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Taxation -- Estate Planning -- The Marital Deduction -- Formula Bequests

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procedure presents the dilemma of whether to preserve the basic concepts of law through orderly process, on the one hand, or to act decisively while it is still possible, on the other. Some procedure must be preserved, and perhaps the best way to do that is through the judge's own thought processes. In a recent federal decision concerning failure to appoint a guardian ad litem for a minor, a judge was reversed not because he had failed to appoint a guardian, but because he had failed to give the matter careful consideration, so that his decision was based on inadvertence. Not the decision itself, but the mode of arriving at it seemed significant to the court. Perhaps Judge Wright was on the right track when he gave the interested parties actual notice of his intention to act and when he advised the patient's husband to obtain counsel. Perhaps he should have gone further in actually explaining to the parties the legal significance of what he might do and their rights with respect to it. Of course, there is great virtue in the mechanics of service of process and filing of pleadings, for such devices nurture the American ideal—law over man. But, in an emergency situation, perhaps the best that can be done is to require the judge to adhere to the rules of procedure as closely as possible, yet allow discretion to temper them.

DORIS R. BRAY

**Taxation—Estate Planning—The Marital Deduction—Formula Bequests**

The marital deduction was first introduced into the federal estate tax law in 1948 to eliminate the inequities between tax treatment of estates in common law states and those in community property states. It allows a deduction of up to fifty per cent of the adjusted gross estate for the value of any property interest, other
than community property, passing from the decedent to the surviving spouse.\textsuperscript{4} Generally, property included in the decedent's gross estate\textsuperscript{5} which passes to the surviving spouse in such a way as to be taxed in her estate, assuming she still owns it at the time of her death,\textsuperscript{6} is eligible for the marital deduction. For many it is the most important deduction in federal estate tax law.\textsuperscript{7}

Since its enactment seventeen years ago, various methods have evolved to express the size of the marital deduction. Among these are nonformula\textsuperscript{8} and formula\textsuperscript{9} bequests. The two most widely used formulas are the fractional share\textsuperscript{10} formula and the pecuniary in-

\textsuperscript{4} INT. REV. CODE OF 1954, § 2056(a).
\textsuperscript{5} INT. REV. CODE OF 1954, § 2056(a).
\textsuperscript{6} GRIswOLD, FEDERAL TAXATION 942 (5th ed. 1960).
\textsuperscript{7} ESTATE PLANNERS QUARTERLY 272 (Huber ed. 1962); Sargent, A.B.C. and D. of Marital Deductions, 7 TAX COUNSELOR'S Q. 178, 180-81 (1963). See 2 Fed. Est. & Gift Tax Rep. ¶ 7155 for a demonstration as to how much it is possible to save in the first estate through use of the marital deduction in estates of various sizes.

\textsuperscript{8} The nonformula bequest is represented by a sum certain gift where testator leaves "the sum of one hundred thousand dollars" to my beloved wife, Jane, or by a fractional gift where testator leaves, "one-half of my residuary estate" to my beloved wife, Jane. 1 CASNER, ESTATE PLANNING 792, 794 (3d ed. 1961). These two methods are employed when testator desires to leave a definite amount, specific property, or a certain percentage of his estate to his surviving spouse without being concerned with obtaining the exact amount of the maximum allowable deduction.

\textsuperscript{9} The formula marital bequest arose when lawyers were faced with a client who wanted his wife to receive the exact amount of the maximum marital deduction and not a cent more; a formula seemed to be the only solution. Stevens, Fourteen Years of Marital Deduction, N.Y.U. 21ST INST. ON FED. TAX 257, 271 (1963). A formula clause by definition seeks to define the property passing to the surviving spouse in terms such that regardless of the size and nature of the decedent's estate, the surviving spouse will receive, from all sources combined, just sufficient property to fully utilize the marital deduction. A formula clause serves no purpose if decedent desires to leave his spouse more or less than the maximum marital deduction. Burch, Use and Misuse of the Marital Deduction, U. So. Cal. 1963 Tax Inst. 609, 641. The formula provisions apply equally to outright gifts or gifts left in trust for the benefit of the surviving spouse.

\textsuperscript{10} The fractional share formula creates a gift of the designated fractional share of each item in the fund to which the described fraction is to be applied. Casner, Marital Deduction Gifts, 99 Trusts & Estates 190 (1960). When this formula appears in a will, the residuary estate normally will be the fund against which the designated fraction is applied. 1 CASNER, op. cit. supra note 8, at 798. Professor Casner suggests the following words to create a fractional share formula:

If my said wife survives me, I give to . . . the following described fractional share of my residuary estate:

The numerator of the fraction shall be the maximum estate tax marital deduction (allowable in determining the Federal estate tax payable by reason of my death) minus the value for Federal estate tax purposes
terest formula. The first of these to be developed was the pecuniary interest formula which allocates an amount for the benefit of the marital distributee equal to one-half of testator's adjusted gross estate. The next step in the formula's development was to add a clause to the governing instrument giving the executor power to satisfy the bequest in kind so that the assets of the estate would not have to be liquidated for distribution in cash. However, when the

of all items in my gross estate which qualify for said deductions and which pass or have passed in a form which qualifies for the estate tax marital deduction from me to my said wife (the words 'pass or have passed' shall have the same meaning as such words shall have under the provisions of the Internal Revenue Code in effect at the time of my death) under other provisions of this will, by right of survivorship with respect to jointly owned property, under settlement arrangements relating to life insurance proceeds, or otherwise than under this fractional share gift of my residuary estate (in computing the numerator, the values as finally determined for Federal estate tax purposes shall control); and the denominator of the fraction shall be the value of my residuary estate (the value of my residuary estate shall be determined on the basis of the values as finally determined for Federal estate tax purposes).

Casner, Estate Planning 308 (Supp. 1964). To illustrate the fractional share formula, assume an adjusted gross estate of $200,000 and those assets composing the residuary estate as being valued at $170,000 as determined for federal estate tax purposes. The numerator of Casner's formula is the maximum estate tax marital deduction and is equal to $100,000. The denominator of the fraction is the value of those assets composing the residuary estate as determined for federal estate tax purposes. Here the denominator is $170,000 and the fraction appears as $100,000/$170,000. In determining the estate tax, when the fraction is applied to the assets composing the residuary estate valued at federal estate tax values, the denominator and the assets composing the residuary estate cancel out, leaving a maximum marital deduction of $100,000; i.e., $100,000/$170,000 X $170,000 = $100,000. In making distribution, the above fraction is applied to the assets composing the residuary estate valued at the date of distribution. Dane, Marital Deduction Questions, 103 Trusts & Estates 112, 113 (1964). The marital distributee will consequently share in appreciation and depreciation of the estate under the fractional share formula. If the assets composing the residuary estate have doubled in value by the time of distribution, the marital distributee will receive 10/17 X $340,000 or $200,000. However, if they have depreciated to half, the marital distributee will receive 10/17 X $85,000, or $50,000. See Smith, Marital Deduction in Estate Planning, 32 Taxes 15 (1954). In addition to allowing the marital distributee to share in the appreciation of the estate, the fractional share formula creates no capital gains problem for the estate because no right to any specific dollar amount is being satisfied. Rev. Rul. 60-87, 1960-1 Cum. Bull. 286; Casner, Fractional Share Marital Gifts, Trust Bull., March 1960, pp. 42, 43. For a good discussion of the fractional share clause see Durbin, Marital Deduction Formula Revisited, 102 Trusts & Estates 545 (1963).


12 In re Campbell's Will, 144 N.Y.S.2d 515 (Surr. Ct. 1955); In re Lazar's Estate, 139 Misc. 261, 247 N.Y. Supp. 230 (Surr. Ct. 1930); 3 Scott, Trusts
executor was given this power, he was required by law to value the property so distributed as of the date of distribution unless a contrary date was expressed in the instrument. And, if an appreciated asset were used to satisfy the pecuniary bequest in kind to the marital distributee, the estate would realize a gain in the amount of the difference between the basis of the appreciated asset and the amount of the bequest so satisfied. When a specific bequest is left to the surviving spouse, the pecuniary interest formula is considered to create a bequest to the marital distributee of a specific sum, the sum becoming fixed in amount when the amount of the adjusted gross estate is established. When the executor is allowed to substitute assets in kind in satisfaction of this specific amount, he is considered to have made a "sale or exchange" of those assets. The estate's basis is the fair market value at the requisite estate tax valuation date. Accordingly, when these assets, valued as of date of distribution, are "sold" in satisfaction of the specific pecuniary amount, any excess of this fictional "selling price" over their basis is treated as recognized gain. To avoid the realization of this gain, the executor came to be instructed in the instrument to satisfy the marital bequest with property valued at its date of death estate tax value. The last step in development of the formula, along with the elimination of gain, opened new doors for the executor to engage in post mortem estate planning. This is best illustrated by way of example.

Suppose testator's will contained the following pecuniary interest formula bequest:

I give, devise, and bequeath to my wife... an amount equal to fifty per cent of my adjusted gross estate as finally determined for

§ 347.6 (2d ed. 1956); Lloyd, Background of Drafting Problems, 103 Trusts & Estates 898 (1964); Zimmerman, The Effect of In-Kind Settlements, N.Y.U. 22d Inst. on Fed. Tax 1111 (1964).

13 Boston Safe Deposit & Trust Co. v. Reed, 229 Mass. 267, 118 N.E. 333 (1918); In the Matter of Clark, 251 N.Y. 458, 167 N.E. 586 (1929).
17 For a good discussion and several variations on the pecuniary interest formula see Cox, Types of Marital Formula Clauses, N.Y.U. 15th Inst. on Fed. Tax 909, 926-30 (1957).
federal estate tax purposes. . . . My executors shall have full au-
thority to satisfy this bequest, wholly or partly in cash or kind . . .
provided however, that any property so conveyed . . . shall be
valued for that purpose at the value thereof as finally determined
for federal estate tax purposes.

Assume that at date of death testator's adjusted gross estate is com-
posed of two blocks of corporate stock, Stock A and Stock B, each
valued as of that time at 200,000 dollars. Using date of death estate
tax values the formula would yield 200,000 dollars for the marital
distributee. However, by the time of distribution, some time after
date of death, Stock A had appreciated in value to 300,000 dollars
and Stock B had depreciated in value to 100,000 dollars. With dis-
cretionary power in the executor to satisfy the bequest in kind at
estate tax values, the executor would be able to transfer Stock B to
the marital distributee and Stock A to the residuary legatee. Thus,
the decedent's estate obtains credit for the full value of the marital
deduction and would pay federal estate tax on 200,000 dollars. Upon
the subsequent death of the widow her gross estate would include
assets of 100,000 dollars, assuming that they had not been disposed
during her lifetime and had not further changed in value. The
result is an aggregate taxable estate for husband and wife of 300,000
dollars, thereby allowing 100,000 dollars in value to escape inclusion
in either estate. It was practice of this nature which provoked the
Internal Revenue Service into issuing Revenue Procedure 64-19.19

In Rev. Proc. 64-19, the Commissioner has asserted that he will
deny the entire marital deduction in the event of any pecuniary be-
quest or transfer to a surviving spouse unless, by applicable state
law20 or by the express or implied provisions of the instrument, it is

18 Smith, Marital Deduction Values, 90 Trusts & Estates 16 (1951).
64-19].
20 The state courts have had a difficult time deciding whether the particular
language created a pecuniary interest or a fractional share formula and
whether the marital distributee would be allowed to share in the appreciation
or depreciation of the estate's assets. The greatest number of decisions come
and In re Estate of Inman, 22 Misc. 2d 573, 196 N.Y.S.2d 369 (Surr. Ct.
1959), the court treated what would appear to be a pecuniary bequest as if it
were a fractional share of the residue and held the marital distributee to
share proportionally in the appreciation and depreciation of the estate's
assets. Accord, In re Estate of Nickelsburg, 34 Misc. 2d 82, 224 N.Y.S.2d
90 (Surr. Ct. 1961). In In re Estate of Bing, 23 Misc. 2d 326, 200 N.Y.S.2d
913 (Surr. Ct. 1960), the marital deduction clause clearly indicated a frac-
clear the fiduciary, in order to implement such bequest or transfer,

(1) must distribute assets, including cash, having an aggregate fair market value at the date, or dates, of distribution amounting to no less than the amount of the pecuniary bequest or transfer, as finally determined for Federal estate tax purposes . . . .

or

(2) must distribute assets, including cash, fairly representative of appreciation or depreciation in the value of all property thus available for distribution in satisfaction of such pecuniary bequest or transfer . . . .21

If the bequest meets either of these tests the marital deduction will not be denied. However, even if it is not clear as to the discretion of the fiduciary, the deduction may nevertheless be allowed in all instruments executed prior to October 1, 1964, if the fiduciary and the surviving spouse file agreements22 with the Internal Revenue Serv-

21 Rev. Proc. 64-19, § 2.02.
22 Sections 5.01 and 5.02 of Rev. Proc. 64-19 contain the applicable forms to be executed by the fiduciary and the surviving spouse. As a practical
ice to the effect that the division of assets so distributed between the marital and the residuary distributees "will be fairly representative of the net appreciation or depreciation in the value of the available matter instruments created prior to October 1, 1964, should be revised. This is true for several reasons: First, it has been held in North Carolina that a codicil to a will amounts to a republication of that will with the result that its date is that of the codicil. Hatch v. Hatch, 3 N.C. 32 (1798). Accord, Young v. Williams, 253 N.C. 281, 116 S.E.2d 778 (1960); In the Matter of the Will of Coffield, 216 N.C. 285, 4 S.E.2d 870 (1939); Battle v. Speight, 31 N.C. 288 (1848). See generally Atkinson, Wills 427 (2d ed. 1953).

Thus if testator's will, published in 1954, comes within the prohibited language of Rev. Proc. 64-19 and a codicil was executed in December 1964, it would appear that the executor and the surviving spouse would be unable to file the appropriate agreements. However, contrary results have been suggested. Covey, The Marital Deduction: Revenue Procedure 64-19 and Formula Provisions, 36 N.Y.S.B.J. 317, 332 (1964). It has been suggested that the agreements should be filed only when the testator is either dead or incompetent and a new will cannot be executed. Colson, The Marital Deduction & Revenue Procedure 64-19, Prac. Law., Oct. 1964, pp. 69, 78.

Second, there is the possibility that the spouse may be incompetent, or refuse to sign, or die before having had a chance to sign. Third, there is uncertainty under state law as to whether an executor would have the authority to file such an agreement. Two pieces of legislation have been proposed for North Carolina. Letter From F. Thomas Miller, Charlotte, N. C., to Members of the Committee on Taxation of the North Carolina Bar Association, Nov. 6, 1964. The purpose of the proposed legislation, assuming that they are not proposed in the alternative, appears to be twofold. First, to allow North Carolina executors to distribute assets to the marital distributee fairly representative of the appreciation or depreciation in value of all property available for distribution and thus comply with section 2.02 of Rev. Proc. 64-19. Second, to allow the executor to file the agreement under section 5.02 of Rev. Proc. 64-19 with the Internal Revenue Service. The first proposed statute provides:

SECTION 1. That whenever under any Last Will and Testament or Trust Indenture the Executor, Trustee or other fiduciary is required to, or has an option to, satisfy a bequest or transfer in trust to or for the benefit of the surviving spouse of a decedent by a transfer of assets of the estate or trust in kind at the values as finally determined for Federal estate tax purposes, the Executor, Trustee or other fiduciary shall, in the absence of contrary provisions in such Will or Trust Indenture, be required to satisfy such bequest or transfer by the distribution of assets fairly representative of the appreciation or depreciation in the value of all property available for distribution in satisfaction of such bequest or transfer. (Emphasis added.)

It is suggested that the emphasized clause, "in the absence of contrary provisions in such Will or Trust Indenture," prevents the proposed statute from accomplishing its intended purpose. If the instrument does, as it well may, contain contrary provisions, this statute will not save it from the grasp of Rev. Proc. 64-19 and the marital deduction will be denied. The second proposed statute provides:

SECTION 1. That the Executor, Trustee, or other fiduciary having discretionary powers under a Last Will and Testament or Trust Indenture with respect to the selection of assets to be distributed in satisfaction of a
property on the date or dates of distribution. If the fiduciary fails to distribute according to the filed agreement, the surviving spouse will be deemed to have made a gift to the beneficiary in whose favor the failure occurs, unless upon first being apprised of the situation, he or she seasonably objects. For all instruments executed on or after October 1, 1964, Rev. Proc. 64-19 states that the marital deduction will be disallowed if the bequest does not meet either of the tests noted in the immediately preceding paragraph.

In further explanation, section 4.01 of Rev. Proc. 64-19 sets forth several situations involving bequests to which it does not apply. The substance of these is:

1. a bequest or transfer in trust of a fractional share formula where each beneficiary shares proportionally in the appreciation or depreciation in the value of the assets to the date of distribution,
2. bequest of specific assets, or
3. a pecuniary bequest (in formula or stated amount)

where:

a) the bequest must be satisfied solely in cash, or
b) the fiduciary has no discretion in the selection of the assets to be distributed in kind, or

bequest or transfer in trust to or for the benefit of the surviving spouse of a decedent shall be authorized to enter into agreements with the Commissioner of Internal Revenue of the United States of America, and other taxing authorities, requiring the fiduciary to exercise the fiduciary's discretion so that the assets of the estate, both cash and other property, available for distribution will be distributed between (i) the marital deduction bequest or transfer in trust and (ii) the balance of the estate available for distribution in satisfaction of such bequest or transfer in trust so that cash and other properties distributed in satisfaction of the marital deduction bequest or transfer in trust will be fairly representative of the net appreciation or depreciation in value of the available property on the date, or dates, of distribution. It is the purpose of this act to authorize such fiduciary to enter into any agreement that may be necessary or advisable in order to secure for Federal estate tax purposes the appropriate marital deduction available under the Internal Revenue Laws of the United States of America and to do and perform all acts incident to such purpose.

The first proposed statute (minus the questioned clause) and the second proposed statute are almost identical to two recent Mississippi statutes. 2 P-H Wills, Est., Trusts, Miss. ¶ 2665 (1964). The North Carolina statutes appear to accomplish the desired results. If the first proposed statute is amended as suggested, quaere whether the legislature can "authorize" the executor to go against the express provisions of the will without raising a constitutional question.

Rev. Proc. 64-19, § 3.01.
Rev. Proc. 64-19, § 3.02.
c) assets to be distributed in kind are required to be valued at their respective values on the date, or dates, of distribution.\textsuperscript{25}

One author\textsuperscript{26} has suggested that as a matter of law the premise of the Commissioner in Rev. Proc. 64-19 was erroneous because fiduciaries are required to act fairly and exercise their powers in accordance with the basic principles of equity. This is undoubtedly true, and where the spouse has received depreciated property and the other legatees appreciated property and she objects, there is authority\textsuperscript{27} for requiring the executor to deal fairly in apportioning the property. However, it is suggested that the Commissioner was primarily concerned with situations where there has been collusion between the executors and the surviving spouse, the latter having agreed to accept the depreciated assets. In such an instance there is no one with standing, and incentive,\textsuperscript{28} to sue to compel the executor to deal equitably in apportioning the property.

The approach of the Commissioner in Rev. Proc. 64-19 was foreshadowed in his actions in Estate of Daniel Walsh,\textsuperscript{29} a case recently pending before the Tax Court. In Walsh a pecuniary interest formula\textsuperscript{30} was employed containing features which were later to be held objectionable by Rev. Proc. 64-19. In computing the taxable estate, the Commissioner limited the marital deduction to

\textsuperscript{25}Rev. Proc. 64-19, § 4.01.
\textsuperscript{26}Lauritzen, supra note 10, at 318; Lauritzen, The Treasury Department and the Marital Deduction Formula—Teapot Tempest in Washington, 7 Tax Counselor’s Q. 251 (1963).
\textsuperscript{27}Hall v. Commissioner, 150 F.2d 304 (10th Cir. 1945); Carrier v. Carrier, 226 N.Y. 114, 123 N.E. 135 (1919).
\textsuperscript{28}It would seem unlikely that the legatees who receive the appreciated assets would object to the widow’s receiving the depreciated ones.
\textsuperscript{30}The formula in Walsh reads:

such portion of my estate as will, but no more than is necessary to, produce the full allowable deduction ....

My Executors shall have full authority and discretion to satisfy this bequest, wholly or partly in cash or kind ... however ... any property so conveyed ... shall be valued for that purpose at the value thereof as finally determined for Federal estate tax purposes ....

Quoted in CCH, Marital Deduction Rule 9-10 (1964).
the value of the non-probate assets passing to the surviving spouse outside of the will. A marital deduction of 330,936.33 dollars was denied with respect to the pecuniary bequest.\footnote{Ibid.}

It is suggested that the Commissioner's approach in \textit{Walsh} and in Rev. Proc. 64-19 of denying the entire marital deduction will not be sustained by the courts, particularly where, although the instrument contains those features held objectionable by Rev. Proc. 64-19, the executor has, in fact, exercised his discretion fairly and equitably in apportioning the estate's assets. A more meaningful and less doubtful solution would be for the Commissioner to limit the deduction to the amount actually received by the marital distributee. The upper limit would still remain one-half of the adjusted gross estate while the lower limit would be the fair market value as of date of distribution of the property actually passing to the surviving spouse. Then, if there were to be collusion between the executor and the surviving spouse for the latter to receive depreciated assets, the estate's marital deduction would be limited to the value of those assets; and the estate, not being able to take maximum advantage of the marital deduction, would suffer an unnecessary tax burden. The possibility of losing part of the marital deduction should act as a sufficient deterrent to prevent the collusive practice of the executor and the surviving spouse. A denial of part of the marital deduction will increase the size of the taxable estate and correspondingly will increase the amount of the estate tax to be paid. The estate tax is generally held to be payable out of assets other than those comprising the marital share.\footnote{For a discussion of the law concerning the apportionment of taxes in the various states, see Durand, \textit{Marital Deduction Litigation}, 101 \textit{Trusts \\& Estates} 8 (1962).} The possibility of the legatee's having to pay a higher estate tax should act as a sufficient incentive to assure that all property is apportioned fairly and equitably. It has also been suggested\footnote{Burch, \textit{supra} note 9, at 647-48.} that the deduction could be limited to the value at the date of distribution of the maximum assets with which the bequest could be satisfied on the theory that this is all the surviving spouse received from the decedent, the excess being given to her by the executors. It is felt, however, that the latter would create an unnecessary fiction in the law.

In the light of Rev. Proc 64-19, providence suggests that, unless
the estate planner is prepared to litigate with the Commissioner and risk the loss of his client's marital deduction, a form of bequest should be employed which is acceptable under section 4.01 of Rev. Proc. 64-19. If the estate planner still prefers to use the pecuniary interest formula, it should be amended to comply with section 2.02 of Rev. Proc. 64-19 by adding: (1) a clause requiring the executor, when satisfying the bequest, to distribute assets, including cash, having an aggregate fair market value at the date, or dates, of distribution amounting to no less than the amount of that bequest, as finally determined for federal estate tax purposes, or (2) a clause requiring the executor to distribute assets, including cash, fairly representative of appreciation or depreciation in the value of all property thus available for distribution in satisfaction of the marital bequest. Consideration should also be given to the use of a fractional share formula which complies with the provisions of section 4.02 of Rev. Proc. 64-19. This formula has not received the attention shown the pecuniary interest formula because of the complexity of its administration. It was thought to require a fraction of each asset to be distributed to each beneficiary.  

It is suggested that whichever path is employed to escape its thrust, Rev. Proc. 64-19 may achieve a beneficial result by inspiring reviews of wills and testamentary plans, reviews which are often long overdue.

THOMAS E. CAPPS

Torts—Hospital's Liability—Standard of Care

In Darling v. Charlestown Community Memorial Hosp., action was brought by a patient to recover damages for personal injuries allegedly caused by the hospital's negligence. The court held that, even though there was no deviation from the local standard of care, the hospital was negligent for failing to adhere to its own regulations which required that it provide qualified physicians. The questions presented by the decision are whether a court should allow hospital rules in as evidence of a higher standard of care and, if it does, would such rules impose an undue burden on a layman administrator in requiring him to ensure that

24 CASNER, op. cit. supra note 8, at 798.