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## Community Property and the Marital Deduction - A Clarification

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# NOTES

## Community Property and the Marital Deduction — A Clarification

### I. THE MARITAL DEDUCTION

The Internal Revenue Code of 1939, as originally enacted, made no special provision for the tax treatment of the interest of spouses in the community property. The courts considered both income ownership and property ownership to be matters of state property law.<sup>1</sup> Thus, under the estate tax provisions one-half of the community property would be included in the gross estate of the first spouse to die, and the other half would be included in the gross estate of the survivor.<sup>2</sup> In the usual case in a common-law jurisdiction, however, the bulk of the marital wealth would be taxed upon the death of the husband.<sup>3</sup> The graduated income and estate tax rates resulted in a discrimination against taxpayers in the common-law jurisdictions. The Revenue Act of 1942<sup>4</sup> sought to achieve an equalization of the effect of the revenue laws by eliminating the advantages enjoyed by the community property states. Community property interests were to be treated as joint interests and included in the gross estate of the first spouse to die<sup>5</sup> unless the survivor could show some part thereof "to have been received as compensation for personal services actually rendered."<sup>6</sup> This provision produced both inequalities and acute administrative difficulties with "tracing."<sup>7</sup>

The second attempt at equalization came in the Revenue Act of 1948,<sup>8</sup> which repealed the Revenue Act of 1942 and took a different approach from its predecessor. By means of a marital deduction, the 1948 Act sought to make the pre-1942 tax advantages of the community property system available to the non-community property jurisdictions without requiring the common-law jurisdictions to

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<sup>1</sup> Commissioner v. Bacon, 282 U.S. 122 (1930); Poe v. Seaborn, 282 U.S. 101 (1930); Commissioner v. Chase Manhattan Bank, 259 F.2d 231 (5th Cir. 1958), cert. denied, 359 U.S. 913 (1959); Sugarman, *Estate and Gift Tax Equalization—The Marital Deduction*, 36 Calif. L. Rev. 223 (1948).

<sup>2</sup> Lang v. Commissioner, 304 U.S. 264 (1938); Commissioner v. Chase Manhattan Bank, *supra* note 1.

<sup>3</sup> S. Rep. No. 1013 (pt. 1), 80th Cong., 2d Sess. (1948).

<sup>4</sup> Int. Rev. Code of 1939, § 811(e)(2), added by ch. 619, 56 Stat. 798 (1942).

<sup>5</sup> In § 811(e) of the 1939 Code, "joint interests" was amended to read "joint and community interests." The joint interest provision is now § 2040 of the Int. Rev. Code of 1954.

<sup>6</sup> *Ibid.*

<sup>7</sup> S. Rep., *supra* note 3.

<sup>8</sup> Ch. 168, 62 Stat. 110 (1948).

adopt the community property system.<sup>9</sup> The marital deduction,<sup>10</sup> to be taken in calculating the *taxable estate*, is allowed for any property interest which "passes"<sup>11</sup> to the surviving spouse, provided such interest is included in calculating the *gross estate* of the decedent.<sup>12</sup> The maximum deduction is fifty per cent of the "adjusted gross estate,"<sup>13</sup> and the value of decedent's share of the community is deducted in calculating the adjusted gross estate.<sup>14</sup> Community property states enjoy the same advantages because the repeal of the 1942 Act restored the original rules by which only one-half of the community property was included in the respective estate of each spouse.

There are several limitations on the marital deduction. The interest must "pass" to the surviving spouse<sup>15</sup> from property included in the decedent's gross estate<sup>16</sup> and must not be a "terminable" interest.<sup>17</sup> The value of the interest must be reduced by any estate tax paid out of the interest.<sup>18</sup> Furthermore, any encumbrance on the property passing to the surviving spouse or any obligation of the surviving spouse with respect to the passing of such interest must be taken into account in determining its valuation.<sup>19</sup> The deduction is limited to fifty per cent of the decedent's adjusted gross estate.<sup>20</sup>

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<sup>9</sup> S. Rep., *supra* note 3, at 27.

With the repeal of the 1942 amendments, your committee recommends estate and gift tax splitting which is similar in its effect to the splitting of the income tax provided for in this bill. It is recognized that complete equalization of the estate and gift taxes cannot be achieved because of the inherent differences between community and non-community property. . . . [U]nder the estate tax provision of your committee's bill a decedent spouse is allowed a marital deduction from his gross estate.

<sup>10</sup> Int. Rev. Code of 1939, § 812(e), added by ch. 186, 62 Stat. 110 (1948), which corresponds to § 2056 of Int. Rev. Code of 1954. Reference will be made to the 1954 Code except in discussion of cases decided under the 1939 Code.

<sup>11</sup> Int. Rev. Code of 1954, § 2056(e) defines the "passing" of property for purposes of the marital deduction.

<sup>12</sup> Int. Rev. Code of 1954, § 2056(a).

<sup>13</sup> Int. Rev. Code of 1954, § 2056(c). The adjusted gross estate is the gross estate less the deductions available under §§ 2053 and 2054.

<sup>14</sup> The "special rule" of § 2056(c)(2)(B)(i) eliminates the value of decedent's share of the community property. The survivor's share of the community is not included in the decedent's gross estate and is thus excluded from the marital deduction by § 2056(a). Thus, although the marital deduction can be funded with community property, the maximum amount of the deduction is approximately one-half of the decedent's separate property.

<sup>15</sup> Int. Rev. Code of 1954, § 2056(a); see note 11 *supra*.

<sup>16</sup> See note 12 *supra*.

<sup>17</sup> Int. Rev. Code of 1954, § 2056(b)(1). In general, a terminable interest is an interest (such as a life estate) which will terminate or fail and to which someone other than the surviving spouse will succeed.

<sup>18</sup> Int. Rev. Code of 1954, § 2056(b)(4)(A).

<sup>19</sup> Int. Rev. Code of 1954, § 2056(b)(4)(B); see text accompanying notes 53-60 *infra*.

<sup>20</sup> Int. Rev. Code of 1954, § 2056(c); see note 13 *supra*.

## II. THE DOCTRINE OF ELECTION<sup>21</sup> AND THE MARITAL DEDUCTION

Under the Texas community property system, each spouse has ownership and testamentary disposition of one-half of the community property.<sup>22</sup> If one spouse, in his will, unambiguously attempts to dispose of the survivor's one-half of the community property and to substitute therefor other benefits, he forces the survivor to *elect* between the inconsistent rights.<sup>23</sup> The survivor is required either to assent to the disposition of the will or to reject the bequests and take the rights at law.<sup>24</sup> The survivor's choice or *election* involves the transfer of property and, hence, estate and gift tax consequences.<sup>25</sup>

With regard to the marital deduction possibilities of the widow's election, the first question involves the extent to which the survivor's rights at law can qualify in the event she elects not to take under the will. In Texas, a surviving wife has a right to her one-half interest in the community,<sup>26</sup> the exempt property or the allowance in lieu thereof,<sup>27</sup> the homestead rights,<sup>28</sup> and the family allowance.<sup>29</sup> For purposes of ascertaining the applicability of the marital deduction, the nature of these interests under state law is generally considered determinative.<sup>30</sup> Of course, for these rights to qualify for the marital deduction, they must meet the conditions discussed above.<sup>31</sup> The right of the surviving wife to the exempt property (other than homestead) exists only if the estate is insolvent;<sup>32</sup> otherwise, this property passes to the heirs or distributees.<sup>33</sup> No cases have arisen on this point, but on principle it would seem that if the estate were insolvent and the separate, exempt property of the husband passed absolutely to the

<sup>21</sup> The widow's election has been treated admirably in Comment, *The Widow's Election—A Study in Three Parts*, 15 Sw. L.J. 85 (1961) (hereinafter cited *Widow's Election Study*); see also Wren, *The Widow's Election*, 100 Trusts & Estates Nos. 1, at 13, and 2, at 108 (Jan. & Feb. 1961).

<sup>22</sup> *Wright v. Wright*, 154 Tex. 138, 274 S.W.2d 670 (1955); *Dakan v. Dakan*, 125 Tex. 305, 83 S.W.2d 620 (1935).

<sup>23</sup> Comment, *Widow's Election Study*, 15 Sw. L.J. 85, 93 (1961). See also *Commissioner v. Chase Manhattan Bank*, 259 F.2d 231 (5th Cir. 1958), *cert. denied*, 359 U.S. 913 (1959).

<sup>24</sup> *Miller v. Miller*, 149 Tex. 543, 235 S.W.2d 624 (1951); *Paschal v. Acklin*, 27 Tex. 174 (1863).

<sup>25</sup> The taxable effect of this election will be considered in detail in text accompanying notes 70-80 *infra*.

<sup>26</sup> Tex. Const. art. 16, § 15; Tex. Prob. Code Ann. § 45 (1956).

<sup>27</sup> Tex. Const. art. 16, § 49; Tex. Prob. Code Ann. § 271 (1956).

<sup>28</sup> Tex. Const. art. 16, §§ 50, 51; Tex. Prob. Code Ann. §§ 271-85 (1956).

<sup>29</sup> Tex. Prob. Code Ann. §§ 286-93 (1956).

<sup>30</sup> *United States v. First Nat'l Bank & Trust*, 297 F.2d 312 (5th Cir. 1961); *Hoffman v. McGuinness*, 277 F.2d 598 (3d Cir. 1960); *Pitts v. Hamrick*, 228 F.2d 486 (4th Cir. 1955); see also Annot., 90 A.L.R.2d 414, 419 (1963).

<sup>31</sup> See notes 15-20 *supra* and accompanying text.

<sup>32</sup> Tex. Prob. Code Ann. § 279 (1956).

<sup>33</sup> Tex. Prob. Code Ann. § 278 (1956).

wife, a marital deduction would be allowed.<sup>34</sup> The survivor's right in the homestead generally is considered a terminable interest and thus excepted from the marital deduction provisions by section 2056(b)(1) of the 1954 Code.<sup>35</sup> The Texas homestead rights would seem to fit this pattern and not be available for the deduction even if they would otherwise qualify.<sup>36</sup> The family allowance should qualify for the marital deduction.<sup>37</sup> Thus, if the wife elects to take *against* the will of her husband and take her rights at law, there is little chance of a significant marital deduction from the husband's gross estate.<sup>38</sup>

Far more often in the marital deduction cases, however, the wife elects to *accept* the will of her husband and take the benefits thereunder. Assuming that the husband has devised property to the survivor in lieu of her rights at law, to what extent, if at all, is the marital deduction allowable? For example, the usual widow's election will requires the widow to elect either to take her share of the community or to take certain specific bequests under the husband's will and allow her share of the community to pass under the will. *United States v. Stapf*<sup>39</sup> is the first case to deal directly with the question of what effect the widow's election to accept such a will has on the availability of the marital deduction to the husband's estate.<sup>40</sup>

### III. THE NET BENEFIT RULE—*United States v. Stapf*

Lowell H. Stapf, a resident of Texas, died July 29, 1953, and his will put his wife to an election. By electing *not* to take under the will, Mrs. Stapf could have retained her one-half of the community property, subject to its prorata share of the administration expenses

<sup>34</sup> It is highly improbable, though not impossible, that such a situation could arise. The \$60,000 exemption provided by § 2052 would eliminate most insolvent estates from paying estate taxes.

<sup>35</sup> *United States v. Hiles*, 318 F.2d 56 (5th Cir. 1963) (concerning Alabama homestead law); *United States v. Lincoln Rochester Trust Co.*, 297 F.2d 891 (2d Cir. 1962).

<sup>36</sup> See generally Speer, *Marital Rights* § 457 (1929). Article 16, § 52 of the Texas Constitution provides for the descent and distribution of the homestead. Whatever the exact nature of the survivor's rights in the homestead, it is settled that it concerns *use* by a family constituent rather than *title*, so that one loses homestead rights upon death or abandonment of the property. So far as the surviving spouse is concerned, it is at most a life estate. *Woods v. Alvarado State Bank*, 118 Tex. 586, 19 S.W.2d 35 (1929).

<sup>37</sup> *United States v. First Nat'l Bank & Trust*, 297 F.2d 312 (5th Cir. 1961); *Estate of William A. Landers, Sr.*, 38 T.C. 528 (1962); *Estate of Rudinck*, 36 T.C. 1021 (1961).

<sup>38</sup> In some states it is possible to get a significant marital deduction by taking one's rights at law. See, e.g., *Isaac Harter, Jr.*, 39 T.C. 511 (1962) (N.Y. law).

<sup>39</sup> 375 U.S. 118 (1963).

<sup>40</sup> No case has dealt with the effect on the marital deduction of a widow's electing her rights at law *other than the community*. Lowndes & Kramer, *Federal Estate & Gift Taxes* 396 (1962), would support the holding of the *Stapf* case (discussed *infra*) when the community property is involved, but distinguishes the survivor's other rights at law on the ground that these other rights "pass" to the surviving spouse rather than being her own property.

and community debts. The net value of her interest in the community was 111,442.68 dollars. Mrs. Stapf elected to take under her husband's will which provided that she was to receive one-third of her husband's separate property (valued at 21,666.66 dollars), the community automobile (valued at 700 dollars),<sup>41</sup> and one-third of the combined community estate. The total value of the bequests to the widow was 106,268.18 dollars.<sup>42</sup> Thus, by electing to take under the will and allowing part of her community interest to pass under the will into a trust for the Stapf children, Mrs. Stapf sustained a net loss of 5,174.50 dollars.<sup>43</sup> In computing Mr. Stapf's estate tax, his executors claimed a marital deduction in the amount of 22,366.66 dollars, which represented the one-third of Mr. Stapf's separate property and the 700 dollar valuation of the automobile. The Commissioner disallowed the deduction, but both the district court<sup>44</sup> and the court of appeals<sup>45</sup> sustained the taxpayer and allowed the marital deduction. On certiorari the United States Supreme Court reversed the lower court on all points and disallowed the marital deduction.

The marital deduction issue<sup>46</sup> presented in the *Stapf* case is whether, in calculating the deduction, the amount of property which passed to Mrs. Stapf under the will must be reduced by the value of the property she gave up in electing to take under the will. Since Mrs. Stapf sustained a net loss in making the election, there would be no marital deduction if she were required to "net" the amounts. On the other hand, if the calculation of the marital deduction does not require a reduction of the value of the bequest under the will by what she gave up, the marital deduction clearly is allowable. The property "passed" to the surviving spouse;<sup>47</sup> it was not a "terminable

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<sup>41</sup> The Supreme Court stated that there was some question regarding to what extent, if at all, the automobile would qualify for the marital deduction, but since this question would not affect the outcome of the case, they accepted the findings of the lower court. 375 U.S. at 121.

<sup>42</sup> Mr. Stapf's will also provided that in the event his wife elected to take under the will "all and not merely one-half" of the community debts and expenses were to be paid by his executors. The Supreme Court disallowed a deduction of the full expenses and debts. For this aspect of the case see Note, 17 Sw. L.J. 499 (1963). With regard to the effect of this provision on the marital deduction issue, the Court stated that even if the payment of the expenses did constitute a gift to the surviving spouse, this still would not give the wife a net benefit and thus would not alter the decision on the marital deduction issue.

<sup>43</sup> The court of appeals used a different calculation with the same result. Mrs. Stapf allowed one-sixth (one-third of her one-half) to pass according to her husband's will (valued at \$27,541.16), and received, in exchange, property of the aggregate value of \$22,366.66. These figures also show the net loss of \$5,174.50. 309 F.2d 592, 594 (5th Cir. 1962).

<sup>44</sup> 189 F. Supp. 830 (N.D. Tex. 1960).

<sup>45</sup> 309 F.2d 592 (5th Cir. 1962).

<sup>46</sup> As to the other issue concerning expenses and debts see note 42 *supra*.

<sup>47</sup> See note 15 *supra*.

interest,<sup>48</sup> and it did not exceed one-half of the decedent's adjusted gross estate.<sup>49</sup>

The Supreme Court, speaking through Mr. Justice Goldberg, unanimously sustained the Commissioner and denied the marital deduction. The Court used three basic arguments in reaching its conclusion—(a) no property passed to the surviving spouse; (b) the property was encumbered; and (c) the deduction would defeat the purpose of the statute.

#### A. No Property Passed To The Surviving Spouse

The taxpayer argued that the marital deduction statute applied to property passing to the surviving spouse, and if property not subject to the limitations of the Code<sup>50</sup> passes, then the marital deduction should be allowed. It is immaterial, the taxpayer argued, that property also passed *from* the surviving spouse in trust for the Stapf children. Looking through the form of the transaction to its economic substance, the Court concluded that no property actually passed to the surviving spouse within the meaning of section 812(c) of the 1939 Code.<sup>51</sup> "What the statute provides is a 'marital deduction'—a deduction for gifts to the surviving spouse—not a deduction for gifts to children or a deduction for gifts to privately selected beneficiaries."<sup>52</sup> The taxpayer's contention would be well taken if, for example, there had been an outright bequest to the wife with a precatory request that she add to the trust for the children. If the wife subsequently complied with the request, the marital deduction certainly would not be defeated. Mr. Stapf, however, made his wife's acceptance of the benefits of the will conditional upon her transfer of property. In other words, he did not pass property *to* the widow but rather *through* her. This conditional nature of the transfer to the wife shades into the second and decisive basis of the Court's decision.

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<sup>48</sup> See note 17 *supra*.

<sup>49</sup> See note 20 *supra*.

<sup>50</sup> Discussed in text accompanying notes 15-20 *supra*.

<sup>51</sup> Mr. Stapf died in 1953; this fact brought the construction of his will under the provisions of the 1939 Code. The relevant section corresponds exactly to § 2056(a) of the Int. Rev. Code of 1954, and reference will hereinafter be made to the 1954 Code except when speaking of the principal case directly.

<sup>52</sup> 375 U.S. at 125. Judge Wisdom, dissenting in the court of appeals, graphically illustrates this argument.

After the dust settled, the economic result of this transaction was a gift by the testator of \$106,268.18 to the trust, and a gift by the wife of \$5,174.50 [the net loss to her in taking under the will] to the trust. There was, therefore, no gift to the spouse. This is fatal to the executor's contention. 309 F.2d at 608.

### B. *The Property Was Encumbered*

Both the Fifth Circuit and the Supreme Court agreed that the marital deduction issue actually turned on a construction of section 812(e)(1)(E)(ii) of the 1939 Code,<sup>53</sup> which provides for the valuation of the interest passing to the surviving spouse as follows:

[W]here such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account as if the value of a gift to such spouse of such interest were being determined.

The difficulties in applying this section to the case at bar are two-fold. First, there is the question whether an election by the surviving spouse is encompassed within the statutory meaning of "obligation" or "encumbrance." The taxpayer contended that this section was limited to a charge on the property itself, *i.e.*, a lien or mortgage. Liens and mortgages certainly do reduce the value of the property passing to the surviving spouse,<sup>54</sup> but the intent of Congress, as shown from the committee reports and the Treasury Regulations based thereon,<sup>55</sup> was to include an election within the term "obligation."<sup>56</sup> Second, and a bit more troublesome, is the proper construction of the phrase "such encumbrance or obligation shall be taken into account as if the value of a gift . . . were being determined." The court of appeals in *Stapf* held that the value of a gift by the husband to the wife would not be reduced for gift tax purposes even though the wife was required to give up property to a third person as a condition precedent to the receipt of the gift. In *Commissioner v. Wemyss*<sup>57</sup> it was held, in effect, that in order to reduce the value of a gift for purposes of the gift tax, there must be a benefit to the original donor. From this the taxpayer argued that if there is no benefit to the donor, the value of the gift to the surviving spouse need not be reduced.<sup>58</sup> In the *Stapf* case it is clear that there is no benefit to the donor (Mr. Stapf) or to his estate. The difficulty with the taxpayer's gift tax analogy is that under the gift tax law there was no gift to the surviving spouse (Mrs. Stapf) but rather an indirect gift in trust

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<sup>53</sup> This section corresponds exactly to Int. Rev. Code of 1954, § 2056(b)(4)(B).

<sup>54</sup> S. Rep. No. 1013 (pt. 2), 80th Cong., 2d Sess. (1948); Treas. Reg. 118, § 81.47c(b) (1939).

<sup>55</sup> S. Rep., *supra* note 54, at 6; Treas. Reg. 118, § 81.47c(b)(2) examples (i), (ii) (1939).

<sup>56</sup> The majority of the court of appeals agreed that the election constituted an obligation within the meaning of the statute. 309 F.2d at 598.

<sup>57</sup> 324 U.S. 303 (1945).

<sup>58</sup> Brief for Respondent, p. 22; Estate of Koert Bartman, 10 T.C. 1073 (1948).



for the children.<sup>59</sup> Since a gift to the surviving spouse is the primary requisite for the marital deduction, the gift tax analogy breaks down when carried to its logical conclusion. Moreover, an example given in the Senate reports on the Revenue Act of 1948 impugns such a contention:

If the decedent bequeaths certain property to his surviving spouse subject, however, to her agreement or a charge on the property for the payment of \$1000 to X, the value of the bequest (and accordingly the value of the interest passing to the surviving spouse) is the value, reduced by \$1000, of such property.<sup>60</sup>

### *C. Deduction Would Defeat Purpose of the Statute*

The Court concludes the marital deduction issue by noting that this holding is in accordance with the general purpose of Congress in creating the marital deduction. First, the Court says that the primary purpose of the marital deduction is to allow married couples in common-law states to have their property taxed in two stages. To round out the plan, the marital deduction is allowed to persons in community property states to the extent of approximately one-half their separate property.<sup>61</sup> However, the marital deduction was not intended to pass property to succeeding generations tax free.<sup>62</sup> Furthermore, the Court indicates that the taxpayer's construction of the statute would thwart the equalization purpose of the Revenue Act of 1948 in that an opportunity for a tax deduction would, as a practical matter, be available more readily to couples in community property jurisdictions than in common-law jurisdictions.<sup>63</sup> This is clearly true since for the election doctrine to apply to any significant degree in a common-law state, the wife would have to own separate property. Every couple in a community property jurisdiction could, however, take advantage of the "windfall"<sup>64</sup> to the extent of the survivor's interest in the community.

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<sup>59</sup> Treas. Reg. 108, § 86.2(a) examples 2, 3 (1939). See also *Helvering v. Hutchins*, 312 U.S. 393 (1941).

<sup>60</sup> S. Rep., *supra* note 54, at 6.

<sup>61</sup> Actually, the deduction is allowed to the extent of one-half of the adjusted gross estate. The language of the court implies that only separate property qualifies for the marital deduction. Actually, the community also can qualify as long as it does not exceed one-half the adjusted gross estate. See note 13 *supra*.

<sup>62</sup> This would have been the effect of allowing the marital deduction here. Mr. Staff's estate would have a marital deduction for the amount which went to the wife, but it was the children, not the wife, who got the economic benefit. Thus, the property would not have been included in her gross estate. 375 U.S. at 128. The Court cites in support of this proposition the "terminable interest rule" of § 2056(b) of the 1954 Code.

<sup>63</sup> 375 U.S. at 129.

<sup>64</sup> The majority in the court of appeals allowing the marital deduction characterized the effect of its decision as a "windfall." 309 F.2d at 598.

## IV. CONCLUSION

The *Stapf* holding on the marital deduction issue is sufficiently clear in its impact on the estate tax of the first spouse to die—the surviving spouse must receive a *net benefit* for the property passing to the survivor to qualify for the marital deduction. A far more complex question is how the *Stapf* case will affect the use of the widow's election and the marital deduction in estate planning. Even assuming that the spouses have property which would qualify for the marital deduction, whether it is wise in a particular case to take advantage of the deduction is a matter replete with inherent complexities.<sup>65</sup> The basic question, of course, is whether to have the property in question taxed upon the death of the first spouse or upon the death of the survivor.<sup>66</sup> The answer to this question involves a number of tax factors,<sup>67</sup> as well as a consideration of the probable economic needs of the survivor. Imprudent use of the marital deduction can cause a severe tax loss upon the death of the survivor.<sup>68</sup> The *Stapf* case does not in any way change the nature of these basic considerations. In fact, the case brings to the foreground the basic proposition that the marital deduction is not a device to allow property to escape estate tax, but rather to allow the estate planner to choose in which estate the property should be included.<sup>69</sup>

With regard to a reduction of the estate taxes on the marital unit,<sup>70</sup> the planner should note particularly one possibility of using a "typi-

<sup>65</sup> "Intelligent use of the marital deduction requires a combination of skills involving knowledge of mathematics, psychiatry, soothsaying, and the law." Tannenwald, *How to Provide for the Marital Deduction Other than Trusts and Powers of Appointment*, found in 1 Lasser, *Estate Tax Techniques* 101 (1963).

<sup>66</sup> "Thus the marital deduction is generally restricted to transfers of property interests that will be includable in the surviving spouse's gross estate." 375 U.S. at 128.

<sup>67</sup> Some of the more important tax considerations are:

- (1) The relative size of the estate of the husband and wife;
- (2) The extent to which the survivor may be expected to consume or make gifts;
- (3) Life expectancies of the parties;
- (4) Whether the estate of the decedent is likely to grow with income or decline by consumption.

See Powers, *How to Solve Mathematical Problems of Husband-Wife Estate Planning*, found in 1 Lasser, *Estate Tax Techniques* 3, 42 (1963).

<sup>68</sup> For a monetary example, see Bowe, *Estate Planning & Taxation* § 4.19 (1961).

<sup>69</sup> See note 62 *supra*.

<sup>70</sup> There is a wealth of commentary and a scarcity of case law on this subject. See, e.g., Bowe, *Estate Planning and Taxation* (1961); Lasser, *Estate Tax Techniques* (1963); Webster, *Avoidance of Marital Deduction Traps in Estate Planning*, 8 Tul. Tax Inst. 259 (1959); Weingarten, *Gift and Estate Tax Consequences of Widow's Election in Community Property States*, 42 A.B.A.J. 1163 (1956); Westfall, *Estate Planning and the Widow's Election*, 71 Harv. L. Rev. 1269 (1958); Wren, *Estate Planning and the Widow's Election*, 34 Rocky Mt. L. Rev. 281 (1962); Wren, *Drafting and Tax Considerations in Community and Common Law States*, 100 Trusts & Estates 13 (1961).

cal<sup>71</sup> widow's election will combined with a marital deduction. Assume the widow elects to take under a will which disposes of the entire community and gives her a life estate therein with a remainder to the children. By her election, the wife gives up the remainder interest in her one-half of the community (retaining a life estate in her one-half) in exchange for a life estate in the husband's one-half of the community. The estate tax consequences of this type of election upon the death of the widow were demonstrated in a recent case with similar facts.<sup>72</sup> In *Vardell v. Commissioner*<sup>73</sup> the Fifth Circuit held that the widow's election constituted a transfer with a life estate retained, and thus the widow's one-half of the community was includable in her gross estate.<sup>74</sup> However, the court also found that the life estate she received in her husband's one-half of the community constituted consideration for the transfer, and, hence, only the *excess* of the value of her one-half of the community over the value of the life estate in the husband's one-half was included in her gross estate.<sup>75</sup> If the consideration received was a simple life estate, the court said that it should be valued by use of the mortality tables at the date of the election,<sup>76</sup> and this value should be credited against the value of the widow's share of the community at the time of her death.<sup>77</sup> Thus, by such a plan it is possible for the husband to give the wife the use of the entire community for her life, dispose of the remainder, and at the same time *reduce* the amount of the wife's gross estate upon her death by the value of the consideration she "receives"<sup>78</sup> for making the election.

If the husband has separate property and also gives the wife property absolutely, an additional question is raised: to what extent can the husband's estate receive a marital deduction? *Stapf* dictates that for the husband's estate to be allowed the marital deduction, the widow must receive a net benefit by making the election. The life estate which passes to the wife is a terminable interest and thus will not qualify for the marital deduction.<sup>79</sup> Logi-

<sup>71</sup> See Comment, *Widow's Election Study*, 15 Sw. L.J. 85 (1961).

<sup>72</sup> The actual case was made much more complex by alternative provisions in case of remarriage and the full power in the wife to sell the property. See text accompanying note 82 *infra*.

<sup>73</sup> 307 F.2d 688 (5th Cir. 1962).

<sup>74</sup> Int. Rev. Code of 1954, § 2036. Alternatively, the court suggested that the property would be included in her gross estate by § 2038 of the 1954 Code. Either section produces the same results.

<sup>75</sup> Int. Rev. Code of 1954, § 2043(a); Treas. Reg. § 20.2043-1(a) (1954).

<sup>76</sup> *Ithaca Trust Co. v. United States*, 279 U.S. 151 (1929); Treas. Reg. § 25.2512-5(c) (1954).

<sup>77</sup> 307 F.2d 688, 693 (5th Cir. 1962).

<sup>78</sup> See note 83 *infra*.

<sup>79</sup> See note 17 *supra*.

cally, however, it will be used in determining whether the wife receives a net benefit.<sup>80</sup> Thus, if the value of the property passing to the widow *plus* the life estate given to her is greater than the remainder interest passing from her, the widow will receive a net benefit and the property passing to the wife can qualify for the marital deduction to the extent of the net benefit. This also will eliminate any gift tax resulting from the election.<sup>81</sup> Moreover, under the holding in the *Vardell* case the benefits passing to the widow are consideration for the transfer by her and thus will reduce her gross estate at her death. A word of caution should be added; the valuation of the consideration received by the widow is currently a matter of confusion. The estate tax regulations require that property must be reducible to money value to serve as consideration.<sup>82</sup> The court in *Vardell* gave several valuation possibilities,<sup>83</sup> but it is uncertain which of them will be used in any particular case. For this type of plan to work advantageously, it is essential that the planner have some idea of the value of the various interests involved. The *Vardell* case is unclear, but perhaps if a simple life estate is used, the planner can estimate correctly its value as consideration by means of the mortality tables.<sup>84</sup>

In summary, the *Stapf* decision does not eliminate the usefulness of the marital deduction in planning community estates. It does, however, require the planner to make difficult valuation prognostications to determine whether any deduction will be allowed and whether it would be beneficial. Moreover, the valuations of property interests, such as life estates and remainders, are changing constantly with the age of the parties, and an estate plan such as outlined above should be re-examined periodically.

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<sup>80</sup> It may seem unusual that property which does not qualify for the marital deduction may be used to calculate the net benefit to the wife, but this does not violate the *Stapf* rule, because to the extent that the husband gets a marital deduction, the property will be included in the wife's gross estate. Indeed in the *Stapf* case itself, one-third of the combined community was included in calculating the benefit to the wife.

<sup>81</sup> Int. Rev. Code of 1954, § 2512(b); *Commissioner v. Chase Manhattan Bank*, 259 F.2d 231 (5th Cir. 1958), *cert. denied*, 359 U.S. 913 (1959); *Commissioner v. Seigle*, 250 F.2d 339 (9th Cir. 1957).

<sup>82</sup> Treas. Reg. § 20.2043-1 (1954).

<sup>83</sup> The court seems to suggest that if the consideration received by the wife is a simple life estate, it should be valued at the time of the transfer by using the mortality tables. However, the court also says that the market value or the "hindsight" method may be used, and that in no event is the credit to exceed the lesser of the amount of the life estate valued as of the date of election and the sums actually received. The particular valuation used can make a great deal of difference in result. In *Vardell*, for example, the actuarial value of the life estate in the husband's part of the community was \$454,014.38, but during her life, Mrs. Vardell actually consumed over a million dollars from this interest.

<sup>84</sup> See note 83 *supra*.