Maryland Law Review

Volume 20 | Issue 1 Article 7

Estate Tax Deduction for an Entire Trust Containing Charitable Bequest with a Possible Diversion of Trust Income - Mercantile-Safe Deposit & Trust Co. v. U.S.

Julian I. Jacobs

Estate Tax Deduction For An Entire Trust Containing Charitable Bequest With A Possible Diversion Of Trust Income

Mercantile-Safe Deposit & Trust Co. v. U.S.[1]

This was an action by the testator's executor to recover estate taxes alleged to have been erroneously and illegally collected. The testator, Dr. Raymond D. Havens, was a resident of Baltimore City. After a number of specific bequests, he willed the residue of his estate as follows:

> "Eighth: All the rest, residue and remainder of my estate, both real and personal and wheresoever situated, I give to my Trustee . . . to hold, manage, invest, and reinvest the same and pay to my sister, Ruth Mack Havens so much of the net income as in its sole discretion it deems necessary and proper for her reasonable living expenses, comfort, maintenance, and general welfare. My Trustee in exercising this discretion shall, however, take into consideration all assets owned by her and any income received from any other source of which my Trustee may have knowledge. It is my desire that the discretionary power given to my Trus-

---

[1] 172 F. Supp. 72 (D. Md. 1959).

tee be liberally construed. Any net income not so required shall be accumulated and added to the principal of the trust from time to time. Upon the death of my sister, or upon my death if she shall not survive me, I give the principal of said trust to the Johns Hopkins University of the City of Baltimore, Maryland for its library."

At the death of the testator the life tenant, Ruth Mack Havens, was sixty-five years old and living in a nursing home because of advanced senility. She was a woman of considerable wealth, having an income of over $10,000 per year from a pension and various trusts and the right to use some $135,000 of capital. It was stated by the trustee's vice president in charge of Dr. Havens' trust that the sister's income greatly exceeded her expenses, and that, therefore no part of the trust income would be used for her support.

The government conceded that the value of the charitable remainder was deductible from the estate in the computation of the estate tax,[2] but it contended that the value of the life estate was not deductible. The executor contended that under the terms of the will and the circumstances existing at the time of the testator's death, it was apparent that none of the trust, including the income therefrom, would be paid to or used for the benefit of the life tenant but would immediately pass to the University on the death of the life tenant. The executor therefore claimed that the entire residuary estate was deductible.

Chief Judge Thomsen of the District Court *held* that, in computing the estate tax, the executor was entitled to deduct the value of the entire trust, since the possibility that the charitable remainderman would not take the entire trust was so remote as to be negligible.

An unusual feature of this case is that the non-charitable beneficiary's interest was in the income from the testamentary trust, not in a right to invade corpus. The typical conditional charitable bequest involves a remainder interest in the charity that is subject to possible diversion of corpus. The court applied the rules used in such typical cases, without mentioning any possible distinction between

[2] 1939 IRC Sec. 812(d) (now 1954 IRC Sec. 2055) provides that in determining the value of the net estate of the deceased, any bequests to a corporation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes where no part of the net earnings of the charitable organization inures to the benefit of any private shareholder or individual may be deducted from the value of the gross estate.

the two situations.[3] This point was touched upon, however, in *Gilfillan v. Kelm,*[4] where the wording of the trust disposition was similar to that in the recent case and the tax issue identical. In that case, the court remarked:

> "While counsel suggests that this case may be unique as involving the invasion of income rather than of principal, the rules involving the invasion of principal would seem applicable."[5]

The test deductibility which the court applied in this case, the one developed for conditional charitable bequests where diversions of trust corpus are possible, is a two-fold one. First, there must be a definite ascertainable standard controlling the life tenant's rights of invasion. The leading case in this area is *Ithaca Trust Co. v. U.S.,*[6] where the court allowed the value of the charitable remainder to be deducted from an estate giving the life tenant the power to invade the corpus of the trust if it were necessary to do so, in order to maintain her station in life. This standard is generally regarded as being sufficiently definite and ascertainable.[7] "The standard must be fixed in fact and capable of being stated in definite terms of money."[8] The invasion of the corpus can not be at the pleasure, happiness, or whim of the life tenant.[9]

The second requirement which must be satisfied before a deduction for a conditional charitable bequest is granted is that "the possibility that the charity will not take the remainder interest must be so remote as to be negligible."[10]

---

[3] The court did point out that there were no Maryland cases defining the nature and scope of a beneficiary's interest in trust income in the case of need, and considered of some relevance the Maryland cases dealing with rights to corpus conditioned upon need.

[4] 128 F. Supp. 291 (D.C. Minn. 1955).

[5] *Ibid.*, 293.

[6] 279 U.S. 151 (1929), noted 9 Boston Univ. L. Rev. 288 (1929).

[7] Mercantile-Safe Deposit, etc. Co. v. U.S., 141 F. Supp. 546 (D. Md. 1956) hereinafter referred to as the Weglein case.

[8] *Supra*, n. 6, 154.

[9] Merchants Bank v. Commissioner, 320 U.S. 256 (1943), noted 29 Cornell L. Q. 406 (1943); Henslee v. Union Planters Bank, 335 U.S. 595 (1949), noted 10 Univ. Pitt. L. Rev. 424 (1949).

[10] Regs. 105, § 81.46 which implemented 1939 IRC sec. 812(d).

"Sec. 81.46. Conditional Bequests.

(a) If as of the date of decedent's death the transfer to charity is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that charity will not take is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of the decedent's death and such right or interest would be defeated by the performance of some act or the happening of some event which appeared to have been highly improbable at the time of decedent's death, the deduction is allowable."

The court in *Ithaca Trust Co. v. U.S.*[11] remarked that "there must be no uncertainty appreciably greater than the general uncertainty that attends human affairs." If the transfer to charity is dependent upon the performance of some act which might or might not happen, then the charitable bequest is not deductible.[12] Thus, where, the charity would only take if the life tenant died without issue[13] or the designated remaindermen predeceased the life tenant,[14] no deduction would be allowed. On the other hand, if the transfer to charity is dependent upon some act or event which is highly improbable, then the charitable bequest is deductible.[15] In *U.S. v. Provident Trust Co.*[16] the court granted a deduction where the charity was to take under the residuary clause if the life tenant died without leaving issue. At the time of the testator's death, the life tenant was fifty years old and had been rendered incapable of having children by an operation removing her uterus, Fallopian tubes, and both ovaries.

In the principal case, Chief Judge Thomsen reaffirmed his position, previously stated in the *Weglein* case,[17] that before a deduction is allowed, it must be shown that the possibility that the charity will not take is so remote as to be negligible. In *Moffett v. Commissioner*,[18] the Fourth Circuit (Judge Thomsen writing the opinion) *held* that a 29% chance that the residuary charity would not take was not a possibility so remote as to be called negligible. In this case the Fourth Circuit quoted with approval the following from *U.S. v. Dean*:[19]

> "The line between those chances which are so remote as to be negligible and those which are not lies somewhere between these extremes. We can not say exactly where. We can only decide specific cases as they arise using the best judgment we have in placing them on one side or the other of the line. And there is no standard to guide us except our estimate of the extent of the encouragement tax-wise which Congress wished to give testators to make gifts to charity. Our judgment being largely subjective, about all we can say is that we do not think one chance in eleven (in

[11] *Supra*, n. 6, 154.
[12] *Supra*, n. 10.
[13] Farrington v. Commissioner, 30 F. 2d 915 (1st Cir. 1929).
[14] U.S. v. Dean, 224 F. 2d 26 (1st Cir. 1955).
[15] *Supra*, n. 10.
[16] 291 U.S. 272 (1934), noted 32 Mich. L. Rev. 702 (1934).
[17] *Supra*, n. 7.
[18] 269 F. 2d 738 (4th Cir. 1959).
[19] *Supra*, n. 14.

> this case the odds are approximately three chances in ten) can be considered so remote a chance as to be negligible, that is, a chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction."[20]

Though the conclusion of the court in the principal case, that the chance of any diversion of income to Miss Havens was so remote as to be negligible, was supportable,[21] this test is often a difficult one to apply. This test, as promulgated in Regs. 105 Sec. 81.46, was presumably designed for charitable bequests contingent upon the happening of a single event. Later when the courts were faced with the problem of granting tax deductions to charitable bequests subject to possible invasions by non-charitable beneficiaries, they continued to apply the same test, combined with the requirement of a definite and ascertainable standard controlling the life tenant's right of invasion. Perhaps these diversion type cases should be handled through a partial disallowance of the charitable deduction rather than as granting either a deduction of the entire bequest to a charity or no deduction at all. Where the chance of diversion of corpus to non-charitable beneficiaries has not been so remote as to be negligible but has been limited to a maximum dollar amount per year, a partial deduction of the trust has been allowed, the maximum possible diversion being subtracted from the value of the trust.[22] Where the rights of invasion are subject to a definite standard, even though the chances of invasion

---

[20] *Ibid.*, 29.

[21] In applying these tests to the principal case, Judge Thomsen found as a fact that "at the time of the death of Dr. Havens the possibility that his sister's *income* and *principal* would not be sufficient to care for her for the balance of her life was so remote as to be negligible". He tried to evaluate the extent of the interest which the beneficiary had where she could obtain income only in case of need and upon the exercise of a trustee's discretion. No Maryland case directly in point, however, could be found. The court then turned to the testimony of the vice president of the trustee, the one handling the trust estate, who had said that his understanding of the intention of the testator and the Maryland law was that Miss Havens would have to exhaust her own assets before any income from the trust could be paid to her. At least technically, the trustee's own interpretation of the trust instrument and the applicable law would not seem relevant. A danger in giving weight to his opinion on these matters is that nothing prevents him from changing his interpretation in the future. It should be pointed out, in this connection, that the testimony of the trustee had been admitted without objection, and the court presumably would have reached the same result, even had the trustee's testimony been completely disregarded.

[22] Estate of B. F. Sternheim, 2 T.C.M. 311 (1943), reversed on other grounds, 145 F. 2d 132 (9th Cir. 1944).

are more than negligible, it would seem sound to treat the situation this same way; that is, to compute the deduction for the bequests to charity on the basis of what would be the maximum possible diversion under the standard used in the trust and the particular circumstances of the case.[23] Under such an approach, some deduction could be allowed without straining the "so remote as to be negligible" criterion, and still the government would be adequately protected.

JULIAN I. JACOBS

[23] LOWNDES & KRAMER, FEDERAL ESTATE AND GIFT TAXES (1956) 366.