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The Estate Tax Marital Deduction - Current Considerations Under Revenue Procedure 64-19

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THE ESTATE TAX MARITAL DEDUCTION–CURRENT CONSIDERATIONS UNDER REVENUE PROCEDURE 64-19

"Revenue Procedure 64-19[1] is the most important single ruling concerning the allowance of the marital deduction. . . . It is must reading for all lawyers and fiduciaries."[2] The strength of this statement indicates the primacy to be accorded the Procedure. Its announcement caused a veritable inundation of fear, speculation, and comment. In response to its pronouncements attorneys hastened to rewrite or amend clients' wills, authorities warned of drastic tax consequences for failure to comply with its provisions, and state legislatures attempted to cure apparent deficiencies in their laws.

The Procedure serves to delineate the nature of an interest which qualifies for the marital deduction under particular circumstances; and in effect, it places the tax benefits of the deduction in jeopardy where there is a violation of its dictates. Thus, it is important that the attorney who is involved in planning and administering estates possess substantial understanding of the problems here involved, as well as their remedies.

The following is an examination of the problem to which the Procedure is directed, the collateral questions which may arise, and the available and potential solutions.

Nature and Use of the Marital Deduction

The marital deduction was established in 1948 for the purpose of giving to estates in common law jurisdictions the same tax benefits enjoyed by those in community property states.[3] The relevant section of the Internal Revenue Code[4] provides that up to one-half of a decedent's adjusted gross estate may pass to the surviving spouse free of estate taxes.[5] However, to qualify for this benefit the interest to which the survivor succeeds must be similar in nature to that recognized in the

1. 1 CUM. BULL. 682 (1964).

2. Lauritzen, *The Estate Tax Marital Deduction*, 103 TRUSTS & ESTATES 318 (1964).

3. Note, *The Estate Tax Marital Deduction–Revenue Procedure 64-19*, 41 IND. L.J. 711, 723 (1966).

4. INT. REV. CODE OF 1954, § 2056.

5. The adjusted gross estate is determined by subtracting from the gross estate expenses, indebtedness, taxes and losses under §§ 2053 and 2054 of the Code. It is also provided for in § 2056(c)(2)(A).

spouse of a community property state, *i.e.*, it must be a nonterminable interest, ascertainable at the time of death.[6]

With these concepts in mind it would be useful to examine the desires and status of the typical testator who will want to take advantage of the marital deduction. He and his wife are happily married (for convenience, the wife will be deemed to be the surviving spouse) and they have one or more beloved children. If the wife is independently wealthy the husband will give the children vested property interests to be enjoyed immediately; otherwise he will employ the "two-trust" will, giving the wife, and perhaps the children, the income from both trusts. One of these will be the "marital trust," giving her at least a general testamentary power of appointment,[7] while the "family trust" will be subject to any lesser interest in the wife, so that the corpus will not fall into her gross estate upon her death.

Our typical testator also has four purposes which he is attempting to effectuate by his will. The first, and most obvious, is to reap the tax benefits of securing the maximum marital deduction.[8] This he can accomplish by giving to the marital trust (or to the wife outright) a qualifying interest in at least one-half of the value of the adjusted gross estate.

His second desire is to prevent "overfunding" the wife's interest. If she takes more than the desired one-half (for example, if she is given all the assets, ignoring the "two-trust" method) serious tax consequences may ensue. The excess amount will presently be subject to estate taxes,[9] and upon a later sale, gift or devise by the wife, it may again incur a tax. This sort of "double taxation" can be avoided by judiciously apportioning values between the spouse's interest and that of the other legatees. Because of the improbability of accurately foreseeing subsequent fluctuations in value, the testator may well want to use some kind of formula clause which will permit so-called "post-mortem planning," by giving the executor some discretion in selecting assets to satisfy the bequests.

6. INT. REV. CODE OF 1954, § 2056(b)(1), (b)(5), (e); Treas. Reg. §§ 20.2056(b)-1, (b)-5 (1958).

7. INT. REV. CODE OF 1954, § 2056 (b)(5) provides that this is the minimum interest which qualifies for the marital deduction.

8. For example, if the taxable estate is $500,000.02, the estate tax is $145,700. By utilizing the maximum marital deduction, the taxable estate may be cut in half, to $250,000.01. The estate tax would then be $65,700, an actual saving of $80,000 in estate taxes (tax rates are found in INT. REV. CODE OF 1954, § 2001).

9. Subject, of course, to the $60,000 exemption, which is deducted from the adjusted gross estate in determining the taxable estate. INT. REV. CODE OF 1954, § 2052.

The achievement of flexibility, which is the third purpose of the husband, also yields a facility of administration, especially where there would otherwise result undesirable joint ownership, or a difficult division of assets. And, if possible, the testator would employ some mode of post-mortem planning which, although securing the full marital deduction, might permit satisfaction of the marital gift with as little actual value as possible (Revenue Procedure 64-19 is aimed at such a result).

The fourth goal is to prevent the estate from incurring a capital gains tax. A capital gain will be recognized whenever a pecuniary (or "dollar amount") bequest is satisfied in full with assets which have appreciated in value since the date of valuation for federal estate tax purposes.[10] The logic behind this policy is that the legatee takes by purchase, not by bequest, when the specific dollar amount is satisfied by, or exchanged for, the distributed assets.[11] Thus, if a $200,000 bequest may be satisfied with assets which, at the time of original valuation, were worth only $150,000, the estate has realized a $50,000 capital gain. To avoid incurring a capital gains tax, the will might provide a method which will not establish a specific dollar amount due. Another possibility is to require the use of some standard other than distribution date values for satisfying the bequest (in light of Revenue Procedure 64-19 such a standard may be fatal in regard to allowance of the marital deduction).

Marital Deduction Clauses

It would be helpful at this point to examine the different types of clauses which have been employed to achieve the marital deduction, as well as to consider the advantages and appropriateness of each in fulfilling the wishes of the testator.

1. The bequest, or transfer in trust, of specific assets.

Under such a clause the fiduciary, of course, has no discretion in the selection of assets, and the bequest or transfer (up to one-half) would clearly qualify for the marital deduction. There is no capital gains problem here, but the inflexibility of this type of clause could easily result in "overfunding" the wife's interest. Furthermore, it would be

10. The date of valuation may be either the date of death, or the alternate date one year thereafter. INT. REV. CODE OF 1954, § 2032. Of course, in times of inflating values, the executor will choose the death date for valuation purposes.

11. See Treas. Reg. § 1.1014-4(a)(3) (1957); Rev. Rul. 56-270, 1956-1 CUM. BULL. 325; Rev. Rul. 60-87, 1960-1 CUM. BULL. 286; Commissioner v. Brinckerhoff, 168 F.2d 436 (2d Cir. 1948).

most difficult to give the wife neither more nor less than would equal the maximum marital deduction. Unless the surviving spouse is to take a substantial (or entire) interest in the assets of the estate, the "specific assets" approach is obviously precarious where values are certain to fluctuate.

II. The bequest, or transfer in trust, of a fractional share.

This type of clause gives the recipient an interest in a precise percentage of the estate (for example, a straight one-half,[12] or a percentage to be determined by a formula). Any fluctuation in value will be shared by each fractional interest. Since there is no specific dollar amount to be satisfied, there can be no capital gains tax assessed against the estate upon distribution of appreciated assets.[13] Of course, the testator should not use such a clause where he wishes the spouse's interest to remain stable in terms of value, regardless of asset appreciation or depreciation.

A fractional share approach theoretically allocates part of each asset to the distributee, but if there will obviously be administrative problems[14] it would be desirable to draft a provision allowing the executor some flexibility in distribution, the only requirement being that the value finally received accurately reflect the fluctuation to be shared (such a clause really converts the fractional share into a type of pecuniary bequest, to be considered presently. It dictates that a certain value, to be adjusted according to fluctuation, is due).

The following is a simple, yet effective, fractional share clause:

> I give to the marital deduction trust that fraction of my residuary estate which will reduce the federal estate tax falling due because of my death to the lowest possible amount.[15]

12. Great care should be used when such fractional language is employed, for indiscriminate use may result in construction of the gift as a specific dollar amount due, and not a fractional share. For example, "an amount equal to one half of my adjusted gross estate" will probably be deemed a pecuniary, rather than a fractional bequest. Even "one half of my adjusted gross estate" may be so construed. See CASNER, ESTATE PLANNING 795, n.27b (3d ed. 1961, Supp. 1965).

13. Treas. Reg. § 1.1014-4(a)(3) (1957).

14. For example, there may be some valuable real estate or a family corporation, in which case allocating fractional owenrship may be difficult and undesirable.

15. From Wright, *The Marital Deduction since Revenue Procedure 64-19*, 106 TRUSTS & ESTATES 101 (1967).

III. The pecuniary formula bequest, or transfer in trust, the amount to be determined by estate tax values,[16] *to be satisfied with assets valued at distribution date.*

Under the pecuniary bequest the wife is entitled to a specific dollar amount, which amount is determined by the formula employed. Thus any appreciation or depreciation will be shared by the other legatees. This type of clause permits some post-mortem planning because of the discretion which the executor has in selecting assets to satisfy the bequest. Thus it is conceivable that the fiduciary could distribute to the wife wasting assets, or assets likely to depreciate in value, so that her subsequent estate would not be unnecessarily inflated. Of course, if the wife's bequest is satisfied with appreciated assets, the capital gains problem[17] would arise; while a general depreciation of the value of assets would result in "overfunding" the widow.[18]

The following is a pecuniary formula clause:

> If my wife survives me, I give to [her or the trustee] the following:
> An amount equal to 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 of all items in my gross estate which qualify for said deduction 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 pecuniary bequest.[19] In making the computations necessary to determine the amount of this pecuniary estate tax marital deduction gift, values as finally determined for federal estate tax purposes shall control.[20] The payment of this amount may be made wholly or partly in kind by transferring to [my

16. According to Wright, *supra* note 15, "income tax basis" should be used rather than "estate tax values," since property acquired by the estate may not have an estate tax value. However, for purposes of this discussion "estate tax value" language is more illustrative of the questions involved.

17. See discussion under NATURE AND USE OF THE MARITAL DEDUCTION, *supra*.

18. *Id.*

19. This provision, allowing credit for value which otherwise passes to the wife, and which qualifies for the marital deduction, is inserted to prevent "overfunding," *i.e.* giving her more than necessary to secure the maximum marital deduction.

20. CASNER, *op. cit. supra* note 12, at 794, n. 25 (Supp. 1965).

> wife or the trustee] specific securities or other personal property at values current at the date of distribution.[21]

IV. The pecuniary formula bequest, or transfer in trust, the amount to be determined at estate tax values, with sharing of appreciation and depreciation to date of distribution.

Like the previous formula, this one permits great flexibility in the selection of assets to satisfy the bequest. However, here the wife's share is subject to changing values, with the attendant possibility that she may receive a greatly diminished share (disastrous, if she requires much) or a greatly inflated share (equally disastrous, tax-wise, because of the overfunding). Obviously this type of clause should not be used where such harmful changes of value can be foreseen.

This particular formula closely resembles the pure fractional share formula, but it differs because it frees the fiduciary from having to divide up each class of assets, an often impossible task. Of course, use of this formula avoids the capital gains problem, as is true of the fractional share formula.

To utilize this type of bequest, simply replace the last sentence in the basic pecuniary formula clause set out in subsection *III* above with the following:

> The assets to be distributed in satisfaction of this bequest will be selected in such manner that cash and other property distributed will have an aggregate fair market value fairly representative of the distributee's proportionate share of the appreciation or depreciation in the value to the date, or dates, of distribution of all property then available for distribution.[22]

V. The pecuniary bequest, or transfer in trust (either formula or stated amount), to be satisfied in kind with assets to be valued for distribution at their federal estate tax values.

Before evaluating this type of clause one should be made aware that its use has been rendered most *inadvisable* in light of Revenue Procedure 64-19.[23]

This form was specifically developed to avoid the capital gains prob-

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21. *Id.* at 816.

22. From Sugarman, *Pecuniary Formula Marital Deduction Bequests: Application of Revenue Procedure 64-19*, 16 W. Res. L. Rev. 257, 277 (1965).

23. See discussion under Revenue Procedure 64-19, *infra*.

lem; and indeed it did accomplish this end, for no change in value of the assets was to be considered at distribution—the only governing values for distribution purposes were to be estate tax values. Furthermore, the executor would have great leeway in selecting assets according to their behavior after the death of the testator. It is apparent that under such a clause the fiduciary could divert the stable or grossly appreciated assets to the children, while appropriating depreciated (or perhaps worthless) assets to the wife. Consider the following example:

$1,000,000 adjusted gross estate,[24] consisting of

	ABC Corp. Stock	XYZ Corp. Stock
Estate Tax Value	$500,000	$500,000
Distribution Date Value	100,000	900,000

If the executor may consider only estate tax values upon distribution, he can satisfy the wife's bequest with the ABC Corp. stock (which has greatly depreciated) while the children can receive the XYZ Corp. stock (which has greatly appreciated). Yet the estate would have received the benefit of the full marital deduction, despite the discrepancy in value received.

This seems to be the perfect solution, for the estate would get the maximum marital deduction and would realize no capital gain; the children would take most of the value at distribution; and the surviving spouse would be happily "underfunded," taking little actual value to be taxed upon later sale, gift, or bequest. Thus came a statement of disapproval by the Internal Revenue Service.

Revenue Procedure 64-19

Revenue Procedure 64-19[25] is directed toward pecuniary bequests (whether dollar amount or formula) where the executor may (or must) satisfy the gift in kind with assets at their federal estate tax values. Under such a provision the marital deduction will be disallowed, regardless of how distribution actually occurs, unless it is clear "either by applicable state law or by the express or implied provisions of the instrument . . . that the fiduciary . . ." is bound exclusively by one of the following alternatives:

24. See *supra* note 5.
25. 1 Cum. Bull. 682 (1964).

(1) He "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. . . ." [26] (the "minimum value" approach) or

(2) He "must distribute assets, including cash, fairly representative of appreciation or depreciation in the value of all property thus available . . ." for satisfaction of the marital bequest (the "ratable sharing" approach).[27]

The Procedure expressly does not apply to a bequest, or transfer in trust, of specific assets;[28] or to a fractional share bequest, or transfer in trust.[29] Nor does it apply to a pecuniary gift (whether a formula or stated amount) if the fiduciary must satisfy the bequest only in cash; if he has no discretion in selecting the assets to be distributed in kind; or if the assets selected to be distributed in kind must be accorded their values at the time of distribution.[30]

Section (3) of the Procedure[31] provides that the marital deduction may still be allowed under an offending instrument which was executed before October 1, 1964, if the fiduciary and the surviving spouse enter into certain prescribed agreements. The agreements in effect say that the executor will use the "ratable sharing" approach in distributing the assets; and that the widow, to the extent she does not fully share in appreciation, will be deemed to have made a gift over to the other distributees, thereby incurring a gift tax when appropriate under the Internal Revenue Code.[32]

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26. *Id.* § 2.02 at 683.

27. *Ibid.*

28. *Id.* § 4.01 at 684. For analysis of such a bequest, see discussion under MARITAL DEDUCTION CLAUSES, subsection *I.*, *supra.*

29. *Ibid.* For an example and analysis of such a bequest, see MARITAL DEDUCTION CLAUSES, subsection *II.*, *supra.*

30. *Ibid.* For an example and analysis of such a bequest, see MARITAL DEDUCTION CLAUSES, subsection *III*, *supra.*

One writer speculated that, where the surviving spouse is the sole executor, his "discretion would appear to be subject to the same basic objection from the standpoint of the Treasury as such discretion granted in the fiduciary" (Lloyd, *Background of Drafting Problems,* 103 TRUSTS & ESTATES 898, 900 [1964]). However, the Internal Revenue Service later declared its position that the Procedure would not apply where the wife is the sole executrix, and that any discrepancy in value distributed would be treated as a gift (Mr. Mitchell Rogovin, then-Chief Counsel, Internal Revenue Service, *The Sound and the Fury,* 104 TRUSTS & ESTATES 432 [1965]).

31. 1 CUM. BULL. 682, 683-684 (1964).

32. The gift tax provisions of the INT. REV. CODE OF 1954 may be found in §§ 2501-2524.

Much initial comment regarding the Procedure concerned the effect of amending a "pre-October 1, 1964" will by codicil, which act "re-executes" the will as of the date of amendment. Most writers were concerned that such re-execution would disqualify an estate from eligibility to take advantage of the agreements in order to save the marital deduction.[33] The Internal Revenue Service attempted to quiet this anxiety by stating its position that, as long as the codicil did not involve the marital bequest, the time of original execution of the instrument would govern.[34]

REASONS FOR THE PROCEDURE

Why did the Internal Revenue Service issue Revenue Procedure 64-19? One authority thought it was entirely unnecessary since, even under the broad discretion given the executor under the offending clause a fiduciary must act fairly toward all beneficiaries, he therefore could not satisfy the wife's bequest with the depreciated assets.[35] However, he indicated that the Treasury probably feared collusion between the spouse and the executor whereby they might "play games" with the assets to achieve the desired result.[36]

Section (2.03) of the Procedure states that, if the fiduciary's discretion is not limited to one of the two alternatives[37] when the condemned clause is used, "the interest in property passing from the decedent to his surviving spouse would not be ascertainable as of the date of death." [38] The Commissioner of Internal Revenue[39] emphasizes that, unless the requirements of the Procedure are fulfilled, the executor will have the power to appoint part of the marital deduction bequest to persons other than the surviving spouse, a further reason for disallowance of the deduction.[40] Furthermore, the Commissioner says that allowing the marital deduction in such a case would give this tax benefit to the estate

33. See, *e.g.*, Lauritzen, *supra* note 2, at 397; Polasky, *Marital Deduction Formula Clauses in Estate Planning—Estate and Income Tax Considerations*, 63 MICH. L. REV. 809, 826 (1965).

34. See Rogovin, *supra* note 30, at 435; P-H EST. PLANNING, FED. EST. & GIFT TAXES, Vol. 3, ¶ 142,066.

35. See, *e.g.*, Lauritzen, *supra* note 2, at 318-319.

36. *Id.* at 319.

37. See discussion under REVENUE PROCEDURE 64-19, *supra*, concerning the "minimum value" and "ratable sharing" approaches.

38. 1 CUM. BULL. 682, 683 (1964).

39. Mr. Sheldon S. Cohen in *Treasury Views on Current Questions*, 104 TRUSTS & ESTATES 9 (1965).

40. See, INT. REV. CODE OF 1954 § 2065 (b)(5); Treas. Reg. § 20.2056(b)-5(j) (1958).

for property which never passed to the wife, and which would not become part of the wife's estate upon her death.[41] The Commissioner also states that the wife's basis for the depreciated property is the higher, estate tax value, thus giving her a potential capital loss if she disposes of it.[42] Also, the provision for the signed agreements was not inserted to prevent misdealing, but rather it serves to inform both the fiduciary and the spouse of exactly what is required. Where the wife has predeceased actual distribution of her husband's estate, the agreements also serve to bind her executors to claim a share of any appreciation, rather than just the dollar amount of the marital bequest.[43]

New "Hybrid" Pecuniary Formula Bequest

One consequence of the Procedure has been the advocacy of a so-called "hybrid" pecuniary formula clause, which appears to satisfy the "minimum value" test.[44] The clause provides that the pecuniary amount may be . . .

> satisfied either by distribution in cash, or a distribution in kind . . ., but to the extent a distribution in kind is made, the property . . . must be assigned as its value in satisfying the pecuniary amount, its [estate tax value] or its value as of the date of distribution, whichever is lower.[45]

41. Cohen, *supra* note 39, at 9.

42. *Ibid.* The Commissioner's statement seems consistent with the general concept that satisfaction of a pecuniary bequest with assets is a sale or exchange (see discussion under NATURE AND USE OF THE MARITAL DEDUCTION, *supra*). Thus, the wife's basis is what she paid for the assets, *i.e.* her claim against the estate for a specific dollar amount.

However, a literal reading of Treas. Reg. § 1.1014-4(a)(3) (1957) suggests otherwise. It states that, where the transfer constitutes a sale or exchange, the wife's basis is the fair market value of the assets at the time of distribution (also see *supra* note 3, at 714). However, it also provides that the transferor must recognize any gain or loss, as required by the revenue laws. So, perhaps this basis provision only applies where a capital gain may be realized (such cannot happen under the offending clause); and the examples in the Regulation only concern situations where a capital gain is recognized.

Furthermore, the Regulation declares that, in case of a fractional bequest, no capital gain or loss can be realized; and the legatee's basis for the property received would be its value as of the date of death (or alternate date). It would seem that the offending clause presents an analogous situation, since no gain can be recognized thereunder, and the actual value to be received by the wife is an unknown factor. This concept would classify a distribution under the condemned clause somewhere between a sale or exchange under a pecuniary bequest, and a direct passage of property under a fractional share bequest.

43. Mr. John T. Sheets, Estate & Gift Tax Branch, Internal Revenue Service in *Practical Solutions to 64-19*, 104 TRUSTS & ESTATES 71 (1965).

44. See discussion under REVENUE PROCEDURE 64-19, *supra.*

45. CASNER, *op. cit. supra* note 12, at 816, n.64 (Supp. 1965). See also Colson, *The*

The test is satisfied, for the fiduciary is required to satisfy the marital gift with value at least equal to the marital deduction. Under this clause the wife cannot share in any general depreciation, but she may share in any appreciation of value.

This "hybrid" clause allows for considerable flexibility and post-mortem planning, since the executor has wide discretion in the selection of assets. Furtherfore, as long as the wife is given the minimum marital deduction value, the fiduciary is not bound to allocate to her share any appreciation (thus avoiding "overfunding"). Also, by diverting appreciation to the residuary trust (or to the other distributees) it will escape taxation upon the death of the wife. Another beneficial aspect is that there can be no capital gain realized by the estate, for even if appreciated assets are used to satisfy the bequest, they are to be allocated at estate tax values. Thus the estate would not be settling a claim for less than its basis of the assets distributed.[46]

It is reassuring to know that this "hybrid" clause has the blessing of the Internal Revenue Service.[47] However, the attorney must realize that there are some circumstances under which this particular clause should not be employed. One author warns that, where the wife or the residuary beneficiary is the sole executor, or either is co-executor with a bank, the discretionary power to select the assets may result in imposition of a gift tax where appreciation is diverted away from the executor's share.[48] Nor should this clause be used where the testator desires a charitable deduction for the residuary trust,[49] since the marital bequest is represented by a minimum, but no maximum value. Thus, all appreciated assets might be allocated to the marital gift, while all depreciated assets could go into the residue. The result would be an uncertainty of interest in the charitable bequest, with the possibility that it would receive even less than its estate tax value, designated for the deduction.[50] If the charitable legacy were made specific (in a will using the "hybrid" marital deduction clause), certainly one of the two deductions could not be allowed; for, if the estate depreciates in value, it might not be possible to satisfy both the marital deduction and the

Marital Deduction and Revenue Procedure 64-19, 10 PRAC. LAW. 69, 76-77 (Oct. 1964); Weinstock, *The Marital Deduction—Problems and Answers under Revenue Procedure 64-19*, 43 TAXES 340, 346 (1965); Wright, *supra* note 15, at 108-109.

46. Wright, *supra* note 15, at 106.

47. Rogovin, *supra* note 30, at 433.

48. Wright, *supra* note 15, at 109.

49. *Ibid.* For the charitable deduction provisions, see INT. REV. CODE OF 1954 § 2055.

50. Wright, *supra* note 15, at 109.

charitable deduction bequests, and it is such possibilities which disallow a deduction, regardless of what actually occurs. Finally, this minimum value approach should not be used where asset depreciation can reasonably be foreseen, unless it is the testator's purpose to assure a minimum value for the marital gift.

"APPLICABLE STATE LAW"

Under a condemned pecuniary clause, the marital deduction will be allowed where "by applicable state law" the fiduciary is bound by either the "minimum value" test or the "ratable sharing" test.[51] However, only a gambling testator or executor would act on the belief that there is sufficient state law to assure compliance with the Procedure. One writer argued that the requirement should always be satisfied, since a fiduciary must act according to basic equitable principles.[52] Others declared that in only Illinois,[53] New York, and "perhaps" Oregon[54] was the case law certain enough on the matter, at the time the Procedure was issued. Another writer claims knowledge of but four states where the fiduciary must use distribution date values, where the instrument is silent as to mode of valuation.[55]

The first reaction to the obvious gap in definitive state law occurred in Mississippi, where the legislature passed a law requiring the fiduciary to choose either the "minimum value" approach or the "ratable sharing" approach in the applicable situation.[56] However, it soon became apparent that this law only made matters worse; for, by forcing him to select one or the other of the methods, the statute actually compelled the fiduciary to exercise the very discretion which would serve to disallow the marital deduction.[57] Since he could still manipulate the various interests after the death of the testator (indeed, if the estate appreciated he could use the "minimum value" method, while if it depreciated he could use the

51. See discussion under REVENUE PROCEDURE 64-19, *supra*.

52. Lauritzen, *The Estate Tax Marital Deduction*, 103 TRUSTS & ESTATES 318, 318-319 (1964) (citing cases in point).

53. Cantwell, *Statutory Relief*, 104 TRUSTS & ESTATES 953 (1965).

54. *Ibid.; see also*, Covey, *Statutory Panacea for 64-19*, 104 TRUSTS & ESTATES 69 (1965).

55. Wright, *The Marital Deduction since Revenue Procedure 64-19*, 106 TRUSTS & ESTATES 101, 107 (1967).

56. Miss. Gen. Acts 1964, S. No. 2059 § 1.

57. See Note, *Marital Deduction Pecuniary Formula Bequests: Revenue Procedure 64-19 and N.Y. Personal Property Law § 17-f*, 30 ALBANY L. REV. 262, 267-268 (1966); Cantwell, *supra* note 53, at 953; Cohen, *supra* note 39, at 10; Covey, *supra* note 54, at 69.

"ratable sharing" method) the interests would be neither ascertainable nor non-terminable. Fortunately, this problem is now academic, since the law was repealed and replaced in 1966.[58]

At this time thirteen states have passed legislation to satisfy the demands of the Procedure. Eleven of the statutes adopt some form of the "ratable sharing" test,[59] while New York has overturned its qualifying case law[60] by enacting a type of "minimum value" statute,[61] which direction was also pursued by California.[62]

The Virginia statute—the "ratable sharing" approach.

Having the advantage of hindsight regarding Mississippi's unfortunate error, Virginia passed corrective legislation which binds the fiduciary to follow the "ratable sharing" approach.[63] Basically, the statute requires the fiduciary to value the assets as of the time of distribution, unless the governing instrument specifically provides otherwise. This provision settles any question as to time of valuation where the will is silent on the matter. Furthermore, where the will directs use of estate tax values (or any date other than that of distribution), the executor must satisfy the bequest by apportioning any depreciation or appreciation, unless the instrument clearly calls for the "minimum value" approach. Thus, under such a "ratable sharing" statute, the estate will lose the marital deduction only where the instrument forbids pro rata sharing in value fluctuation, and where it is silent as to fulfillment of the "minimum value" test.[64]

Whether this type of statute is the better will depend upon the result

58. Miss. Gen. Acts 1964, S. No. 2059 § 1 was repealed. It was replaced by a "ratable sharing" statute which became effective May 20, 1966. Miss. Code Ann. § 644.7 (Supp. 1966). This act applies "to wills of decedents dying before or after" May 20, 1966 (§ 2), and "is not intended to imply that the present law of the State . . . has been otherwise. . . ." (§ 3).

59. Colo. Revised Stats. Ann. (citation unavailable); Fla. Stats. Ann. § 734.031 (Supp. 1966); Ann. Code of Md. Art. 93, § 392 (Supp. 1966); Minn. Stats. Ann. ch. 765, § 525.528 (Supp. 1965); Miss. Code Ann. § 644.7 (Supp. 1966); Gen. Stats. of N.C. § 28-158.1 (Supp. 1965); Page's Ohio Rev. Code Ann. § 1339.41 (Curr. Material); Code of Laws of S.C. § 19-567 (Supp. 1966); Tenn. Code Ann. § 30-1317 (Supp. 1965); Va. Code Ann. § 64-71.2 (Supp. 1966); West's Wis. Stats. Ann. § 318.15 (Supp. 1967).

60. Note, *supra* note 57, at 269, citing case law and a private letter ruling by the Internal Revenue Service, acknowledging New York's "ratable sharing" requirement.

61. N.Y. Personal Property Law § 17-f (Supp. 1966).

62. Cal. Probate Code § 1029 (Supp. 1966).

63. Va. Code Ann. § 64-71.2 (Supp. 1966).

64. *The Annual Survey of Virginia Law*, 53 Va. L. Rev. 181, 251 (1967).

of each case where it is applied. Of course, it eliminates the capital gains and charitable residuary problems;[65] but, at the same time, it effectively ignores the intent of the testator, since a type of fractional share is substituted for a dollar amount legacy.[66] However, an effective counter to this argument is the probable governing intent of the testator to secure the marital deduction, rather than to lose it because of a refusal to apportion fluctuation in value. Also, it is said that this type of statute yields more equitable results, for all beneficiaries share in any appreciation or depreciation.[67] This argument is certainly valid in a situation where the executor is not otherwise required to follow any particular standard in distributing the assets.[68]

The New York and California statutes—the "minimum value" approach.

The New York response to Revenue Procedure 64-19 was enactment of a statute requiring the executor to distribute assets having a value, at time of distribution, "no less than" the amount of the pecuniary bequest, and "to the extent practicable" no more than that amount.[69] This legislation requires satisfaction of the gift with value equal to the pecuniary amount, with the added leeway that, in dividing up the property, the fiduciary may appropriate a greater value to the marital gift if ease of administration so requires. It is recited in the code section that this law represents an ". . . aggregate value rule which carries out, as nearly as possible, the intention of the testator . . . to give a fixed amount not subject to fluctuation." [70]

It is difficult to tell what this definite-minimum, yet only reasonably certain-maximum test will yield in terms of the charitable deduction and capital gains problems.[71] Perhaps the Internal Revenue Service will examine each situation to see whether there is any real question as to the

65. In this respect, its operation resembles a fractional share bequest, with sharing of appreciation or depreciation. See discussion under MARITAL DEDUCTION CLAUSES, subsection *II, supra.*

66. Covey, *supra* note 54, at 70.

67. Note, *Estate Tax Marital Deduction—Compliance with Revenue Procedure 64-19*, 18 VAND. L. REV. 319, 323 (1964).

68. It is interesting to note that the Minnesota "ratable sharing" statute (*supra* note 59) contains a "dangerous exception" (Cantwell, *supra* note 53, at 954) which converts every pecuniary bequest into a "ratable sharing" formula, unless the instrument specifically refers to the statute, declaring that it shall not apply.

69. N.Y. PERSONAL PROPERTY LAW § 17-f (Supp. 1966).

70. *Ibid.* See "Note of Commission."

71. See Note, *supra* note 57, at 271.

precise interests involved. Certainly, if the amount of the pecuniary bequest is satisfied with greatly appreciated assets, a capital gains tax will be imposed.

Because of the mild confusion inherent in the New York statute, some writers would prefer a simple "equal to" statute to meet the "minimum value" test.[72] Such legislation would comply with the testator's intent that the wife receive a fixed dollar amount, but it would also effectively ignore the "estate tax value" language of the instrument. Again, however, the primary purpose of the testator is usually to obtain the maximum marital deduction. Certainly, where affirmation of this desire is evidenced by a "bootstrap" clause, ignoring the "estate tax value" language may be readily justified.[73]

California chose to use the language of the Revenue Procedure in requiring that the property distributed have a value "no less than" the amount of the bequest.[74] As long as the property distributed has an estate basis at least equal to the minimum amount to be satisfied, there should be no capital gains tax imposed. However, serious problems may confront the executor, for he is under a duty to act impartially as to all beneficiaries. Since the California statute establishes only a minimum and no maximum amount, the fiduciary is seriously lacking in guidelines when he must decide on a proper distribution of assets. Theoretically, he could allocate the entire estate to the marital gift, leaving the residuary beneficiaries out completely. This, of course, could hardly be called impartiality, and such action would most certainly be a breach of fiduciary duties.

There are some other generally recognized detrimental aspects of "minimum value" legislation. First, the wide discretion of the executor may render the charitable residuary interest unascertainable, terminable, and therefore non-deductible.[75] Also, if the estate severely depreciates in value, there might be nothing left for the other legatees, after satisfaction in full of the marital gift. Of course, this result would not obtain under a "ratable sharing" statute where all interests would share in fluctuations of value. Finally, overfunding the wife's interest is a concomitant problem, in case of asset depreciation.

72. See, *e.g.*, Cantwell, *supra* note 53, at 954; Covey, *supra* note 54, at 70.

73. Covey, *supra* note 54, at 70.

74. CAL. PROBATE CODE § 1029 (Supp. 1966). Although California is a community property state, this statute will apply to that non-community property which falls into the adjusted gross estate. See INT. REV. CODE OF 1954 § 2056 (c)(2)(B).

75. See discussion under NEW "HYBRID" PECUNIARY FORMULA BEQUEST, *supra*.

A "preferred solution?"

One writer has proffered a legislative solution to the adversities of adopting one or the other of the alternatives.[76] The statute would provide that, under an offending will, a local court would determine whether the decedent intended a dollar amount legacy, or whether he intended a fractional share. Upon this determination the law would require application of the "equal to" approach if a legacy, or the "ratable sharing" approach if a fractional share was intended. This, says the proponent, would least subvert the testator's intent, while assuring qualification for the marital deduction.[77] The "estate tax value" language, under this statute, would not automatically be construed so as to convert an intended legacy into a fractional share. Furthermore, the charitable deduction problem would not appear,[78] and the capital gains question could arise only if judicial construction indicates an intent to use the dollar amount legacy. However, it is recognized that such a statute is simply a "method of ignoring 'estate tax value' language and . . . giving lip service to the decedent's presumed intent. . . ." [79]

This type of approach was considered by the state of Florida[80] but it was subsequently rejected in favor of a "ratable sharing" statute,[81] so it has not yet been enacted in any jurisdiction.

EXECUTING THE AGREEMENTS OF REVENUE PROCEDURE 64-19

The agreements set out in the Procedure[82] are, of course, required to correct a condemned "pre-October 1, 1964" instrument only where state law is insufficient or uncertain regarding the two tests discussed in the Procedure.[83] It should be pointed out that two of the states which have passed corrective legislation concerning the duties of the fiduciary, have also expressly authorized the making of any agreement which assures allowance of the marital deduction, and the performance of all acts incident thereto.[84]

76. Covey, *supra* note 54, at 70.
77. *Ibid.*
78. *Ibid.*
79. *Ibid.*
80. *Ibid.*
81. Cantwell, *supra* note 53, at 953.
82. See discussion under REVENUE PROCEDURE 64-19, *supra.*
83. *Ibid.*
84. GEN. STATS. OF N.C. § 28-158.2 (Supp. 1965); VA. CODE ANN. § 64-71.2 (Supp. 1966). Mississippi had also authorized the making of such agreements (Miss. Gen. Acts of 1964, S. No. 2060 § 1), but this law has been repealed, *supra* note 58, and the new statute, *supra* note 58, does not have this provision.

When the agreement would be required to secure the marital deduction, there may still be a question of whether the fiduciary has the power to enter into it. Indeed, a change in the terms of the will is involved, since a pecuniary bequest is thereby converted into a fractional share; and such alteration of the instrument is contrary to the case law of some jurisdictions.[85] Executing the agreement would also be beyond the executor's power where the testator's primary intent may be construed as precisely determining the wife's share, rather than securing the marital deduction.[86] Furthermore, the possible adverse effect of the agreement upon the other beneficiaries (in case of appreciation, the wife must share therein[87]) may be deemed a violation of the executor's duty of impartiality toward all the legatees.[88] However, one authority suggests that executing the agreement may well be considered consistent with the broad discretion regarding distribution of the assets granted by the decedent.[89]

Entering into the agreement would surely be a violation of the executor's duties where the instrument may reasonably be construed as requiring some approach other than "ratable sharing." [90] Indeed, where state case law would require construing the clause as a fixed sum, the agreement would clearly be proscribed.[91]

As to when the agreements must be filed, the Internal Revenue Service suggests that they accompany the return, although they would be accepted as late as the time of auditing the estate.[92]

Conclusion

The initial fear provoked by Revenue Procedure 64-19 has since subsided. The validity and the value of responsive state legislation have been well evaluated, so that those jurisdictions which have thus far abstained from enacting statutes might proceed, in order that a poorly structured clause can be prevented from causing disallowance of the

85. See Lauritzen, *supra* note 52, at 320.

86. Sugarman, *Pecuniary Formula Marital Deduction Bequests: Application of Revenue Procedure 64-19*, 16 W. Res. L. Rev. 257, 267 (1965).

87. See discussion under Revenue Procedure 64-19, *supra*.

88. See Polasky, *Marital Deduction Formula Clauses in Estate Planning—Estate and Income Tax Considerations*, 63 Mich. L. Rev. 809, 823 (1965).

89. *Id.* at 823-824.

90. Sugarman, *supra* note 86, at 267.

91. See Note, *Marital Deduction Clauses*, 53 Geo. L. J. 791, 782-793 (1965) (citing cases in point).

92. Sheets, *supra* note 43, at 72.

marital deduction. Only experience can indicate what form the legislation should take, but there seems ample logic for enacting the "preferred solution,"[93] which has so far been rejected. While some legislatures might hesitate to burden their courts further with the duty to construe the donor's intent, hopefully there would be very few cases where the condemned clause would appear so as to raise the issue. In any event, it is apparent that legislation which clearly defines the duties of the fiduciary in a "Revenue Procedure 64-19" situation would serve the vital function of releasing him from any doubt-provoked hesitancy to act; and the beneficiaries would be made equally certain of what they may expect.

Although the automatic tax avoidance of certain property in community property states is a decided advantage over the occasional uncertainty of achieving the marital deduction, the Procedure has certainly clarified the law in one hazy estate planning area.[94] Where "*alia acta est*," the attorney should be able to determine the feasibility and advisability of entering into the requisite agreements. Furthermore, the diligent lawyer who has full knowledge and understanding of the problems and solutions under the Procedure, should be able to draft an instrument which will comply with its requirements. A trite but true statement is that each estate is unique, and ultimately the most satisfactory results will obtain where thoughtful planning prevails. Under the present law there is always some gamble involved in each case in regard to satisfying fully the wishes of the testator, but it is up to the draftsman to achieve the best odds for the estate.

Charles E. Kent

93. See discussion under APPLICABLE STATE LAW, "*A Preferred Solution?*" *supra*.

94. While the present status of the law seems quite clear, ominous notes regarding the future occasionally sound. For example, in *Tax Clinic*, J. ACCOUNTANCY 75, 76 (January, 1967), it is stated that "From a technical standpoint, one government official asserts that with [marital deduction formulas] nothing really qualifies for the marital deduction, since there is no vesting at the time of death. Instead, there are contingencies that must abide the outcome of estate tax values and the determination of whether expenses are taken in the income tax return or the estate tax return."

If this idea were to prevail, it is conceivable that the only sure way to secure the marital deduction would be to use a specific bequest, with all its attendant disadvantages. Such a change in position by the Treasury would certainly cause great outcries of disapproval. Perhaps the only tenable solution would be for Congress to set out precisely what will and what will not qualify for the marital deduction. In light of the uncertainty that such a solution would be provided, one may readily envision a race by the state legislatures to enact community property laws, to protect their estates from the possible caprices of administrators. Hopefully, no such crisis will arise.