribution or at the value determined therefor in the Federal estate tax proceeding in my estate, whichever value shall be lower." Surrogate Bennett, noting that the executors proposed to satisfy the legacy in cash in the amount of the marital deduction allowed, held that "executors may not satisfy the amount of the marital trust in cash without adding to such bequest its proportionate share in the appreciation realized by the estate." *Ibid.*

in overall values will be borne by the nonmarital share. For example, assume that the *A* stock had appreciated to 110 dollars per share (or a total of 550,000 dollars) while the *B* stock had declined in value to 60 dollars per share (or a total of 300,000 dollars). Assuming an absence of any requirement of sharing in appreciation and depreciation, a distribution of the *A* shares would require distribution of all 5,000 shares (the federal estate tax value of 500,000 dollars being less than the fair market value of 550,000 dollars) in order to match values determined for distribution purposes with the 500,000 dollar amount due.

On the other hand, an attempt to allocate all of the *B* shares (federal estate tax value 500,000 dollars and current value 300,000 dollars) to the marital share would also require distribution of 1,818.18 shares of *A* stock (current value of 200,000 dollars and federal estate tax value of 181,818 dollars) since the *aggregate* current value of the *A* and *B* shares distributed (500,000 dollars) is less than their aggregate federal estate tax value (681,818 dollars). Should the trustee consider a pro-rata distribution of shares, it is clear that, since the current value of half of each group of shares (275,000 dollars for *A* and 150,000 dollars for *B*, or a total of 425,000 dollars) is less than the 500,000 dollar federal estate tax valuation of the shares, the formula would require that additional shares be added to the marital transfer. This might be 441.176 shares each of the *A* stock and *B* stock (with a fair market value of 75,000 dollars and federal estate tax value of 88,235.20 dollars), thus transferring assets valued at the lower aggregate fair market value of 500,000 dollars as compared to total federal estate tax values of 588,235.20 dollars.

Perhaps this brief illustration of the operation of this type clause will at least give pause to those who have been considering its use.

III. The Fractional Share as an Alternative Clause

Limitations of space and the shortness of life preclude full exploration herein of the fractional share formula clause in its infinite variations. Suffice it to say that varying patterns for expressing the fractional share have developed, and debate over the preferable method has not ended.[94] Yet it is not to be gainsaid that the frac-

94. See, *e.g.*, Golden, *supra* note 73; Kiley & Golden, *The Residue Formula as an Aid to the Executor*, 90 Trusts & Estates 824 (1951); Kiley & Golden, *A Residue Formula for Maximum Marital Deduction*, 89 Trust & Estates 744 (1950). *Cf.* Bolte, *Choosing a Marital Deduction Formula Clause*, 44 Marq. L. Rev. 532 (1961); Durbin, *Marital Deduction Formula Revisited*, 102 Trusts & Estates 545 (1963). And see generally Cox, *Types of Marital Deduction Formula Clauses*, N.Y.U. 15th Inst. on Fed. Tax. 909 (1957); Craven, *Marital Deduction Problems—Use of the Percentage Formula Clause*, N.Y.U. 19th Inst. on Fed. Tax. 613 (1961).

tional share formula has been the favorite of corporate fiduciaries,[95] and at least one report of the Committee on Estate and Tax Planning of the American Bar Association's Section of Real Property, Probate and Trust Law has indicated a preference for it.[96] A more recent report of that Committee suggested that until "the questions recently raised by the Internal Revenue Service have been put to rest, it would seem that the fractional share of the residue type of formula clause has fewer pitfalls and is the safer to use of the two types of formulas."[97] And, almost as if in vindication, it has been observed that recent events have "increased the popular appeals of the fractional share of the residue clause."[98]

Yet it may be noted that, while Rev. Proc. 64-19 does set forth the Service's current position on tax-value pecuniary formula clauses, it does not (as it need not have) express approval of all fractional share clauses as such.[99] Rather, it simply indicates that the problems giving rise to Rev. Proc. 64-19 are not present in fractional share dispositions "under which each beneficiary shares proportionately in the appreciation or depreciation in the value of assets to the date . . . of distribution."[100]

A quick glance at the methods of expressing the fractional share clause and at a few of the potential problems arising in its administration may furnish some basis for deciding whether, and when, such a clause is to be preferred to the pecuniary formula. A rather simple, indeed atypically simple, example may be useful by way of illustration.

A. *The Fractional Share Illustrative Case*

The will of the hypothetical client is to specify that all expenses, debts, and taxes are to be paid from, and borne by, assets other than those comprising the marital share;[101] it is to provide further

95. See Bronston, *State and Federal Taxation—Tax Problems of Formula Type of Marital Deduction Bequest*, 96 TRUSTS & ESTATES 887 (1957); Lovell, *Administering the Marital Deduction—A Summary of Five Years' Experience*, 92 TRUSTS & ESTATES 812, 813 (1953).

96. Durand, *Draftsmanship—Wills and Trusts*, 96 TRUSTS & ESTATES 871, 873 (1957).

97. *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 92, at 945. See also Durbin, *supra* note 94.

98. Lloyd, *Revenue Procedure 64-19, Background of Drafting Problems*, 103 TRUSTS & ESTATES 898, 899 (1964).

99. *Ibid.*

100. Rev. Proc. 64-19, § 4.01(1).

101. This dispositive direction is deliberately phrased in ambiguous language for illustrative purposes. As will be noted in the text, several alternatives are possible, and the draftsman should obtain a more specific directive after consideration has been given to the ramifications of the several choices. For example: (1) Normally an early

that the executor may waive any rights to reimbursement for taxes attributable to non-probate assets.[102] The testator desires to bequeath 50,000 dollars to a friend, Able, and further desires that the maximum marital deduction be obtained by placing such share[103] of the estate as is necessary to achieve that result in a marital trust *A* for the benefit of his wife,[104] she to have all of the income for life

paragraph of the will contains a direction to pay debts, funeral expenses, and expenses of administration. In addition, pecuniary legacies will be provided for in an early paragraph of the will and will take precedence over dispositions of the residue. Thus the fractional share to be qualified for the marital deduction will, in those circumstances, allocate only a share of the probate estate remaining *after* provision for the debts, expenses, and legacies. Further, (2) payment of succession taxes, though they are to be paid from other than the marital share, may be subject to two quite different types of direction. On the one hand, the testator may direct payment of such taxes (as an administration expense) prior to determination of the residue from which the fractional marital share is to be carved. See Golden, *supra* note 73, at 538; Kiley & Golden, *supra* note 94, at 746. To some, defining the fraction after taxes seems most logical, since the fraction is then applied to the "true residue." See Bolte, *supra* note 94, at 543. For a discussion of the operation of the "pre-tax" residue pattern, see Casner, *How To Use Fractional Share Marital Deduction Gifts*, 99 TRUSTS & ESTATES 190, 191 (1960). Adequate specification is essential; absent such specification a construction problem may be presented. *E.g.*, Matter of Milholland, 31 Misc. 2d 1046, 221 N.Y.S.2d 199 (Surr. Ct. 1961).

102. See I.R.C., §§ 2206, 2207.

103. If the formula is to be a fractional share, it seems prudent to express it in those terms and not in terms of a "portion," a "percentage," or other potentially ambiguous terms which could (however illogically) be construed as giving the widow an amount equal to the formula-derived sum. For example, in In the Matter of Estate of Kantner, 50 N.J. Super. 582, 143 A.2d 243 (App. Div. 1958), the gift was "a portion of my estate equal in value to (a) one-half of the value of my adjusted gross estate," followed by a disposition of the residue in a succeeding clause; it was construed as a general pecuniary bequest. In Althouse Estate, 404 Pa. 412, 172 A.2d 146 (1961), the lower court construed a bequest of "so much of my estate [as] . . . shall equal the maximum marital deduction" to be a gift of a fractional share; the Supreme Court of Pennsylvania held the bequest to be a pecuniary gift, stressing that the marital trust was created in a separate paragraph prior to the disposition of the residue. *Id.* at 414, 172 A.2d at 147. These cases are discussed in Lauritzen, *Marital Deduction Bequests—Current Problems and Drafting Suggestions*, 8 TAX COUNSELOR'S Q. 125, 141 (1964). The numerous New York cases construing formula language are collected and discussed by Surrogate Hildreth in *In re* Umpleby's Will, 252 N.Y.S.2d 674 (Surr. Ct. 1964).

104. Here again, the testator has a number of alternatives. He might leave the property to his wife by an outright bequest or by a gift to be qualified under I.R.C., § 2056(b)(5) (either a legal life estate or gift in trust), giving her all of the income for life with a general power of appointment exercisable in all events. Alternatively, he might provide for an "estate trust" in which income distributions to the widow would be discretionary but any undistributed income and principal would have to be distributed to her estate. The tax and non-tax factors influencing the choice are discussed in Polasky, *Estate Tax Marital Deduction in Estate Planning*, Tax Counselor's Q., June 1959, pp. 1, 36-41. Once the choice has been made, it becomes important to consider the probate rules, or lack thereof, governing payment of income or interest on a bequest during the period of administration. The matter is discussed in detail in *Report of Committee on Probate and Estate Administration*, *supra* note 87. In general, the outright pecuniary legacy would not be entitled to income during the normal period of administration, but would receive interest where payment was delayed beyond that time (say, one year); the legacy in trust would, however, share in income, though the degree may be uncertain. These are matters

from Trust *A* coupled with a testamentary power of appointment.[105] The balance of the estate is to be placed in a second trust, Trust *B*, the income of which is to be paid to the wife,[106] with remainder to specified remaindermen. Let it be further assumed that the executor does not elect the alternative valuation date, that funeral expenses and debts amount to 30,000 dollars, and that administration expenses aggregate 50,000 dollars, all of which are taken as deductions for federal estate tax purposes.[107] The anatomy of the estate is set out in Chart I on page 839.

---

to be considered and specifically provided for in the dispositive instrument in accordance with the testator's wishes.

105. The life-estate coupled with a general power of appointment and designed to qualify under the specific requirements of I.R.C., § 2056(b)(5) is perhaps the most commonly used provision. Again, a knowledge of local law is essential if the deduction is not to be lost. In Estate of Pierpont v. Commissioner, 336 F.2d 277 (4th Cir. 1964), the testator's will provided for creation of a trust with all income payable to the widow for life and on her death the remaining principal to "be paid over free of this Trust in such manner and proportions as my said wife may designate and appoint in her Last Will . . . ." *Id.* at 279. While the disposition appears to be a classic qualifying gift under § 2056(b)(5), both the Tax Court and the court of appeals held that under governing Maryland law the general power of appointment is "a rather strange animal . . . a creature apart from the general power of appointment found in the other states"; the trust did not qualify under § 2056(b)(5) because the widow could not appoint the trust property to her own estate.

106. The provision for distribution of all income from both the marital trust *A* and residuary trust *B* will simplify the problems of administration, particularly if it is coupled with a provision that income received on account of assets later used to pay taxes, administration expenses, and the like is to be treated as income in accord with the modern trend. See discussion in text accompanying note 141 *infra*. If the wife is to receive only the income from Trust *A*, the trustee is faced with the problem of allocating the appropriate share of income even though the determinative fraction may not be ascertainable until federal estate tax values have been finally determined. Failure to allocate a proper share of income to the testamentary § 2056(b)(5) type marital trust should not endanger the marital deduction, since Rev. Reg. 20.2056(b)-5(f)(9) specifically provides that, "An interest is not to be regarded as failing to satisfy the conditions . . . (that the spouse be entitled to all the income and that it be payable annually or more frequently) merely because the spouse is not entitled to the income from estate assets for the period before distribution of those assets by the executor, unless the executor is, by the decedent's will, authorized or directed to delay distribution beyond the period reasonably required for administration of the decedent's estate." When the trust is carved out of an inter vivos trust, however, it may be prudent to permit discretionary distributions of income from the non-qualifying residuary trust *B* in order to assure compliance without need for later adjustment of the respective income shares. For a discussion of carving the fractional share marital gift out of an inter vivos trust, see 1 CASNER, ESTATE PLANNING 801-03 (3d ed. 1961). Although the point has been raised, it would seem that division of the trust into marital and nonmarital trusts according to a true fractional share provision should not give rise to recognition of gain or loss. One commentator suggests that the same should be true if a true pecuniary formula is used. Dane, *supra* note 92, at 114; but for a contrary view, see Covey, *supra* note 69, at 320.

107. For a discussion of the problems arising from the election to take certain expenses as deductions under *either* § 642(g) *or* under §§ 2053 and 2054, and methods of finessing the problem, see Polasky, *supra* note 104, at 6-17, and authorities cited therein. Later cases include *In re* McTarnahan's Estate, 27 Misc. 2d 13, 202 N.Y.S.2d 618 (1960). An illustration is set out at note 154 *infra*. Recently enacted New York

CHART I

FRACTIONAL SHARE ESTATE ANALYSIS-BASIC DATA

Assets Includable in Gross Estate	*Rate of Return*	*Fair Market Value at: Date of Death*	*One Year Later*	*Non-Probate Estate (Date of Death Value)*	*Probate Estate*	*Non-Probate Assets Qualified for Marital Deduction*	*First-Year Income Non-Probate Assets*	*Probate Assets*
Life Insurance (interest payable to the widow for life under an option; non-qualifying terminable interest)	2%	$ 50,000	$ 50,000	$ 50,000			$1,000	
Life Insurance (qualified for the marital deduction)	2%	100,000	100,000	100,000		$100,000	2,000	
Residence, joint tenancy (qualified)	—	50,000	50,000	50,000		50,000		
Cash (savings account in decedent's name)	4%	100,000	100,000		$ 100,000			$ 4,000
Stock *A* (3,000 shares)	4%	300,000	600,000		300,000			12,000
Stock *B* (3,000 shares)	6%	300,000	300,000		300,000			18,000
Stock *C* (3,000 shares)	2%	300,000	200,000		300,000			6,000
Income During First Year							$3,000	$40,000
Totals { Date of Death		$1,200,000		$200,000	$1,000,000	$150,000		
Totals { One Year Later			$1,400,000					

The computation of the maximum estate tax marital deduction (based on date of death values) is as follows:

Gross Estate		$1,200,000
Less:		
Administration Expenses	$50,000	
Debts, Claims	30,000	80,000
Adjusted Gross Estate		$1,120,000
Maximum Marital Deduction		$ 560,000

B. *Drafting Problems*

Assume that the problem, as the attorney sees it, is to draft dispositive provisions which will direct the executor to transfer to the Marital Trust *A* that share of the probate estate which will permit taking full advantage of the marital deduction without any unnecessary overfunding of the surviving spouse's estate. Since the maximum marital deduction is 560,000 dollars, and bearing in mind that the value of non-probate assets qualifying for the marital deduction aggregates 150,000 dollars,[108] it is apparent that an additional 410,000 dollars is to be qualified by the formula clause.[109]

legislation recognizes and deals with the problems. Section 17-e of the Personal Property Law (Chapter 165 of the Laws of 1964, effective June 1, 1965) provides, in § 17-e(1), statutory recognition of the requirement for reimbursement if estate taxes are increased by the election to take deductions as income tax deductions rather than for estate tax purposes *unless* the will provides that such adjustment is not to be required. Subdivision 2(a) of § 17-e(1) provides that no adjustment is required where the marital share has been increased by the election (with the resultant effect on the "adjusted gross estate" and the available marital deduction) *unless* the will provides otherwise. Similarly subdivision 2(b) provides, absent a contrary will provision, that no adjustment is required as a result of election of the alternative valuation date. For a detailed discussion, see Lewis, *Tax Elections by Executors and Administrators*, 36 N.Y.S.B.J. 498, 501-04 (1964) discussing potential problems arising from the interplay of § 17-e and of Decedent Estate Law § 18.

108. This ignores the possibility that a widow's support allowance will be granted and will qualify for the marital deduction. Since the decision in Jackson v. United States, 376 U.S. 503 (1964), it is doubtful that many such widow's awards will qualify. The *Jackson* case and qualification of widow's awards is the subject of a comprehensive note. See 63 MICH. L. REV. 924 (1965). Even in a state such as Ohio, where the award is deemed vested if the widow survives the decedent, provisions may be found permitting review and curtailment of the award, thus casting doubt upon the qualification of any significant amount. In a state like Illinois, which holds the award vested and specifies a minimum award of $1,000 even though the surviving spouse lives only a few hours longer than the decedent, this amount should qualify but will not seriously affect the computations; neither does it permit effective post-death planning to salvage the results of failure to qualify sufficient property. In such case, the major effort to qualify property for the marital deduction is through the device of having the surviving spouse claim against the will, taking a statutory share. See, *e.g.*, Isaac Harter, Jr., 39 T.C. 511 (1962); Indiana Nat'l Bank v. United States, 191 F. Supp. 73 (S.D. Ind. 1961). In certain cases, the receipt of the commuted cash value of the widow's elected dower right will qualify. See, *e.g.*, First Nat'l Exch. Bank v. United

The attorney now faces two quite different drafting problems. The first is an exercise in semantics; he must decide how he may most clearly express the fraction.[110] The second involves a decision with greater substantive effect; he must specify the pool of assets on which the fraction is to operate. This decision may have an effect on the quantum of assets the marital share will ultimately receive. Further, in the view of one commentator, it may affect the actual makeup of the assets distributed.[111]

It is helpful to note that the fraction prescribed serves two quite different purposes. First, it describes the proportionate share of the residuary estate that is to be qualified for the marital deduction. Necessarily this will produce an *amount*, expressed in dollars, to be claimed on the estate tax return. Second, once constituted, the *fraction* will be applied to actually allocate the aliquot shares of the described residuary estate to the marital and nonmarital trusts at the distribution date. Since the actual value of assets comprising the residue will change during administration,[112] the distribution date value of the marital share will rarely be the same as the amount claimed for the marital deduction. But the fraction itself will change

---

States, 335 F.2d 91 (4th Cir. 1964); Wachovia Bank & Trust Co. v. United States, 234 F. Supp. 897 (M.D.N.C. 1964). These avenues are, however, poor substitutes for proper planning. For example, in Michigan, upon election to take against the will, the surviving spouse is entitled to the share of personal property receivable in case of intestacy until the amount reaches $5,000, but her statutory share includes only one-half of the amount of the residue of the personalty to which she would be entitled in case of intestacy. (The elected statutory share in real estate is the same in the case of intestacy.) MICH. COMP. LAWS § 702.69 (Supp. 1961). Thus, if the husband left his wife a life estate in the entire estate (all of which was personalty), an election to take against the will would give her only about one-sixth (assuming there were children of the decedent), and she might be quite reluctant to reduce estate taxes at such a sacrifice of her rights.

109. The testator might first (and, hopefully, not last) consider a simple clause describing the marital share as "one-half of my adjusted gross estate." This will not accomplish his purpose if he seeks to avoid overqualification. One-half of the adjusted gross estate will produce a share of the estate with an estate tax value of $560,000 ($150,000 more than necessary). In King v. Citizens & So. Nat'l Bank, 103 So. 2d 689 (Fla. 1958), the will provided a bequest to the widow of "50 percent of my adjusted gross estate." The bequest to the widow was deemed to be unambiguous; the amount under the will was not reduced by non-probate assets passing to the widow and otherwise qualified for the marital deduction! The problem is discussed in Berger & Kanter, *Shop Talk*, 15 J. TAXATION 382, 383 (1961). A second problem which is not considered for present purposes, but which should always be considered by the professional adviser, is whether it would be advisable to pass more (or less) than the precise amount needed to qualify for the maximum marital deduction. For discussion of this point, see Polasky, *supra* note 104, at 32.

110. *Compare* Golden, *supra* note 73, *with* Durbin, *supra* note 94.

111. Casner, *supra* note 101.

112. Not only will the values of particular assets vary, but, when the executor exercises his power to sell, invest, and reinvest, the *composition* of the residue also will vary.

only with non-pro-rata interim distributions or additions to the described asset pool.[113]

One illustrative clause provides, "Trust *A* shall be comprised of the fractional share of all property passing under this Article [the residuary estate] (exclusive of property or interests in property, if any, which would not qualify for the estate tax marital deduction under the Internal Revenue Code if left outright to my wife) required to obtain for my estate a full marital deduction of fifty per cent of the adjusted gross estate as finally determined for federal estate tax purposes, taking into account the aggregate marital deductions allowable other than under the provisions of this Article. Said share shall not be diminished by any portion of the taxes payable by reason of the death taxes payable by reason of my death."[114]

The above clause makes it reasonably clear[115] that the numerator of the fraction, applied to whatever residue is designated (the latter being valued as for federal estate tax purposes),[116] will be 410,000 dollars. (The maximum marital deduction was 560,000 dollars and 150,000 dollars otherwise qualified.) Further, to avoid the "tainted asset" problem, it specifically excludes from the defined pool any asset which would not qualify.[117] (Some scriveners prefer to exclude these assets from the pool by an antecedent paragraph specifically directing such assets to Trust *B*, the residuary trust.)[118]

113. For the view of a service official that interim distributions require recalculation of the fraction, *see* Sheets, FED. EST. & GIFT TAX REP. ¶ 8147, at 7241 (1964).

114. *Report of Subcommittee on Forms for Marital Deduction Planning*, 103 TRUSTS & ESTATES 961, 965 (1964).

115. See Golden, *supra* note 73; Durbin, *supra* note 94.

116. Occasionally, a clause is encountered which defines the denominator as the residuary probate estate valued at fair market value as of the distribution date. This "sliding fraction" clause would appear to be simply a bequest of a pecuniary amount; it merely provides for distribution of assets with a distribution date value of $410,000 from the residue.

117. As noted earlier, absent specification to the contrary the fraction would allocate a fraction of all assets comprising the residue, including those which would not qualify for the marital deduction, thus additional property would be passed to the widow's share without any increased benefit. The problem with a true fractional share is, however, confined to overfunding. In cases where a pecuniary clause is used and the dispositive instrument fails to specify that only property qualifying for the marital deduction is to be used, the available deduction is reduced by the non-qualifying assets which could be used to satisfy the bequest. I.R.C., § 2056(b)(2); Rev. Reg. §§ 20.2056 (b)-1(c)(2)(ii), 20.2056(b)-2; John P. Hoelzel, 28 T.C. 384 (1957). See also Craven, *supra* note 94, at 625; Polasky, *supra* note 104, at 25.

118. *E.g.*, Bolte, *supra* note 94, at 541, suggests "also a mandatory power to exclude from the marital share those assets appearing in the gross estate which would not qualify for the marital deduction if so included, might cause a new complication, however. The problem is this—if the executor should allocate one asset to the marital share, and another asset having an equal value at that time, but a different basis to the estate, to the non-marital share, perhaps it will be considered a taxable exchange." See also Peeler, *Unsuspected Realization of Profit in Estates and Trusts*, 98 TRUSTS & ESTATES 1191, 1192 (1959). See Sheets, *Practical Solutions to 64-19*, 104 TRUSTS & ESTATES

Since both the numerator (the desired marital deduction share) and the denominator (the pool from which it is to be drawn) must be valued at federal estate tax values, many counselors prefer to spell out the fractional share in terms of a numerator and denominator as indicated in the footnote.[119]

Once the pool (the denominator) is adequately described, the results should be the same no matter which form of expression is used. But does the dispositive clause adequately spell out the pool against which the fraction is to be described? If the general pecuniary legacy, debts, claims, and taxes were all to be paid from the residue after constitution of the fraction (a possible, though admittedly atypical, direction),[120] the fraction would be 410,000 dollars (the marital gift at federal estate tax values) over 1,000,000 dollars (the residuary probate estate, at federal estate tax values, to which the fraction is to be applied). Actually, the form quoted above provides for the general pecuniary legacy and payment of debts, claims, and expenses in antecedent paragraphs, while directing that death taxes be paid from the nonmarital (Trust *B*) portion of the residuary estate. As thus defined, the fraction has a numerator of 410,000 dollars and a denominator equal to 870,000 dollars (the 1,000,000 dollar probate estate less the 50,000 dollar general pecuniary legacy and the 80,000 dollars of debts, claims, and administrative expenses). Applied to the defined residuary estate of 870,000 dollars, the fraction of 410/870 again produces a marital gift of a fractional share of the residue with a federal estate tax value of 410,000 dollars.

If, as some have suggested, the residue is to be defined as an "after-tax residue,"[121] the fraction becomes 4100/7243 (the probate estate having been reduced to 724,300 dollars for purposes of defining the residue by deduction of 275,700 dollars, comprised of 50,000 dollars for the legacy, 80,000 dollars for debts, claims, and administrative expenses, and 145,700 dollars for federal and state succession

71, 72 (1965), for the views of a senior official of the Internal Revenue Service. If the executor is given a specific direction to use only qualifying assets in constituting the fractional share, this suggestion does not seem to present a realistic danger. Nevertheless, it does seem preferable, simply as a matter of drafting, to allocate the non-qualifying assets to the non-qualifying trust before constituting the residue or pool on which the fraction will operate.

119. Durbin, *supra* note 94; see form at note 162 *infra*.

120. For an illustration, see Casner, *supra* note 101, at 191.

121. *E.g.*, see Golden, *supra* note 73, at 538 n.11: "The fractional share formula suggested by the Harris Bank for use by attorneys directs payment of taxes as administration expenses and divides the remaining residuary estate . . . ." See also *Report of Subcommittee on Forms for Marital Deduction Planning*, *supra* note 114, at 965: "I give . . . the residue of my estate remaining after payment of all death taxes . . . ."

taxes). Again, the fraction (4100/7243) applied to the defined residue (724,300 dollars) produces a marital gift of 410,000 dollars.

C. *Operational Problems*

Although in each case the fraction qualifies an additional 410,000 dollars for the marital deduction, it will be recalled that the fraction serves a second purpose. At date of distribution, it is applied to the defined residue and directs the allocation of the prescribed fractional share of the pool to the marital trust. If nothing has changed, the distribution date value of the designated fractional share will be the same as the marital deduction it was designed to obtain. But values do change during administration, and it is at this juncture that differences in the value of the marital share arise from the varying alternative methods of describing the residue.

In the example posited, the value of probate assets had increased from 1,000,000 dollars to 1,200,000 dollars at the date one year later when all payments and distributions are made. If the residue against which the fraction is to be applied is the entire probate estate before payment of any obligations, the fraction 41/100 produces a forty-one per cent interest for the marital share. Assuming that the fraction is to be applied to the available assets and a fractional share of each is to be distributed to the marital share,[122] no revaluation is necessary; the fractional interest in each asset is distributed. But for purposes of illustration it can be seen that forty-one per cent of 1,200,000 dollars produces an aggregate value of 492,000 dollars.[123] Had the fraction been constituted after payment of the legacy, debts, claims, and administration expenses, the fraction would be 41/87 of the assets remaining after appropriation of assets for those purposes (1,200,000 dollars less 130,000 dollars equals 1,070,000 dollars) and a *distribution date* value of 504,250 dollars would result. Similarly, the "after-tax" clause would produce a fraction of 4100/7243 or 56.6064 per cent and, applied to the "true residue" after all other distributions, would produce a fractional share of the remaining available assets equal in value to 523,312.80 dollars.

Several observations are possible at this point. Shrinking the

122. The clause should clearly indicate that the executor is to distribute the marital share in kind; otherwise, a distribution in cash equal to the fractional share may be decreed. See *In re* Umpleby's Will, 252 N.Y.S.2d 674 (Surr. Ct. 1964).

123. If the residue was defined to exclude only the $50,000 legacy, the fraction would be 41/95 (43.16%), producing $496,320.

residue to which the fraction is to be applied obviously increases the percentage interest of the marital share in the remaining available assets, since the numerator stays the same while the denominator diminishes.[124] Further, shrinking the defined residue gives the executor an increasing power to choose assets to satisfy the general pecuniary legacy and other non-residue obligations and a concomitant power to affect the makeup, in terms of the specific assets remaining, of the pool to which the fractional share will be applied, though obviously the aggregate distribution date *value* of the quantum distributed will be frozen by the particular fraction described.

We have been assuming that, once determined, the fraction is simply applied to whatever assets comprise the defined residue at the distribution date. Discussions with trust administrators in various sections of the country indicate that in many cases this accords with actual practice. But the argument might be made that the ascertained fraction is to be applied to each asset of the defined residue as *initially* constituted, rather than to those items comprising the residue at the date of distribution. One writer has suggested this,[125] while another has expressed the view that courts are likely to, and should, apply the fraction to the assets available at date of distribution.[126] Mercifully, perhaps, most commentators have not mentioned the issue when discussing fractional share clauses.

The difficulty of the tracing problem involved, even in our simple case, is obviously increased when the basic values (upon which both numerator and denominator are based) *as finally determined for federal estate tax purposes* may not be ascertained for a good many months, if not years. Ignoring that problem for the moment, the possible application of the formula to the residue, *as initially constituted,* might produce the following results.

1. *The Effect of Different Methods of Constituting the Fractional Share*[127]

(1) Assume the fractional share is to be constituted after payment of the pecuniary legacy but *before* debts, taxes, and

124. As a result, the marital share will receive an increasing proportion of any appreciation or depreciation of residuary asset values during administration.

125. Casner, *supra* note 101.

126. Covey, *supra* note 92.

127. See Casner, *supra* note 101, for a somewhat similar set of examples.

expenses (41/95 = 43.16 per cent). Debts, taxes, and expenses are to be paid from the nonmarital share.[128]

(a) The executor sells 1,500 shares of *C* and 1,000 shares of *B* (raising 100,000 dollars + 100,000 dollars). He pays the 50,000 dollar legacy and 225,700 dollars of debts, administrative expenses, and taxes. He receives a stock dividend of ten per cent on the remaining *B* shares (2,000). He sells 500 shares of *A* stock and purchases 10,000 shares of *D* stock with the proceeds.

(b) At the time of distribution the executor holds:

	Value
2,500 shares of *A*[129]	$500,000
10,000 shares of *D*[129]	100,000
2,200 shares of *B*[129]	200,000
1,500 shares of *C*	100,000
Cash (original cash after legacy of $50,000 was $50,000; payments for taxes from this cash amounted to $25,700)	24,300
	$924,300

(c) The marital share of each is determined according to the percentage of the *original* assets:

	No. of shares	*Value*
Cash: 43.16% (of $50,000)		$ 21,580
A shares 43.16% of 2,500	1,079	215,800
D shares 43.16% of 10,000	4,316	43,160
B shares (43.16% of original 3,000 shares)	1,424.28[130]	129,480
C shares (43.16% of 3,000 shares)	1,295	86,300
		$496,320[131]

128. While normally the residue will be constituted after payment of legacies, debts, and expenses, this example is used to emphasize the differing results which could occur.

129. The remaining 2,500 shares of *A* stock and the 10,000 shares of *D* stock *together* represent the original 3,000 of *A* stock. This example assumes that the aggregate value of the *B* stock was unaffected by the 10% stock dividend.

130. The marital share should have been allocated 1,294.80 shares of the *B* stock (this being 43.16% of 3,000 shares). The 10% stock dividend on those shares added 129.48 shares of *B* stock to the marital share, making a total of 1,424.28 shares.

131. Note: (1) The shares sold to pay taxes were taken from the nonmarital share; other shares sold to purchase new stock were drawn pro-rata from the marital and nonmarital share; (2) The net gain of $200,000 has inured ratably to the marital share (43.16% of $200,000 = $86,320).

(2) Assume the fractional share is to be *constituted after* payment of legacies, administration expenses, debts, and taxes (4100/7243 = 56.6064 per cent). (Note the modification of the tracing problem.)

(a) The executor sells 1,500 shares of *C* and 1,000 shares of *B* (raising 100,000 dollars + 100,000 dollars). He pays out 275,700 dollars (legacy, debts, expenses, and taxes). He receives a stock dividend of ten per cent on the remaining *B* shares. He sells 500 shares of *A* stock and purchases 10,000 shares of *D* stock with the proceeds.

(b) At the time of distribution the executor holds the same assets as under (1) (b).

(c) The marital share is 56.6064 per cent of each asset held at date of distribution (total value equals 523,212.96 dollars), since the fraction is applied to the "true residue" after payment of all other obligations (and no non-pro-rata distributions have been made):

Cash (56.6064% of $24,300)	$ 13,755.36
A and *D* shares ($600,000)	339,638.40
B shares ($200,000)	113,212.80
C shares ($100,000)	56,606.40
	$523,212.96[132]

(3) Same facts as in (2), except that the only stock transaction is a sale of 1,000 shares of *A* (for 200,000 dollars). The marital share, equal to 56.6064 per cent:

Residue	*Value of Marital Share*
Cash	$ 13,755.36
A ($400,000)	226,425.60
B ($300,000)	169,819.20
C ($200,000)	113,212.80
	$523,212.96

Countless additional variations might be suggested.

Proof: Prior Marital Share	$410,000
Add: "Appreciation" (43.16% of $200,000)	86,320
	$496,320
Proof: $1,150,000 × 43.16 (—) =	$496,320

132. Proof: Original Marital Share 56.6064% of $200,000 — $410,000.00
Appreciation — 113,212.96
$523,212.96

2. *Other Problems*

It may not be inappropriate to depart for a moment from the simple, clinically sterile hypothetical posed in order to briefly sketch *a few* of the other problems which may arise during administration.

a. *Income Earned on "Expended Assets" (Assets Used To Pay Funeral and Administration Expenses, Taxes, Debts, and General Legacies)*[133]

(1) *Allocation Between the Marital Share and the Residue*

First, it will be recalled that forty thousand dollars was earned by the probate estate during the first year of administration. To what extent should this be allocated to the marital and nonmarital income beneficiaries? In the posited case, the answer is "relatively" easy since the widow is entitled to the entire income from both shares. We are assuming that no part of the income is to be distributed to the legatee under the general pecuniary legacy.[134]

Had the widow been entitled to income from the marital share only and, to stabilize a few variables for analytical purposes, assuming that the residue was comprised of all 1,000,000 dollars, the widow would appear to be entitled to at least forty-one per cent (16,400 dollars). But is she entitled to more?

It might be suggested that income earned during the first year of administration was derived as follows:

Marital Share	$410,000 at 4% =	$16,400
Residuary Trust	314,300 at 4% =	12,572
Assets Used To Satisfy Legacy, Administration Expenses, Debts, and Taxes	275,700 at 4% =	11,028
Total	$1,000,000	$40,000

A problem thus arises as to appropriate allocation of the 11,028 dollars earned on funds used to pay the legacy, administration expenses, debts, and taxes. Three of the possible choices are:

Choice	*Applicable Fraction*	*Widow's Share*
(a) Ratio of Marital Share to "After-Tax" Residue	$\frac{410,000}{724,300} \times \$11,028$	$6,242.55

133. *Report of Committee on Probate and Estate Administration, supra* note 87.
134. See *id.* at 916; 3 SCOTT, TRUSTS § 234.3 (2d ed. 1956).

(b) Ratio of Marital Share to Probate Estate	$\frac{410{,}000}{1{,}000{,}000} \times \$11{,}028$	$4,521.48
(c) All to Residuary to the Extent Satisfaction of Obligations Drawn Therefrom	-0-	-0-

Choice of one or another of these alternatives might be based upon the following theories:

(a) Those entitled to income share ratably. Thus the marital share (widow) should receive 4100/7243 (or 6,242.56 dollars) and the nonmarital trust 3143/7243 of the income.
(b) The marital share (widow) is entitled to that portion of income earned during administration on amounts used to pay debts, taxes, and the like in proportion to her share of the gross probate estate. Thus here she would receive forty-one per cent of the 11,028 dollars, or 4,521.48 dollars.
(c) The marital share is simply entitled to forty-one per cent of the estate before any payments, and, therefore, to forty-one per cent of the total income (40,000 dollars) received during administration.

Obviously, other alternatives are possible. Indeed, a more probable choice is indicated by a recent study which suggests, "Assume an estate, *after administration expenses and debts* of $1,000,000 bequeathed one-half outright to the widow and one-half outright to other individuals [and] that estate taxes are paid, charged solely against the half of the estate bequeathed to the other individuals. Of the $750,000 remaining in the possession of the executor, the widow is still entitled to $500,000, which is now two-thirds of the undistributed assets. . . . Before the estate taxes are paid, the estate will yield $40,000 annually which will be distributed $20,000 to the widow and $20,000 to other beneficiaries."[135]

A strict application of the analogy to our hypothesized case would suggest that the widow was entitled to 410/870 of 40,000 dollars or approximately 18,850 dollars (thus sharing in the income produced by amounts used to satisfy all obligations except taxes). The report cites no authority, and an informal survey of corporate fiduciaries suggests varying approaches not necessarily keyed to the particular definition of the residue. Some apply the fraction produced by the formula while others allocate to the marital share only

135. *Report of Committee on Probate and Estate Administration, supra* note 87, at 922. (Emphasis added.)

that amount of income which the average rate of return would produce on the calculated marital share.

(2) *Allocation Between Income and Principal for Trust Accounting Purposes*

If it be assumed, for the moment, that the executor will allocate all income earned on expended assets to the nonmarital Trust *B* (a particularly appropriate result where the denominator is comprised of the entire probate estate and taxes are to be paid from Trust *B*[136]), a further problem arises. Shall the 11,028 dollars be treated for trust accounting purposes as income or principal or as some combination thereof? Again, there are at least three choices, and a lack of unanimity among the various jurisdictions is shown by a recent study.[137]

Under the so-called "Massachusetts rule,"[138] the entire distribution would be treated as income and distributed to the income beneficiaries of Trust *B*. This is the position now adopted by the Revised Principal and Income Act[139] and the *Restatement of Trusts, Second*.[140] The trend is distinctly in this direction.[141] Several other approaches have been taken at various times, however. The "Old

136. If the fractional share is applied to the true residue (4100/7243 of $724,300), and income allocated proportionately, the marital trust receives $22,642.56 (56.6064% of $40,000). (This is $16,400 representing income on $410,000 plus 56.6064% of the $11,028, since the expended assets have been excluded from the residue and residuary legatees share ratably in income accruing to the residue.) See *id.* at 917. 3 SCOTT, *op. cit. supra* note 134, § 234.3. If the "English rule" (see text accompanying note 144 *infra*) is applicable, however, the fraction is applied only to $29,396 ($10,704 being allocable to corpus of the residue) and the fraction itself becomes 410,000/735,044. See text accompanying note 145 *infra*. Suffice it to say, this potential result may be appropriately avoided by specifying (1) allocation of income in the same proportion as the defined fractional share of the residue and (2) providing that income from "expended assets" is to be treated as income of the trusts created from the residue.

137. *Report of Committee on Probate and Estate Administration, supra* note 87, at 917. The problem is discussed in 3 SCOTT, *op. cit. supra* note 134, at § 234.4; Lauritzen, *Estate Income During Administration*, Tax Counselor's Q., Dec. 1959, p. 1.

138. *E.g.*, Old Colony Trust Co. v. Smith, 266 Mass. 500, 165 N.E. 657 (1929).

139. Section 5(c). For a detailed analysis of the Revised Principal and Income Act which was approved by the Commissioners on Uniform State Laws in 1962 (HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 249 (1962)) and by the American Bar Association in 1963 (Proceedings of the 1963 Midyear Meeting of the House of Delegates, 49 A.B.A.J. 385, 393 (1963)), see Note, *The Revised Uniform Principal and Income Act*, 1963 U. ILL. L.F. 473, 479 (emphasizing the historical development of the Illinois rule).

140. RESTATEMENT (SECOND), TRUSTS § 234, comment *g* (1959).

141. *E.g.*, New York switched from the "Old New York" rule to the Massachusetts rule in 1931. Laws of 1931, ch. 706 (now N.Y. PERS. PROP. LAW § 17(b). In 1949, Maryland abandoned the rule enunciated in Tilghman v. Frazer, 199 Md. 620, 87 A.2d 811 (1952), and adopted the Massachusetts rule with respect to estates of persons dying after enactment of the statute. MD. ANN. CODE art. 93, § 391 (1964). The shift in the *Restatement* position, *supra* note 140, is symptomatic of the trend toward the simpler Massachusetts position.

New York" rule (no longer applied in New York, which has shifted to the Massachusetts rule[142]) would allocate the entire amount to principal.[143] A third possibility, and an appalling one for non-mathematically inclined counselors, is the so-called English Rule[144] under which the income would be calculated as follows:

Amount Needed To Pay Debts, etc.	$275,700	
Divided by Principal Plus Interest, Using a 4% Discount Rate	÷ 104%	
Amount of Principal Needed To Pay Legacy, Expenses, Debts, Taxes	$265,096	
Balance to Principal (4% of $265,096)	10,604	$11,028
Income on $10,604 (and distributable as income)	424	

The theory of the "English Rule," as illustrated, is that obligations are considered as having been paid from principal in an amount which, with the income thereon at the rate of return received on the whole estate from the death of the testator to the dates of payment, would equal the amounts paid.

To take but one illustration, if the English rule should be deemed applicable and were actually applied by the executor, it would appear that an "after-tax" formula would be constituted a bit differently from any previously considered. In this situation, the net amount of original principal utilized to pay taxes, legacies, debts, and the like was 265,096 dollars (rather than 275,700 dollars). The numerator would remain the same, but both the denominator and the residuary estate as defined would be 734,904 dollars (reflecting the *net* principal used in the amount of 265,096 dollars, or, phrased differently, reflecting the addition of 10,604 dollars to the corpus of the defined residue). If asset values had not changed, the application of the formula to the defined residue would seem to be:

$$\frac{410{,}000}{734{,}904} \times 734{,}904^{145}$$

Asset values do, however, change, and the formula fraction would actually be applied to the defined residue at distribution date which would have a value of 934,904 dollars (the 924,300 dollars shown in the previous examples plus the 10,604 dollars allocated to corpus under the English rule).

The attorney need not be appalled; the solution lies in appro-

142. See note 141 *supra*.

143. See, *e.g.*, Tilghman v. Frazer, 199 Md. 620, 87 A.2d 811 (1952); Proctor v. American Security & Trust Co., 98 F.2d 599 (D.C. Cir. 1938).

144. See Allhusen v. Whittell, [1867] 4 Eq. 295; *In re* McEuen, [1913] 2 Ch. 704; 3 SCOTT, *op. cit. supra* note 134, § 234.4.

145. See note 136 *supra*.

priate draftsmanship. If he is convinced that the "Old New York" and English views add an unwarranted complexity to an already troubled area, it would seem prudent to provide in the will that income received from "expended assets" should (1) be deemed income and (2) distributed to the income beneficiaries.[146] In such cases, he need not be concerned with the rule the testator's jurisdiction follows.

b. *Payment of Legacies, Debts, Expenses, and Taxes Prior to Complete Distribution*

A number of additional administrative problems may be posed. For example, payment of some or all of the legacy, debts, administration expenses, and taxes might occur prior to complete distribution of the respective shares.

Under an "after-tax" clause, the administrator will probably continue to apply the "ascertained" fraction in determining income distributions. Yet occasions for partial non-pro-rata distributions are not unknown. If this occurs, theoretically the fraction applicable to income distributions should be altered, creating substantial burdens in terms of estate accounting. These burdens may well account for the reluctance of corporate fiduciaries to make non-pro-rata partial distributions during administration.[147] The problem is starkly illustrated when the fraction is constituted before the payment of taxes, the latter being made a charge on the nonmarital share of the residue and paid during administration.[148]

146. *Ibid.*

147. Another problem tending toward this same reluctance, however, is created by income tax treatment of partial distributions as "distributable net income" under I.R.C., § 663(a)(1). This problem is considered in the next section of this article.

148. See generally *Report of Committee on Probate and Estate Administration*, 102 TRUSTS & ESTATES 916, 922 (1963), setting forth the four principal methods of allocation of income: (1) the gross share method "under which the income is distributed among the residuary legatees in the shares fixed by the will; i.e., in the proportions in which they are entitled to share in principal before taxes have been paid. The unequal apportionment of taxes is ignored and the income distribution ratio remains constant throughout the administration . . . ; [(2) the] 'net share' method, in which income is allocated on the basis of the net distributable shares, either as determined on the final accounting or as projected from the date of death on the basis of estimated expenses and taxes . . . ; [(3)] a third method . . . in which the allocation ratio is adjusted as taxes are paid . . ." *ibid.*; and (4) a method making pro-rata distributions to the marital share, as taxes and other distributions are made from the nonmarital share, to maintain the identical fractional ratio between the marital and nonmarital trusts. The administrative and "Subchapter J" income tax problems of the latter method are apparent. The first method has been characterized as easiest to administer —and least fair in operation. Apparently, difficulty of administration increases proportionately with equity of result! The Committee's comment on this wonderland is informative, "We have not referred to any of the four methods mentioned as the general or favored rule. Reports from members of the Committee indicate that the

c. *Administrative Powers*

Separate articles could be, and have been, written about the effect of various administrative powers, either (1) granted the executor by the dispositive instrument, or (2) thrust upon him by the Internal Revenue Code.[149] Illustrative of the former is the power sometimes given the executor to value assets at distribution.[150] Where used to allocate specific assets in satisfaction of the value which would be produced by the actual allocation of a fractional share of each asset, a contention might be made that this power in the executor permits a variance of the marital share, with potential disqualification. Of course, the argument should fail where it is clear that the executor is bound by the normal fiduciary principle of impartiality. Nevertheless, a problem of this type has arisen in the Boston area.

The second type of problem (powers thrust upon the fiduciary by the Code itself) might be illustrated by the executor's choice between valuing assets as of date of death or at the permitted alternative valuation date.[151] Similarly, the Code permits the execu-

gross share rule is used most frequently, as might be expected from its relative ease of administration. Because there is little case or statute law establishing one or the other of the available methods as a standard, however, allocations are usually governed by local practice, about which it is difficult to generalize. Often, the method of allocation used in a particular estate is selected by the executor or his attorney solely on the basis of what they consider to be just and equitable on the facts of that matter. One of the other methods might be selected in another estate, if the circumstances should warrant. The probate courts appear generally disposed to accept whatever allocation is presented if it is not obviously outrageous and there are no objections." *Id.* at 924.

149. See, *e.g.*, Casner, *A Fiduciary's Powers and the Marital Deduction*, 100 TRUSTS & ESTATES 247 (1961); Dane, *Marital Deduction Questions*, 103 TRUSTS & ESTATES 112 (1964); Rodman, *Executor's Power To Allocate Property To Qualify for the Marital Deduction*, 94 TRUSTS & ESTATES 801 (1955).

150. Under the "Boston powers" clause, the executor is given the power to value assets as of the date of distribution when a second valuation is necessary, as in the case of a distribution of selected assets equal in value to that quantum produced by applying the fraction to the "pool" or defined residue at distribution date. Boston fiduciaries have suggested that this avoids a second appraisal where assets, such as closely-held corporate stock, may be involved and that the fiduciary is limited by normal trust principles of impartiality. In the Chicago area, fiduciaries discourage the use of such a clause, reasoning that the fiduciary already possesses such a power and specific reference to it can serve only as a "red flag."

151. For example, in the hypothetical case, use of the alternative valuation date would produce an adjusted gross estate of $1,320,000 and an additional quantum to be qualified of $510,000 ($660,000 maximum marital deduction *minus* $150,000 of assets otherwise qualified). Both the gross estate and the federal estate tax would be altered, with correlative changes in the constitution of the fraction (or amount, under a pecuniary formula). Even in a rising market, however, basis considerations combined with the additional marital deduction might tip the scales in favor of the alternative date despite the higher federal estate taxes. See Casner, *supra* note 149, at 249. While it is not believed that the choice of alternative date should in any way affect the allowability of the maximum marital deduction based on such choice, questions have been raised by representatives of the Internal Revenue Service. See Reiling, *Revenue*

tor to take administration expenses either as a deduction for estate income tax purposes[152] or as an estate tax deduction.[153] This again affects the determination of the adjusted gross estate[154] and, con-

Procedure 64-19—Rethinking Marital Deduction Clauses, 103 TRUSTS & ESTATES 905, 906 (1964); *cf. Revenue Procedure 64-19—Panel Discussion*, 103 TRUSTS & ESTATES 917, 919-20 (1964).

152. I.R.C., § 642.
153. I.R.C., § 2053.
154. See note 107 *supra*. A simplified illustration:

	(a) *Deduction Taken for Income Tax Purposes per § 642*		(b) *Deduction Taken for Estate Tax Purposes per § 2053 (a)(2)*	
	Federal Tax Computation	*Probate Estate*	*Federal Tax Computation*	*Probate Estate*
Gross Estate	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Less: § 2053 Ded'ns	-0-	50,000	50,000	50,000
Adj. Gross Est.	$1,000,000	$ 950,000	$ 950,000	$ 950,000
Gift to surviving spouse equal to maximum marital deduction	500,000	500,000	475,000	475,000
		450,000		475,000
Taxable Estate (after Exemption of $60,000)	440,000		415,000	
Estate Tax*	126,500	126,500	118,500	118,500
Residue—Probate Estate		323,500**		356,500**
Difference (Decrease in Residue)				
Increase in Estate Taxes under (a)		8,000	33,000	
Increase in Wife's "Share" under (a)		25,000		
Income Tax on Income				Difference
Gross Income of Estate	70,000		70,000	
Less: Administration Expenses	50,000		-0-	
Income from Estate	20,000		70,000	
Tax***	7,260		42,120	34,860
Benefit to Wife from:				
Election (a) Increased share of Residue			25,000	
Reduction of Income Taxes Payable on Estate's Income			34,860	
			59,860****	

Notes:
* Assume state succession taxes equal to maximum credit allowable.
** Assume state succession taxes equal to maximum credit allowed for federal estate tax and that all taxes are paid from the residue.
*** Computed for illustrative purposes without consideration of other deductions and exemptions, and using 1963 rates.
**** Less the actuarial value of the income from $17,000 for life (income from $25,000 for life minus the income from $8,000 for life). The wife was already entitled to the income from the entire estate. She therefore is benefitted to the extent of present value of the remainder in the additional bequest of $25,000, but this "gain" is cut down by the loss of income from the additional $8,000 paid from the residue to fund the additional tax.

sequently, the fraction used to determine the marital share. These clearly should not affect qualification of the determined share for the marital deduction, though the election will affect the quantum of the interest passing and the *amount* of the deduction allowable. Again, these problems are explored in detail elsewhere.[155]

A recently suggested ploy is the inclusion of a "bootstrap" clause, specifying that the fiduciary is not granted any power which would result in disallowance of all or a part of the marital deduction. Appealing though it is, it leaves the fiduciary in the unenviable position of complete uncertainty as to the extent of his powers, absent litigation which he would prefer to avoid![156]

(3) *Fractional Share of* Each *Item?*

To this point, it has been assumed that, under a fractional share clause, distribution will be made of a fractional share of each item of the residue. While one writer suggests that this "is feasible in the majority of estates and limits the significance of this question to unusual fact situations,"[157] it will be demonstrated later in this article that such distribution may create cumbersome dispositions and post-administrative problems. This raises the question of whether the executor might distribute selected assets having a distribution date value equal to the aggregate value of the marital share's aliquot fraction of each item of the residue. Would he have the authority (and "nerve") to do so absent a specific grant of authority? And would the grant of such authority to the executor create possibilities of gain upon distribution of appreciated assets? Further, if it appears that the marital share is entitled to demand an aliquot share of each item in the residue, what tax effects would flow from an agreement by the executor and all beneficiaries to an appropriate agreed allocation of selected items to the marital and nonmarital shares? It is to these income tax questions, and others, that attention is turned as a final bit of background before considering in summary the relative advantages and disadvantages of the various types of formula clauses. But, before we turn to these questions, it should be noted that the foregoing analysis suggests

155. See Polasky, *Estate Tax Marital Deduction in Estate Planning*, Tax Counselor's Q., June 1959, pp. 1, 6.

156. See Dane, *supra* note 149, at 113. An example of a "bootstrap" clause that has recently been proposed reads: "Any provision in this instrument shall be ineffective to the extent the existence of such provision would result in the estate of the donor failing to be entitled to the maximum such marital deduction."

157. Bolte, *Choosing a Marital Deduction Formula Clause*, 44 MARQ. L. REV. 532, 543 (1961).

that the fractional share formula clause, at both the drafting and operational stages, is not without problems!

IV. Income Tax Aspects

At this juncture, an analysis of the *income tax* problems associated with various types of marital gifts designed to qualify for the marital deduction[158] hopefully should serve several purposes. First, it should emphasize and sharply delineate the quite separate nature of the income tax aspects of such bequests from the question of qualification for the federal *estate* tax marital deduction. Second, while tending to clarify the approaches and underlying reasons inherent in the income tax treatment of distributions, it should furnish some additional framework for discussing the relative advantages and disadvantages of the several types of formula clauses.

While keeping in mind that this facet of the discussion deals *only* with *income* tax aspects, it becomes necessary to recognize that here, too, we deal with a hierarchy of distinct questions. First, the consequences to the *estate* of a distribution must be differentiated from the tax results to the *distributee*. Second, tax questions applicable to both the estate and distributee involve: (a) Is there a realization of income (gain) or loss; (b) If so, how much; (c) Is such income or loss recognized; and (d) Is any gain or loss treated as a *capital* gain or loss and, if so, what was the holding period.

A. *Illustrative Types of Dispositive Directions*[159]

It is sometimes helpful to work from well-defined polar approaches and, with these as points of departure, to direct consideration to the spectrum of cases which fall between the extremes.

Reverting to the first basic example of an estate in which the maximum marital deduction was 500,000 dollars, one might encounter a direction to provide a qualifying sum for the widow (*whether ascertained by formula or not*) couched in any of the following forms:

158. These problems are considered in depth elsewhere. See, *e.g.*, 1 Casner, Estate Planning 84, 816 (3d ed. 1961); Roberts & Muller, *Constructive Receipt of Income by Estates and Trusts Through Distributions in Kind to Beneficiaries*, 4 Tax L. Rev. 372 (1949). See also Stevens, *How To Draft Marital Deduction Formula Clauses Under New Rev. Proc. 64-19*, 20 J. Taxation 352 (1964); Stevens, *Fourteen Years of Marital Deduction*, N.Y.U. 21st Inst. on Fed. Tax. 257, 272 (1963).

159. Illustrative dispositive clauses of various types are set out in Casner, *How To Use Fractional Share Marital Deduction Gifts*, 99 Trusts & Estates 190 (1960); Polasky, *supra* note 155, at 1; Stevens, *How To Draft Marital Deduction Formula Clauses Under New Rev. Proc. 64-19*, 20 J. Taxation 352 (1964).

1. "Pecuniary" and "Hybrid" Clauses:[160]

a. Assets to be valued at distribution date value; value at distribution thus equal to 500,000 dollars.

(1) Direction to pay the widow or her estate 500,000 dollars in cash (a general dollar legacy);

(2) Direction to pay the widow 500,000 dollars in cash, or to distribute property with an equivalent value at the time of distribution, or to distribute some combination of cash and property which would transmit assets with a *distribution date value* of 500,000 dollars.

b. Assets to be valued at federal estate tax values or which may be so valued under specified circumstances.

(3) Direction to distribute to the widow assets with a *value for federal estate tax* purposes equal to 500,000 dollars. (This is typical of problem-pecuniary language.)

(4) Direction to distribute to the widow assets with a *value for federal estate tax* purposes of 500,000 dollars, but in no event having a distribution date value of less than

160. In view of the spate of decisions involving the issue of whether a particular dispositive clause constituted a pecuniary gift or a transfer of a fractional share of the estate and the varying interpretations placed upon dispositive language by the trial level and appellate courts, it would require a marked degree of bravado for a commentator to attempt to categorize any language as certain to produce either a pecuniary gift or a fractional share. *E.g.*, In the Matter of Estate of Kantner, 50 N.J. Super. 582, 143 A.2d 243 (App. Div. 1958) (increase in value of closely-held stock during administration; the lower court held the clause a "fractional share of the residue" type; the appellate court held it was a pecuniary, greatly diminishing the wife's share); Althouse Estate, 404 Pa. 412, 414, 172 A.2d 146, 147 (1961) (increase in value of estate during administration; will created a marital trust of "so much of my estate [as] . . . shall equal the maximum marital deduction"; a subsequent paragraph left the remainder to his children. Rejecting the widow's claim of a right to share in estate appreciation (with which the lower court agreed), the appellate court held the bequest to be a pecuniary gift, *stressing* creation of the trust in a separate paragraph prior to disposition of the residue); Maguire v. Stirling, 317 F.2d 147 (D.C. Cir. 1963).

Other cases posing formula interpretation problems for state courts include, Osborn v. Osborn, 334 S.W.2d 48 (Mo. 1960) (abatement of specific bequests to satisfy pecuniary formula marital bequest in later paragraph); King v. Citizens & So. Nat'l Bank, 103 So. 2d 689 (Fla. 1958) (bequest to widow of "50% of my adjusted gross estate" was *not* reduced by assets passing to the widow outside the estate, *but* widow was not entitled to share in asset appreciation during administration!). Similar to the first point in *King, supra*, is *In re* Rebens Will, 115 N.Y.S.2d 228 (Surr. Ct. 1952).

The cases are discussed in Durand, *Planning Lessons From Marital Deduction Litigation*, 101 TRUSTS & ESTATES 8 (1962); Lauritzen, *Marital Deduction Bequests*, 8 TAX COUNSELOR'S Q. 125, 138 (1964). The numerous New York cases (mostly Surrogate's court) are collected in Stein, *How To Provide for a Marital Deduction by Trust or Power of Appointment*, in ESTATE TAX TECHNIQUES 117 (Lasser ed. 1964). An interesting example of the type of dispositive provision which may confront a court is found in Estate of Alan M. Johnson, No. 14814, Orange County J. Ct., Fla., 1958 (will construction suit involving an attorney's own will: "I hereby give, devise and bequeath to ———— Bank of ———— Florida, in trust nevertheless, my adjusted gross estate. This shall be divided half and half . . . The first half will be Trust A . . . (and) would qualify as a marital deduction. . .")!

The groupings used here are simply for convenience and to illustrate the spectrum of shadings from those clauses most likely to be categorized as pecuniary to those most likely to be recognized as creating a true fractional share.

500,000 dollars. (This is typical of a minimum-value pecuniary formula designed to satisfy the requirement of Rev. Proc. 64-19.)

(5) Direction to distribute property with a value of 500,000 dollars, values to be determined by reference to the lower of the aggregate basis of the assets or fair market value at date of distribution.

(6) Direction requiring a distribution of assets with a federal estate tax value of 500,000 dollars *and* so constituted that the assets distributed are fairly representative of appreciation or depreciation in the value of all property available for distribution in satisfaction of the bequest. (This type of direction would represent the ratable-sharing approach to qualification within the requirements of Rev. Proc. 64-19.)

c. Distribution of an amount ascertained by reference to a fraction of either the residue or particular property:

(7) Direction to distribute an amount produced by the sale of specified assets.[161]

(8) Direction to distribute an amount of cash equal to a fraction or percentage of the residuary estate (perhaps phrased to designate the fractional interest necessary to produce the maximum marital deduction).

(9) Direction to distribute assets representing, in terms of distribution date values, an aggregate quantum equal to the quantum of that fraction of the residue which would produce the maximum marital deduction. (Actually, this direction is similar to the one immediately preceding it, number (8), except that it directs the distribution of assets, valued at the time of distribution, whose value would equal the cash required to be distributed under number (8). A bit of reflection will suggest that this is really the basic fractional share clause, with the exception that the executor may ascertain the distribution date value of the fractional share to which the distributee is entitled and satisfy it with selected assets having an aggregate value equal to the aggregate value producible by a sharing in each asset (a characteristic feature of the true fractional share distribution). This type of direction is included at this point only for contrast. If satisfiable in cash or in kind, is it a pecuniary or a fractional share clause? Perhaps all that can be ventured is that one need not describe a zebra as either a horse because its conformation is similar to the equine or as a tiger because it has stripes!)

2. Fractional Share Directives and Those Shading into the "Hybrid" and "Pecuniary" Areas:

a. Direction to distribute a fractional share of the residue under a fractional share formula as previously described with:

(10) Distribution to comprise a fractional share of each asset available for distribution,[162] or

161. This type of disposition was used in the instrument involved in Commissioner v. Brinckerhoff, 168 F.2d 436 (2d Cir. 1948), *affirming* 8 T.C. 1045 (1947).

162. The following phrasing is set forth in Casner, *supra* note 159, at 190 n.3: "The *numerator* of the fraction shall be the maximum estate tax marital deduction

(11) Distribution to comprise selected assets whose distribution date value would exactly equal that of a distribution of a fractional share of each asset, or

(12) Distribution of either assets described as above or equivalent cash, or partly in cash and partly in kind (a provision similar to directive 9), or

(13) Distribution to be in cash after sale of the assets. (It will be noted that this is really a pecuniary bequest, as set forth in directive 8.)

B. *Realization of Gain and Loss*

1. *True Pecuniary Clauses*

In the first basic hypothetical example,[163] the maximum marital deduction would have been achieved had the testator simply bequeathed a sum of 500,000 dollars to his surviving spouse. Receipt by the widow of this specific sum from the executor would not result in any gross income to her. But since the testator could not be certain at the time of executing the will that his adjusted gross estate would be exactly 1,000,000 dollars (or any other definitely ascertainable sum), he might have bequeathed to his wife a sum fixed by operation of a formula directing the executor to pay her in dollars that sum which would produce the maximum marital deduction.

It will be noted that this sum is ascertained by computing a dollar amount equal to one-half of the value of the adjusted gross estate (based upon the federal estate tax value of assets and necessarily expressed in dollars), less the federal estate tax value of dispositions otherwise qualifying for the marital deduction. While disputes may rage after the decedent's death over the includability of assets in the gross estate or over the valuation of such assets for federal estate tax purposes, the sum payable to the widow is never-

(allowable in determining the federal estate tax payable by reason of my death) minus the value for federal tax purposes of all items in my gross estate which qualify for said deduction and which pass or have passed to my said wife (the words 'pass or have passed' shall have the same meaning as such words shall have under the provisions of the Internal Revenue Code in effect at the time of my death) under other provisions of this will, by right of survivorship with respect to jointly-owned property, under settlement arrangements relating to life insurance proceeds, or otherwise than under this bequest and devise (in computing the numerator, the values as finally determined in the federal estate tax proceedings shall control); and the *denominator* of the fraction shall be the value of my residuary estate, and to the extent that items in my residuary estate are included in my gross estate the value at which they are included in my gross estate shall control in determining the denominator, and to the extent they are not so included, their value at the time they would have been valued if they had been so included, shall control in determining the denominator." A somewhat revised version appears in CASNER, ESTATE PLANNING, SUPPLEMENT 308 (1964).

163. See text accompanying notes 40-41 *supra*.

theless ascertainable once there has been a resolution of the factual and legal issues. And, laying aside questions of both qualification and the allowable quantum of the marital deduction (arising from the executor's ability to choose the alternative valuation date[164] or to vary the adjusted gross estate by his option to take administrative expenses and section 2054 deductions as deductions in computing either the estate's income tax or federal estate tax[165]), it is clear that the amount ultimately ascertained constitutes a fixed claim against the estate assets.[166]

a. *Gain to Surviving Spouse?*

Applied to the hypothetical case, the marital gift of one-half of the adjusted gross estate (amounting to 500,000 dollars) is a fixed sum receivable by the widow. The executor has no right to distribute assets to her with a greater or (assuming assets available for distribution are sufficient) a lesser value.

Absent specification to the contrary in the will, the executor normally would be under a duty to convert all personal property, except that specifically bequeathed, into cash.[167] In the posited case, sale of both the *A* and *B* stock would result in recognition of long-term capital gains and losses of 300,000 dollars and 100,000 dollars respectively (a "net long-term capital gain" of 200,000 dollars),[168] with resultant income tax consequences. The widow, upon receipt of her 500,000 dollars, would recognize no gain on the transaction; and, assuming that all of the estate's "distributable net income" for the year has been distributed to the several beneficiaries pursuant to a mandatory direction, receipt by the widow of the corpus distribution equivalent to her dollar claim should not result in taxable income to her.[169]

---

164. I.R.C., § 2032.

165. For discussion of this question, the administrative problems it poses, and suggestions as to how to meet it, see Polasky, *supra* note 155, at 6.

166. *E.g.*, Kenan v. Commissioner, 114 F.2d 217 (2d Cir. 1940), *affirming* 40 B.T.A. 824 (1939); Rev. Rul. 56-270, 1956-1 CUM. BULL. 325; Rev. Rul. 60-87, 1960-1 CUM. BULL. 286.

167. See, *e.g.*, *In re* Lazar's Estate, 139 Misc. 261, 247 N.Y. Supp. 230 (Surr. Ct. 1930); 1 CASNER, *op. cit. supra* note 158, at 814. Similarly, the beneficiary usually has a right to distribution of a pecuniary legacy in cash, absent further specification. The rule is not universal, however, and statutory provisions to the contrary may be found. *E.g.*, ILL. REV. STAT. ANN. Ch. 3, § 209 (1961); and see Estate of Comiskey, 24 Ill. App. 2d 199, 164 N.E.2d 535 (1960). As to limitations, and procedures, in connection with a distribution in kind, see Rodman, *supra* note 149.

168. I.R.C., § 1222(7).

169. I.R.C., § 663(a)(1) specifies that the distribution of an amount in satisfaction of a bequest of a *specific sum* of money does not constitute a distribution for purposes of allocation of distributable net income and, therefore, does not become gross income of the distributee where the amount is actually distributed or distribution is made in three or less installments. The normal pecuniary bequest does not specify a time

However, it has become common, if not universal, to provide that the executor may retain assets in the estate and may distribute assets in satisfaction of the general pecuniary legacy[170] (the 500,000 dollars due the widow). If the executor made a distribution in kind of *A* stock, the widow would receive 3,125 shares (fair market value of 500,000 dollars at distribution and basis to the estate, equal to federal estate tax value, of 312,500 dollars). Again, the widow has received exactly what her husband bequeathed to her—a distribution of assets worth 500,000 dollars in satisfaction of a pecuniary legacy of that specific amount; and, as in the preceding example, the distribution should have no taxable effect as to her, assuming that she is not deemed to have received a share of the estate's distributive net income for the year nor an additional amount compensating for any delay in distribution of the legacy.[171] Further, it seems to be accepted that the widow's basis for the shares is the fair market value at distribution (equal to her claim) of 500,000 dollars;[172] "the property was not 'transmitted at death' or 'acquired by bequest . . . from the decedent' . . . [rather the property] . . . is acquired in an exchange and the legatee's basis would seem to be the value of the claim surrendered in exchange for the securities . . . ."[173]

---

for payment and is deemed to be payable in a single installment during the course of administration; this is recognized by the Regulations. Treas. Reg. § 1.663(a)-1 (1956). However, the Regulations specify [Treas. Reg. § 1.663(a)-1(b)(1) (1956)] that, "In order to qualify as a gift or bequest of a specific sum . . . the amount of money or the identity of the specific property *must be ascertainable* under the terms of a testator's will *as of the date of his death*, [italics added] or under the terms of an inter vivous [*sic*] trust instrument as of the date of the inception of the trust." The Service has taken the position that an amount payable under a pecuniary formula clause is not ascertainable as of the testator's death and, therefore, within the specific bequest exemption of I.R.C., § 663(a)(1). A distribution in satisfaction of the marital gift produced by the formula may, therefore, constitute distributable net income amounting to receipt of gross income by the distributee and giving the estate a deduction for income tax purposes, absent careful timing of distributions by the executor. The subject is considered in detail in 1 CASNER, *op. cit. supra* note 158, at 84. "It remains to be seen whether the position taken by the Service in the regulations will be sustained by the courts. But in the absence of decided cases on the question, it is perhaps best to assume that the Commissioner is correct . . . ." Stevens, *supra* note 158, at 273. See also Dane, *supra* note 149, at 114, suggesting, "This problem can be eliminated by providing for the marital deduction in an inter vivos trust rather than in a will. In that event all that happens is a division of the trust in two on the grantor's death. No distribution is involved." This approach presents certain problems of its own if the marital share is qualified under I.R.C., § 2056(b)(5) and the widow is not entitled to the income of *both* marital and nonmarital portions or trusts. The fractional share formula gives rise to the same problem and consequences, see Stevens, *supra*, at 276; Dane, *supra*, at 114.

170. 1 CASNER, *op. cit. supra* note 158, at 814.

171. I.R.C., § 102; 1 CASNER, *op. cit. supra* note 158, at 84, 85; see Rev. Rul. 60-87, 1960-1 CUM. BULL. 286.

172. Treas. Reg. § 1.1014-4(a)(3) (1957); 1 CASNER, *op. cit. supra* note 158, at 816.

173. Kenan v. Commissioner, 114 F.2d 217, 220 (2d Cir. 1940). Bolte, *supra* note 157, at 541. See, *e.g.*, Sherman Ewing, 40 B.T.A. 912 (1939).

b. *Gain to the Estate?*

The estate, on the other hand, will be regarded as having realized a gain of 187,500 dollars, premised on this same idea of exchanging *its* property for the claim of the widow.[174] The theory, as expressed in *Suisman v. Eaton*,[175] is that "the property which the . . . estate received from the 'sale or other disposition' of said stocks was the discharge of the corpus from [the legatee's] equitable right to receive [$500,000] therefrom; the amount realized . . . was [$500,000]; and the excess of the amount realized over the basis was properly . . . assessed as part of the taxable income of the estate."[176]

2. *True Fractional Share Clauses*

a. *Gain to the Estate?*

Turning to the other extreme, distribution of assets in satisfaction of a true fractional share clause should not give rise to any gain on the part of the estate; it is simply a distribution of a fractional share of each asset as directed by the testator.[177] The distributee of the legacy, in turn, takes the estate's basis.[178]

The point to be noted, then, is that the estate will not be deemed to have "sold or exchanged" property unless (1) it has used estate

174. Rev. Rul. 60-87, 1960-1 CUM. BULL. 286; see Treas. Reg. § 1.1014-4(a)(3) (1957).

175. Suisman v. Eaton, 15 F. Supp. (D. Conn. 1935), *aff'd mem.*, 83 F.2d 1019 (2d Cir.), *cert. denied*, 299 U.S. 573 (1936).

176. *Id.* at 115. Similarly, in Kenan v. Commissioner, 114 F.2d 217, 219 (2d Cir. 1940), the court stated: "In the present case, the legatee had a claim which was a charge against the trust estate for [$500,000] . . . in cash or securities and the trustees had the power to determine whether the claim should be satisfied in one form or the other. The claim, though enforceable only in the alternative, was, like the claim in Suisman v. Eaton . . . a charge against the entire trust estate. If it were satisfied by a cash payment securities might have to be sold on which (if those actually delivered in specie were selected) a taxable gain would necessarily have been realized. Instead of making such a sale the trustees delivered the securities and *exchanged* them [emphasis added] *pro tanto* for the general claim of the legatee, which was thereby satisfied. . . . Under circumstances like those here, where the legatee did not take securities designated by the will or an interest in the corpus which might be more or less at the time of the transfer than at the time of decedent's death, it seems to us that the trustees realized a gain by using these securities to settle a claim worth [$500,000] . . . just as the trustee in Suisman v. Eaton, realized one."

177. See Rev. Rul. 55-117, 1955-1 CUM. BULL. 233; O.D. 667, 3 CUM. BULL. 52 (1920). See also 1 CASNER, *op. cit. supra* note 158, at 817; Cox, *Types of Marital Deduction Formula Clauses*, N.Y.U. 15TH INST. ON FED. TAX. 909, 943 (1957). As some have phrased it, "under the fractional share of the residue type of formula, the fiction of sale does not apply if distribution is made in kind," *Report of Subcommittee on Estate Planning and the Marital Deduction*, 102 TRUSTS & ESTATES 934, 944 (1963).

178. I.R.C., § 1014. If the distribution in kind is deemed to be income under I.R.C., § 662 because of inapplicability of § 663(a)(1) as discussed in note 169 *supra*, the distributee receives a basis equal to the fair market value at date of distribution. Treas. Reg. § 1.661(a)-2(f)(3). This does not, however, mean that the *estate* realizes gain on the distribution. See Treas. Reg. § 1.661(a)-2(f)(1).

assets to satisfy a fixed obligation to distribute a specified dollar amount *and* (2) the dollar amount is satisfied with assets having a basis to the estate which is not equal to that specified amount. The dollar amount need not be determinable at the time of the decedent's death; it is sufficient that the distributee's claim be measured by a specific sum at the time of distribution.[179]

Where the distributee's rights are simply to receive a fractional share of property comprising the residue or to receive property equal in value to that share, it seems clear that the distribution is not an exchange or constructive sale of the property in satisfaction of a specific, fixed dollar claim.

b. *Gain to the Surviving Spouse?*

Similarly, the widow who has only the right to receive a fractional share of property cannot be said to have realized a gain or loss, even though the property distributed to her has appreciated or depreciated during administration.[180] She has not sold or exchanged anything; she has simply received a distribution of estate assets in accordance with testamentary instructions.

This is not to suggest, however, that a distribution pursuant to a fractional share formula may not result in recognition of income. Suppose, for example, that the will contained a true fraction of the residue clause by virtue of which the widow was entitled to a fractional share of each asset, and let us assume her share figures out to one-half. Assume further that the residuary estate against which the fraction is to be applied consists of 1,000 shares of *A* stock now worth 100,000 dollars (federal estate tax value of 40,000 dollars) and Greenacres, a tract of valuable undeveloped real estate now worth 100,000 dollars (federal estate tax value of 60,000 dollars). The executor, a practical fellow, suggests that while the widow is entitled to one-half of each asset it would make better sense for her to receive all of one asset or the other. Economically, the result would be the same as the distribution of a fractional interest in each asset as the will directs. The widow agrees and receives Greenacres, the stock being retained by the estate for ultimate distribution to other residuary beneficiaries.

May it be suggested that the widow realized, and must recognize,

179. This was the situation in Commissioner v. Brinckerhoff, 168 F.2d 436 (2d Cir. 1948), discussed at text accompanying notes 200-07 *infra*. A "sale or other disposition," giving the distributee a new basis equivalent to the distribution date value of the distribution, was found in a similar situation in Lindsay C. Howard, 23 T.C. 962 (1955).

180. See 1 CASNER, *op. cit. supra* note 158, at 817.

a gain in accord with the doctrine of *Rouse v. Commissioner*?[181] The theory would be that she had a vested interest in one-half of the stock (basis of her interest 20,000 dollars) which she exchanged for the additional one-half interest in Greenacres (that one-half interest having a fair market value of 50,000 dollars), thus realizing a gain of 30,000 dollars.[182] Further, since this is not a "like-kind transaction,"[183] neither section 1031 nor any other section of the Internal Revenue Code would seem to afford a ground for postponing recognition of the gain.[184] For such solace as it might afford, characterization of the transaction as an "exchange" would seem to afford the opportunity for capital gains treatment and the widow's basis for Greenacres would appear to be 80,000 dollars (30,000 dollars for her original half-interest[185] and 50,000 dollars for the newly acquired half-interest,[186] with the holding period of the latter beginning to run as of the date of acquisition[187]). Similarly, the transferor of the one-half interest in Greenacres might be deemed to have realized a recognizable gain, having exchanged that interest (basis 30,000 dollars) for an additional one-half of the stock worth 50,000 dollars.

Presumably, if the executor had been given the power, either expressly or by implication, to distribute specific assets with a distribution date value equal to the value of the computed fractional share of the residue available for satisfying the dispositive direction, no "exchange" of interests would have occurred. But attempts to avoid the hypothetical possibility of capital gain by mongrelization of the true fractional share disposition may not be wholly successful and are not without their own side effects. It has been suggested:

> "[G]iving the executor discretion on distribution to allocate property to the nonmarital share and to transfer to the marital share from the nonmarital share property of equivalent value in place thereof . . . should not be a taxable exchange but it may be regarded as giving the executor the power to establish a dollar claim in favor of the marital share when property is taken from the marital share and given to the nonmarital share. If so, the satisfaction of the dollar claims may conceivably produce a taxable gain."[188]

181. 159 F.2d 706 (5th Cir. 1947), *affirming* 6 T.C. 908 (1946). *Cf.* Frances R. Walz, 32 B.T.A. 718 (1935) which the Tax Court distinguished. For a firm statement that capital gains may result in this type of situation, see Casner, *supra* note 159, at 277.

182. I.R.C., § 1001.

183. I.R.C., § 1031.

184. I.R.C., § 1002.

185. I.R.C., § 1014.

186. I.R.C., § 1012.

187. I.R.C., § 1223.

188. Casner, *supra* note 159, at 277. See also Bolte, *supra* note 157, at 541; Peeler,

Further, the observation has been made that the executor may be obligated to distribute in such a manner that each legatee or remainder will "have the same cost basis if his share is to be in equal proportion to the others, and how can the fiduciary effect such equalization except by an actual or constructive sale of the property?"[189] The problem posed refers to the fact that distribution of property with equal value at distribution date, but with different tax bases, will result in an unequal allocation of potentiality of gain or loss upon subsequent disposition by the legatee.[190] A further administrative factor is that such distributions require a second valuation, often a difficult problem where closely-held stock is included.[191] Even those who would advocate the granting of such powers of allocation recognize the existence of additional, potentially troublesome administrative problems, absent skillful planning and drafting.[192]

3. *Hybrids—Tax-Value Clauses*

Having looked at the extremes—the bequest of a pecuniary amount and the true fractional share—what are the income tax results of clauses in the middle range of the spectrum? For example, what are the tax effects of the two types of "tax-value" pecuniary formula clauses designed to comply with Rev. Proc. 64-19?

When the draftsman uses a "tax-value" pecuniary clause to avoid recognition of gain by the estate upon distribution of appreciated assets in satisfaction of the marital bequest, the results should be quite different from those arising from distribution of appreciated assets in satisfaction of a fixed amount claim. Whether the will simply provides for a bequest of "assets with a basis of 500,000 dollars" or utilizes a pecuniary formula clause granting the executor

Unsuspected Realization of Profit in Estates and Trusts, 98 TRUSTS & ESTATES 1191, 1193 (1959).

189. Roberts & Muller, *supra* note 158, at 378. See also Golden, *Rev. Proc. 64-19*, 103 TRUSTS & ESTATES 536, 538 (1964).

190. Roberts & Muller, *supra* note 158, at 377.

191. See Stevens, *How To Draft Marital Deduction Formula Clauses Under New Rev. Proc. 64-19*, 20 J. TAXATION 352, 355 (1964).

192. See Rodman, *supra* note 149. Suppose, for example, the executor could allocate to the marital trust stock of either Company *A* or Company *B*, both of which have a fair market value at this time of $200,000. However, the federal estate tax basis of the *A* stock is $250,000 while the basis of the *B* stock is only $50,000. If the stock of Company *A* is allocated to the widow's trust, might not the remaindermen of the nonmarital trust question a capital gains tax paid by the trust upon sale of the *B* stock at a profit?

Suppose, further, the executor elects to allocate to the marital trust all of the stock in a family business or all of the interest in an oil and gas field having tremendous potential. If such assets do better over the years than the assets of like value allocated to the nonmarital trust might not the remaindermen challenge the impartiality or judgment of the fiduciary in making such allocation?

the power to select assets (valued as for federal estate tax purposes) to satisfy the bequest in kind, it seems clear that the widow is not entitled to specific assets, nor to a set fractional share of the estate (*unless otherwise required by local law*), nor to a specific amount or claim against the estate. She is simply entitled to a distribution satisfying the terms of her husband's dispositive provision; assuming changes in asset values between date of death and date of distribution, the quantum she receives may vary markedly with the shift in actual values of assets and the manner of exercise of the discretionary power granted the fiduciary.

In carrying out the direction, the executor would first have to determine the "bench mark" for measuring the gift in terms of the tax basis. On the hypothetical facts, the bench mark is 500,000 dollars (the figure representing one-half of the adjusted gross estate and, accordingly, the maximum marital deduction), which is to be satisfied with assets having a federal estate tax value (or basis) equal to that figure. Absent any further requirement of local law[193] or of a tax agreement[194] restricting the executor's discretion in selecting assets to satisfy the bequest, distribution of either all of the *A* stock or all of the *B* stock would comply with the testamentary direction. The executor has not satisfied any fixed dollar amount claim with assets having a different basis; rather, he has simply exercised the power apparently vested in him to allocate estate assets in satisfaction of a bequest of an indefinite portion of the estate. Similarly, the widow has not exchanged a fixed-amount claim; rather, she has simply received a portion of the estate pursuant to the special power of the executor to determine the quantum she is to receive. Thus, from an income tax standpoint, the transaction would result in neither gain nor loss to either the estate or the distributee.[195]

193. *E.g.*, N.Y. DECED. EST. LAW § 125-2. It has been held that this statute requires that even though the executor is given power to select assets to satisfy the pecuniary gift, the allocation must be made in such manner as to result in equivalent sharing of appreciation and depreciation by the respective beneficiaries. *In re* Bush's Will, 2 App. Div. 2d 526, 156 N.Y.S.2d 897 (1956), *aff'd*, 3 N.Y.2d 908, 145 N.E.2d 872 (1957). But see note 69 *supra*. See discussion of the rationale of the statute in Rodman, *supra* note 149, at 804. *In re Bush's Will* and subsequent cases are explored in detail in the articles cited *supra* note 160. The Internal Revenue Service now recognizes that New York law is "clear" in requiring that the widow share in appreciation and depreciation and indicates that pecuniary bequests and formulas containing the "problem pecuniary" language will qualify for the federal estate tax marital deduction. Private Ruling from Lester H. Wallace, Acting Chief, Estate and Gift Tax Branch, IRS, to Fiduciary Trust Co. of New York, P-H FEDERAL TAXES ¶ 142051 (1965). See Nicolai v. Hoffman, 232 Ore. 105, 373 P.2d 967 (1962) (direction to use federal estate values in ascertaining the quantum to satisfy the pecuniary bequest held to require a mandatory sharing of appreciation). The case is discussed in Stevens, *supra* note 191, at 353, and Lauritzen, *supra* note 160, at 145.

194. As where the agreements required by Rev. Proc. 64-19, §§ 3 and 5 are executed.

195. Again it will be noted that such a distribution might constitute gross income

The pecuniary marital bequest (whether specified amount or formula-determined) may utilize problem-pecuniary language (as it has been defined herein), subject to a further requirement (under either the express terms of the dispositive instrument, local law, or an effective tax agreement of the type referred to in Rev. Proc. 64-19) that the assets so allocated (1) shall have a distribution date value not less than the marital deduction allowed with respect to such assets *or* (2) shall be fairly representative of aggregate appreciation or depreciation in the value of distributable assets to the date of distribution.

a. *Minimum-Value Pecuniaries*

Under the first type of clause, the so-called minimum-value pecuniary, the income tax results should be similar to those just considered under the old problem-pecuniary language. Although the widow is assured of a minimum amount to the same extent as would be afforded by an outright specific bequest of that specified sum, the fair market value of assets distributed may exceed the minimum, subject only to the discretionary power of the executor or further limitations such as a local law requirement of a ratable sharing. Therefore, the ultimate value of the bequest is not ascertainable until distribution; and receipt of assets cannot be said to be in satisfaction of a fixed dollar amount bequest or claim.

Regardless of the value of the assets distributed, the widow has not sold, exchanged, or relinquished a fixed dollar amount claim for assets worth more or less than the fixed claim; she has simply received a distribution in accordance with the testamentary provision. Assuming it does not constitute distributable net income of the estate, the widow should have no recognizable income as a consequence.

While the executor presumably could have satisfied the bequest with a distribution of cash or assets having a distribution date value of 500,000 dollars, he is clearly not satisfying a fixed-amount claim with assets having a different basis. Further, by definition, the basis of the assets distributed must be exactly equal to the only amount (a distribution date value of 500,000 dollars) of which the widow is assured. Thus there can be no gain to the estate; neither can there be a loss when the distribution is viewed as the exercise of a power granted to the executor and not as an exchange or sale. Nothing in

(in the form of distributable net income) to the distributee under the Service's position that such a transfer does not constitute a distribution of a specific sum of money for purposes of I.R.C., § 663(a)(1). Rev. Rul. 60-87, 1960-1 CUM. BULL. 286; see notes 169-71 *supra*.

Kenan,[196] *Suisman*,[197] Rev. Rul. 56-270,[198] or Rev. Rul. 60-87[199] would seem to require a different result since each deals with a situation requiring that assets distributed must have a distribution date value of a specified amount; that is quite different from a variable amount limited only by a specified minimum.

b. *"Ratable-Sharing" and "Lower of Basis or Distribution Date" Tax-Value Clauses*

As in the case of the minimum-value clause, there should be no recognized gain or loss upon satisfaction of the tax-value pecuniary formula of either the ratable-sharing or lower-of-federal-estate-tax-or-distribution-date value type. In the latter case, the widow had no definite claim and the income tax consequences of satisfaction of the bequest should be similar to those outlined under the minimum-value clause. This *should* be the case also where the ratable-sharing pecuniary is used. In that case, however, though the widow had no ascertainable claim at the date of establishing federal estate tax values, it may be argued that her claim, in terms of then current dollars, may be definitely ascertained as of the date of distribution. Would distribution, therefore, be satisfying a fixed claim? It is believed that it should not; yet, one case merits consideration.

c. *Implications of Brinckerhoff*

Brinckerhoff v. Commissioner[200] contains language which might prove troublesome. Hopefully the case will be confined to its precise factual situation: The testatrix had directed that certain property be sold at a later date and that the proceeds be divided among four legatees. Instead of being sold, however, the property was distributed to the legatees, who released the executors from any liability for failure to carry out the direction. Upon a sale of the property some thirteen years later, the Second Circuit held that the legatees had received a basis equal to the value of the property when distributed to them.

If the testamentary direction had been to distribute a pro-rata share of the property to each legatee, it seems clear that each would have received a basis equal to that of the estate (and with no recogni-

196. 114 F.2d 217 (2d Cir. 1940).

197. 15 F. Supp. 113 (D. Conn. 1935), *aff'd mem.*, 83 F.2d 1019 (2d Cir.), *cert. denied*, 299 U.S. 573 (1963).

198. 1956-1 CUM. BULL. 325.

199. 1960-1 CUM. BULL. 286.

200. 168 F.2d 436 (2d Cir. 1948), *affirming* 8 T.C. 1045 (1947). See also Lindsay C. Howard, 23 T.C. 962 (1955); Wilson v. Tomlinson, 306 F.2d 103 (5th Cir. 1962).

tion of gain). Yet the court, citing *Kenan*[201] and *Suisman*[202] and emphasizing that the legatees were entitled to a mandatory cash distribution, stated:

> "A tax liability however arose against the executors when the stock was transferred to the taxpayers in exchange for a release of their claims as legatee-beneficiaries to the cash proceeds which the executors would have realized had they instead exercised the mandatory power of sale given them under the will. We have heretofore held that the use of the executor of property of the estate to satisfy a legatee's claim for cash payment is a taxable transaction in which gain or loss of the estate is to be recognized to the extent of the difference between the estate's basis and the value of the cash liability satisfied."[203]

While recognizing that the cited cases involved only cash legacies of fixed amounts unaffected by fluctuation in the value of the property out of which the legacy was satisfiable, the court reasoned:

> "The taxpayers had no interest in the real estate during the period of its increase in value but only in such cash as they might receive from the exercise of the executor's power of sale. The real estate itself belong to the executors in trust who retained the title until it was disposed of. . . . *The present case is therefore to be distinguished not from other legacies which are of a fixed amount in cash but from gifts which belong as such to the legatee under a will of property.* The fact that the ultimate value realized by the taxpayers in the present case depends upon the fluctuating value of the property devised to the executors does not affect our conclusion. . . ."[204]

Several interpretations and limitations may be placed on *Brinckerhoff*. Most restrictively, and preferably, it may be argued that it simply holds that where the will contains a *mandatory* direction to sell assets and distribute cash, even a distribution in kind will be treated as if the estate sold the asset for its distribution date value. A gain will be recognized to the extent the distribution date value exceeds the estate's basis, and a basis equal to the value of the assets received will be passed on to the distributee who is deemed a purchaser.

The language employed, however, is capable of a broader interpretation: namely, that whenever a dollar amount, or the dollar value of the quantum of property required to be distributed at dis-

201. 114 F.2d 217 (2d Cir. 1940).

202. 15 F. Supp. 113 (D. Conn. 1935), *aff'd mem.*, 83 F.2d 1019 (2d Cir.), *cert. denied*, 299 U.S. 573 (1936).

203. 168 F.2d at 440.

204. *Id.* at 440. (Emphasis added.)

tribution date, is measurable at distribution date as a fixed dollar amount, then use of property with a lesser basis will result in both a gain to the estate and a new basis, equal to distribution date value, for the distributee. Although even this interpretation should create no problems of potential gain under a minimum-value pecuniary clause (since no fixed value amount is involved), it could result in a claim of gain where the ratable-sharing pecuniary is used since the executor must distribute assets "fairly representative" (and this might be regarded as meaning "equal") of appreciation and depreciation. When the executor values the assets at distribution date and, as in the case of a fractional share clause which does not require pro-rata distribution of a share of each asset, determines the value of the share to which the distributee is entitled, he has calculated a definite amount which will be satisfied with assets having a current value of that amount.[205]

The danger is not lessened by the court's statement that, "The fact that the ultimate value realized by the taxpayers in the present case depends upon the fluctuating value of the property devised to the executors does not affect our conclusion."[206]

It would be ironic, indeed, if the executor achieved the same result as under a true fractional share by actually distributing an undivided fractional share of each asset to the marital share (avoiding the necessity of a second valuation of the assets on the distribution date and finessing any problems or claims of favoritism arising from selection of assets with differing tax bases and potentiality for future capital gains[207]), *and yet* gain resulted to the estate because the executor *could* have selected assets to satisfy an ascertainable dollar amount obligation!

The presence of even such a slight cloud may suggest the desirability of using either the minimum-value tax-value pecuniary or a fractional-share provision in preference to a ratable-sharing bequest. After all, the task of the planner of estates is not to speculate on the probability of danger, however slight, where a safer course is available.

---

205. In this situation, a claim of gain has at least as strong a basis as it has when the executor, operating under a fractional share clause, has power to allocate specific property to the nonmarital share and to transfer property of equivalent value to the marital share. See note 32 *supra* and accompanying text. Dean Casner has suggested that the latter situation may be viewed as a grant to the executor of "the power to establish a dollar claim in favor of the marital share." Casner, *supra* note 159, at 277.

206. 168 F.2d at 440.

207. See note 189 *supra* and accompanying text.

4. *Summary of Gain*

In summary, the possibility of gain or loss to the estate and a new basis and holding period for the distributee should arise only where assets having a basis different from distribution date values are used to satisfy a fixed dollar obligation due the distributee.

A typical example of a disposition deemed to give rise to this result is the direction to distribute assets having an aggregate distribution date value equal to a specified sum (such as 500,000 dollars) or equal to that sum necessary to produce the maximum marital deduction as determined by a formula (illustrative directive 2).[208] (Obviously a direction, as in illustrative directives 1, 8, and 13, to distribute cash would not in itself produce gain; the sale of assets to raise the cash might have this result, however.)

Where the direction is to satisfy a pecuniary bequest, whether of a stated amount or determined by formula, with selected assets valued at their *estate tax* values (the problem-pecuniary language giving rise to Rev. Proc. 64-19 and illustrated by directive 3) no gain should result. But what of additions to that language designed to comply with the requirements of Rev. Proc. 64-19? The addition of a provision that the aggregate distribution date value of assets so distributed must be at least equal to the pecuniary amount (the minimum-value pecuniary clause as illustrated by directive 4) should not result in realization of gain since the widow's rights are clearly not equal to a fixed monetary sum. This would also be true of the addition of a provision that the assets distributed should be valued, for distribution purposes, at the lower of their federal estate tax value or fair market value at date of distribution (illustrated by directive 5). But, because it might be deemed to establish a fixed amount due at distribution date, though satisfiable in property, illustrative directive 6 (a ratable-sharing pecuniary direction) might conceivably be characterized as having created a fixed pecuniary claim at the date of distribution with a resultant possibility of gain to the estate should the distribution date value of distributed assets exceed basis. A direction to distribute a "fractional share" of the estate with power to select and distribute assets (or perhaps cash) equal in value to the share rather than distributing fractional interests in assets (illustrative directions 9, 11, and 12) would present similar problems. Even more clearly, a provision requiring the

208. The illustrative directive clauses are set forth in the text at the beginning of Part IV of this article, *supra*.

distribution of an amount produced by the sale of specified assets (directive 7) would, under the reasoning of the *Brinckerhoff*[209] case, produce gain where the proceeds of sale or distribution date value of the assets exceeded basis.

Distribution of a true fractional share should not result in gain to the estate since it clearly does not represent satisfaction of a claim but is simply a distribution of inheritance—the prescribed fractional interest in property bequeathed to the distributee.[210] Yet, while none of the directives would give rise to realization of gain by the distributee[211] since she would not be selling or exchanging anything, her agreement to accept an additional interest in one asset in lieu of the fractional interest in another asset to which she was specifically entitled could result in gain to her as well as to the transferor.[212]

C. *Other Income Tax Questions*

Only when the distribution gives rise to gain need the succeeding questions of the hierarchy of key tax questions be answered. But, if a gain has been realized, it will be necessary to determine the amount (by reference to the value of the consideration received and the basis of the asset transferred), to ascertain whether the gain must be recognized (since an exchange of like-kind assets in the case of trading fractional interests might be a like-kind transaction within the definition set forth in section 1031 of the Code), and to determine whether the gain, if recognized, may be treated as a long-term capital gain resulting from a sale or exchange[213] of a transferred asset deemed held for the requisite period of time.[214]

D. *Suggestions for Drafting and Administration*

Just as the discussion of possibilities of gain on distribution have pre-empted an inordinate portion of this article, so have thoughtful writers[215] suggested that the preoccupation with the gains problem has been overemphasized, though an occasional commentator may have ventured a contrary opinion.[216]

---

209. 168 F.2d 436 (2d Cir. 1948), *affirming* 8 T.C. 1045 (1947).

210. Bolte, *Choosing a Marital Deduction Formula Clause*, 44 MARQ. L. REV. 532, 541 (1961).

211. SURREY & WARREN, FEDERAL INCOME TAXATION 666 (1960 ed.).

212. See Treas. Reg. 1.1001-1(a) (1957).

213. I.R.C., § 1222. The question whether the debtor engages in a sale or exchange in these situations does not seem to be seriously questioned. "Most of the cases involve the issue whether any gain is realized, and if gain does result it is apparently assumed to be capital gain." SURREY & WARREN, *op. cit. supra* note 211, at 666.

214. 1 CASNER, ESTATE PLANNING 818 (3d ed. 1961), discusses the question.

215. See, *e.g.*, Bolte, *supra* note 210, at 536; Stevens, *supra* note 191, at 353.

216. See, *e.g.*, Polasky, *Estate Tax Marital Deduction in Estate Planning*, Tax Counselor's Q., June 1959, pp. 1, 51.

Often, the problem of potential recognition of gain can be minimized by an appropriate selection of assets to be distributed to the marital share. Although there may have been a major increase in aggregate asset[217] values during the period of administration, there will usually be some assets that have increased little, if at all.[218] Of course, if the bulk of the estate consists of the stock of a closely-held corporation, significant gains may be realized in the process of administration and distribution.[219] Yet even this situation should not be viewed as catastrophic. The tax-oriented testator and draftsman normally seek overall tax minimization.[220] Use of the pecuniary bequest directing a definitely ascertainable fixed amount should produce the maximum marital deduction while directing appreciation during administration to the nonmarital share.[221] This same result can usually be obtained by using a minimum-value type of pecuniary clause specifying use of federal estate tax values to avoid recognition of gain; however, a rather general across-the-board increase in asset values will require some allocation of appreciation to the marital share, although its effect may be minimized by selection of those assets with the smallest percentage of increased value.

The basic difference, then, between the pecuniary amount satisfiable at distribution-date values and the tax-value pecuniary (directing use of federal estate tax value in computing the distributable quantum, coupled with a provision that distribution date values may not be less than the amount of the pecuniary bequest) arises where appreciated assets must be distributed in satisfaction of the

---

217. Bolte, *supra* note 210, at 536; *Report of Subcommittee on Forms for Marital Deduction Planning*, 103 TRUSTS & ESTATES 961, 962 (1964); *Report of Subcommittee on Estate Planning and the Marital Deduction*, 102 TRUSTS & ESTATES, 934, 944 (1963); Stevens, *supra* note 191, at 353.

218. Bolte, *supra* note 210; Stevens, *supra* note 191.

219. The severity of the problem depends upon the degree to which relief provisions, such as I.R.C., § 303, may be utilized within a short time after death as well as the presence and effect of buy-sell agreements setting effective estate tax valuations. These problems are discussed in detail in a series of three articles: Polasky, *Planning for the Disposition of a Substantial Interest in a Closely Held Business* (pts. 1-3), 44 IOWA L. REV. 83 (1958), 45 IOWA L. REV. 46 (1959), 46 IOWA L. REV. 516 (1961).

220. Bolte, *supra* note 210, at 536.

221. This is not indicative of an "anti-widow" attitude. The will may provide that income from the nonmarital portion be distributed to the widow, that she have a special power of appointment over the nonmarital share, and the distributions of corpus may be made by the corporate fiduciary for her benefit. See Craven, *Marital Deduction Problems—Use of the Percentage Formula Clause*, N.Y.U. 19TH INST. ON FED. TAX. 613, 615 (1961), citing *In re* Estate of Uhl, 241 F.2d 867 (7th Cir. 1957), and Commissioner v. Irving Trust Co., 147 F.2d 946 (2d Cir. 1945). The formula simply allocates appreciation to the nonmarital share in order to avoid inclusion of such assets in the widow's estate, thus minimizing estate taxes imposed upon her death.

bequest. The former gives rise to recognition of gain to the estate and directs all appreciation to the nonmarital share; the latter avoids recognition of gain but augments the marital share by at least a portion of the appreciation. As a practical matter, this type of situation will not be frequently encountered and the use of either may effectively avoid net taxable gains and at the same time direct appreciation to the nonmarital share.

Again using an adjusted gross estate comprised of *A* stock with a federal estate tax value of 500,000 dollars (distribution date value of 800,000 dollars) and *B* stock with a federal estate tax value of 500,000 dollars (distribution date value 400,000 dollars), the suggestion may be illustrated.

1. *Using Distribution Date Values*

Assuming that assets are to be valued at their actual distribution date value in satisfying the bequest, the wife could be given all of the *B* stock (fair market value 400,000 dollars) and one-eighth of the *A* stock (fair market value 100,000 dollars) resulting in a net "loss"[222] to the estate of 62,500 dollars (100,000 dollar loss on *B* and 37,500 dollar gain on *A*), with allocation of the entire appreciation to the nonmarital share. Conversely, the executor might distribute *A* stock with a distribution date value of 500,000 dollars (basis of 312,500 dollars) causing the estate to recognize a gain of 187,500 dollars but with the net appreciation in asset values flowing to the nonmarital share.

Where the estate and gains are much smaller than those hypothesized, recognition of gain by the estate might actually, though rarely, be desirable. For example, if the estate's income tax bracket were forty per cent, the effective rate on the gain would be twenty per cent.[223] If the widow were in a sixty per cent bracket and, for some reason, would have occasion to sell the stock, the minimum effective rate (assuming no offsetting losses and the required holding period) would be twenty-five per cent.[224] Thus, gain to the estate and a conse-

222. This assumes no impediment to deduction of the loss offsetting the gain. It seems clear that the loss could be realized and recognized by a sale on the open market. But what of a distribution by the executor to the obligee-beneficiary? I.R.C., § 267 does forestall recognition of loss in certain circumstances (*e.g.*, a transaction between a fiduciary of a trust and a beneficiary of a trust [§ 267(b)(6)] or a fiduciary of another trust [§ 267 (b)(5)]; the pour-over from an inter vivos trust to a marital trust might well run afoul of these provisions)? However, nothing in §§ 267(a) or (c) would appear specifically to deny recognition of the loss upon distribution by the executor to the obligee-beneficiary.

223. I.R.C., § 1202.

224. I.R.C., § 1201.

quently higher basis for the widow could conceivably result in lower overall taxes.[225]

In the more typical situation, the executor might work out the distribution so that no net gain or loss would result. For example, he might allocate one-fourth of the *A* stock and three-fourths of the *B* stock with the following results:

Assets Allocated	*Basis*	*Fair Market Value at Distribution*	*Gain or (Loss) to Estate*	*Basis to Widow of Distributed Shares*
A (1/4 of shares)	$125,000	$200,000	$75,000	$200,000
B (3/4 of shares)	375,000	300,000	(75,000)	300,000
Total or Net	$500,000	$500,000	-0-	$500,000

It will be noted that, while the widow's total basis is 500,000 dollars, as was the estate's, the allocation has been reshuffled to accord with values actually existing at the time of distribution. This minimizes the potentiality of gain or loss to the widow on disposition of a portion of the distributed assets.[226]

2. *Using Federal Estate Tax Values*

Under a tax-value clause of the minimum-value type, satisfaction of the bequest with *A* stock only would require distribution of all of the shares and, though no gain would be realized, the value of the shares would exceed the allowable marital deduction by 300,000 dollars; this is in contrast to the gain recognized on distribution of 500,000 dollars worth of *A* shares where distribution date values were used in calculating the quantum of stock necessary to satisfy the bequest.

---

225. The strained nature of the example should be recognized. Should the widow retain the distributed assets, they would receive a new stepped-up basis upon her death whether or not she recognized gain at the time of distribution. I.R.C., § 1014. And, of course, the widow might be in a 40% bracket and the estate in a 60% bracket with the result that a distribution to the widow prior to sale and without recognition of gain on distribution would result in a lower tax rate on the gain. Where the distributed assets were made the subject of a gift, the donee's basis in turn would be affected by whether or not gain had been recognized on distribution, the donee succeeding to the donor's basis subject to appropriate adjustments. I.R.C., § 1015.

226. Compare the resulting basis in this instance to that of a similar distribution under a minimum-value clause. See note 227 *infra*.

Finally, the executor might distribute three-fourths of the *B* stock and one-fourth of the *A* stock, an appropriate distribution under either formula. In this case, there would be no net gain or loss; the only difference would be that under the tax-value clause the assets would retain the same basis as that of the transferor (375,000 dollars for the *B* shares and 125,000 dollars for the *A* shares).[227] There would be no "over-funding" of the marital share, since the aggregate appreciation accrues to the nonmarital portion.

Perhaps the illustration has been sufficient to indicate that in the normal case neither type of formula clause (despite their differing operative effects) need give rise either to recognition of net gain or to allocation of appreciation to the marital share. It may be suggested that the dragon is not as dreadful as rumored.

V. Advantages and Disadvantages of Types of Formula Clauses—A Comparison

A. *Formula Versus Non-Formula*

Perhaps a few tentative inferences, if not conclusions, may now be drawn as to the desirability of various types of formula clauses, subject always to the caveat that each client's situation will be somewhat unique and choice of a pattern must be made, if at all, in the light of the factors involved in the particular situation.

The debate over the desirability of using a formula clause has spanned the life of the marital deduction[228] and is likely to continue,[229] though it may be forecast that a trend will develop toward

227. The basis of the *B* shares would be $300,000 and that of the *A* shares $200,000 under the pecuniary bequest that values assets at distribution date values. *Cf.* Colson, *The Marital Deduction and Revenue Procedure 64-19*, 10 The Practical Law. 69, 79 (1964), suggesting avoidance of attempted qualification under the "minimum-value" approach for reasons based upon that author's interpretation of Rev. Proc. 64-19.

228. See, *e.g.*, the delightful exchange in Sargent, *To Each His Own*, 93 Trusts & Estates 933 (1954); Trachtman, *Leaping in the Dark*, 93 Trusts & Estates 922 (1954), and Sargent, *Drafting of Wills and Estate Planning*, 43 B.U.L. Rev. 179 (1963); Trachtman, *Marital Deduction—Use of Non-Formula Provisions*, N.Y.U. 19th Inst. on Fed. Tax. 631 (1961). See also Sargent, *A.B.C. and D. of Marital Deduction*, 92 Trusts & Estates 746 (1953).

229. Stevens, *supra* note 191. A recent Trachtman-Sargent exchange, unfortunately reported only briefly under the intriguing title of *Dialogue on Eschatology*, in 102 Trusts & Estates 932 (1963), featured the annual Meeting of the Section of Real Property, Probate and Trust Law in August 1963 in Chicago. To the author, who served as "moderator" (and the term is moderately descriptive) of that exchange and served with Messrs. Trachtman and Sargent on a panel which discussed "Common Sense in Estate Planning" at the University of Illinois-Illinois Bar Association 1964 Short Course on Estate Planning held in Champaign in April 1964, it appeared that basic views of these friendly feuders had not appreciably changed in the past decade.

a middle ground. In that event, there will be less dependence upon the formula as the major source of funding the marital share and less reluctance to use it as a "backup" clause to obtain the maximum marital deduction under circumstances unforeseen or unforeseeable at the planning stage. The arguments have been marshalled ably and at length elsewhere.[230]

Briefly stated, the opponent of such clauses will suggest that the formula will not operate where assets providing more than the desired marital deduction pass to the spouse apart from the dispositive instrument;[231] but this hardly seems disadvantageous other than in terms of wasted effort. The opponent may also suggest that it will create uncertainty as to the amount (or quantum of assets) ultimately passing to the widow;[232] this will be true in the case of a fractional-share formula just as in the gift of a non-formula fraction of an as yet undetermined estate.[233] The choice, then, would appear to be between securing the maximum allowable marital deduction and providing a specific sum for the widow (which can also be done by a bequest preceding the formula). A somewhat more serious objection is that the *time* for determining the composition of the marital gift will be delayed due to dependence on estate tax determinations, though the problems created thereby are somewhat less in the case of the true pecuniary than in the case of the fractional share.

It may be suggested that the formula clause will create conflicts of interest between the spouse and other legatees;[234] but these are certainly not unknown in non-formula dispositions. Indeed, problems arising from the election to take administrative expenses as deductions for estate tax or income tax purposes,[235] from the deter-

230. Cox, *Types of Marital Deduction Formula Clauses*, N.Y.U. 15TH INST. ON FED. TAX. 909, 915 (1957); Craven, *Marital Deduction Problems—Use of the Percentage Formula Clause*, *supra* note 221, at 615; *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 217, at 943; Mannheimer, Wheeler & Friedman, *The Use of a Formula Clause for the Marital Deduction*, 32 TAXES 381, 386 (1954).

231. *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 217, at 943.

232. *Ibid.*; Craven, *supra* note 221, at 617.

233. *Ibid.*

234. *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 217, at 943; Craven, *supra* note 221, at 619.

235. For a detailed mathematical analysis and suggested palliative, see Polasky, *supra* note 216, at 10. Some forms utilize a formula clause providing, "If my wife . . . survives me . . . I give her . . . an amount equal to one-half of the value of my adjusted gross taxable estate, as determined for federal estate tax purposes, *after* deducting all debts and funeral and administration expenses, but before deducting succession taxes, less the value of other property qualifying." (Emphasis added.) In Empire Trust Co. v. United States, 226 F. Supp. 623, 629 (S.D.N.Y. 1963), it was held that although the administration expenses were deducted on the estate's income tax

mination of rights to income accruing during administration on "expended assets,"[236] as well as from a host of other administrative decisions,[237] must be foreseen and prudently handled whether the dispositive instrument contains a formula clause or not. To the extent that such conflicts could arise from the fiduciary's power to prefer one or other through selection of assets,[238] the problems may be ameliorated by an appropriately drafted formula clause; yet it cannot be gainsaid that pivoting the widow's share on the determination of the adjusted gross estate for federal estate tax values does tend to make her interest adverse to that of the residuary legatees when questions arise as to the election of the alternative valuation date[239] or includability of assets in the gross estate for estate tax purposes.[240]

Another argument in opposition to formula clauses is that they breed difficult problems of construction[241] for courts unfamiliar with tax-oriented terminology; this is certainly true as the cases show,[242] but construction problems plagued the courts long before the advent of formula clauses. The continuing exposure of judges to such dispositions, accompanied by enlightened guidance from attorneys and use of court-proven orthodox language[243] may go far toward mitigating whatever peril is posed.

The further argument that changes in the tax law may necessitate

---

return under I.R.C., § 642(g), this did not increase the amount which was to pass to the widow under the provision of the will. The maximum marital deduction was therefore limited to the adjusted gross estate less such administration expenses. The court indicates in dicta, however, that, if the will had provided only that the wife receive "an amount equal to one-half the adjusted gross estate as computed for federal estate tax purposes," the larger amount equal to one-half of the adjusted gross estate would have been deductible.

236. See text accompanying notes 133-46 *supra*, for a description of fractional-share problems. A leading case discussing the problem is Tilghman v. Frazer, 119 Md. 620, 87 A.2d 811 (1952), discussed in 37 MINN. L. REV. 303 (1953). See also Proctor v. American Security & Trust Co., 98 F.2d 599 (D.C. Cir. 1938).

237. See, *e.g.*, Boehm, *Comparing the Relative Tax Costs of Alternative Treatment of Estate and Income Deductions and Valuation Adjustments*, 31 ROCKY MT. L. REV. 172 (1959); Polasky, *supra* note 216, at 6, and authorities collected therein.

238. *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 217, at 943; Craven, *supra* note 221, at 619.

239. I.R.C., § 2032.

240. Craven, *supra* note 221, at 619.

241. Craven, *supra* note 221, at 618; Juhl, *Executor Should Have Power To Choose Assets for Marital Deduction Bequest*, 15 J. TAXATION 335 (1961); *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 217, at 943; Straus, *Revenue Procedure 64-91—When Should Agreements Be Made?*, 103 TRUSTS & ESTATES 911 (1964).

242. See Durand, *Planning Lessons From Marital Deduction Litigation*, 101 TRUSTS & ESTATES 8 (1962).

243. *Ibid.*

revision of the provision[244] hardly militates against use of a formula clause by the lawyer aware of the need for constant review of dispositive plans in the light of changing circumstances, nor does the possibility of a warping of the plan by the widow's possible election to take against the will[245] or the once-raised but apparently dissipated spectre that such clauses might violate the rule against perpetuities.[246]

To most counselors, the arguments against formula clauses are impressive but not persuasive when balanced against the tendency of the formula clause to allow adjustments to changing circumstances[247] (particularly those involving uncertainty as to asset values)[248] in order to obtain the maximum marital deduction and the additional factor of avoidance of frequent redrafting of dispositive instruments.[249]

For many, therefore, the question is not "whether" to use such a clause but "which" type of formula to employ.[250]

B. *Choice as Between Formula Clauses*

1. *"True" Pecuniary and Fractional Share Clauses*

Marshalling the pros and cons in choosing between types of formula clauses is somewhat more difficult because of the proliferation of varieties of pecuniary and fractional share patterns and the emergence of clauses which can only be described as hybrids.

If discussion can be limited to the "true fractional share" clause (requiring a distribution of a fractional interest in each asset of the residuary estate, as described) and the "true pecuniary" clause (distribution date values being used to measure the quantum necessary to satisfy the gift), some observations are possible.

a. *Advantages of Pecuniary Clauses*

Most commentators would probably agree that the pecuniary formula is easier to express than the fractional share;[251] certainly

244. Craven, *supra* note 221, at 618.

245. *Ibid.*

246. *Id.* at 620; Polasky, *supra* note 216, at 43, and citations therein.

247. Craven, *supra* note 221, at 621; Durand, *Draftsmanship—Wills and Trusts*, 96 TRUSTS & ESTATES 871, 874 (1957); *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 217, at 943.

248. Craven, *supra* note 221, at 616. See Stevens, *How To Draft Marital Deduction Formula Clauses*, 20 J. TAXATION 352 (1964).

249. Craven, *supra* note 221, at 617.

250. See *Report of Subcommittee on Forms for Marital Deduction Planning*, *supra* note 217.

251. Bolte, *supra* note 210, at 538.

it is easier to explain to the client.[252] Others, however, have suggested that the fractional share provision is perfectly susceptible of lucid draftsmanship, though they differ as to whether it should be explained in somewhat less complex language[253] than that used in the numerator-denominator approach.[254]

The pecuniary formula also offers somewhat greater opportunities for post-mortem planning than does the true fractional share,[255] though some of the imagined joys of the tax-value formula have been curtailed by Rev. Proc. 64-19. As an officer of a major corporate fiduciary puts it, "This type of formula clause permits a certain amount of post-mortem estate planning if the fiduciary is given authority to select and allocate assets. With such a grant of authority, municipal bonds may be allocated to the marital gift and stocks allocated to the residuary trust designed to bypass the wife's estate for estate tax purposes, or perhaps a balanced portfolio allocated to the marital gift and stock in a family business to the residuary trust. A clause of this type may be set up in a way which permits a good deal of flexibility in the allocation of assets."[256]

Further, as suggested by the analysis of income tax consequences, the pecuniary formula allowing selection of assets permits a choice of timing and tax impact in recognition of gains and allocation of tax basis at distribution.[257] In addition, it does freeze the widow's share, in terms of dollar value,[258] upon determination of the "amount"; this is accompanied by a shifting of appreciation (and depreciation)[259] during administration to the nonmarital share.[260]

---

252. And, presumably, it is easier to explain to revenue agents. See the detailed brief in favor of the numerator-denominator type of fractional share clause and the reasons why it should become understandable for Service personnel in Durbin, *Marital Deduction Formula Revisited*, 102 TRUSTS & ESTATES 545, 546 (1963).

253. Golden, *Rev. Proc. 64-19*, 103 TRUSTS & ESTATES 536 (1964). See also Craven, *supra* note 221, at 623-25.

254. Discussion of the numerator-denominator approach is found in Bolte, *supra* note 210, at 543-44; Casner, *How To Use Fractional Share Marital Deduction Gifts*, 99 TRUSTS & ESTATES 190 (1960); Durbin, *supra* note 252.

255. *Id.* at 546.

256. Stevens, *supra* note 248.

257. This statement assumes, of course, that effective use of problem-pecuniary language with the addition of a clause meeting the minimum-value test is permissible under state fiduciary law. *Cf. In re* Bush's Will, 2 App. Div. 526, 156 N.Y.S.2d 897, 900 (1956), construing N.Y. DECED. EST. LAW § 125-2. See also *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 217, at 944 n.66, which collects the New York cases.

258. The time for fixing the amount depends upon determination of federal estate tax values and upon the executor's election of whether to use the alternative valuation date permitted by I.R.C., § 2032.

259. See Craven, *supra* note 221, at 621.

260. Stevens, *supra* note 248, at 352.

b. *Advantages of Fractional Share Clauses*

These latter features, which explain the appeal of the pecuniary to some counselors, are regarded by fractional-share enthusiasts as reasons for avoiding a pecuniary clause.[261] The flexibility, as they see it, leads to administrative problems stemming from "the fundamental duty and responsibility of a fiduciary to be impartial and the inadvisability of employing any technique which might possibly sow the seeds of family discord by giving to the wife and children a different type or quality of interest in the estate."[262] A true fractional share, deemed to require distribution of a fractional interest in each available asset, tends to forestall opportunity for preferential treatment stemming from asset selection and clearly avoids recognition of gain or loss on distribution (while passing the estate's basis to the distributee).

To some, it appears safer[263] and would be preferable on this ground alone, although this assumption seems questionable. The fractional share does, nevertheless, present greater administrative problems for the fiduciary. Even when properly drawn, extreme care in trust accounting is required[264] in applying the fraction to income and principal distributions, and the problem is compounded by the fact that the fraction cannot be definitely ascertained until federal estate tax values and the content of the gross estate have been finally determined. Meanwhile, non-pro-rata partial distributions alter both the pool and the fraction of the pool to which the marital share is entitled.

On final distribution, distribution of a fractional share of each asset does have the advantage of not requiring a second valuation of assets (a not inconsiderable burden where closely-held stock or other small business interests are involved); yet the distribution of fractional interests presents both a cumbersome procedure and seemingly undesirable fractional property interests. Even applying a relatively simple fraction like 4100/7243 to 100 shares of stock indicates the problem, though it is common practice to sell the portion not apportionable in whole shares (with such expense as that involves). Distribution of a similar fractional interest in Greenacres is certainly possible (if not desirable), but it leaves a rather awkward fractional interest in the several devisees, particularly if later disagreement

261. See, *e.g.*, Golden, *supra* note 253, at 537.

262. *Id.* at 536.

263. *Report of Subcommittee on Estate Planning and the Marital Deduction*, *supra* note 217, at 945.

264. See, *e.g.*, McGorry, *Pecuniary or Fractional Formula?*, 98 TRUSTS & ESTATES 422, 425 (1959).

leads to a partition action. Disagreement has been expressed[265] with the conclusion that a fractional share of each asset should be distributed absent specification to the contrary.[266] Some have suggested that the clause could permit selection of assets equivalent to the distribution date value of the fractional share.[267] Yet such selection of specific assets, equal in value, requires a second valuation as of distribution date; and in this context it is possible that the Service may raise the very questions posed in earlier articles.[268]

2. *"Hybrid" Clauses*

Departure from the true fractional share in favor of a ratable-sharing fraction (satisfiable with selected assets) tends to ameliorate some of the true fractional share's disadvantages, but at the same time some of the orthodox fractional share's posited advantages are lost (thus incurring disadvantages similar to those posed by the pecuniary). Similarly, departure from the orthodox or true pecuniary in favor of one of the several tax-value pecuniary clauses tends to pick up, in some measure, advantages associated with the fractional share while modifying or departing from advantageous features of the orthodox pecuniary clause. Neither of the exchanges, however, is even! The degree to which relative advantages and disadvantages are substituted varies with the type of clause used.

a. *Minimum-Value Pecuniaries*

The tax-value pecuniary employing a minimum-value clause represents a comparatively minor departure from the orthodox pecuniary. In many cases, it will yield quite similar results (except for possible differences in allocation of bases of assets received by the distributee). In other, less typical situations, such as a distribution comprised entirely of appreciated assets, the tax-value clause results in "over-funding" and no capital gain vis-à-vis minimum funding but recognition of capital gain under a true pecuniary. But, in either case, the widow is assured of at least a minimum actual value equal to the allowed marital deduction.

---

265. *Report of Subcommittee on Estate Planning and the Marital Deduction, supra* note 217, at 945.

266. 1 CASNER, ESTATE PLANNING 798 (3d ed. 1961).

267. Golden, *supra* note 253, at 538. The view of one official of the Internal Revenue Service is expressed in Reiling, *Revenue Procedure 64-19—Rethinking Marital Deduction Clauses*, 103 TRUSTS & ESTATES 905, 906 (1964).

268. See Casner, *supra* note 254; see also Casner, *A Fiduciary's Powers and the Marital Deduction*, 100 TRUSTS & ESTATES 247, 248 (1961) (particularly "Case 4").

b. *Ratable-Sharing Pecuniaries*

The ratable-sharing pecuniary, that hybrid using tax values and requiring a sharing of appreciation or depreciation, results in a significantly greater deviation from the true pecuniary. One commentator[269] has summarized its advantages as follows: (1) like the true pecuniary (and fractional-share) "it makes certain that the maximum marital deduction will be available," (2) it eliminates the "constructive sale" possibility and avoids recognition of gains on distribution, (3) the requirement of equitable sharing of appreciation or depreciation during administration avoids the administrative problems posed by a formula (like the true pecuniary) permitting the fiduciary to prefer one beneficiary over another, and (4) the "tax value formula clause requirement of sharing of appreciation or depreciation does not apply to each individual asset but only to the estate as a whole,"[270] as distinguished from the true fractional share.

In short, it has the same advantages and disadvantages as a fractional share formula, which permits distribution of selected assets equivalent to the distribution date value of the fractional interest in the residue. But, *in addition,* it presents the additional administrative problem, previously noted, of apparently requiring that at distribution date the assets distributed must have both a federal estate tax value equal to the marital deduction to be obtained and distribution date values representing a ratable sharing of appreciation and depreciation of the pool from which they are drawn. To the jaundiced eye, the acquired disadvantages seem to somewhat outweigh any additional advantages as compared to the true pecuniary, the tax-value minimum-value pecuniary, the true fractional share, and, last *and* least, the "pecuniary fractional share" (permitting distribution of selected assets equal in value to the fractional share of the pool to which the marital share is entitled).

3. *The Ultimate Choice*

One could not have predicted with certainty the development of the recent controversy over problem-pecuniary language,[271] though some perceptively suggested the possibility.[272] Perhaps some latter-day seer, peering under small blades of grass, will venture to suggest

269. Stevens, *supra* note 248.
270. *Id.* at 354, 355.
271. Golden, *supra* note 253.
272. 1 CASNER, *op. cit. supra* note 266, at 816; Casner, *supra* note 268, at 248 (Case 3).

publicly that a fractional share clause granting the fiduciary the broad powers described by one commentator may also give rise to a similar problem.[273]

Rev. Proc. 64-19 has now clarified the Service's position on the effect of problem-pecuniary language and the circumstances under which the gift will qualify for the marital deduction. Where analysis suggests that it will probably be desirable both to avoid recognition of gain or loss at distribution and to minimize augmentation of the widow's potential estate by channeling appreciation to the residuary trust, the tax-value pecuniary with a minimum-value provision may be useful. In the larger number of estates, where possible recognition of gains is not deemed serious from an overall tax analysis or where the probable composition of estate assets suggests that careful selection of assets for distribution can largely avoid gain on satisfaction of a fixed amount due, the true pecuniary formula may appear best.

Both the minimum-value and the true pecuniary assure the widow of a minimum amount equal to the available marital deduction, though a decline in values during administration may significantly reduce the share of assets allocable to the residuary legatees. If this latter point is of major concern to the testator, it might be well to provide pecuniary legacies in the minimum desired dollar amount for both the widow and other beneficiaries, these to be satisfied before application of the formula to the residue.

If, on the other hand, family relationships and circumstances suggest the desirability of ratable-sharing of appreciation and depreciation during administration, it may be suggested that the true, orthodox fractional-share formula should be employed in preference

273. See Casner, *supra* note 254; see also Casner, *supra* note 268, at 248 (particularly "Case 4").

Our latter-day seer might suggest, for example, that the executor could, during administration, vary the quantum flowing to the marital share by his choice of assets to satisfy pecuniary bequests, expenses, debts, taxes, and the like when the residue is constituted only after these obligations have been satisfied. The Service has, after all, expressed some rather disturbing thoughts about the requirement of "vesting" and about a qualifying interest being determinable at death: "A bequest to a surviving spouse may qualify for the marital deduction only to the extent that it vests at the time of the testator's death. Thus, since the executor may elect to value the estate one year after death, the significant question is whether a pecuniary bequest in the amount of the 'maximum marital deduction' can vest prior to the alternate valuation date and the time when the executor is bound to make the election or decide not to do so." Reiling, *supra* note 267. A well-phrased rebuttal is set forth in Straus, *supra* note 241. See also *Revenue Procedure 64-19—Panel Discussion*, 103 TRUSTS & ESTATES 917 (1964).

Of course, such arguments should not be persuasive to a court which bears in mind the purpose of the legislation. (*Report of Subcommittee on Estate Planning and the Marital Deduction*, 102 TRUSTS & ESTATES 934 (1963); WARREN & SURREY, FEDERAL ESTATE AND GIFT TAXATION 749 (1961).) But suffice it to say that a prudent estate planner is not inclined to risk controversy where a less hazardous path is available for reaching the same goal!

to any of the described hybrid clauses; and the inherent administrative obligations of careful fiduciary accounting and distribution of the available residue according to the determined fraction should be manfully shouldered.

Obviously, problem-pecuniary language should be avoided unless measures are taken to comply with the requirements of Rev. Proc. 64-19. Further, though thoughtful and able commentators may rationally differ, this preliminary analysis suggests that the ratable-sharing tax-value pecuniary formula, regardless of local fiduciary law, may be an unhappy choice absent peculiar circumstances not here considered. Indeed, *should* state law be deemed to require ratable-sharing when a tax-value pecuniary provision is employed, use of the true pecuniary would be preferable to the minimum-value provision.[274]

C. *A Word About "Clarifying" Legislation*

This suggests a thought about proposals for state legislation to complement Rev. Proc. 64-19. The wisdom of enacting state statutes prescribing rules of fiduciary administration for the sole purpose of seeking compliance with federal tax fiat as expressed in administrative releases may be open to serious question.[275] But, if such legislation should somehow be deemed necessary to make clear that state law requires distributions within the permitted limitations of Rev. Proc. 64-19, the legislation should direct use of the minimum-value route.[276] If the analysis herein is valid, such legislation should not require that assets distributed under a tax-value clause must be fairly representative of appreciation or depreciation.[277] Nor, apparently, should it be drafted along the lines of the recently enacted Mississippi statute, which provides that such a tax-value clause re-

274. As to the grant of discretion in the dispositive instrument, see note 69 *supra*.

275. The testator's choice of dispositive directions should not be fettered because of fear of loss of tax "advantages" by the unwary; at the least, the legislation should be phrased in terms of "unless otherwise provided . . ." in order to permit leeway for desired dispositions.

276. Would such legislation change the effect of problem-pecuniary language from the result decreed in *In re Bush's Will* and its interpretation of N.Y. DECED. EST. LAW § 125-2? Such legislation would not seem necessary in New York. Moreover, since it prescribes only that property distributed in satisfaction of the bequest shall amount to "no less than" the deduction allowed, would not the executor be required to allocate *appreciation* ratably under the New York rule? The legislation *could* make it clear that only the *minimum* amount is *required* (in order to permit the advantages outlined for the "minimum-value" route) and that the testator may grant a power to the fiduciary to allocate *appreciation* entirely within his discretion.

277. A letter, dated December 7, 1964, from Mr. G. Van Velsor Wolf of Baltimore, Maryland, indicates that a statute of this type was recently presented for the consideration of the Probate and Estate Law Committee of the Maryland State Bar Association.

quires the fiduciary to "satisfy the bequest by either distributing (1) assets having an aggregate fair market value on the dates of distribution not less than the amount of the pecuniary bequest or transfer in trust as finally determined for federal estate tax purposes, or (2) assets fairly representative of appreciation or depreciation in the value of all property available for distribution. . . ."[278] It has been reported that "the Chief Counsel [of the Internal Revenue Service] has recently pointed out that the new Mississippi statute does not make the grade."[279] This, presumably, is because the legislation affords the fiduciary the choice of satisfying the bequest by *either* a minimum-value or ratable-sharing approach. Apparently, to "qualify" under Rev. Proc. 64-19, state law must clearly direct distribution in accordance with one, *and only one,* of the alternative routes (minimum-value *or* ratable-sharing);[280] the fiduciary is not to be allowed a choice in the light of hindsight. Undoubtedly other variations will appear in proposed legislation.[281]

VI. Observations in Retrospect

The mind of man is indeed a fertile breeding ground for ingeniously devised schemes, which in turn require the utmost skill to implement. All too often this is at the risk of an inordinate expenditure of time and effort, to say nothing of the anxiety of the draftsman and fiduciary and the confusion of the testator and beneficiaries. Perhaps this is simply a hallmark of an extremely tax-conscious and economically-oriented society; perhaps it is characteristic of the professional inheritance of the modern lawyer derived from a long tradition of a hallowed craft dedicated to precise (if complex and cumbersome) draftsmanship in order to avoid the strictures and effects of extant legislation.

Surely there will be some who will continue to question the wisdom of employing complex dispositive provisions. But attempts at modification such as substitution of a non-formula fractional share

278. 4 P-H Federal Taxes ¶ 32361 (1964), as reported therein.

279. Speech by Mr. John Sheets, Estate and Gift Tax Branch, National Office, Internal Revenue Service, before the Chicago Bar Association, Dec. 1, 1964, in CCH Fed. Est. & Gift Tax Rep. ¶ 8147, at 2739 (1964).

280. Rev. Proc. 64-19, § 2.02.

281. It is reported that proposed Florida legislation would require the fiduciary to apply a form of "minimum-value" approach to a pecuniary bequest and a ratable-sharing approach to a clause which the court construes as a fractional share. This would seem to put a premium on the necessity of a court construction in order to determine the executor's duty; however, more complete analysis should await appearance of an actual draft. See discussion in Covey, *Statutory Panacea for 64-19?* 104 Trusts & Estates 69 (1965).

(for example, a bequest to the marital trust of "one-half of the residue of my estate") will not obviate entirely the necessity for careful legal drafting if the gift is to qualify for the marital deduction and be capable of administration; indeed, such clauses give rise to problems of their own.

Others in quest of greater simplicity may turn to specific allocation of assets with an attempt at qualifying assets directed toward the wife or marital trust, letting the chips fall where they may if significant changes in the nature or valuation of the clients' assets produce either under-qualification or over-funding. Rumor has it that some may even turn to a non-formula pecuniary gift such as a bequest to the wife of "forty-five per cent of my adjusted gross estate . . . ."

It seems likely, however, that, despite the anxiety caused by periodic flurries of excitement over the tax consequences and problems of judicial interpretation of formula clauses, their use by a major segment of the profession will continue. Hopefully, exposure of potential problems will lead to the evolution of dispositive provisions that will produce the desired qualification for the marital deduction and be susceptible of effective administration. Perhaps, on the other hand, the draftsman will eschew the clever clause designed to achieve the best of all worlds—achievement of the maximum marital deduction coupled with the possibility of disinheriting the Director of Internal Revenue through sage application of hindsight —or the development of hybrid clauses designed to incorporate the best features of both a pecuniary bequest and a fractional share (and perhaps reaping the potential disadvantages of each). One might even express the pious hope that when that day arrives, the Internal Revenue Service, mindful of the technical difficulties inherent in qualification for the marital deduction, will approach the question of disallowance with an attitude conducive to effectuating the spirit of the legislation and with somewhat less concern for inadvertent errors which under strict technical application of the statute could draconically deny the entire deduction.

If the arrival of the millenium is not likely in the realistically foreseeable future, perhaps we shall see a reasonable accommodation of the views of both those who would counsel against the formula clause and those who regard them as useful, if not essential.

Even today, the wise attorney does not automatically and unthinkingly apply a stock formula clause in all dispositive instruments. As he always has, he continues to analyze carefully the potential assets of both the gross estate for tax purposes and the probate estate which must be administered. His goal now, as before the

advent of the marital deduction, is to counsel with the client in order to work out a wise disposition of assets in the best interests of survivors and then to draft appropriate dispositive instruments which will achieve those aims with a minimal tax impact and a minimization of foreseeable administration problems. Perhaps he will follow the wise suggestion of one of the profession's ablest spokesmen[282] and put major emphasis on careful arrangement of assets, both those passing under the will and those falling outside the probate estate. Careful attention will be given to qualifying for the marital deduction what is deemed to be a desirable quantum of assets; and specific assets will be bequeathed to designated beneficiaries and trusts in accordance with the sensible aims of the testator. For example, where the estate consists partly of stock in a closely held corporation and this is to be retained for certain beneficiaries,[283] it may be appropriate to bequeath the stock specifically, or at least a portion of it, to those beneficiaries and to carve out other assets (such as the residence, investment securities, and the like) to be qualified for the marital gift. Similarly, other assets which would not qualify for the marital deduction may be allocated to the nonmarital trust when this seems desirable.

But the dispositive plan will not end here. Just as the attorney recognizes (and advises his client) that a planned disposition of assets tailored to meet current problems may later need revision to meet changing circumstances, so too he will realize that the estimated gross estate for federal tax purposes may be augmented by receipt of additional assets and, all too commonly, by undisclosed or inappropriately described assets which were not properly taken into consideration in "carving out" the allocation of assets in the will. Having allocated assets on the basis of existing known circumstances, the prudent attorney may employ a formula clause as a "back-up," funding an additional qualifying bequest or share from assets unallocated by the dispositive instrument. True, there may be little or nothing upon which it can operate. But, if the decedent should later acquire substantial additional assets for which appropriate provision had not been made, the formula clause could direct allocation of a desirable share for the surviving spouse's benefit in a manner which would produce a desired additional qualification of assets for the available marital deduction.

282. Trachtman, *Marital Deduction—Use of Non-Formula Provisions*, N.Y.U. 19TH INST. ON FED. TAX 631 (1961).

283. See generally Polasky, *Planning for the Disposition of a Substantial Interest in a Closely Held Business—The Corporation: Stock-Purchase Agreements and Redemption of Shares*, 46 IOWA L. REV. 516 (1961).

Admittedly, this method is directed primarily to the problem of unforeseen underqualification. It does not solve or even mitigate overqualification resulting from passing to the widow a quantum of qualifying assets which is greater than that necessary to achieve the maximum marital deduction. No mere formula clause by its own sole operation can completely cover that problem if qualifying nonprobate gifts, such as insurance and joint tenancy property, exceed the maximum available marital deduction, although in such cases the formula will "mitigate the tax impact" of overqualification by directing assets subject to its operation to the nonmarital share.

Concern over overqualification led to the use of the formula clause as the basic dispositive device and still suggests to some writers its desirability as contrasted to the carving-out pattern, which may minimize the mitigating effect of the formula by reducing the assets upon which it operates. Nevertheless, just as the problem of avoiding capital gains may be overemphasized, so too may the danger of overqualification. If death of the surviving spouse occurs within a ten-year period, a credit for previously taxed (overqualified) property will be available. While the credit decreases with the passage of time, that time interval itself will usually provide a reasonable opportunity for further planning to minimize potential taxes and probate expenses upon the death of the surviving spouse.

Finally, and perhaps by way of postscript, we may ultimately see the day when the allegory with which the article began is concluded. Some have become at least mildly disenchanted with the attempt through use of the marital deduction to achieve actual equality of tax burdens as between community property and common-law states; a rough parity is, at best, achieved.[284] The philosopher-lawyer who labors in the vineyard of "estate planning" may experience at least some mild dissatisfaction when, in a thoughtful moment, he contemplates today's somewhat frenzied efforts to tailor dispositions to surviving spouses in a manner largely influenced by tax considerations. Surely it may occur to him, as it has to others,[285] that, if interspousal transfers were freed of succession

284. On the marital deduction and community property, see generally Anderson, *The Marital Deduction and Equalization Under the Federal Estate and Gift Taxes Between Common Law and Community Property States*, 54 MICH. L. REV. 1087 (1956); DeWind, *The Approaching Crisis in Federal Estate and Gift Taxation*, 38 CALIF. L. REV. 79 (1950); Hammonds & Ray, *Understanding the Community-Property Idea Clarifies Taxation of Individuals*, 6 J. TAXATION 2 (1957).

285. DeWind, *supra* note 284, at 109; Surrey, *Federal Taxation of the Family—The Revenue Act of 1948*, 61 HARV. L. REV. 1097, 1161 (1948). See GRISWOLD, FEDERAL TAXATION 943 (5th ed. 1960).

tax burdens, somewhat more rational dispositions might often be made;[286] and it can be seen that such exemption of interspousal transfers should not result in drastic reduction of federal estate tax revenues if it be recalled that the exemption will not permit assets to escape taxation but will merely result in a postponement of tax. Bearing in mind that the federal estate tax has a progressive rate structure, there might still be attempts to minimize overall taxes by passing only a portion of the estate to the surviving spouse, leaving a portion to be taxed in the husband's estate. Yet, as applied to large estates, the tax rate brackets are quite broad, and the rate of progression is reasonably modest. The effective rate on a taxable estate of 2,000,000 dollars is about 37.5 per cent (tax being 753,200 dollars), while on taxable estates of 1,000,000 dollars the effective rate is about 32.5 per cent (the estate tax figure being 325,700 dollars). Since the difference in effective rates is somewhat less than confiscatory, any unhealthy predisposition toward the tax tail wagging the dispositive dog might tend to evanesce.

Should such a change in the law come to pass,[287] the marital deduction, that delightful newcomer born to an eager and joyous profession, that golden-haired child which proved a source of comfort and of only occasional irritation during its early years, which entered upon the terrible teens and became a source of exasperation, bewilderment, and frenzied attempts to cope with it, which finally reached maturity and with adult treatment responded to the needs of the society it served and was regulated by reasonable sanctions (subject only to occasional aberrational conduct by both the governed and governor), will ultimately, as do all men, pass from the scene having served its purpose; it will leave only memories (and a few scars), gradually fading with time, of the excitement and frustration which occurred during its limited life.

---

286. This issue is likely to be considered in connection with the ALI's Federal Estate and Gift Tax Project. Although the author is a consultant for the Project, the view suggested here is a purely personal one, and no conclusion should be drawn of either agreement or disagreement by others connected with the Project.

287. Less far-reaching legislation affecting marital bequests may be advanced in the interim. Such proposals may include statutory modification of the effect of Jackson v. United States, 376 U.S. 503 (1964). See the suggestions in 63 MICH. L. REV. 924 (1965). In addition, modification of the Treasury's position that formula legacies do not come within the specific bequest exemption of I.R.C., § 663(a)(1) may be advanced anew. See 1 CASNER, *op. cit. supra* note 266, at 88-91, discussing earlier legislation which failed of enactment.