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THE MARITAL DEDUCTION—USE AND FORM OF THE MARITAL BEQUEST*

FREDERIC SAMMOND**

I. INTRODUCTION AND SCOPE OF SUBJECT.

When the 1948 Congress adopted the principle of the marital deduction for estate and gift taxes, it opened a subject that would occupy and fascinate lawyers in estate planning and estate administration for many years. While there are undoubtedly more cases now on the way to becoming authorities and citations, we are still at the stage of being largely dependent on the statute as written and as interpreted by the regulations; there are no decisions of importance on the subject. Such decisions as there are simply give strict application to the severe limitations of the allowance. We are still using Section 81.47 of Regulations 105, along with the new statute Section 2056, I.R.C., pending new regulations, but there is no reason to expect much change, when they are issued.

The statute is one of those difficult ones where the draftsman started out with a good idea: the equalization of estates under the common law and the civil law. As you read it, you can picture the draftsman discovering one situation after another in which the statute might operate too favorably for the taxpayer, and putting in a stop or limitation clause, following which another member of the group would discover a discrimination against the taxpayer and immediately an exception to the limitation would be drafted, which in turn was found to require qualification. In my opinion an attempt has been made to make the statute too precise, inviting difficulty, in an attempt to avoid unfairness in a situation where isolated unfairnesses are unavoidable anyway. Basically, of course, the purpose of the law is to allow the estates of spouses to be equalized and to allow as a deduction, within limits, that which will appear in the estate of the survivor (unless the survivor consumes it), and nothing more.

The Revenue Act of 1954 made few changes in this field, but happily does away with two restrictions that tripped people very easily. One was the provision that prohibited portions of a trust or life insurance policy from being used as deductions no matter how well such portion qualified and the other was the rule that denied a deduction for a legal life estate otherwise qualified merely because it was a trust. These changes will be discussed in their place.

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Since we are happily in a common law state, I do not attempt to explore any part of the community property portions of the statute.

Most of you will recall that there was agitation for many years over the fact that, before the federal statutes recognized the marital deduction concept, there were about a dozen civil law states where the community property principle permitted substantially the same results for income tax, estate tax and gift tax that the Revenue Act of 1948 later granted to married couples in all states. There were more or less mild grumblings through the depression years, and these rose to a decided crescendo during World War II along with the equally high tax brackets. Several common law states proposed to adopt community property laws; and our neighbor Michigan even did so with a law enacted shortly before 1948 which got their titles and trusts into a great deal of difficulty, and was repealed after the Revenue Act of 1948 was passed. Several other states were on the verge of passing similar laws, and it was even proposed and discussed in Wisconsin. As might be expected where one-quarter of the states were enjoying a tremendous advantage, it did not remain exclusive very long in the hands of the congressmen from the other three quarters. As I recall it, the high tax enthusiasts proposed laws to take the privilege away in the civil law states, but not only were there constitutional doubts with regard to this course, but rewards of the other course were too attractive to the rest of us. Of course, the principal advantage came through the income tax provision which is applied much more universally as well as annually, but the estate and gift tax provisions offer substantial savings.

It is, of course, appropriate to discuss the advantages and disadvantages of the marital deduction in estate planning, but, before doing so, it may be desirable to examine the device itself. As it is a highly technical concept, this discussion may well first take the form of examining the ways in which the deduction may advertently be lost. The marital deduction is available, of course, upon the death of the earlier of two spouses, but for convenience in discussion I shall treat the masculine gender as more perishable and the feminine gender as the survivor, as seems to be the case in life.

II. EXPLICIT STATUTORY BARRIERS TO MARITAL DEDUCTION.

A reading of the statute suggests quite a number of places where marital deductions can be lost in the process of trying to meet the general wishes of a testator.

(a) The basic purpose of the marital deduction requires that the surviving spouse in all events shall so own the bequest as to include it in her estate. This is the reason for the great effort in the statute to exclude "terminable interests" however contrived. For many years the standard estate planning, as a minimum, provided a life estate to the

spouse with remainder to the succeeding generations. This was the basic tool, and still is, where the marital deduction is not helpful. To the extent of half of the estate, this life estate and next generation idea obviously loses the marital deduction, and the basic purpose to by-pass the estate of the survivor in favor of the next generation is squarely at odds with the purpose of the marital deduction. Not only is this true as to simple life estates, but also as to a life estate where the right of the survivor or her estate to the remainder is conditioned in any way, as by continued widowhood or consent of anyone else. In short, the remainder must vest in the survivor, although there is no objection to giving the survivor a life estate with the remainder to her own estate or with a power of appointment, testamentary or otherwise. It was formerly important that a life estate, accompanied with a power of appointment, did not qualify for the deduction, unless it is specifically provided through a trust designed to meet the very specific requirements of subsection (e) of the statute.¹ In other words, a devise of a life interest in a farm with power of appointment was not valid if the trust form was not used. There was no logical reason for this distinction and it might easily have trapped people, so it was one of the two limitations which went out in the 1954 Code.²

A bequest to a fiduciary to purchase assets for the survivor is declared unqualified if it would be similar to an annuity or a term interest of some kind as distinguished from purchase of an investment.³ This is a rare device and of no practical importance as a restriction if not met inadvertently.

Under the 1948 Act, the power of appointment following life estate not only had to be in trust as mentioned, but also had to be a life estate and power relating to the *whole* corpus.⁴ Quite a number of such bequests have already gone down on this. Under the 1954 Code a specific portion of a corpus may qualify for the deduction if the life estate and the power relate to the same specific portion.⁵

(b) One of the most important statutory disqualifications, and one which well might produce more inadvertent loss of the deduction than any other, is that which is plainly stated, but which I fear many of us have not appreciated sufficiently in our planning work. This is the provision that, if a bequest to the surviving spouse may be satisfied out of assets which include any asset which is not qualified for the marital deduction, it shall conclusively be presumed that such asset was included in the bequest and the bequest to that extent fails to qualify.⁶

¹ §812 (e) (1) (F) of the old Code.

² §2056 (b) (5).

³ §2056 (b) (1).

⁴ Note 1, *supra*.

⁵ Note 2, *supra*.

⁶ §2056 (b) (2).

It is not at all unusual for a marital bequest to be designated out of the residue, or by percentage of the whole, or, if made the subject of a specific bequest, for there to be no specifications of what assets shall be used to satisfy the marital bequest. In either case, where there is any unallowable asset in the estate, it is immediately conclusively attributed to the marital bequest, and the deduction thereof is reduced accordingly.

Examples of unallowable or "tainted assets" are various terminable interests, including those terminating by remarriage, partnership interests, sale of property by a fiduciary on an installment basis, and property passing through the exercise or non-exercise of a nontaxable power.

A good example of what might frequently be encountered is an *inter vivos* trust created by decedent with income to decedent and wife for their lives and remainder to children. The income interest would be an asset in his estate, but an unqualified asset. It and any other unqualified asset would be treated as used to pay the marital deduction (whether so used or not) and reduce the deduction. This "tainted asset" clause, while still important, has lost some of its sting with the removal by the 1954 Code from the list of unqualified assets of (1) life estates with powers which are not trusteeed and (2) portions of a trust.

Where there is any likelihood of an unqualified asset existing in the estate, the effect of this statutory clause can easily be removed by a simple sentence in the will to the effect that the marital bequest shall be satisfied only out of assets as to which the marital deduction would be allowed if the same passed directly from the decedent to the spouse.

(c) The statute provides that a bequest may be conditioned upon survival for a specified period not exceeding six months or, alternatively, if death occurs as a result of a common disaster causing the death of both, provided that the surviving spouse does in fact take.⁷ While this provision undoubtedly meets the wishes of many testators, it nevertheless indicates very clearly how the entire marital deduction advantage may be destroyed by the operation of such a clause where the survivor does in fact die within the period specified in the will, or as a result of a common disaster. The usual purpose of such a clause is to avoid the expense of double administration, something which has been faced and allowed for as a rule, in calculating the desirability and size of the marital deduction bequest. This situation must be carefully considered not only in drafting of wills, but with regard to similar clauses in life insurance policies, if frustration of the plan of marital deduction is not to be risked.

⁷ §2056 (b) (3).

Wisconsin is one of the many states with the Uniform Simultaneous Death Act which provides that, in the absence of evidence of which person died first, neither shall take from the other.⁸ It will be seen that the operation of this Act may very well defeat an ordinary unconditioned bequest in a will or a marital deduction in an intestate estate. The conventional common disaster clause in wills works the same way, of course. It operates as it is intended to do, not only to avoid difficult questions of proof, but also dual administration of the same assets, while such dual administration is the very thing that is the essential of the marital deduction. The Simultaneous Death Act contains a provision that a contrary provision in a will or insurance policy shall prevail, and it may well be that it would be desirable in some wills and insurance policies to negative the operation of this Act by a clause so saying.

Where, for one reason or another, it is desired to take advantage of the statutory clause which retains the marital deduction and yet permits the defeat of the bequest where the surviving spouse dies within a limited period or in a common disaster, it is exceedingly important to be clear that in the event the surviving spouse does not so die, any powers of appointment in a life insurance policy or otherwise will be operative from the date of death and not from the date when the condition has been eliminated. For example, where a bequest or life insurance policy is stated to be conditioned on survival for more than six months and is dependent for its deductibility on its power of appointment clause, it should be clear that the power can be exercised by the surviving spouse at any time after the death of the deceased; otherwise the bequest will not be deductible even though the spouse survives the six months, because the power would be held to be not exercisable "in all events" as the statute specifies.

One of the few reported cases on the subject of marital deduction was decided in 1953 by the United States District Court in the Western District of South Dakota. The reported decision does not state the terms of the will, but it seems that a bequest, conditioned on survival until distribution, was allowed as a marital deduction since distribution did occur within the six months' period, in the face of vigorous opposition by the Commissioner. The opinion indicates that the judge was greatly influenced by the evident intent of the testator to provide a marital deduction.⁹ The case is on appeal.^{9a}

In Revenue Ruling 54-121,¹⁰ the Commissioner ruled that a payment of insurance proceeds, conditioned upon survival of spouse to the time

⁸ WIS. STATS. (1953) §237.10.

⁹ *Kellar v. Kasper*, 53-2 U.S.T.C. Par. 10919 (W.D.S. Dak., 1953).

^{9a} *Editor's Note*: The Kellar case was reversed by the Court of Appeals for the Eighth Circuit. C.C.H. Federal Estate and Gift Tax Reporter, Par. 11, 501.

¹⁰ I.R.B. 1954-14, 8.

of proof of decedent's death, is a "tainted asset" and not a part of the marital deduction, even though the payment might in fact be made within a very short time and within the six months' period. The Ruling depends on the fact that it does not *have* to occur within the period. The Ruling itself points out that it is squarely in conflict with the decision in the *Kellar* case in basic reasoning.

(d) The adjusted gross estate is reached by certain deductions which do not include estate and inheritance taxes.¹¹ On the other hand, the statutes specifically provide that the marital deduction should be reduced by any death tax applicable to the same.¹² Consequently, if it is desired to obtain the full 50% deduction, care must be taken to prevent allocation of estate and inheritance taxes to the bequest and deduction therefrom. Of course, it can be avoided by appropriate provisions in the will. However, the usual provision throwing all the taxes against the residue will only make the situation worse where the marital bequest is to be paid out of the residue.

Recently a Revenue Agent took the position that a will, which had no provision relative to payment of taxes and had a marital bequest in the popular form to provide the maximum, should be construed as requiring the federal and state death duties to be paid out of residue, and not out of the marital bequest, in view of the specification that the bequest should be the maximum. This case went before the Appellate Division on a value question, and this rule of construction was there followed also, but reluctantly and only after an argument. This is a somewhat tenuous authority on which to rely; it is better to make the will specific on the point.

(e) As we have stated, the 1954 Code removed the requirements that a life estate with power of appointment must be in trust and also that the whole of the corpus was necessary to a deduction, as distinguished from a specific portion. Desirable as these changes are to eliminate traps for the unwary and for wills which have not been revised since 1948, the things which the statutes formerly required are still desirable otherwise than merely to obtain the marital deduction.

Thus several separate trusts, instead of fractions of one trust, are desirable from an income tax standpoint, as every estate planner knows.

Likewise, such a trust, instead of a life estate with power, does avoid the second expense of administration; and, where the power is not exercised, it even avoids state taxes in such states as do not tax the non-exercise of a power. Its only disadvantage seems to be the introduction of complexity into the will.

Those who have worked with the regulations are familiar with the

¹¹ §2056 (c) (2).

¹² §2056 (b) (4).

five rules specified as to each trust,¹³ which give no particular difficulty and on the whole seem quite reasonable and in accord with the purpose of the statute. Essentially they spell out what has been said here. Probably the forthcoming regulation will extend these rules to the non-trusteed bequest. It is important to note that, as pointed out before, the power of appointment must be effective and available at the original death even though it is permissible to postpone enjoyment of income during administration of the estate. It hardly needs stating that a binding agreement as to the exercise of the power will destroy it and make the bequest nondeductible. It is also of some importance that text writers believe that a bequest through such a trust of nonproductive assets, such as a depletable property, might be held to show intent not to give income to the spouse, and that it is safer to provide the fiduciary with power to convert such property to other property.

(f) The rules as to life insurance where there is a power of appointment are much like those dealing with a trust and power of appointment. Originally there was a good deal of doubt as to whether the statute recognized the right of withdrawal as a power of appointment, but fortunately that was cleared up affirmatively by a retroactive amendment before 1948 was over.

Most policies that have been written subsequent to the establishment and understanding of the Revenue Act of 1948 are so drawn as to meet all requirements for marital deduction where that is desired and do not contain hidden provisions which unintentionally tend to knock out the deduction. Where it is desired to include the proceeds of older policies in the marital deduction, it is of value to scrutinize them very closely.

(g) Finally the statute provides that a spouse may cut down a marital bequest by a disclaimer, but that no marital bequest may be enlarged by a disclaimer of anyone else.¹⁴ The first part of this rule does offer an opportunity to cut down an excess of marital deduction where circumstances have changed or planning has been lacking and the net effect of the marital deduction bequest before disclaimer is costly because of its being too large.

III. OPPORTUNITY FOR SAVING OR LOSS OF MARITAL DEDUCTION NOT EXPLICIT IN STATUTES.

There are several matters to consider on this, outside of the express statute covering the marital deduction.

(a) Before the Revenue Act of 1954, there was an important leakage of taxes in connection with the marital deduction in that the credit for estate taxes paid on deaths within the preceding five years was denied as to all property passing after 1947 from spouse to spouse,

¹³ Treas. Regs. 105, §81.47a (c).

¹⁴ §2056 (d).

whether by death or living gift and whether creating marital deduction or not. The most important thing to watch under that state of affairs was a bequest of more than fifty per cent to the wife, which gave her assets, which created a tax in her estate, but no credit. It could be avoided, of course, by the classic trust of life interest with remainder over to the next generation. This is no longer a problem as the 1954 Code permits credit of previously paid estate taxes on property received from a spouse after 1947 but excludes only that which created the marital deduction.¹⁵ This is fair.

(b) In many estates there are certain assets, be they stocks or real estate, on which extensive appreciation is anticipated to occur in the future. This is particularly true in some closed corporations. It is to be seen that care should be taken to steer this property away from the marital deduction, perhaps to an ordinary non-appointive trust with remainder in the next generation so as to keep this appreciation from building up in the estate of the survivor; otherwise such a build-up could easily consume the benefits of the marital deduction. It follows from the same reasoning that it would be desirable to use property likely to depreciate, either physically or otherwise, in connection with marital deduction. This is on the same theory as that under which a trust may be set up in estate planning for consumption of principal by the surviving spouse so as to minimize her estate as an additional saving over the original marital deduction.

(c) Where opportunity permits, savings may sometimes be achieved in a review of the marital deduction during the period between the date of death and the initiation of probate or the filing of proofs under insurance policies. It is entirely possible that changes of circumstances or valuation of assets may result in a bequest which is in excess of marital deduction, although intended to provide the same and that disclaimers and insurance elections might be made at this stage to bring the maximum of marital deduction savings to the estate, while such actions might be precluded later.

(d) In every estate of size, a study is necessary, of course, at the anniversary of death to ascertain which date of valuation should be elected by the executor. This familiar study should now be supplemented by a consideration of the marital deduction at the same time. The conditions necessary to establish marital deduction, such as lack of terminability, effectiveness of power of appointment, etc., exist only as of the date of death and do not enter into the study a year later. Nevertheless the valuation for the marital deduction will follow the date of principal election (including disposal date if sold during the year) and the value of such assets might change so as to be entirely different from the value of the estate as a whole and thus produce a

¹⁵ §2013.

change in the marital deduction which might influence the election as to valuation date.

IV. USE OF MARITAL DEDUCTIONS IN ESTATE PLANNING.

(a) On extensive consideration of formulae and tables and even mechanical counters. I have come to the conclusion that, while these devices may give horseback answers, the only safe method involves analysis of the estates of husband and wife and actual trial computations based on different hypotheses as to testamentary plans. Federally, of course, the closer one can get the estates of the two spouses to equality, the closer one obtains the theoretical maximum tax-saving, and this goal could then be modified by use of reasonable judgment to take care of important non-tax problems. Unfortunately this theoretical simplicity is ruined by several considerations which include:

- (a) the duplicate state taxes resulting from the marital bequest as distinguished from a life estate with remainder over;
- (b) duplicate administration expenses for the same reason;
- (c) ages of the parties and probable length of survival of one spouse beyond the other;
- (d) the advantage of postponing a large part of the tax to the death of the survivor; thus easing the problem of providing liquid funds and also making the liquid funds available for the use of the survivor, leaving the next generation to struggle with liquidity, liquidation or sale of closely held businesses, etc.;
- (e) the income earning potential of the postponed tax;
- (f) the possibility of using depreciating assets or reducing marital trusts as the subject of the marital bequest.

From the foregoing, it will be seen that the conclusion of whether and how to use the marital deduction statute either by bequest or gift (even after due allowance for personal non-tax problems) is one which must be arrived at by patient trial and error, giving heavy weight to dollar saving along with due consideration to matters of convenience as well. I have seen published tables showing that in Wisconsin the maximum benefit of a marital deduction is reached where one spouse has an estate of \$200,000 and the other zero and becomes a costly disadvantage when one estate is \$500,000 and the spouse's is zero. In the face of such tables, I have seen substantial advantages obtained in the use of marital deduction in larger estates and with larger discrepancies between the two estates simply because of the use of a reducing marital trust or a wasting asset. A good example of a wasting asset is an employment contract which provides for payment to the widow for a given span of years and then ceases. A reducing marital trust permits the widow to take both principal and income from the trust and live it up, or give it to her children if in excess of her needs, so that

those assets appear in neither estate if she survives a reasonable time. In such a plan security can be provided by the trust provisions as to the residue. Insurance options may be worked out to the same effect, while getting the \$1,000 per year interest saving.

It will be seen that there is an infinite variety of circumstances and combinations in estate planning, and that the subject does not lend itself to rules and tables.

(b) I have been requested to furnish a "formula cause" and discuss its use. I have attached to the outline a formula clause which we believe will provide a maximum deduction where that is desired.¹⁶ A formula for maximum may be desirable in a well-organized estate where the widow is likely to work closely with counsel because, while there may be many situations where a marital deduction of less than the maximum would be desirable, this can be achieved through the disclaimer after the testator's death. Obviously this is unwise for reliance where it will not be reviewed and considered at the proper time. With this caution, I see no objection to using a maximum clause. The clause submitted to you does not deal with the six months' survival privilege and common disaster, either of which may be desired in some cases and not in others, or with the simultaneous death statute. This can be added by appropriate language after the recommended clause.

(c) The gift tax statute allows a deduction of 50% of each gift made to a spouse with the substantially same limitations, definitions, and qualifications which are involved in the estate tax.¹⁷ The changes made by the 1954 Code in the estate tax as discussed also appear with regard to the gift tax. For occasional gifts between spouses, of course, the deduction is simply a tax-saving. For estate planning the question of gifts between spouses is usually associated with the same study which produces the decision as to the scope of marital deduction desired in the will. A living gift is, of course, cheaper tax-wise than a bequest for three reasons:

- (a) The rates are lower.
- (b) It falls into a separate set of brackets.
- (c) It removes the tax itself from the estate and thus saves the tax on the tax.

Where such a gift is indicated otherwise, it becomes even more desir-

¹⁶ "I give and bequeath to the trustees hereinafter named, to have and to hold the same in trust for the following uses and purposes, such amount as will be required to obtain the maximum marital deduction in my estate for federal estate tax purposes, *viz.*, fifty percent (50%) of my adjusted gross estate as reduced by the value of other property included in my gross estate for federal estate tax purposes which passes or has passed to my said wife in such a manner as to qualify for the marital deduction, all computed upon the value used initially by my executors for purposes of filing returns, such bequest to include only assets which qualify for said marital deduction."

¹⁷ §2523.

able where a marital deduction can be available under the gift tax rates. Of course, the reduced gift tax has to enter the detailed computations which are necessary to the estate planning. This subject is so well covered in other lectures in this course, that I merely mentioned it in passing.

V. CONCLUSION.

It is suggested that the two outstanding conclusions on this subject are, first, the importance of re-checking estate plans, wills and insurance policies frequently, both before and after death, because of changes in factual situations; and, secondly, the impossibility of reducing the subject to rules and formulae.