View metadata, citation and similar papers at core.ac.uk
brought to you by CORE
provided by University of Denver

Denver Law Review

Volume 36 | Issue 3 Article 2

May 2021

Ten Years of Experience with the Marital Deduction

William P. Cantwell

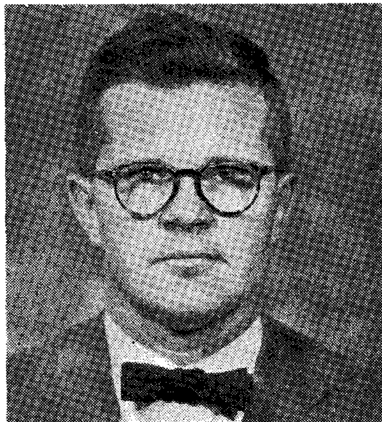
Follow this and additional works at: https://digitalcommons.du.edu/dlr

Recommended Citation
William P. Cantwell, Ten Years of Experience with the Marital Deduction, 36 Dicta 197 (1959).

This Article is brought to you for free and open access by the Denver Law Review at Digital Commons @ DU. It has been accepted for inclusion in Denver Law Review by an authorized editor of Digital Commons @ DU. For more information, please contact jennifer.cox@du.edu,dig-commons@du.edu.

TEN YEARS OF EXPERIENCE WITH THE MARITAL DEDUCTION*

By WILLIAM P. CANTWELL



William P. Cantwell received his A.B. degree from Williams College in 1942 and his LL.B from Yale Law School in 1948. He was in practice in New York until 1953 when he moved to Colorado. He is active in the American, Colorado, and Denver Bar Associations and is a member of the Denver firm of Holland and Hart.

Even though the Revenue Act of 1948[1] first used the term and enacted the concept into law, the true history of the "marital deduction" started in 1942. Before that year residents of community property states enjoyed a very substantial advantage under federal tax laws. In an effort to correct the situation Congress deprived these people of their advantage in the field of estate and gift taxation by its 1942 legislation[2] although no change was made in the income tax situation. It soon became apparent that a worthwhile differential still existed in the income tax field, and that the continuation of the income tax advantage for residents of community property states made it sufficiently attractive so that states which had been common law property states were willing to change to a community property system for the sole purpose of obtaining the benefit of split income treatment on federal income taxation.[3] As a result of an extensive study, the Revenue Act of 1948 altered the situation and extended the benefits of split income treatment to residents of all states of the United States. At the same time, it enacted into law a dramatic new concept of estate and gift taxation which has since become the single most important weapon in the estate planner's arsenal. This was the "marital deduction." The amendments were heralded as the adoption of a new national system for ascertaining federal estate and gift tax liability[4] and at least one court has taken the clear intent of Congress to have been the equalization of estate tax results between community property states and common law states.[5]

* This article is based on an address given at the 8th Annual University of Denver Tax Institute.
1 Int. Rev. Code of 1939, § 812(e), added by 62 Stat. 117 (1948) (now Int. Rev. Code of 1954, § 2056).
2 Int. Rev. Code of 1939, § 811, as amended, 56 Stat. 941 (1942).
3 Int. Rev. Code of 1939, § 51, 53 Stat. 27 (1939). Under community property law, one-half of the earnings of either spouse is attributed to the other and must be taxed as such. Poe v. Seaborn, 282 U.S. 101 (1930).
4 H.R. Rep. No. 1274, 80th Cong., 2d Sess. 4 (1948).
5 Newton v. Wiseman, P-H Est. & Gift Tax Serv. ¶ 140,811 (W.D. Okla., July 22, 1958).

Thus the original vista was the complete equalization of the tax consequences of deaths and gifts in common law and community property states. The extent to which this vista has been realized has followed the typical pattern of practically every tax benefit conferred by legislatures. This particular tax benefit has become a true workhorse in the field of estate planning and to this extent the vista of the 1948 legislation has been and is being realized, day in and day out, throughout the country. To the extent that it has failed of realization, these failures are due to the taxpayer's perennial enemies of ingenuity on the part of revenue agents on the one hand and careless, incompetent or unsophisticated draftsmanship and advice on the other.

It is noteworthy that there has been no legislative erosion, and indeed, only legislative liberalization. In the Revenue Act of 1954[6] Congress took its first liberalizing steps and extended marital deduction benefits to situations in which a surviving spouse was accorded appropriate rights over a fractional share of trust principal,[7] thus abandoning the original requirement that a marital deduction trust must be a separate trust in which no one else could have an interest, in order to qualify.[8] In addition, it permitted a marital deduction for a legal life estate coupled with a general power of appointment.[9] Case law has indicated[10] that this power of appointment must be one over the remainder, rather than a mere lifetime power of consumption. The second legislative liberalization occurred in 1958, when Congress made the liberalizing features of the 1954 legislation retroactive to April 1, 1948.[11]

Aside from legislative developments, however, the deduction has been one more arena of conflict in the great unending match of ingenuity between the Internal Revenue Service and the taxpayer. The areas in which this conflict has developed represent the true developments in the past ten years of experience with the deduction, and the remaining inquiry spotlights a few of these areas from the point of view of the literature, the case law, and the actual experiences of banks and trust companies working in the field.

A. PROBLEMS INVOLVING FORMULA CLAUSES

The first and most persistent problem area has concerned formula clauses. Whatever it is that a formula clause really is, there are at least several things that it is not. For example, concern with a formula clause and its use is not the same thing as concern with whether a testator should plan his estate to take a maximum marital deduction. This question is really a prior question and no formula-clause question arises until someone decides, on the basis of appropriate analysis of a particular estate, that the last penny of mari-

6 Int. Rev. Code of 1954, § 2056.
7 Int. Rev. Code of 1954, § 2056(b)(5); Treas. Reg. § 20.2056(b)-5 (1958).
8 Int. Rev. Code of 1939, § 812(e)(1)(F), added by 62 Stat. 118 (1948).
9 See Int. Rev. Code of 1954, § 2056(b)(5); Treas. Reg. § 20.2056(b)-5 (1958).
10 Estate of McGehee, 28 T.C. 412 (1957).
11 Technical Amendments Act of 1958, 18 U.S. Code Cong. & Ad. News 6634 (1958), amending Int. Rev. Code of 1939, § 812(e)(1)(F), 62 Stat. 118 (1948). These changes apply to estates of decedents dying after April 1, 1948, and before August 17, 1954. Refunds without interest are authorized even if the statute of limitations has run, provided that the claim for refund is filed by September 2, 1959.

tal deduction is significant.[12] This is a question which is ignored all too frequently, for it is easy to overlook the fact that substantial differences in tax brackets between the two spouses must exist before it is imperative to obtain every last penny of marital deduction.[13] Neither is the formula clause question one of an outright disposition as opposed to a trust disposition. A marital deduction gift, whether formula or determined by other means, may be either outright or in trust, although care must always be taken that the trust be qualified for the deduction.

The formula clause is actually an ingenious development of tax oriented practictioners, intended to achieve a qualification of just that quantum of the decedent's adjusted gross estate which is needed to obtain the maximum marital deduction and no more, even though the exact amount will fluctuate right down to the audit of the federal estate tax return because of changing values, composition, transfers and other factors composing the gross estate.[14] One feature that no formula clause can correct is an "overqualification" of assets. For example, if a testator gives his wife his entire estate outright, he probably has "overqualified" assets passing to his spouse by rendering the entire estate passing to her subject to taxation at her death. The fact that a formula clause in and of itself cannot correct this defect is a source of some criticism by those who have indicated opposition to the use of such clauses.

Indeed, critics of the formula clause have developed a formidable case against its use.[15] Some of the points they score are the possibility of unconsciously passing all of the benefit of appreciation of assets during administration to someone other than the surviving spouse; frustration of intent when a formula clause operates in a situation involving many non-probate assets which were not thought to have been includible in the gross estate, such as gifts in contemplation of death, retained life interests, and the like; the possibility of future changes in the law; the fact that the actual amount of the

12 Durand, *Draftmanship: Wills and Trusts*, Proceedings, Probate and Trust Law Divisions of the A.B.A. 70, 72 (1957).

13 Regarding the tax on various sized taxable estates (before deducting the $60,000 exemption), only a 5% jump in brackets occurs between an estate of $160,000 and one of $810,000, and only a 7% jump occurs between $160,000 and $1,060,000. (Int. Rev. Code of 1954, § 2001). An estate of $100,000 is actually in a 4.8% bracket since the first $60,000 is exempt and the next $40,000 is subject to a tax of $4800.

14 Bronston, *Tax Problems of Formula Type of Marital Deduction Bequest*, Proceedings, Probate and Trust Law Divisions of the A.B.A. 96 (1957); Cox, *Types of Marital Deduction Formula Clauses*, N.Y.U. 15th Inst. on Fed. Tax. 909 (1957).

15 Trachtman, Estate Planning 35-41 (1958).

Reed-Vollhaber

CLOTHING

Men's Hats & Furnishings

Men's Shop Seven fifteen Seventeenth Street KE. 4-0334

gift being given by the testator is uncertain; and the possibility of conflicts of interest between the surviving spouse and the fiduciary and the residuary beneficiaries. In this latter area, for example, it has been suggested that a surviving spouse might wish to argue for a higher valuation of the gross estate since it would mean a larger gift under a formula clause. It has also been suggested that, for the same reason, she may argue to include certain inter vivos transfers which might otherwise be excludible. It has also been suggested that she may wish to argue for the use of administration expenses in a way which would produce a greater overall tax burden to the estate, but a larger marital deduction gift for her.[16] One interesting feature of all of these suggested conflicting interests is that they assume that the surviving spouse and relatives of a decedent who confers a marital deduction gift by the use of a formula clause will fight among themselves. While this may be the unfortunate fact in some cases, most draftsmen seem to take a more cheerful outlook on such matters, and the facts seem to sustain them. The revealing result of a survey of financial institutions' experience with the deduction, discussed later in this paper, discloses no conflicts of interest in these areas in the administration of nearly two thousand estates involving the marital deduction.

16 Cox, *supra* note 14, at 920.

ELECTRICITY
and
NATURAL GAS
the
biggest bargains
in any
household budget

PUBLIC SERVICE COMPANY

Without intending to deprecate the articulate and persuasive arguments that have been made against the use of formula clauses, it seems fair to suggest that the profession generally has not been persuaded.[17] The literature abounds with discussions of formula clauses and very little of the current discussion is concerned with the question of whether or not they should be used.[18] Rather, the question has become: Which formula clause should be used — a "pecuniary formula," or a "fraction-of-the-residue" formula.

Historically the "pecuniary formula" was the earliest development in the field.[19] Its developers and early advocates preferred it because it avoided a difficult problem of computing estate taxes in a situation in which two mutually dependent indeterminants were involved,[20] and in addition the idea prevailed that a marital deduction trust had to be completely separate and therefore created by a separate article in the will, ahead of the residue. Unfortunately, disadvantages soon appeared. Usually the pecuniary formula clause had the effect of setting aside a pecuniary legacy, fixed in amount, and not subject to fluctuation. As a result of this, if such a dollar amount legacy was satisfied by distribution of assets which had appreciated in value, a capital gain would be realized by the estate.[21]

The second disadvantage was that any appreciation of assets during the period of administration would not usually pass in satisfaction of a pecuniary formula clause, but would instead pass to residue. Obviously, the significance of this last disadvantage would vary from case to case, depending upon who the beneficiaries might be and how the property has been left among them. Certainly if the wife herself is an income-tenant of a residuary trust which would not again be subject to taxation at her death, it would be preferable to avoid appreciation of the marital deduction share and to permit appreciation to go to the residuary trust. On the other hand, in a situation in which a marital deduction gift was one to a second wife while the residuary beneficiaries were children of a first marriage, some antagonism might be anticipated. Under these circumstances, difficulties might very well be avoided if the widow and the children shared equally in appreciation, rather than having substantially all of it go to one set of such beneficiaries. And finally, appreciation may be desirable and even usual, but depreciation of assets during administration has been an occasional—if unfortunate —fact, and in addition, some estates will consist largely of debt-type investment which will vary little in value during administration.

Concern about these disadvantages of the pecuniary type formula clause resulted in the development of what has come to be

---

71 Durand, *supra* note 12, at 70.

18 E.g., Bowe, Estate Planning and Taxation 99-103 (student ed. 1957); Casner, Estate Planning 640-51 (2d ed. 1956); Shattuck and Farr, An Estate Planner's Handbook § 52 (2d ed. 1953); Bronston, *supra* note 14; Cox, *supra* note 14; Golden, *A Decade with the Marital Deduction*, 97 Trusts and Estates 304, 305 (1958).

19 Golden, *supra* note 18, at 304-05.

20 *Ibid.*

21 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. 270, 1956-1 Cum. Bull. 325.

SACHS-LAWLOR·CORPORATION SEALS·ALPINE 5-3422

called a "fraction-of-the-residue" clause.[22] This is a clause specifically developed to answer the problems discovered in applying pecuniary clauses. Since a fraction-of-the-residue clause merely measures out a fractional participation in *whatever* is left after all other dispositive provisions of the will are satisfied, it participates in appreciation (and in depreciation as well!). In addition, satisfaction of this clause will not result in any capital gain to the estate, since no specific dollar amount is being satisfied with appreciated assets.

Some of the other advantages which have been recited in favor of a fraction-of-the-residue formula gift include solution of the problem of allocation of income received during administration. Since a trust gift which is intended to procure the maximum deduction will ordinarily require that the wife receive all the income from and after death[23] anything which will insure that the trust participates in its pro-rata share of income without the necessity for complicated calculations of such income will be beneficial. In addition the fraction-of-the-residue clause has been described as easier to understand than the pecuniary formula clause. Testators have traditionally dealt in terms of fractional shares of the residue, but they have only come to formula-type phraseology since the Revenue Act of 1948 and seem generally slower to grasp it than they do the concept of a fractional share of the residue.

The use of a fractional share of the residue clause will not necessarily solve the problem of the interrelationship between the amount of the deduction and the death taxes, unless the will directs that taxes are to be paid out of assets other than the surviving spouse's share.[24] While computations to solve such an interrelated problem are admittedly difficult and complex, they are certainly not insoluble, and if substantial other benefits come from the use of such a clause, the deterring effect of such tax calculations should not rule the determination of which type of clause to use, even though a testator may want his surviving spouse to bear her apportionable share of death taxes.[25]

The fact of the matter is that both types of clauses can be exceptionally useful. If a draftsman is confronted with a situation in which it would *not* be good estate planning for a spouse to obtain the benefits of appreciation of assets, a pecuniary formula may very well be the solution of the problem. Such a situation would definitely exist, for example, where there were no children and the surviving spouse obtained the income benefits from a trust as to the second half of the estate as well as the income from the marital deduction portion. Since the taxes on the second half of the estate would have been paid at the death of the first spouse, and since the second half would not again be subject to taxation, then apprecia-

---

[22] Lovell, *Administering the Marital Deduction—A Summary of Five Years' Experience*, 92 Trusts & Estates 812 (1953).

[23] Treas. Reg. § 20.2056(b)-5(f)(8), (9) (1958); Special Ruling 9-20-57, 2 CCH Est. & Gift Tax Rep. ¶ 8127, 1958 P-H Fed. Tax Serv. ¶ 140,456 stated that the marital deduction would not be lost because of a provision in the will that income received during administration (including income from property passing to the surviving spouse) should be used for expenses of administration, but that the marital deduction would be reduced by the amount of income so expended.

[24] Treas. Reg. § 20.2056(b)-4(c) (1958).

[25] U.S. Treas. Pub. 210: *Interrelated Death Taxes and Marital Deduction for Form 706* (Aug. 1955).

tion would be desirable in such second half, while it would be equally desirable to keep the marital deduction trust invested in assets which were not expected to appreciate, and to first charge any necessary principal distributions against such trust. Under these circumstances, a good case would exist for the use of a pecuniary type formula which would tend to limit the use of appreciated assets to satisfy the marital deduction gift.

In addition, it is submitted that the capital gains problem which would ordinarily exist in satisfying a pecuniary formula gift with appreciated assets can in itself be solved by careful attention to the wording of the controlling instrument. Just how significant such wording can be is demonstrated by a recent series of cases which discuss in detail the question of whether or not a particular form of phraseology requires or permits satisfaction with appreciated assets.[26] The problem that arose in these cases is similar to problems that will probably continue to arise in marital deduction cases which use language relating to certain standards of "value" to be followed, without indicating whether such standards of value refer only to determination of the dollar-value of a pecuniary formula gift, or whether they also refer to the value-standard to be used in making distributions to satisfy that gift. The general rule is that distributions from estates are to be valued at the date of distribution. Questions raised by pecuniary formula clauses demonstrate that draftsmen have not always made it clear whether they intended to change this rule for distribution purposes, or whether the language they used about value-standards applied only to the quantum of the gift, and otherwise left the general rule in force as to distributions.

In the *Kantner* case[27] for example, the language in the pecuniary formula clause stated that "all values shall be those finally determined for federal estate tax purposes." At issue in the case was the meaning and application of this phrase. The executor contended that the phrase meant that the stock which was to be distributed in satisfaction of the pecuniary gift should be valued for distribution purposes at the value actually set in the federal estate tax return, regardless of an increase in value on the actual date of distribution. A guardian ad litem for minor children resisted this application, and contended that the shares should be valued for distribution purposes at the higher market value they had on the actual date of distribution. An acceptance of this position would decrease the number of shares required to be distributed in satisfaction of the pecuniary gift and thereby penalize the surviving spouse. It would correspondingly increase the amount going to the trust for the minors. The court agreed with the guardian's position, and required that the shares be valued, for purposes of distribution, at date of distribution value, and held that the language in the pecuniary formula clause did not relate to *distribution* values but only to values used to determine the *quantum* of the pecuniary amount.

---

26 Estate of Kantner, 50 N.J. Super. 582, 143 A.2d 243 (App. Div. 1958); *In re* Bush's Will, 2 App. Div. 2d 526, 156 N.Y.S.2d 897 (1956), *aff'd*, 3 N.Y.2d 908, 167 N.E.2d 927 (1957); Estate of Jephson, 1956 N.Y.L.J. 8 (Surr. Ct., N.Y. City, Nov. 13, 1956).
27 Estate of Kantner, *supra* note 26.

In *Jephson*[28] the analogous language was: "All values shall be determined as of the date of my death." Here the court held that the testator wished to avoid capital gains tax and therefore that the shares should be valued at the date of death value for *distribution* purposes, even though they had appreciated at the actual date of distribution. Consequently, a more substantial number of shares would pass in satisfaction of the pecuniary formula gift than would have been the case had the *Jephson* court followed the same reasoning as the *Kantner* court. In the third case, *In re Bush's Will,*[29] the language required distribution of the securities "at the appraised values thereof" and the court found an intent similar to that in the *Jephson* case.

The type of problem that can arise in this area can be illustrated by an example. It can be assumed that a testator uses a pecuniary formula, and that the formula requires a marital deduction gift with a dollar value of $100,000. Assume also that at the date of death there are 100 shares of the *X* corporation worth $100,000 and 100 shares of the *Y* corporation also worth $100,000. At the date of distribution, the 100 shares of *X* have increased in value to $150,000 and the 100 shares of *Y* have decreased in value to $50,000. Adoption of different value concepts may alter completely the share distributed in satisfaction of the $100,000 pecuniary gift from $50,000

28 Estate of Jephson, 1956 N.Y.L.J. 8 (Surr. Ct., N.Y. City, Nov. 13, 1956).

29 *In re* Bush's Will, 2 App. Div. 2d 526, 156 N.Y.S.2d 897 (1956), *aff'd*, 3 N.Y.2d 908, 167 N.E.2d 927 (1957). The court applied date of death values in measuring the value of securities to be distributed, these values having been selected by the executor for estate tax appraisal purposes. The court further required that the executor distribute appreciated securities in such a way that the widow and the residuary legatees share in these securities proportionately.

Today's biggest bargain in complete research! Complete answers to your everyday problems for only 30 cents—that's the average cost of an annotation in any current volume of ALR2d. The annotation gives the controlling law and facts and holdings of all cases on both sides of the question, *including all your local cases.*

Ask about low terms now in effect on ALR2d "50 Series."

BANCROFT-WHITNEY CO.
McAllister & Hyde Streets
San Francisco 1, California

BENDER-MOSS CO.
91 McAllister Street
San Francisco 2, California

to $150,000—a very considerable swing. If, for example, it could be argued that the valuation language in the will permitted the executor to distribute at date of death values, he could distribute either the $50,000 of *Y*, in which event the widow would actually get something which was worth $50,000 less than the amount required by her pecuniary formula at the time of receipt, or she could get $150,000 worth of *X*, which would in effect allocate appreciation in satisfaction of the pecuniary formula. Some commentators have been considerably concerned about the use of clauses which would permit such possibilities, particularly with reference to the possibility of the distribution of assets with a value, at the distribution date, below the amount called for in the formula.[30] They have suggested, as a matter of caution, that it would be well to include a proviso, if date of death values are actually being used for distribution purposes, which would require the executor to distribute property which was worth, on the date of distribution, at least as much as the dollar value required by the pecuniary formula. To do otherwise, they suggest, would be to endanger the marital deduction.[31]

In summary, the area of the marital deduction formula clause is a potential problem area, much as any other area of complex drafting is. Many problems could be avoided by diligent analysis of the particular problems and desires of a testator and by meticulous use of language which specifically covers the known problem areas. To do less is to invite serious and irremediable difficulty.

VARIANTS FOR OBTAINING A MARITAL DEDUCTION OF THE "RIGHT" AMOUNT.

Adequate planning may often require that something less than a maximum marital deduction should be taken. Draftsmen have been concerned with this problem, since it is certainly not solved by a formula clause alone. Some of the ideas developed can be used either with or without formula clauses for obtaining or attempting to obtain maximum tax benefits in this area. For example, one author has suggested the possibility of setting forth multiple gifts in the will.[32] Under such a plan, a testator could offer his surviving spouse a choice of fifteen per cent of his estate outright, thirty per cent of his estate in trust with a right to draw on the principal, or fifty per cent in trust with a testamentary power of appointment.[33] The multiple gift idea has been one of fairly recent development and therefore has not yet attracted widespread attention. However, it may have particular usefulness in situations in which the value of the estate is so volatile that precise pre-death planning is difficult. Whether it is preferable to a formula clause will depend upon the apprehension of the draftsman as to the problems inherent in the use of the formula clause, and on other factors such as the includibility of inter vivos transfers. Certainly if the multiple gift idea is used, it should be coupled with a provision which would require that the executor distribute *something* absolutely to the surviving spouse if no choice has been made within six months after

30 Casner, *op. cit. supra* note 18, at 648-51; Cox, *supra* note 14, at 930-32.
31 *Ibid.*
32 Bowe, *op. cit. supra* note 18, at 98.
33 *Ibid.*

death. For if a spouse is required to make a choice and fails to do so within the six-month period,[34] it would appear that it might be very difficult to protect the estate's right to any marital deduction, unless she was sure to get something even if she made no choice.

One other post-mortem possibility which has occasioned attention is the use of partial disclaimers to whittle down the amount qualified for the marital deduction in a situation in which post-mortem conditions make this desirable.[35] The new federal gift tax regulations appear to throw draftsmen back to conditions of their state law to determine whether or not a *partial* disclaimer may involve a taxable gift,[36] which is a considerable advance over the tentative regulations, which were very affirmative in indicating that such a partial disclaimer would in fact be taxable as a gift.[37] Certainly if local law permits a disclaimer[38] and if the conditions of local law are such that a partial disclaimer would not result in a taxable gift, it is quite evident that this may be a particularly useful tool in situations where the exact composition of the estate of a surviving spouse as well as the taxable estate of a deceased spouse can only be realistically appraised after the death of the first of them.

THE MARITAL DEDUCTION AND GIFTS IN TRUST

Within the first ten years of experience with the marital deduction, a considerable amount of litigation has been developed with respect to trusts. Basically, two types of trusts are possible under the regulations. The most widely used is the power of appointment trust, under which the surviving spouse is given all income for life, payable annually or more frequently, with a power of appointment over the corpus in favor of herself or her estate, exercisable by her alone and in all events, and with no power of appointment over the trust in any other person.[39] The second type of trust is the "estate trust"[40] which is a trust which is coupled with a vested remainder in the surviving spouse's estate. The estate trust has been recommended as useful in situations where there are non-income producing assets, since it is felt that it will qualify under such circumstances, while qualification of a power of appointment trust would be open to question, since it requires that the widow receive all of

---

34 Cf. Treas. Reg. § 20.2056(b)-3 (1958).
35 Treas. Reg. § 20.2056(d)-1 (1958); Casner, op. *cit. supra* note 18, at 659-61.
36 Treas. Reg. § 25.2511-1(c) (1958).
37 Proposed Treas. Reg. § 25.2511-1(c) (1957).
38 Colo. Rev. Stat. § 152-5-44 (Supp. 1957). "Disclaimer. Any person who may be entitled to receive any property . . . under a devise, bequest . . . shall have the right to disclaim irrevocably the whole or any part of such property . . . . Any property . . . so disclaimed shall pass . . . as if the person disclaiming had predeceased such decedent . . . ."

39 Treas. Reg. § 20.2056(b)-5(a) (1958) sets forth the requirements for a power of appointment trust as follows:

(1) The surviving spouse must be entitled for life to all of the income from the entire interest or a specific portion of the entire interest, or to a specific portion of all the income from the entire interest.

(2) The income payable to the surviving spouse must be payable annually or at more frequent intervals.

(3) The surviving spouse must have the power to appoint the entire interest or the specific portion to either herself or her estate.

(4) The power in the surviving spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The entire interest or the specific portion must not be subject to a power in any other person to appoint any part to any person other than the surviving spouse.

40 Treas. Reg. § 20.2056(e)-2(b) (1958); Bowe, op. *cit. supra* note 18, at 92-93; Casner, *Estate Planning under the Revenue Act of 1948—The Regulations,* 63 Harv. L. Rev. 99 (1949).

the income for life,[41] and further requires her to have power to cause the assets to be made income producing.

The main area of dispute with respect to power of appointment trusts concerns the actual power of appointment given to the spouse. Here there have been a number of cases, and they appear to turn largely on provisions of state law regarding the scope of a power conferred.[42] For drafting purposes, the most significant item to remember regarding a power of appointment is the specific language of the regulations[43] which provide that the surviving spouse must have a power of appointment "exercisable in favor of herself or her estate and exercisable alone and in all events." Attempting to cavil with these requirements by restricting a power of appointment has been the most important factor which has given rise to litigation in the field of marital deduction trusts.[44]

In addition to problems with respect to the powers of appointment, the creation of marital deduction trusts involves certain other drafting problems. For example, a wife may die between income periods. In such a situation, a draftsman will be safe in being silent about the use of income collected during the last period and never paid to the wife while living, *if* he is certain as to the status of his "local law."[45] On the other hand, if he cannot firmly convince himself as to *what* the local law may be on the disposition of such income, it is a simple matter for him to insert a phrase in the will subjecting this income to the wife's power of appointment.

Another area which requires penetrating analysis of the assets of an estate at the planning stage is that in which a marital deduction formula gift is made in trust, with no recognition of the fact that many non-probate assets may make this a very small, or indeed, a dry trust. Such a disposition would be inefficient, and could be avoided in most cases where it might be present by simply providing for an outright gift if the gift did not meet a certain dollar limit, with a trust transfer if it did exceed such a limit.

Use of a power of appointment trust raises certain questions with respect to taxation in the surviving spouse's estate and also with respect to the exercise of the power of appointment. In many

---

41 Casner, *supra* note 40, at 101.

42 Commissioner v. Ellis' Estate, 252 F.2d 109 (3d Cir. 1958) ("power of invasion in widow . . . she to be the sole judge . . . ." *Held:* Not equivalent to a fee simple and not qualified as power of appointment trust.); Estate of Pipe v. Commissioner, 241 F.2d 210 (2d Cir. 1957) (Widow had power "to use, enjoy, sell or dispose of the income and principal . . . in her uncontrolled discretion." *Held:* Under New York law, this is not equivalent to a fee simple interest and is not qualified for the marital deduction.); Starrett v. Commissioner, 223 F.2d 163 (1st Cir. 1955) (Power to invade corpus would be lost in event of widow's legal incapacity or upon appointment of guardian. *Held:* Power not exercisable in all events.); Dexter v. United States, 163 F. Supp. 442 (D. Mass. 1958) (Testator "authorized and empowered" trustee to make payments for benefit of widow. *Held:* Trustee could refuse to make a payment requested by the widow and trust does not qualify.); Matteson v. United States, 147 F. Supp. 535 (N.D.N.Y. 1956) (Will gave widow a power to invade corpus if trust income was insufficient, of which the widow would be the sole judge. *Held:* Disqualified for the marital deduction because insufficiency of income was a condition to exercise of the power to invade.); Estate of Allen, 29 T.C. No. 52 (1957) (Testamentary power "to appoint as the widow sees fit" did not qualify as a power of appointment trust because of Maryland decisions limiting a testamentary power to a special power of appointment.).

43 Treas. Reg. § 20.2056(b)-5(g) (1958).

44 Cases cited note 42 *supra*.

45 Treas. Reg. § 20.2056(b)-5(f)(8) provides that it is sufficient if trust income not distributed to the wife is accumulated and subject to the wife's power of appointment.

SACHS-LAWLOR·CORPORATION SEALS·ALPINE 5-3422

states, a residuary clause will *automatically* exercise a power of appointment, unless there is an affirmative showing of intent to avoid exercise of the power. Under these circumstances, the assets of a power of appointment trust could be subjected to an additional set of administration expenses, even though they might pass under the residuary clause of the surviving spouse's will to the same persons who would be the takers in default if the power was not exercised. In addition, since the assets of a power of appointment trust will be includible in the estate of the surviving spouse if she does not dispose of them during life, it is incumbent upon the draftsman to ascertain whether or not death taxes attributable to such assets can be paid from other assets of such surviving spouse, or whether some provision for apportionment of taxes to the corpus of the power of appointment trust should be included in the surviving spouse's will. To overlook this could wipe out the surviving spouse's probate estate which might unduly penalize beneficiaries preferred by that spouse over takers in default under the first decedent's will, or might, if brought to the attention of the surviving spouse, result in an exercise of the power of appointment which might not be otherwise desirable because of state death tax consequences or otherwise.

GENERAL MARITAL DEDUCTION DRAFTING PROBLEMS

There is a series of general drafting problems raised by the use of a marital deduction, whether the gift passes outright or in trust. One of these involves the allocation of the burden of taxes, and requires a new analysis of how the burden should be allocated. This is because any taxes which are payable out of the marital deduction share will reduce that share and correspondingly raise the taxes.[46] An entirely different set of results will obtain in a situation in which taxes are apportioned to the marital deduction share from one in which they are not. For example, in a $300,000 estate, if the wife takes a $150,000 marital deduction, and if the taxes are paid out of the other half, then the federal estate tax is $17,500. If they are payable out of both halves equally, then the tax is $20,163.17. Consequently, it is incumbent upon the draftsman to review such problems with the testator and to ascertain which of these two results seems preferable to him. No stock answer will apply in all situations, since testators will have varying ideas as to whom they wish to favor.

[46] U.S. Treas. Pub. 210, *supra* note 25; Casner, *op. cit. supra* note 18, at 651-55.

• Skilled • Tested • Bonded Kelly Girls
Typists & Secretaries To Meet All Law Office Needs

ON YOUR STAFF

ON OUR PAYROLL

• IN COLORADO SPRINGS
MElrose 3-4659
MIDLAND BLDG.

• IN DENVER
AMherst 6-3383
240 Petroleum Club Bldg.

• IN GREELEY
ELgin 2-5922
GREELEY BLDG.

Another problem which has arisen in a number of cases is the tax result of an election by the surviving spouse. There is a widespread conflict among the various states here,[47] and every draftsman must canvass his own situation to determine what the effect of an election would be. While an attempt might be made to regulate the burden of taxes in the event of an election, it would certainly be a courageous individual who would predict the success of such an attempt. Consequently, the best thing that can be done is to simply make the testator aware of the possible tax consequences of an election and to suggest to him that his liquidity problems and other administrative and dispositive desires will depend on such a contingency.

The requirement in a power of appointment trust that the wife receive all of the income from and after the testator's death has caused most draftsmen to use phraseology which would make this possible. However, should there be any affirmative indications in an instrument that this result was not desired during the period of administration then it would appear that the deduction proper would not necessarily be lost, but that it would be *reduced.*[48]

Another area of concern is that of the distribution of nonqualifying assets to satisfy a marital deduction gift. If there are nonqualifying assets in a testator's estate, section 2056 of the 1954 code provides that if they may be used to satisfy the marital deduction gift, they will reduce it by a pro-rata share which is deemed to pass to the marital deduction gift by an application of a "marital deduction conduit theory," in the absence of language preventing the satisfaction of the gift with nonqualifying assets. Consequently, whether the distribution is to be outright or in trust, good draftsmanship would appear to require phraseology which would affirmatively prevent the satisfaction of the marital share with assets which are not qualified for the marital deduction.

Considerable discussion has arisen regarding survivorship and simultaneous death clauses, and there has been litigation in the field as well.[49] In this area, the draftsman and planner must first decide whether or not he is interested in the marital deduction *in any event,* or whether he only wants the deduction if the surviving spouse should survive for a considerable period. In approaching this question, an analysis must be made of *both* estates. Even though both estates may have substantial assets, if there is a wide gap in ages, or if the spouses are young, there is certainly a better statistical possibility that the surviving spouse would survive for some considerable length of time and therefore that the yield on the estate tax money saved by the use of the marital deduction would be a significant factor over the period of survivorship. In these situations, it would appear to be desirable to spin out the sur-

---

[47] Estate of Jaeger, 27 T.C. 863 (1957), *aff'd,* 252 F.2d 790 (6th Cir. 1958). Under local law, taxes attributable to property passing to the surviving spouse are apportioned to her share of the estate. *Contra,* Street v. United States, 246 F.2d 410 (7th Cir. 1957); Estate of Babcock v. Commissioner, 234 F.2d 837 (3d Cir. 1956); Hamrick v. Pitts, 135 F. Supp. 835 (W.D.S.C.), *aff'd,* 228 F.2d 486 (4th Cir. 1955). Under local law, the share of the estate passing to the surviving spouse should bear no portion of federal estate tax.

[48] See note 23 *supra.*

[49] Smith v. United States, 158 F. Supp. 344 (D. Colo. 1957); Estate of Steele v. United States, 146 F. Supp. 316 (D. Mont. 1956); California Trust Co. v. Riddell, 136 F. Supp. 7 (S.D. Cal. 1956); Kellar v. Kasper, 138 F. Supp. 738 (D.S.D. 1956).

vivorship requirement to the maximum period of six months by use of a "time clause."[50] Since *yield* on tax money saved is the basic thing at stake, the longer the postponement the more likely the long-range survival which would make the yield a significant factor. In other situations, in which the marital deduction is desired *regardless* of the time of survivorship, since an overall tax saving would be made in both estates so long as the substantial estate owner is the first decedent, then the only sensible clause is a "survivorship clause" which injects a presumption that the spouse with the small estate survives, in the absence of proof to the contrary.[51]

With respect to the administration expenses involved in the use of survivorship clauses which would pass estates through two administrations, it is often asserted that a double dose of administration expenses will be payable if a survivorship clause is used. This is not necessarily true in the case of a power of appointment trust, since its assets would not enter the probate estate of the spouse with the power of appointment, unless such spouse exercised it in favor of his or her estate. Consequently, a second set of expenses on such a trust as a part of the surviving spouse's probate estate would not be present.

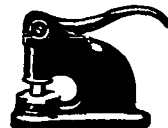
A SURVEY OF ACTUAL EXPERIENCE—1948-1958

In the interest of obtaining a sampling of experience with the actual administration of the marital deduction, a survey was taken in connection with the preparation of this discussion. The survey was based upon an analogous survey which was conducted after five years of experience with the deduction in 1953.[52] Similar questions were asked, although the present survey was limited in its geographic ambit to banks and trust companies in the western part of the United States, with particular emphasis on the Rocky Mountain states.

The following description of the questions asked and the responses, with certain notes from the institutions responding, reports this survey. The questionnaire was sent to twenty-six banks and trust companies. They were first asked how many estates involving the marital deduction they had administered. The total sampling involved in their responses was 1956 estates. They were

50 Treas. Reg. § 20.2056-b(3) (1958).
51 Bowe, *Draftsmanship: Wills and Trusts, Proceedings, Probate and Trust Law Divisions of the A.B.A.* 25-28 (1955).
52 Lovell, *supra* note 22.

HEART OF DOWNTOWN: 1409 Stout -- TA 5-6596 -3404
1 HOUR SERVICE — NOTARY AND CORPORATION SEALS
Stock Certificates, Minute Books, Stock Ledgers

ACE-KAUFFMAN
RUBBER STAMP & SEAL CO.

The "Sampson Punch" shears eyelets without mutilating paper
W. E. LARSON, *Proprietor*

next asked how many estate tax audits had been completed, and it developed that only 361 of the 1956 estates, or 18.35 per cent, were still open.

In an effort to determine how many difficulties existed in these estates as a result of the use of the marital deduction, the banks were asked to describe what difficulties they had had. They reported difficulties in only thirty-three estates, or 1.7 per cent of all of the estates, as a result of the use of the marital deduction. One of the institutions responding to this question pointed out, as an example of the kind of difficulties encountered, that in a particular case an agent had gone into questions such as the production of income, payment of dividends on closely held family stock, long term leases, and the administration of the trust. Another bank responded as follows:

> "Since I have been with the Bank, the Federal Field Agents have not gone beyond their traditional interests in assets and deductions and have not been concerned with the way the estate has been administered and what has been used to satisfy the marital share. I recall one case during my years with the Internal Revenue Service wherein they were interested in what was used to satisfy the marital share. I do not recall the exact facts, but they are substantially as follows: *H* and *W* had entered into an antenuptial agreement; by his Will *H* left his entire estate to the children of his prior marriage. About the only asset remaining in *H's* estate after the payment of his debts, expenses, and taxes, was stock in *X* Corporation, a closely-held corporation which was valued at $300,000—the adjusted gross estate; *W* filed her election to take against *H's* Will; the children of *H* filed their objection to *W's* election and relied on the antenuptial agreement; finally, *W* sold her one-half interest in *X* Company stock to *H's* children for $75,000 and simultaneously *H's* children withdrew their objections to *W's* election to take against the Will. The marital deduction was limited to $75,000 (the amount which *W* received upon the sale of her interest in the stock of *X* Company) instead of one-half of the adjusted gross estate ($150,000). I am informed that the local office often requires assurance as to what assets comprise the marital deduction trusts where individuals are acting as sole trustees. However, we have had no such difficulty."

Still a third reported:

> "I can only recall one estate in which the marital deduction, as such, occasioned the federal audit's difficulties. This arose in a situation where trusts were set up long before the marital deduction was ever heard of and the widow had power to draw down the proceeds of the sale of the assets of one-half of the trust. The problem was the indivisibility of the trust, and, as you know, the technical amendments act of 1958 may make it possible for us to claim a refund on this score, in view of the fact that there

is one year in which to file claims for refund where the trusts were not divided by the specific provisions of the instruments concerned."

Another one pointed out that:

"Our local Federal Estate Tax Examiner is inclined to go beyond the checking of assets and deductions where marital deduction is involved in some instances. Several years ago in the matter of the estate which was not handled by our trust department he had the income tax department assess a large capital gain tax on assets delivered to satisfy the marital deductions which was computed as a dollar amount and the assets during that particular period of administration had advanced to a considerable extent over the date of death values used for the Federal Estate Tax Return."

However, answers like these must be read against the statistic of only 1.7 per cent having *any* difficulty whatsoever, as well as encouraging answers like that from still another bank which said:

"We did not have any difficulties in making the settlement with the Federal authorities. In fact, the field agents and the examiners have been very helpful and have seemed to lean over backwards to help us settle any questions in this regard. This has been true whether or not clauses designed to make sure that a trust would qualify were in the Will."

The next question asked was whether or not agents had gone beyond their traditional interest in assets and deductions and had concerned themselves with how the estate had been administered and what had been used to satisfy the marital share. Only three of the twenty-six banks, or 11.5 per cent of those responding, indicated that this had ever occurred.

With regard to the deduction generally, the banks were asked whether or not a series of protective clauses which were intended to affirmatively safeguard the marital deduction were significant in qualifying marital deduction gifts. Eight of the twenty-six banks answered this question affirmatively. As to formula clauses them-

Expert
Brief Printers

- Commercial Printing
- Catalogues and Brochures
- Year Books — Magazines
- Books — Book Binding
- House Organs

THE *Golden Bell* PRESS

AM 6-3277

2400 CURTIS STREET
Denver, Colorado

selves, the banks were asked the number of cases in which such clauses had caused actual administrative difficulty. Surprisingly, such difficulties have apparently been caused in only fifteen of the 1956 estates, or about .8 per cent. Some of the banks commented about the types of difficulties being encountered, pointing out that:

> "We have had several instances in which the marital deduction has caused some administrative difficulties, such as in determining the matter of the income to which the widow is entitled when her share is not determined until late in the administration, and a question as to allocation of assets; i.e., whether the marital trust must contain a fractional interest in each and every asset. However, in each case the matter has been worked out satisfactorily with all parties concerned, and usually has been a matter of mathematics more than anything else. We have been recommending to attorneys that clauses be inserted to avoid these difficulties, particularly with regard to how the marital gift is satisfied so that, for instance, the trustees may satisfy the marital trust in any manner deemed to the best interests of the estate without the necessity of assigning fractional interests so long as qualified assets are used."

And again:

> "As a side light you might be interested in a situation which we anticipate will come up from time to time, and has already come up here, as to the effect on the marital deduction when we select to use administration expenses as a deduction for income tax purposes rather than federal estate tax purposes, which I would say is almost always the case where a marital deduction is involved because of the low federal estate tax rate. A question has arisen as to whether our election to so treat administration expenses will increase, in effect, the value of the marital trust. In the one case here where this has been of significance, the matter was settled by agreement, and it was determined:
>
> "(1) That the value of the marital trust would be determined as though the deduction had been taken for federal estate tax purposes even though they were actually taken as income tax deductions; and
>
> "(2) That the income beneficiaries, including the widow, would have to reimburse corpus to the extent that the federal estate tax was increased. Even with these adjustments the election still proved very beneficial. I think also there are cases along these lines, at least as to the reimbursement by the income beneficiaries."

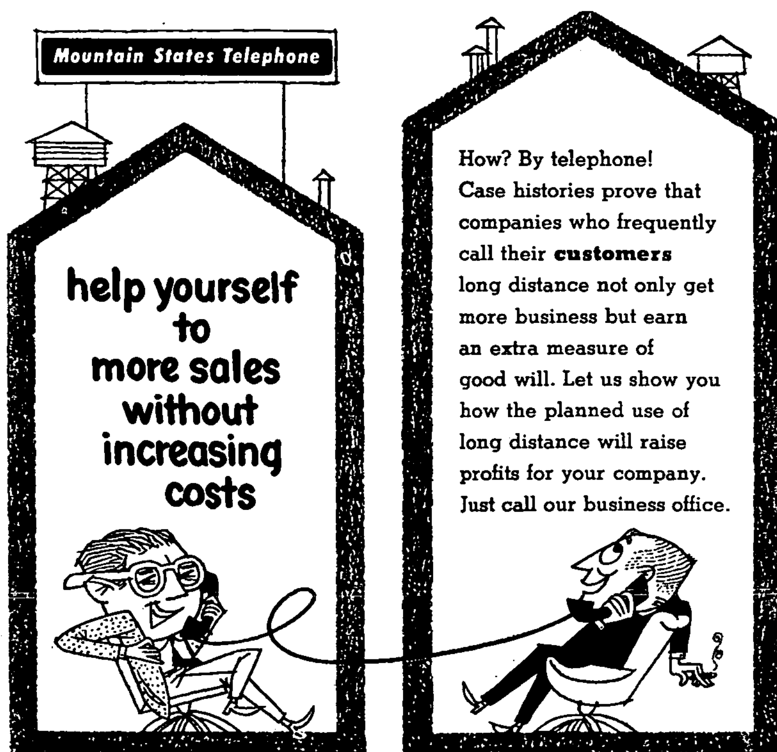
The banks were next asked whether or not they preferred the use of a "formula" marital deduction clause. Eighteen answered an unqualified "yes," two a qualified "yes," one indicated no preference, and four of the banks indicated that they did not prefer the use of such a clause. They were next asked whether or not they preferred a "pecuniary" clause or a "fraction of the residue" clause. 79.2 per cent of the banks prefer the fractional clause, while 20.8

per cent prefer the pecuniary clause. One of them pointed out a valuable practice in stating that:

> "We have been reviewing Wills very carefully when filed with us and have been insisting on necessary changes so we have not had a serious situation involving incomplete or defective qualification clauses."

In attempting to canvass the suggestions made by opponents of formula clauses regarding efforts by surviving spouses to alter the administration of the estate in a way which would favor them, the banks were asked whether or not they had encountered situations in which the surviving spouse had urged the election of the federal optional valuation which would result in a larger federal estate tax in order that her marital share would be bigger. Only one out of the twenty-six indicated that this had ever occurred, and they pointed out that the consideration of it had been at *their* suggestion in a single instance, and not at the surviving spouse's suggestion. That bank pointed out that it was *rejected* after such consideration, and that the bank felt that even if an attempt was made by itself along these lines, that the other beneficiaries could probably raise serious objection. They would recommend insertion of appropriate clauses covering the situation.

The next question concerned the type of clause preferred regarding *date of distribution* value as against *date of death* value in



satisfying a pecuniary gift. The banks were asked whether or not they preferred one or the other of these and 41 per cent indicated that they preferred a clause which would authorize distribution at *date of distribution* values, while 59 per cent indicated a preference for a clause authorizing distribution at date of death or federal estate tax values.

Finally, the banks were asked whether or not fewer problems had developed regarding the marital deduction than anticipated. Not all banks answered this question, but of those which did, only 9 per cent indicated that more questions had developed than they had anticipated. Some of the comments here are equally interesting in giving the point of view of institutions actually involved in administering the marital deduction. For example, the following are typical:

> "We have encountered much less difficulty with regard to the marital deduction than we anticipated. Perhaps this is chiefly due to the interest and industry of our Bar Associations and individual attorneys in finding out how to properly draft marital deduction Wills. I might mention that we have three men in our Estate Planning Division who have been kept busy on Estate Planning work throughout the state for a number of years. They do not ring any doorbells and make no "cold calls" but work only on references from attorneys, underwriters, C.P.A.'s, etc. Their first objective is to get the prospect to an attorney, and we have had wonderful cooperation from attorneys who were glad to learn about trust administration, even though it might be an entirely new field to them. The marital deduction seems to have generated a tremendous and lasting emphasis on trust administration and probate practice in general among the State Bar."

Again:

> "Generally, the larger estates that we have handled have been complicated by the marital deduction, and particularly Estate Planning, in the larger brackets, has developed severe problems. The particular area that has been brought to our attention, due to the impact of the marital deduction, involves those wishing to provide properly for their families and their interests who are not compelled to seek a tax solution rather than an economic and a personal solution.
>
> "In commenting, I feel the governmental function of taxes for revenue purposes has been so distorted in the estate tax field that it is no longer recognizable."

And finally:

> "Generally we have had very few difficulties develop in Federal audits. In this state the Federal agents are currently disallowing the spouse's award as a qualifying marital deduction. There are several cases pending in the courts and we will probably have a decision fairly soon.

Meanwhile there exists some uncertainty as to the proper payment to be made under a formula type of legacy. Life insurance and modes of settlement have proved troublesome in connection with some Federal audits.

"The primary problems that have arisen to date are in the administration rather than in the tax field. The formula type of will adds to the complexity of the administration and results in more paper work. The computations as to income and principal and allocation of securities are more involved. Other difficulties arise out of the use of elective deductions during the probate period and the consideration of possible adjustments between principal and income. A longer period of administration is also an undesirable feature of formula marital deductions."

CONCLUSION

No economic step in a commercial society which can alter the flow of hundreds of millions of dollars can be perfectly achieved from its inception. The marvel of the marital deduction, which has such a role, is that so few serious difficulties have developed. This is at once a tribute to advisors and administrators, and a source of confidence in the basic workability of the "new system" of taxation. If all tax changes of equal impact were as well conceived, interpreted and administered, we should be a nation of more comfortable taxpayers, if such an anomaly can exist!

THE DENVER DRY GOODS CO.
WHERE DENVER SHOPS WITH CONFIDENCE
Downtown • KEystone 4-2111
Cherry Creek • DExter 3-8555
Lakeside • GEnesee 3-6611

A Knox Straw of Distinction

This handsome milan by Knox is a hat most men can wear with flattery. In new shades of gray and brown . . . with a smart band . . .

10.95

Men's Shop, all 3 Stores