

THE MARITAL DEDUCTION

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As is so often the case, Earl and Betty Beaver have simple one-page wills in which each of them leaves his entire estate outright to the other. Thus, each of them has already made full use of the estate tax marital deduction, and some of the sting resulting from the grant of too much property from each to the other has been eliminated by the 1954 change in the rules governing the estate tax credit for property previously taxed.¹ If Earl Beaver should die while his present will is in effect, his federal estate tax would be approximately \$30,000. Since all his property is left to Betty Beaver, the estate tax on her death, computed on the assumption that the same property should remain in her estate at the same value and without regard to possible utilization of the credit for property previously taxed, is approximately \$90,000. Effective use of the marital deduction—qualifying just enough and not too much—can reduce this second tax, on the same circumstances and assumptions, to approximately \$32,000. Obviously, Earl Beaver's will must be changed; and it is equally clear, considering taxes alone, that Betty Beaver's will should be changed so as not to pile her small estate on Earl's large one.

GENERAL

With this introduction, I will review certain aspects and current problems involved in the use of the marital deduction—the federal estate tax deduction for property passing from one spouse to another under certain conditions and subject to certain limitations. The discussion below by no means purports to be a complete or comprehensive review of all the technical niceties of the marital deduction; there is neither time nor space nor need for such a work.² Instead it is limited to a rapid coverage of certain aspects which may be of particular interest at this time to Ohio lawyers, with examples of provisions suggested by a leader in this field.

WHETHER AND TO WHAT EXTENT TO USE THE MARITAL DEDUCTION

Since enactment of the Revenue Act of 1948, full use of the marital deduction has become a habit and, like most habits, is hard to break. Since drafting a will is a rather unrewarding and tiresome

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¹ INT. REV. CODE OF 1954, § 2013, extends the period in which the credit is allowed to ten years and allows a 100 per cent credit if the initial transferor's death occurred within two years of that of the decedent, declining twenty per cent each two-year period thereafter.

² For complete discussions, see LOWNDES AND KRAMER, *FEDERAL ESTATE AND GIFT TAXES* 371-422 (1956); CASNER, *ESTATE PLANNING* 634-93 (2d ed. 1956); SHATTUCK AND FARR, *AN ESTATE PLANNER'S HANDBOOK* 253-75 (2d ed. 1955).

process, which may also be time-consuming, the easier course is to follow the familiar path, employ the usual clauses and reach the customary result. But one cannot overstate the necessity of making a careful examination of all the facts of each situation and of making an independent judgment and recommendation, based upon such specific facts, as to whether the marital deduction should be used at all and, if so, to what extent. In performing this job, the draftsman should consider the factors which are reviewed below, but consideration cannot be limited to such factors alone.

The first thing to do is to obtain and examine the arithmetical facts of the specific case.³ For the Beavers, it should suffice to point out that under the circumstances existing at the time of consultation the marital deduction should not be used in Mrs. Beaver's will,⁴ and, as shown above, rewriting Earl Beaver's will so as to eliminate the over-qualification of assets for the marital deduction should effect a very substantial decrease in aggregate taxes on passing the Beaver property to the next generation.

The Beaver facts as changed by the proposed gift program present a different and more difficult question in which there is not such a great disparity in value between the estate of the husband and that of the wife. Under such circumstances, arithmetical computations, excluding all other factors, point toward a marital deduction bequest in the larger estate equal to one-half the excess of the larger over the smaller estate.

One should not overlook another advantage of the marital deduction; even if it may not decrease total taxes payable on transmission of property to the next generation, deferment of payment of a substantial part of such aggregate taxes is itself a major benefit. Reducing the tax burden in the estate of the spouse first to die to the maximum extent means that the funds which otherwise would have been employed to pay such tax will be available to the second spouse during his or her lifetime for the production of income. Particularly in the case of a young couple or a May-and-December marriage surprising results can be determined by the use of tables showing the present value of a right to future income over the remaining lifetime of the surviving spouse.⁵ The value of this income right, even after reduction by income taxes to be imposed upon it, may well offset any estate tax detriment in taking maximum use of the marital deduction. Furthermore, it should be re-

³ For a brief but excellent discussion, see TWEED AND PARSONS, *LIFETIME AND TESTAMENTARY ESTATE PLANNING* 38-41 (rev. ed. 1955).

⁴ The estate tax exemption of \$60,000 is more than sufficient to cover the property to be included in her estate on the facts which are stated and, presumably, provable. INT. REV. CODE OF 1954, § 2052. *But see* the discussion *supra* dealing with the difficulty of proving the source of funds used to acquire joint and survivorship property. Alexander, *Joint and Survivorship Property*, 20 OHIO ST. L.J. 75, 78 (1959).

⁵ See Rev. Reg. § 20.2031-7(f).

called that the estate tax rates progress very slowly,⁶ and there may be no additional estate tax cost in over-qualification to a small extent.

Another and more important reason why the result of an exercise in basic arithmetic should not automatically result in rejection of use of the marital deduction is that shrewd taxpayers may not only have their cake but may eat a substantial part of it. The property qualifying for the marital deduction may be consumed by the surviving spouse or given away by her, in whole or in part, thus escaping the estate tax penalty otherwise imposed upon the second estate as a condition to tax reduction in the first. This advantage should be borne in mind by the draftsman and explained to the client, for it affords an excellent method of transmitting property to the next generation at minimum tax cost. Whenever feasible, the marital deduction trust should be drawn in very broad terms so as to permit invasion and consumption of principal, with consequent conservation of income of the so-called "B" trust which will not be included in the estate of the surviving spouse.⁷ Furthermore, the surviving spouse should be given, wherever feasible, a limited power of appointment or other right to transfer property out of the marital deduction trust to the next generation. Although the Service has ruled that the exercise of this power is a taxable gift as a release of the requisite general power of appointment⁸ judicious use of gifts (even taxable ones) can result in substantial aggregate savings on the transmission of property.

On the other hand, the draftsman should not overlook disadvantages inherent in the use of the marital deduction. The estate taxes progress to higher levels at a slow rate, but the progression is surely there, and if both spouses have substantial estates, have made substantial gifts, and are aged or in bad health, the possibility of consumption or disposition by the survivor so as to counteract the increased cost in transmission from one generation to another may be of only theoretical value. Furthermore, one must recall that the Ohio inheritance tax law contains no marital deduction. The lower rates and slightly increased exemption⁹ applicable to dispositions in favor of the surviving spouse reduce, but, in most cases, do not eliminate, an added cost in transferring property through the estates of both spouses to the next generation. Experience has shown that the credit allowed against the federal estate tax for the Ohio inheritance tax is ordinarily insufficient to cover the tax chargeable on the transmission of an estate in which substantial or full use of the marital deduction is made.¹⁰ Thus, the Ohio inheritance tax on Earl Beaver's death exceeds the allowable federal credit by more than \$5,000,

⁶ INT. REV. CODE OF 1954, § 2001.

⁷ Durkin, *Planning the Disposition of Property Not Included in the Marital Deduction*, 20 OHIO ST. L.J. 114, 115 (1959).

⁸ E.T. 23, 1950-1 CUM. BULL. 133; Rev. Reg. § 25.2514-1(b)(2).

⁹ OHIO REV. CODE §§ 5731.09, .12 (1953). See also OHIO REV. CODE § 5731.03 (1953).

¹⁰ INT. REV. CODE OF 1954, § 2011.

even if one assumes that no part of the insurance proceeds are subject to Ohio tax.

Furthermore, if the surviving spouse owns substantial property in her own right, one may reasonably assume that she has a substantial income. If so, the requirement that all the income from the qualifying interest be paid at least annually to the surviving spouse means wastage of much of the income derived from the qualifying interest through taxation at higher brackets otherwise avoidable to a considerable extent.¹¹

Often the estate of the decedent may consist largely of stock in a closely-held business, such as Earl Beaver's Manufacturer's Representative, Inc., and taking maximum advantage of the marital deduction requires that the stock be split. Division of that which should not be divided may not be harmful if the interest is sold soon after the death of the decedent, but one cannot ordinarily be certain of obtaining a satisfactory price. Also, diminishing the split by limiting the widow's rights cannot completely remove the problem, for the widow must have an unrestricted lifetime or testamentary power of disposition.¹² Furthermore, in some cases, the testator may insist that the draftsman should write his will so as to keep a family business or inherited estate in the blood line. Possibilities of second marriages and of unfortunate dispositions cannot be eliminated if one is to utilize the marital deduction, and the additional tax cost may be outweighed by the desirability to some persons of establishing an inflexible disposition not subject to the frailties of the flesh or to predatory fortune hunters.

HOW TO USE THE MARITAL DEDUCTION

Interests Passing Outside the Will

After it has been decided to employ the marital deduction, the next question is how to effectuate this decision. Many believe the draftsman should begin his study by reviewing interests which will not pass under the proposed will, as such assets often include items which already qualify for the marital deduction or which should be qualified to bring about the most advantageous and sensible disposition of the testator's property.

A good starting point is the family residence. In the Beaver case the residence is owned in the joint names of Earl and Betty Beaver with rights of survivorship. This means that it will pass in its entirety to Betty if Earl should die first, and, with the bank account and bonds held in similar fashion, will qualify for the marital deduction.¹³

After the residence and joint interests have been disposed of, the

¹¹ *But see* the throwback rules applicable to trusts in which accumulation is permitted. INT. REV. CODE OF 1954, §§ 665-68.

¹² Knecht, *Special Administrative Clauses for Trusts*, 20 OHIO ST. L.J. 51, 57 (1959), discusses a program of gradual purchase of closely-held stock from the marital trust by the "B" trust but this plan is not immune from posthumous trouble and some trustees might perhaps be hesitant to use it.

¹³ INT. REV. CODE OF 1954, § 2056(e)(5).

draftsman should then check on other assets passing outside the will,¹⁴ and by far the most important of these is insurance on the life of the testator. In the Beaver situation, the face amount of insurance on Earl's life is \$100,000, and we may assume that this insurance is payable in the usual way, to Betty if she survives Earl, with the children as contingent beneficiaries.

The disposition of Earl Beaver's insurance has already been discussed.¹⁵ To the extent that such insurance policies have been transferred to others and thus excluded from Earl's taxable estate, they cannot qualify for the marital deduction. If Earl Beaver, or any other testator, retains ownership of insurance policies on his life, however, the settlement provisions should be carefully reviewed with the marital deduction in mind, for certain features of insurance make it a particularly desirable type of property to use.

The simplest method of qualifying insurance for the marital deduction is to provide that the proceeds are to be paid outright to the widow, if she survives. Such policies will qualify, even though the widow is given the right to elect optional forms of settlement.¹⁶ If the proceeds are paid into an insurance trust, the trust must qualify under the rules discussed below; the requirements of the marital deduction provision relating to insurance apply only to proceeds paid out or held by the insurer.¹⁷ In order to save Ohio inheritance taxes, it is desirable to have the insurance paid to a beneficiary other than the estate of the insured.¹⁸

The rules governing the qualification of insurance proceeds paid under optional settlements are spelled out in the regulations¹⁹ and are modeled on those applicable to trusts. In brief, the surviving spouse must (a) receive annual installment or interest payments which begin not later than thirteen months after the decedent's death, and (b) have power to consume or appoint all amounts held by the insurer, with no such power in any other person. Insurance companies have made careful studies of these requirements, and a broad variety of tested options are available to qualify settlements for the marital deduction. Although the regulations take a rather liberal view toward certain requirements which must be satisfied prior to making any payments under policies of certain companies,²⁰ it is quite important for the draftsman to review

¹⁴ Particular attention should be paid to the interests of the testator in any trust created by others, general or limited powers of appointment, and inter vivos trusts created by the testator.

¹⁵ Colquhoun, *Planning Respecting Life Insurance, Endowment, and Annuity Contracts*, 20 OHIO ST. L.J. 35 (1959).

¹⁶ TRACHTMAN, *ESTATE PLANNING* 99 (rev. ed. 1958).

¹⁷ INT. REV. CODE OF 1954, § 2056(b)(6); Rev. Reg. § 20.2056(b)-6.

¹⁸ OHIO REV. CODE § 5731.06 (1953).

¹⁹ Rev. Reg. § 20.2056(b)-6(a).

²⁰ Rev. Reg. § 20.2056(b)-6(d).

the exact wording of old settlements and make necessary changes to convert disqualifying conditions into harmless formalities.²¹

An important advantage of qualifying insurance for the marital deduction is that it can be consumed through installment payments during the lifetime of the survivor, thus (a) furnishing funds, both income and principal, for the maintenance of the widow, and (b) escaping the second estate tax. Also, the interest element in installment proceeds is exempt from income tax in the hands of the surviving spouse to the extent of \$1,000 annually.²² Particularly in the case of substantial estates, it may well be advisable to make the maximum use of this exemption.

The familiar widow's allowance, granted by Section 2117.20 of the Ohio Revised Code, may amount to a sizeable sum in large estates and a substantial portion of small ones.²³ The recent *Rensenhouse*²⁴ and *Cunha*²⁵ cases, construing Michigan and California law respectively, have raised a question whether amounts paid as widow's allowances may qualify for the marital deduction by escaping the ban against terminable interests. The applicable provisions of the regulations make the issue turn on this question.²⁶

It is submitted that the widow's allowance in Ohio clearly qualifies for the marital deduction, and this is the position of the Internal Revenue Service. If the widow's rights are not curtailed by the Ohio common disaster statute,²⁷ they are fully vested, not subject to divestment by reason of death or remarriage.²⁸

Although property exempt from administration²⁹ seems to have been generally allowed as part of the marital deduction, a close exami-

²¹ One cannot count upon all courts taking the liberal view recently adopted by the third circuit toward a poorly-written settlement provision. *Eggleston v. Dudley*, 58-2 U.S. Tax Cas. ¶ 11,807 (3d Cir. 1958).

²² INT. REV. CODE OF 1954, § 101(d)(1)(B).

²³ In the period immediately following enactment of the Revenue Act of 1948 many wills were written so as to give the widow forty-nine per cent or forty-five per cent of the estate, depending upon the widow's allowance to pick up the excess necessary to take full advantage of the marital deduction. This practice seems to have diminished.

²⁴ 252 F.2d 566 (6th Cir. 1958). The Tax Court had decided the question against the taxpayer on the more fundamental issue of whether the allowance "passed" to the widow within the meaning of INT. REV. CODE OF 1954, § 2056(e), but on appeal the government abandoned this argument, which conflicted with its regulations and rulings. Although holding on remand that the Michigan widow's allowance qualified, the Tax Court remained unconvinced. *Estate of Proctor D. Rensenhouse*, 31 T.C. No. 81 (1959).

²⁵ 30 T.C. No. 80 (1958). *But cf.* *King v. Wiseman*, 147 F. Supp. 156 (W.D. Okla. 1956).

²⁶ Rev. Reg. §§ 20.2056(e)-2(a), 20.2056(b)-1(g), Example 8.

²⁷ OHIO REV. CODE, § 2105.21 (1953). *In re Estate of Metzger*, 140 Ohio St. 50, 42 N.E.2d 443 (1942).

²⁸ *In re Estate of Croke*, 155 Ohio St. 434, 99 N.E.2d 483 (1951).

²⁹ OHIO REV. CODE § 2115.13 (1953). *Cf.* REV. RUL. 419, 1955-1 CUM. BULL. 458.

nation of the statute discloses certain rather difficult questions. If minor children survive the decedent, the rights of a surviving spouse to certain properties may be cut off if the spouse ceases to provide for such children.³⁰ Of course, the fact that the amount passing under this provision cannot exceed \$2,500 prevents it from presenting a major problem, but to avoid any possible question, it seems advisable for the spouse to elect to take money rather than chattels in cases where there are surviving minor children.

Marital Deduction Provisions of Wills

Perhaps the most important current topic in this field is how to express the provisions giving the surviving spouse the proper share of the decedent's property. The present Beaver wills solve the problem simply, but not effectively, by giving the entire estates of each spouse to the other. Specific bequests and the traditional form of pecuniary legacy may, of course, be used in appropriate cases or to transfer particular property (*e.g.*, household effects and automobiles) to the surviving spouse. Generally, however, more is needed and in most instances of larger estates it will be found that the familiar "marital trust" is the appropriate vehicle.

The conditions requisite for qualification of such a trust are clearly stated and fully discussed in the regulations,³¹ and it appears sufficient here to mention only that the surviving spouse must receive the entire income for life, payable at least annually, and must have a complete and unrestricted power of consumption, disposition or appointment over the proceeds, with no such power in any one else.³²

Changes made in the 1954 Code permit qualification of (a) property in which the spouse is given a legal life estate plus power of appointment, and (b) an undivided interest in a trust, called a "specific portion" in the statute.³³ These provisions seem to be of little benefit in estate planning. Establishing separate trusts rather than attempting to qualify part of a single trust avoids semantic difficulties in determining what is a "specific portion,"³⁴ and it is difficult to envision any disadvantages of substance to this route. Although one bent on utilizing all tax-saving devices, however transparent or transitory, might attempt to use a legal life estate instead of a trust to take advantage of a recent decision³⁵

³⁰ *But see In re Schneider's Estate*, 108 N.E.2d 363 (Ohio P. Ct. 1952).

³¹ Rev. Reg. § 20.2056(b)-5.

³² Of course, a power to appoint may be granted to another if either (a) the sole appointee is the surviving spouse or her estate, or (b) the other power cannot be exercised in derogation of that granted the surviving spouse. Rev. Reg. § 20.2056(b)-5(j). For comprehensive discussions and analyses of these requirements see the authorities cited at note 2 *supra*.

³³ INT. REV. CODE OF 1954, § 2056(b)(5).

³⁴ See Rev. Reg. § 20.2056(b)-5(c).

³⁵ *United States v. Cooke*, 228 F.2d 667 (9th Cir. 1955). See also *de Bonchamps v. U.S.*, 1 AFTR2d 1240 (D. Cal. 1958), and *Brown v. U.S.*, 58-2 U.S.

which apparently sanctions a tax-free sale of property by the life tenant, there seem to be few other considerations favoring such a disposition.³⁶ The recent congressional largesse³⁷ in rescuing those who had received no advice or poor advice by retroactively amending the 1939 Code to incorporate these 1954 amendments deserves no discussion here.³⁸

1. Formula Clauses: to Use or Not to Use

The major problems of draftsmanship have arisen in instances where it appears desirable to use the marital deduction to the fullest extent but no more.³⁹ Two highly vocal schools of thought have been developed; one group, usually named for its leader Joseph Trachtman, believes that traditional forms of dispositive provisions should be used, and the other, and probably larger, force believes that the marital deduction gift should be expressed in terms of the language of the Internal Revenue Code. Considerable public controversy has resulted,⁴⁰ and a brief description of the objectives and methods of each school may be helpful.

The Trachtman group believes and can demonstrate rather effectively that claiming the marital deduction down to the last penny is unnecessary. Furthermore, they point out that splitting the non-testamentary assets into qualifying and non-qualifying portions and then dividing the testamentary assets in the same way by use of the traditional language may, in certain instances, achieve the exactitude sought but not necessarily discovered by the formula-clause group without introducing difficult questions of construction.⁴¹ On the other hand, the exponents of the formula clause maintain that their wills provide a means by which

Tax Cas. ¶ 9861 (D. Hawaii 1958), following *Cooke*. These cases turn, to a considerable extent, upon the application of local law, and it is doubtful whether they would be followed in other circuits.

³⁶ See OHIO REV. CODE § 2105.20 (1953) (liability of life tenant for waste); 20 OHIO JUR. 2D *Estates* § 89 (1956).

³⁷ Technical Amendments Act. of 1958, § 93, amending INT. REV. CODE OF 1939, § 812(e) (1) (F).

³⁸ For excellent discussions of the unfortunate trend in Congress to pass private relief bills in the guise of public tax legislation, see Surrey, *The Congress and The Tax Lobbyist—How Special Provisions Get Enacted*, 70 HARV. L. REV. 1145 (1957); Cary, *Pressure Groups and the Revenue Code: A Requiem in Honor of the Departing Uniformity of the Tax Laws*, 68 HARV. L. REV. 745 (1955).

³⁹ Since hindsight is indisputably better than foresight in estate planning as well as other fields, it may well be advisable in some cases to qualify too much rather than too little, relying on the judicious use of complete or partial disclaimers to achieve the best results.

⁴⁰ See, e.g., Trachtman, *Leaping in The Dark: More Adventures with the Marital Deduction*, 93 TRUSTS & ESTATES 922 (1954); Sargent, *To Each His Own*, 93 TRUSTS & ESTATES 933 (1954).

⁴¹ *But cf.* Braun v. Central Trust Co., 92 Ohio App. 110, 109 N.E.2d 476 (1952) (formula clause bequest upheld as not violating Ohio rule against perpetuities).

the share passing to the wife is automatically adjusted to the proper amount as changes take place in the non-testamentary and testamentary assets of the testator after the execution of the will.⁴² With the passage of time and the growth of a body of law which cannot be considered unfavorable, the group fearing "federal prose"⁴³ and formula clauses has apparently lost some of its adherents.

2. Types of Formula Clauses

Two general types of formula are now in use. An example of the first, which has been construed to grant a pecuniary legacy, is as follows:

If my said wife survives me, I give to . . . that amount which equals the maximum estate tax marital deduction (allowable in determining the federal estate tax payable by reason of my death) diminished by 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 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 paragraph. In making the computations necessary to determine such amount, the final determinations in the federal estate tax proceeding shall control. The payment of such amount may be either in cash or in kind, or partly in cash and partly in kind, and to the extent payment is made in kind, the value of the distributed property at the date of distribution shall control.⁴⁴

As a pecuniary legacy, the above example and similar clauses may cause substantial income tax problems.⁴⁵ Following a private ruling issued in response to a request for field advice, the Internal Revenue Service stated in Revenue Ruling 56-270⁴⁶ that an estate realized capital gain or loss upon the transfer of property, apparently valued at date of distribution, in satisfaction of a bequest of an amount sufficient to utilize the maximum marital deduction. Such position has been reaffirmed in

⁴² For an excellent, although brief, discussion of the views of both sides, see *Report of the Committee on Draftsmanship: Wills and Trusts*, AMERICAN BAR ASSOCIATION SECTION OF REAL PROPERTY, PROBATE AND TRUST LAWS 72-76 (1957).

⁴³ TRACHTMAN, *op. cit. supra* note 16, at 40.

⁴⁴ CASNER, OUTLINE OF ADDRESS PRESENTED AT UNIV. OF CINCINNATI COLLEGE OF LAW, MARX SEMINAR (MAY 9, 1958) 1. Professor Casner's sample clauses, like Topsy, grow with the years. Cf. Casner, *Estate Planning—Marital Deduction Provisions of Trusts*, 64 HARV. L. REV. 582, 584 (1951).

⁴⁵ See Alexander, *Two Current Income Tax Problems of Executors*, 39 OHIO BAR 752 (1956).

⁴⁶ 1956-1 CUM. BULL. 325.

the regulations.⁴⁷ This means that if property has appreciated in value between the date of estate-tax valuation and the date of distribution, an executor transferring such property in satisfaction of a formula clause such as that in the example will realize a capital gain.⁴⁸

Some have suggested avoidance of these income tax problems by providing that the executor should distribute assets at estate tax values in satisfying a marital bequest.⁴⁹ It seems sufficient to mention that many believe that distribution at estate tax values may give the executor a power of appointment, may endanger the marital deduction, or its amount, and may heighten rather than diminish the problem of conflict between the surviving spouse and other beneficiaries.⁵⁰

The problems created by the pecuniary legacy type of formula clause have caused an apparent majority of experts in the field to shift to the use of formula clauses which transfer a share of the residue.⁵¹ An example of a fractional share which leaves nothing to chance is the following:

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 of all items in my gross estate which qualify for said deduction and which pass or have passed 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 paragraph; and the denominator of the fraction shall be the value of my residuary estate, and to the extent that items in my residuary estate are included in my gross estate the value at which they are included in my gross estate shall control, and to the extent they are not so included their value at the time they

⁴⁷ Rev. Reg. § 1.1014-4(a)(3).

⁴⁸ Despite the realization of gain, the Treasury has taken the position in its regulations under the new income tax provisions governing estate distributions that an amount transferred in satisfaction of a marital deduction formula clause carries with it a proportionate part of the distributable income of the estate. Rev. Reg. § 1.663(a)-1(b)(1).

⁴⁹ See Stevens, *Troublesome Will Provisions*, 34 TAXES 809, 817 (1956).

⁵⁰ See *Report of Committee on Draftsmanship: Wills and Trusts*, *supra* note 42 at 75; SHATTUCK AND FARR, AN ESTATE PLANNER'S HANDBOOK 271 (2d ed. 1953).

⁵¹ See Cox, *Types of Marital Deduction Formula Clauses*, 15 N.Y.U. INST. ON FED. TAX 909, 933 (1957).

would have been valued if they had been so included shall control, in determining the denominator.

When distribution is made, there shall be distributed the above described fractional share of my residuary estate without regard to whether the total value of what is distributed is more or less than the numerator of the above described fraction.⁵²

A clause granting a fractional share of the residue avoids realization of gain,⁵³ and the surviving spouse shares in the increase or decrease in the residue to the date of distribution. If the estate appreciates in value after the valuation date, the surviving spouse will take more than the amount deducted on the estate tax return of the decedent, and the aggregate cost of transmission of property to the next generation may be increased. On the other hand, this speculative disadvantage is probably outweighed in the usual situation by avoidance of the problems attendant to the use of a clause granting a pecuniary legacy.⁵⁴ Satisfaction of a formula bequest of the residuary-share type carries with it, under present law, a proportionate share of the income of the estate,⁵⁵ but recommendations for legislative changes have been made to correct these rules which attribute estate income to persons receiving distributions of corpus.⁵⁶

Whether the widow takes a pecuniary legacy or a share of the residue, it is important to have an express provision for payment of federal estate and Ohio inheritance taxes out of the non-marital share of the estate.⁵⁷ Such action is necessary to obtain the maximum marital deduction and to avoid difficult algebraic computations in situations in which the exact amount of the marital deduction may not be important.

⁵² CASNER, OUTLINE OF ADDRESS PRESENTED AT UNIV. OF CINCINNATI COLLEGE OF LAW, MARX SEMINAR (MAY 9, 1958) 2. Almost identical wording is found in CASNER, ESTATE PLANNING 504-05 (1958 Supp.). Simpler language could be used in the usual situation where all the residuary assets will be included in the gross estate. See Casner, *Estate Planning—Marital Deduction Provisions of Trusts*, *supra* note 44, at 585-86.

⁵³ Rev. Rul. 117, 1955-1 CUM. BULL. 233; Rev. Reg. § 1.1014-4(a)(3).

⁵⁴ In the article cited at note 49 *supra*, the author contends that residuary-share bequests are undesirable for the executor may be required to allocate assets "strictly on a proportionate basis." 34 TAXES at 817. This does not seem to be the law in Ohio, particularly if the will contains the usual provision permitting disproportionate distributions in kind. OHIO REV. CODE § 2113.55 (1953). Cf. *In re Mellott's Estate*, 162 Ohio St. 113, 121 N.E.2d 7 (1954). For a simple clause permitting this result, see TWEED & PARSONS, LIFETIME AND TESTAMENTARY ESTATE PLANNING 89 (rev. ed. 1955).

⁵⁵ Rev. Reg. § 1.663(a)-1(b)(2).

⁵⁶ See *Final Report of the Advisory Group on Subchapter J* 30-31 (1958), H.R. 3041 § 9, 86th CONG., 1st SESS. (1959). These changes would apply, *a fortiori*, to formula clauses of the pecuniary legacy type.

⁵⁷ See *Estate of Jaeger*, 27 T.C. 863 (1957), *aff'd per curiam*, 252 F.2d 790 (6th Cir. 1958).

3. Common Disasters

What happens if both spouses should die in a common disaster or within a comparatively short period of time? A six-month requirement of survival may be written into a marital deduction bequest without disqualifying it for the marital deduction provided, of course, that such condition does not become effective.⁵⁸ Also, Section 2105.21 of the Ohio Revised Code provides, in the absence of a provision in the will to the contrary,⁵⁹ that a spouse or other legatee must survive the decedent by thirty days to take an interest granted under the will or by law. If the estates of the spouses are substantially disproportionate, however, the shoe is on the other foot and the decedent may wish to pass property through his wife's estate in the event of a common disaster to obtain the estate tax savings resulting from the equalization permitted by the marital deduction. A clause intended to accomplish this result is as follows:

If my said wife and I die under such circumstances that the order of our deaths cannot be established by proof, my said wife shall be deemed to have survived me.⁶⁰

The regulations adopt a liberal view in this respect, honoring a presumption of survival effective under local law.⁶¹ But if such a twist is to be employed, it is important that certain other limitations (*e.g.*, restricting exercise of a power of appointment to wills executed after the husband's death) be omitted. Furthermore, any common disaster clause may invite litigation, particularly if it has the effect of shifting assets from the family of the wealthier spouse to that of the other. Accordingly, it should be used with extreme care.

4. Power of Appointment

The requirement of an unrestricted power of appointment, consumption or disposition over the property in the marital trust, mentioned earlier, has been illustrated in some fairly harsh recent decisions which deny the marital deduction if state law protects the contingent remaindermen by imposing standards for or conditions of exercise.⁶² If the sole power given the surviving spouse is the right to consume, the draftsman should spell out expressly that the spouse may withdraw property from the trust without any restriction whatever and for any purpose whatever, including the making of gifts.⁶³ If the power of

⁵⁸ INT. REV. CODE OF 1954, § 2056(b)(3).

⁵⁹ See *Weir v. Weir*, 102 Ohio App. 231, 139 N.E.2d 361 (1957).

⁶⁰ CASNER, OUTLINE OF ADDRESS PRESENTED AT UNIV. OF CINCINNATI COLLEGE OF LAW, MARX SEMINAR (MAY 9, 1958) 3.

⁶¹ Rev. Reg. § 20.2056(e)-2(e).

⁶² *Commissioner v. Estate of Ellis*, 252 F.2d 109 (3d Cir. 1958); *Estate of Tarver v. Commissioner*, 255 F.2d 913 (4th Cir. 1958).

⁶³ Prudence forbids reliance upon Ohio law alone. Compare *Rippel v. Rippel*, 82 N.E.2d 140 (Ohio App. 1948), *dismissed*, 154 Ohio St. 83, 93 N.E.2d 285 (1950) with *Vondohre v. Vondohre*, 71 N.E.2d 141 (Ohio App. 1946).

appointment can be exercised only by will, it is advisable to include a specific reference to the estate of the donee as a recipient of the property.⁶⁴

As mentioned previously, the testator may desire to impose as many restrictions as possible against a disposition by the surviving spouse contrary to his wishes. Guarding against a second husband is an important consideration in the minds of many successful men, and many wealthy women are aware that widowers often remarry, sometimes neither wisely nor well. Of course, it is impossible to qualify a bequest or devise for the marital deduction without granting the surviving spouse an unrestricted right to consume or dispose of the property during lifetime or provide for its destination at death. Nevertheless, certain formal restrictions and limitations are permissible under the regulations⁶⁵ such as a requirement that an inter vivos power be executed by deed filed with the trustee, that reasonable notice be given or reasonable intervals elapse between partial exercises of such a power or that a testamentary power be exercised by a will specifically referring to the power. Perhaps the most that one can safely do here is to restrict the power to a testamentary one, thus preventing lifetime squander, and provide that the will must expressly refer to and exercise the power,⁶⁶ but the draftsman should point out that such limitations are costly in that they prevent the surviving spouse from withdrawing funds from the marital trust for transmission at minimum tax cost to the next generation.

ASSETS WHICH SHOULD NOT BE QUALIFIED FOR THE MARITAL DEDUCTION OR WHICH SHOULD BE USED WITH CAUTION

Finally, some mention should be made of assets which should not be qualified for the marital deduction if other assets are available or can be used if necessary, but with appropriate protective clauses. The familiar rules with regard to non-qualifying assets, or carved-out estates, need little amplification here.⁶⁷ The draftsman should be careful, however, to avoid a trap in the law which reduces the marital deduction by the value of such non-qualifying interests if the bequest to the surviving spouse may be satisfied from a group of assets containing such an interest.⁶⁸ Similarly, assets which carry special estate or income tax ad-

⁶⁴ See *Estate of Allen*, 29 T.C. 465 (1957) (construing Maryland law to limit testamentary power to a special power where right to appointment to estate or creditors not specifically mentioned); *but cf. In re Howald's Trust*, 65 Ohio App. 191, 29 N.E.2d 575 (1940).

⁶⁵ Rev. Reg. § 20.2056(b)-5(g)(4).

⁶⁶ There is considerable danger in going further than this, for the Internal Revenue Service may attempt to spell out an agreement not to exercise the power, thus disqualifying the bequest. TRACHTMAN, *supra* note 16, at 131-2.

⁶⁷ See LOWNDES AND KRAMER, *FEDERAL ESTATE AND GIFT TAXES* 387-97 (1956).

⁶⁸ INT. REV. CODE OF 1954, § 2056(b)(2); Rev. Reg. § 20.2056(b)-2. A protective clause drafted by Professor Casner is as follows: "There shall not be allocated, distributed, delivered or transferred to the marital deduction gift under

vantages should not be qualified for the marital deduction if such qualification results in the loss or reduction of such benefits. For example, many investors own securities in Canadian companies, and qualifying such interests for the marital deduction means the loss of the credit otherwise allowable for Canadian death taxes imposed with respect to said securities.⁶⁹ Also, the credit for estate taxes paid attributable to items of income with respect to a decedent is lost if such items are qualified for the marital deduction.⁷⁰ Furthermore, it may be inadvisable in any event to pyramid such income on the other taxable income of the surviving spouse.

Perhaps the most important current question in this area is the qualification of stock in closely-held companies. Other disadvantages in satisfying marital bequests with such property have been mentioned above, but an additional difficulty is caused by the fact that the stock frequently yields a nominal dividend or no dividend at all. Earl Beaver's corporation, Manufacturer's Representative, Inc., is unusual in that it makes substantial dividend distributions, but other testators are not in Mr. Beaver's fortunate situation in this respect.

The problem is created by the fact that the Treasury Department has interpreted the statutory requirement of life income to the spouse to mean, in effect, that one must reasonably expect the property in the marital trust to produce income during the life of the surviving spouse, or such spouse may demand, if she chooses, the conversion of this property into another form which will produce the requisite degree of beneficial enjoyment normally afforded a life beneficiary.⁷¹ Although the validity of this rule may be questioned,⁷² no draftsman should deliberately defy the regulations if there are any reasonable means of compromise. If applicable state law requires that the surviving spouse obtain income consistent with the value of the trust corpus, the deduction is not endangered,⁷³ but here, as well as in the case of a power to consume, a lawyer will hesitate to place sole reliance upon Ohio law, particularly if the will contains the usual broad set of administrative exculpatory clauses.⁷⁴ If stock in closely-held businesses comprises a sub-

paragraph ----

1. Any property, or the proceeds of any property, which would not be allowed as part of the marital deduction in determining the federal estate tax on my estate. . . ."

CASNER, OUTLINE OF ADDRESS PRESENTED AT UNIV. OF CINCINNATI COLLEGE OF LAW, MARX SEMINAR (MAY 9, 1958) 2.

⁶⁹ INT. REV. CODE OF 1954, § 2014(c)(2). See Estate Tax Convention between Canada and the United States, Art V.

⁷⁰ INT. REV. CODE OF 1954, § 691(c)(2).

⁷¹ Rev. Reg. § 20.2056(b)-5(f).

⁷² TRACHTMAN, ESTATE PLANNING 127 (rev. ed. 1958).

⁷³ Rev. Reg § 20.2056(b)-5(f)(2).

⁷⁴ Cf. *Holmes v. Hrobon*, 158 Ohio St. 508, 110 N.E.2d 574 (1953); OHIO REV. CODE § 5303.21 (1953); See 40 OHIO JUR. *Trusts* § 159 (1935).

stantial part of the marital deduction, it is strongly recommended that the draftsman add a protective clause, perhaps similar to one of the following examples:

During the lifetime of my said wife, the Trustee shall convert unproductive trust property to productive trust property wherever requested to do so by my said wife.

During the lifetime of my said wife, in any year in which there is unproductive trust property, the trustee shall pay to my said wife, from the corpus of the trust, if requested to do so by my said wife, an amount which when added to the income of the trust for the year will give my said wife in such year an amount equal to the income she would have received if the unproductive property had produced income during the year in question at a rate of return equal to the average rate of return in such year from the productive property.⁷⁵

CONCLUSION

The above summary of current questions in the use of the marital deduction will have served its purpose if it assists the draftsman to avoid pitfalls and to realize the tax benefits which he seeks for his client. The advantages to be obtained are great, but the obstacles which must be surmounted to obtain such benefits cannot be minimized.

⁷⁵CASNER, OUTLINE OF ADDRESS PRESENTED AT UNIV. OF CINCINNATI COLLEGE OF LAW, MARX SEMINAR (MAY 9, 1958) 2-3. Of course, if the surviving spouse has an unrestricted power to consume or draw down principal, these clauses are unnecessary. See also the discussion *supra* of the plan mentioned above, in which the marital trust sells closely-held stock to the "B" trust, distributing all or part of the proceeds of sale to the beneficiary. Knecht, *supra* note 12, at 57.