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Does a state court determination of property rights control, for federal estate tax purposes, when the government was not a party to the state court proceeding? That was the issue before the Supreme Court in *Commissioner v. Estate of Bosch*.[1]

In the 1930s, Herman Bosch created a revocable trust giving his wife all income for life, and a general testamentary power of appointment. At that time, there was no estate tax marital deduction.[2] It became available for decedents who died after the enactment of the Tax Reform Act of 1948 but generally only for outright transfers or transfers to a trust from which the surviving spouse had an annual right to income and a general power of appointment (in favor of the surviving spouse or his or her estate) exercisable alone and in all events.[3]

In 1951, Mrs. Bosch executed an instrument purporting to release the general power and make it a non-general one. In 1957, Mr. Bosch died, and his estate claimed an estate tax marital deduction for the trust.

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1 387 U.S. 456 (1967).

2 Bosch was decided together with *Second National Bank of New Haven v. United States*, 351 F.2d 489 (2d Cir. 1965). There, the probate court construed decedent's Will to throw estate tax onto the non-marital trust. The United States District Court, while stating that the probate court ruling was not binding, agreed with its application of state law. The United States Court of Appeals for the Second Circuit reversed, interpreting the Will under state law to charge part of the tax to the marital trust (thereby reducing the estate tax marital deduction).

3 Revenue Act of 1948, ch. 158, pt. 1, § 361(e)(1)(F), 62 Stat. 110, 117-118 (1948).

The deduction was denied because Mrs. Bosch lacked a general power,[4] and the case went to the United States Tax Court. While the Tax Court proceeding was pending, the estate successfully petitioned the New York Supreme Court (a trial court) to rule that Mrs. Bosch's release was invalid so that she had a general power,[5] as required to qualify the trust for the marital deduction.

Pre-*Bosch,* federal courts struggled to develop a rule about the effect of state court decisions for federal estate tax purposes.[6] *Freuler v. Helvering*[7] and *Blair v. United States*[8] indicated that state court decrees about property rights should control if the state court had proper jurisdiction and the proceeding was not "collusive."[9] However, what constituted "collusion" was not clear, with some courts opining that non-adversary decisions aimed at reducing tax were suspect,[10] while others gave more weight to the binding effect of the state court decree on the taxpayer,[11] suggesting that collusion required some kind of fraud.[12] Thus the Tax Court in *Bosch* justifiably observed, "the law in this field is highly confusing."[13] However, based on the New York ruling, the Tax Court allowed the marital deduction, relying on several factors, including that the New York court had jurisdiction over the parties and its decision was final and binding upon them.[14] The Second Circuit affirmed, reasoning that the New York court had "authoritatively determined the [wife's] rights under state law."[15]

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4 *Estate of Bosch*, 387 U.S. at 458; *see* I.R.C. § 2056(b)(6). The situation would be different today under the so-called QTIP rules of I.R.C. § 2056(b)(7).

5 Comm'r v. Estate of Bosch, 363 F.2d 1009, 1010-11 (2d Cir. 1966), *rev'd*, 387 U.S. 456.

6 For extensive analysis of pre-*Bosch* law, see Paul L. Caron, *The Role of Federal State Court Decisions in Federal Tax Litigation:* Bosch*,* Erie *and Beyond*, 71 OR. L. REV. 781, 816 (1992) and Gilbert Paul Verbit, *State Court Decisions in Federal Transfer Tax Litigation: Bosch Revisited*, 23 REAL PROP. PROB. & TR. J. 407, 431 (1988).

7 291 U.S. 35 (1934).

8 300 U.S. 5 (1937).

9 *Frueler*, 291 U.S. at 47; *Blair*, 300 U.S. at 10.

10 *See, e.g.*, Stephenson v. United States, 241 F. Supp. 402, 403-04 (W.D. N.Y. 1965).

11 *See, e.g.*, Estate of Faulkerson v. United States, 301 F.2d 231, 232 (7th Cir. 1962).

12 *See* Gallagher v. Smith, 223 F. 2d 218, 225 (3d Cir. 1955); Saulsbury v. United States, 199 F.2d 578, 580 (5th Cir. 1952).

13 Estate of Bosch v. Comm'r, 43 T.C. 120, 122 (1964), *rev'd*, 382 F.2d 295 (2d Cir. 1967).

14 *Id.* at 123-24. The Tax Court also observed that the NY Supreme Court has precedential state law value, the Commissioner was aware of the suit, it was a reasoned opinion, and it had prospective tax consequences.

15 Comm'r v. Estate of Bosch, 363 F.2d 1009, 1015 (2d Cir. 1966), *rev'd*, 387 U.S. 456 (1967). *But see id.* at 1018 (Friendly, J., dissenting) (urging the adversary test).

The Supreme Court reviewed what it characterized as three circuit court positions about the effect of state court adjudications on federal estate tax liability:

- If the state court decision is binding on the parties, it controls in determining the federal estate tax result.
- The state court decision controls only if the federal court independently concludes it is consistent with state law as determined by the state's highest court.
- The state court decision controls only if it is the result of an adversary proceeding (the Commissioner's litigating position).

The Supreme Court essentially adopted the second position, holding that, absent a decision of the state's highest court, "federal authorities must apply what they find to be the state law after giving 'proper regard' to relevant rulings of other courts of the State. In this respect it may be said, in effect, to be sitting as a state court."[16] The Court relied on both the *Erie* doctrine[17] and the legislative history and purpose of the marital deduction to support its holding. Indeed, the phrase "proper regard" comes from the Senate Finance Committee report,[18] and the Court's reasoning suggests that it saw deference to a lower state court decision as less appropriate where a federal tax statute was involved than in a classic *Erie* diversity case. The Court hoped its holding would eliminate the need for extensive factual inquires, stating, "We believe this would avoid much of the uncertainty that would result from the 'non-adversary' approach and at the same time would be fair to the taxpayer and protect the federal revenue as well."[19]

Despite the Supreme Court's desire to avoid "uncertainty," federal courts have incorporated additional variables, including continued consideration of "adversary-ness," complicating the *Bosch* analysis.[20] However, the core *Bosch* holding is well established and overall precludes taxpayer reliance on lower state court decisions for federal estate tax

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16 Comm'r v. Estate of Bosch 387 U.S. 456, 465 (1967).

17 *Id.*; *see* Erie R.R. Co. v. Tompkins, 304 U.S. 64, 79 (1938).

18 S. REP. NO. 80-1013, pt. 2, at 4 (1948).

19 *Estate of Bosch*, 387 U.S. at 465.

20 *See, e.g.*, Estate of Warren v. Comm'r, 981 F.2d 776, 784 (5th Cir. 1993) (Texas probate court decision approving settlement of bona fide adversarial dispute respected for charitable deduction purposes, relevance of state court judgment depends on particular tax statute and nature of state proceeding); Estate of Palumbo v. United States, 788 F. Supp. 2d 384, 394 (W.D. Pa. 2011) (taxpayer's motion for summary judgment granted, settlement agreement for charitable deduction); Estate of Hubert v. Comm'r, 101 T.C. 314 (1993) (settlement of will contest); Estate of Aronson v. Comm'r, T.C. Memo. 2003-189, 85 T.C.M. (CCH) 1561 (2003) (consent decree); Shirley Kovar, *Adversity After* Bosch, 28 ACTEC J. 88, 94 (2002).

purposes. That obviously makes it harder to construe or reform documents to achieve dependable tax results.[21] The Service has issued relevant private letter rulings in certain contexts, for example, applying *Ahmanson Foundation v. United States*[22] under the umbrella of *Bosch* to accept court-approved settlements where it finds recognition of an enforceable claim.[23] The Service has also accepted non-adversarial decisions (often reforming a trust for scrivener's error) under *Bosch* where sufficient proof was furnished that state law supports the court's action.[24] The final regulations under section 2053 also may represent a "relaxing" of *Bosch* as they provide, "if a court of competent jurisdiction . . . reviews and approves expenditures . . . a final judicial decision in that matter may be relied upon to establish the amount of the claim or expense . . . provided that the court actually passes upon the facts on which deductibility depends."[25]

Some taxpayers have successfully obtained approval of a state's highest court to satisfy *Bosch*.[26] In practice it also seems that federal courts, while reciting the *Bosch* test, will typically follow the decision of an intermediate appellate state court.[27]

In Revenue Ruling 73-142,[28] decedent created a discretionary family trust reserving the power to remove and replace trustees (including naming himself). A lower state court in a non-adversary proceeding decreed that the trust allowed the decedent to remove and replace the

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21 *See* Richard Barnes, *Repairing Broken Trusts and other Fallen Estate Plans*, 41 EST. PLAN. 3, 8 (2014); Diana Zeydel, *Developing Law on Changing Irrevocable Trusts: Staying Out of the Danger Zone*, 47 REAL PROP. TR. & EST. L.J. 1, 24 (2012); F. Ladson Boyle, *When It's Broke, Fix It: Reforming Irrevocable Trusts to Change Tax Consequences*, 53 TAX LAW. 821 (2000). As these articles discuss, state court reformations may themselves create adverse tax consequences.

22 674 F.2d 761 (9th Cir. 1981).

23 *See, e.g.,* PLR 201532013 (Dec. 8, 2014). Not precedent under I.R.C. § 6110(k)(3).

24 *See, e.g.,* PLR 201521002 (Nov. 12, 2015); PLR 201442046 (June 18, 2014); PLR 201147010 (Aug. 17, 2011).

25 Jonathan G. Blattmachr, Mitchell M. Gans & Diana S.C. Zeydel, *Final Regs. On Deducting Expenses and Claims Under Section 2053 – Part 1*, 37 EST. PLAN. 3, 9 (2010).

26 *See, e.g.*, *In re* Paul F. Suhr Trust, No. 102, 230, 2010 Kan. Unpub. LEXIS 1, *10-11 (Kan. Sup. Ct. Jan. 15, 2010) (reformation approved by trial court affirmed by highest Kansas court); First Union Nat'l Bank of S.C. v. Cisa, 361 S.E.2d 615, 618 (S.C. 1987) (appeal of declaratory judgment to highest state court). *But see* Bank of Am. v. Babcock, 18 N.E.3d 348, 350 (Mass. 2014) (declaration not appropriate for consideration). In TAM 8346008 (Aug. 4, 1983), the I.R.S. argued a decision of Georgia's highest court was not binding because it did not determine property rights within the meaning of *Bosch.*

27 *See, e.g.,* Estate of Starkey v. United States, 233 F.3d 694, 699 (7th Cir. 2000); Estate of Swallen v. Comm'r, 98 F.3d 919, 923 (6th Cir. 1996); Estate of Posner v. Comm'r, T.C. Memo. 2004-112, 87 T.C.M. (CCH) 1288 (2004).

28 Rev. Rul. 73-142, 1973-1 C.B. 405.

trustee only once, and precluded naming himself as trustee. The decedent then removed the trustee and named a new trustee, which under the court's decree extinguished any retained power. The ruling states, "it appears that the decree is contrary to the decisions of the highest court of the state."[29] Nonetheless the ruling concludes because, unlike *Bosch*, the decree was handed down "before the time of the event giving rise to the tax (that is, the date of the grantor's death)," the decree controlled once it was issued and the time for appeal expired.[30] In both planning and administration, Revenue Ruling 73-142 may prove valuable.[31]

Under the current state of the law the *Bosch* result is a rational one and seems to avoid most gaming of state courts. The government might consider allowing reformations for marital deduction and other tax qualifying purposes, as it does for split interest charitable trusts under section 2055(e)(3), which would avoid the Service's concern about being whipsawed and also reduce litigation.

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29 *Id.*

30 *Id.*; *cf.* Estate of Rapp v. Comm'r, 140 F.3d 1211, 1217 (9th Cir. 1998) (taxpayer unsuccessfully tried to rely on Rev. Rul. 73-142, arguing that date of QTIP election, rather than date of death, was measuring date).

31 For example, in determining whether a trustee is authorized under state law or the governing instrument to deem within the meaning of Treas. Reg. § 1.643(a)-3(e) a distribution of corpus as consisting of capital gain (and thereby be reportable by the beneficiary rather than the trust), a lower court decision obtained before the distribution occurs should be binding for federal tax purposes.