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Federal Transfer Taxation And The Role Of State Law: Does The Marital Deduction Strike The Proper Balance?

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ARTICLE

FEDERAL TRANSFER TAXATION AND THE ROLE OF STATE LAW: DOES THE MARITAL DEDUCTION STRIKE THE PROPER BALANCE?

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INTRODUCTION

The federal transfer-tax system often makes state law a critical determinant. This is a necessary feature of a system that taxes the transfer of property, a concept that ordinarily derives its meaning from state law. As a matter of federal tax policy, however, it is important that the system neither overemphasize nor underemphasize state law. Part I undertakes a consideration of the role of state law in the transfer-tax system and the negative consequences that occur where the tax law fails to strike the proper balance.

Part II then focuses on the marital deduction, applying the framework developed in Part I. The marital deduction, which exempts transfers between spouses from tax, is central to the system. From its inception, the marital deduction has given state law a pivotal role. In order to qualify for the deduction, the decedent spouse's property must pass to the surviving spouse under state law: the so-called "passing" requirement. In 1948, when the martial deduction was originally created, it had a limited function: to maintain parity between couples residing in common-law and community-property states. And in the context of this limited function, the passing requirement's state law component made sense. However, when the marital deduction was reformulated in 1981, it assumed a broader function. In the context of that broader function, it will be argued, it no longer makes sense to make the marital deduction turn upon whether the property passes under state law. In

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other words, in light of the 1981 amendment, the passing requirement inappropriately emphasizes state law.

Part III considers how the passing requirement might be modified to cure its overemphasis on state law. Several alternatives are examined, drawing upon a theme implicit in the 1981 reformulation. Two of the more modest alternatives would simply overrule the Supreme Court's decision in *Commissioner v. Estate of Bosch,*[1] which adopted a construction of the statute that in effect exacerbates its overemphasis on state law. The less modest alternatives would make state law completely irrelevant. Instead, the availability of the deduction would be made to depend upon whether the decedent spouse's property would eventually be subject to tax in the surviving spouse's estate (if not consumed). In short, the focus would no longer be on the method by which the surviving spouse acquired the decedent spouse's property, but rather on whether the property would trigger a tax at the death of the surviving spouse.

I. STATE LAW: STRIKING THE PROPER BALANCE

State law is often determinative in matters of federal taxation.[2] This is particularly so in the transfer-tax context.[3] Indeed, the very decision to impose

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[1] 387 U.S. 456 (1967).

[2] *See, e.g.*, I.R.C. § 1014(b)(6) (1994 & Supp. III 1997) (establishing a special basis rule for property held under state community property law); Commissioner v. Estate of Bosch, 387 U.S. 456 (1967) (finding that surviving spouse's rights under state law must be established in order to determine the availability of the estate-tax marital deduction); Helvering v. Stuart, 317 U.S. 154 (1942) (examining the nature of the parties' rights under state law to determine if the trust's grantor was subject to income tax on trust income); Morgan v. Commissioner, 309 U.S. 78 (1940) (deeming it necessary to ascertain the nature of property rights under state law in order to determine estate tax consequence); Blair v. Commissioner, 300 U.S. 5 (1937) (finding state law relevant in determining, for income tax purposes, the validity of an assignment of a beneficiary's interest under a trust); Poe v. Seaborn, 282 U.S. 101 (1930) (relying on state law to determine which spouse in a community property state was taxable on community income); Threlkeld v. Commissioner, 87 T.C. 1294 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988) (holding it necessary to examine the nature of a claim under state law to determine if amounts received with respect to the claim are excludible under I.R.C. § 104(a)(2)); *see generally* RICHARD B. STEPHENS ET AL., FEDERAL ESTATE AND GIFT TAXATION ¶ 4.05[2][a], at 4-101 (6th ed. 1991); Edmond N. Cahn, *Local Law in Federal Taxation*, 52 YALE L.J. 799 (1943) (cited with approval by the Court in *Bosch*, 387 U.S. at 479 n.8); Paul L. Caron, *The Role of State Court Decisions In Federal Tax Litigation:* Bosch, Erie, *and Beyond*, 71 ORE. L. REV. 781, 782-83 (1992); Richard B. Stephens & James J. Freeland, *The Role of Local Law and Local Adjudications in Federal Tax Controversies*, 46 MINN. L. REV. 223 (1961).

[3] *See Morgan*, 309 U.S. at 80-81; *see also Bosch*, 387 U.S. at 462-65; STEPHENS ET AL., *supra* note 2, ¶ 4.05[2][a], at 4-101; Gilbert Paul Verbit, *State Court Decisions In Federal Transfer Tax Litigation:* Bosch *Revisited*, 23 REAL PROP. PROB. & TR. J. 407, 407-08 (1988).

a federal excise tax on the transfer of wealth[4] necessarily implicates state law, because the question whether a decedent has made a transfer of a particular item of wealth can be resolved only by examining the decedent's transfer rights,[5] which normally are the exclusive concern of state law.[6]

As a matter of policy, the tax law should not permit discrimination among taxpayers on the basis of arbitrary or improper criteria.[7] As a matter of constitutional law, the principle of uniformity[8] requires that two taxpayers living in different states not be taxed differently on that account.[9] At the same time, in order to avoid inappropriate discrimination, taxpayers living in different states must be taxed differently where relevant differences in state law make it necessary.[10]

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4 *See, e.g.*, United States Trust Co. v. Helvering, 307 U.S. 57, 60 (1939) (holding that estate tax is an excise tax imposed on the transfer of property at death).

5 *See, e.g.*, Estate of DiMarco v. Commissioner, 87 T.C. 653, 662-63 (1986), *action on decision*, (Sept. 24, 1990) (holding that an "act of transfer" must occur in order to trigger the estate or gift tax and that such an act does not occur unless the decedent or donor had the right to select the beneficiary); Estate of Miller v. Commissioner, 14 T.C. 657 (1950) (in accord with *DiMarco*); STEPHENS ET AL., *supra* note 2, ¶ 4.05[2][a], at 4-101.

6 *See, e.g., Morgan*, 309 U.S. at 80-81 (indicating that state law determines the nature of the underlying legal interests and rights for purposes of federal transfer taxation). On occasion, however, federal law will determine the content of these rights. *See, e.g.*, Rev. Rul. 76-102, 1976-1 C.B. 272 (determining that coal miner's benefit payable to decedent's spouse was not includible in gross estate because, under federal statute, decedent did not have right to select recipient); Rev. Rul. 67-277, 1967-2 C.B. 322 (finding certain Social Security benefits payable to decedent's spouse not includible in gross estate because, under applicable federal statute, decedent did not have right to control selection of recipient).

7 *See* Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 NAT'L TAX J. 139 (1989); Louis Kaplow, *A Note on Horizontal Equity*, 1 FLA. TAX REV. 191 (1992); Richard A. Musgrave, *Horizontal Equity: A Further Note*, 1 FLA. TAX REV. 354 (1993); Richard A. Musgrave, *Horizontal Equity, Once More*, 43 NAT'L TAX J. 113 (1990). Use of improper or arbitrary criteria could render a tax questionable in constitutional terms as well. The courts are "especially deferential" to the legislature in the tax context and are therefore typically reluctant to strike down classifications or distinctions contained in tax legislation. *See* Nordlinger v. Hahn, 505 U.S. 1, 11 (1992) (indicating that the Court is "especially deferential" in the tax context and upholding, under the rational-basis test, California's real property tax system even though it imposed a greater tax on newcomers than on homeowners of longer duration). Nevertheless, a tax imposed on the basis of one's religion would surely violate the Equal Protection Clause. *See, e.g.*, Bray v. Alexandria Women's Health Clinic, 506 U.S. 263, 270 (1993) (indicating that a tax on the wearing of yarmulkes could not be sustained because it would constitute a tax on the basis of religion).

8 *See* U.S. CONST. art. I, § 8, cl. 1.

9 *See* Knowlton v. Moore, 178 U.S. 41, 84-90 (1900) (holding that the uniformity requirement contemplates a prohibition against geography-based discrimination); *see also* Bruce Ackerman, *Taxation and the Constitution*, 99 COLUM. L. REV. 1, 2-3 (1999); Erik M. Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Constitutional?* 97 COLUM. L. REV. 2334, 2340 (1997).

10 *See generally* Commissioner v. Estate of Bosch, 387 U.S. 456 (1967) (taking state law into account in determining the availability of the marital deduction); *Morgan*, 309 U.S. at 78 (indicating that state law must be taken into account for transfer-tax purposes where relevant).

In any given case, deciding whether, or the extent to which, state law should be determinative of a federal tax issue can be difficult.[11] An overemphasis or underemphasis on state law can be problematic. In the case of an underemphasis, the tax base is distorted, and inappropriate discrimination occurs—or, in tax parlance, principles of equity are violated.[12] In the case of an overemphasis, equity violations and distortions in the tax base also result; in addition, distortions in behavior occur, opportunities for taxpayers with sophisticated counsel to take advantage of the tax system emerge, and, ultimately, inappropriate considerations shape state law.

A. *Underemphasis and Its Consequences*

To illustrate the problematic aspects of an underemphasis on state law, consider how the issue of adverse possession would be treated for transfer tax purposes if federal law were determinative. Assume that a taxpayer's property has been in the possession of an adverse claimant for eight years and that, under state law, a claim to recover property from an adverse claimant is barred after six years. As a matter of state law, the taxpayer, having lost all interest in the property, would be unable to transfer or control it by will. Consequently, under current law, if the taxpayer were to die, the property would not be included in the taxpayer's gross estate.[13] If Congress were to amend the Code to establish, for transfer tax purposes, a federal rule of ten years for adverse-possession claims, the property would be included in the taxpayer's gross estate, even though, under state law, the taxpayer had no interest in the

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[11] For example, there is presently a conflict in the federal circuits over the deductibility of estate administration expenses under I.R.C. § 2053 (1994 & Supp. III 1997). Several circuits hold that administration expenses, in order to be deductible, must satisfy state-law standards and be reasonable as a matter of federal law. One circuit holds that state law provides the sole test for deductibility and is therefore determinative. *Compare* Estate of Millikin v. Commissioner, 125 F.3d 339, 343-44 (6th Cir. 1997); Estate of Love v. Commissioner, 923 F.2d 335, 337 (4th Cir. 1991); Marcus v. DeWitt, 704 F.2d 1227, 1229-30 (11th Cir. 1983); Hibernia Bank v. United States, 581 F.2d 741, 744-45 (9th Cir. 1978); Estate of Smith v. Commissioner, 510 F.2d 479, 482-83 & n.4 (2d Cir. 1975) *and* Pitner v. United States, 388 F.2d 651, 659 (5th Cir. 1967), *with* Estate of Jenner v. Commissioner, 577 F.2d 1100, 1106 (7th Cir. 1978).

[12] It is conceivable that an underemphasis on state law might raise constitutional questions as well. In *Knowlton*, the Court upheld the estate tax, against a constitutional challenge that it was a direct tax and therefore had to be apportioned, on the ground that the tax was imposed on the act of transferring property. 178 U.S. at 56; *see also* Ackerman, *supra* note 9, at 32-33. If a tax were imposed without regard to the taxpayer's transfer rights under state law, it could well be viewed as an unconstitutional direct tax (because of its failure to comply with the apportionment requirement). *See* Tech. Adv. Mem. 98-42-003 (July 2, 1998) (intimating that the imposition of the transfer tax where no transfer of wealth has actually occurred would be viewed as a direct tax that, because it was not apportioned, would be unconstitutional).

[13] *Cf.* Estate of Beggs v. Commissioner, 13 T.C. 131, 136-37 (1949) (finding creditor who, prior to her death, allowed statute of limitations to run on debt not required to include debt in her gross estate).

property at the time of death and therefore could not transfer it. Thus, the underemphasis on state law effected by federalizing the rule concerning adverse possession would result in distorting the tax base by creating a wealth transfer for tax purposes that did not correspond to an actual transfer of wealth.[14]

To illustrate how an underemphasis could produce equity violations, consider how two taxpayers living in different states would be treated for tax purposes under a federalized adverse possession rule. Assume that Taxpayer A is domiciled in State X and that Taxpayer B is domiciled in State Y. Assume further that Taxpayer A and Taxpayer B both own real property in their domiciliary states and that the property, in both cases, has been in the possession of an adverse claimant for eight years. If, under the law of State X, a claim to recover property from an adverse claimant is barred after six years, the property would not be included in Taxpayer A's gross estate. In contrast, if under the law of State Y, such a claim is barred after ten years, the property would be included in Taxpayer B's gross estate under current law if he or she were to die before the expiration of the ten-year period. This disparity in Taxpayer A's and Taxpayer B's transfer-tax outcome would be appropriate, because the amount of wealth transferred by Taxpayer B at death is greater than the amount transferred by Taxpayer A. Indeed, equity dictates that the Code discriminate between these two taxpayers. But if Congress were to establish a federal ten-year rule for transfer tax purposes, this discrimination would disappear and inequity would result in that both taxpayers would be required to include the property in their gross estate, even though Taxpayer A could not control or transfer the property by will under state law, while Taxpayer B could. Simply put, providing the same tax outcome for differently situated taxpayers is not equitable.

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14 Under current law, a person losing title to an adverse claimant in a hostile context—which would ordinarily be the case given the state-law requirement that such claims be hostile, *see* R.H. Helmholz, *Adverse Possession and Subjective Intent*, 61 WASH. U. L.Q. 331, 334 (1983)—would not be subject to gift tax because the loss is analogous to consumption or a decline in the value of an investment. *But cf.* Rev. Rul. 81-264, 1981-2 C.B. 185 (ruling that permitting the statute of limitations to run on a debt in the context of a family transaction constitutes a taxable gift, but indicating that it would not constitute a taxable gift if the taxpayer permitted it to run inadvertently and in the ordinary course of business); *see also* Estate of Lang v. Commissioner, 64 T.C. 404, 413 (1975), *aff'd*, 613 F.2d 770, (9th Cir. 1980) (supporting the result of Rev. Rul. 81-264).

B. Overemphasis and Its Consequences

To illustrate the consequences of an overemphasis on state law, consider I.R.C. § 1014(b)(6) ("section 1014(b)(6)"), which establishes the rule for determining basis with respect to community property.[16] Under the provision, a surviving spouse's basis in his or her share of community property is equal to its fair market value on the date of death of the deceased spouse. Thus, all community property—the deceased spouse's share as well as the surviving spouse's share—enjoys a basis equal to fair market value determined as of the date of the deceased spouse's death.[17] If a couple has community property with a basis of $100,000 and one spouse dies when the property has a fair market value of $1,000,000, the surviving spouse's basis in the property will be $1,000,000. In contrast, a couple living in a common law state and owning all of their property jointly enjoys the date-of-death basis rule only with respect to the deceased spouse's share, with the surviving spouse's basis in his or her share not changing on account of the other spouse's death.[18] If the aggregate value of the couple's jointly owned property is $1,000,000 when one spouse dies and each spouse enjoyed a pre-death basis of $50,000 in his or her share, the surviving spouse's basis in the property would be $550,000 (the surviving spouse's basis of $50,000 in his or her share and the date-of-death value of the deceased spouse's share). Thus, the special community-property basis rule produces equity violations:[19] two couples identically situated receive significantly different tax treatment in terms of basis simply because one chooses to live in a community property state and the other chooses to live in a common law state.[20]

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15 *See* I.R.C. § 1014(b)(6) (1994 & Supp. III 1997).

16 *See* I.R.C. § 1014(b)(6) (1994 & Supp. III 1997).

17 *See* Arthur W. Andrews, *Community Property with Right of Survivorship: Uneasy Lies the Head that Wears a Crown of Surviving Spouse for Federal Income Tax Basis Purposes*, 17 VA. TAX REV. 577, 579 (1998).

18 *See id.* at 580-81. Utilizing the date-of-death value under section 1014 can actually result in a disadvantage to the taxpayer where the date-of-death value is less than the pre-death basis. *See* Jonathan G. Blattmachr et al., *Tax Planning with Consensual Community Property: Alaska's New Community Property Law*, 33 REAL PROP., PROB. & TR. J. 615, 624 (1999). Because, however, assets generally tend to increase in value over time (by virtue of inflation, market appreciation or, in the case of corporate stock, retained earnings), section 1014 is ordinarily favorable to the taxpayer. *See id.*

19 Recognizing the inappropriateness of section 1014(b)(6), Treasury recently proposed its repeal. *See* Treas. Release 1999-4614 (Feb. 1, 1999); *see also* Treasury Dept., *Treasury Releases Explanation of Administration's 2000 Budget Proposal*, TAX NOTES TODAY, Feb. 2, 1999, at 21-36, *available in* LEXIS, TNT file.

20 It is, of course, true that, in a common law state, all of a couple's property could receive a basis equal to date-of-death value upon the death of the first spouse to die if all of the property is titled in that spouse's name. But, in order to achieve this, it would be necessary for the couple to anticipate the order of

When the Code creates or tolerates such inequity, taxpayers can be expected to seek changes in state law and to seek to exploit state-law provisions that are taxpayer friendly. Not surprisingly, Alaska recently enacted legislation that enables couples residing in or outside of Alaska to convert non-community property into community property by contributing it to a trust situated in Alaska and making an election to have it so treated.[21] Under this legislation, assuming that its validity for tax purposes is sustained,[22] couples residing in common-law states who wish to take advantage of the community-property basis rule can do so through the simple expedient of establishing a trust in Alaska.

Such tax-driven state legislation is neither a new phenomenon nor an uncommon one. For example, prior to 1948, community property legislation was enacted by some states to enable couples to enjoy income splitting for federal income tax purposes.[23] Some of these states repealed the legislation after the Code was amended in 1948 to establish income splitting as a matter of federal law.[24]

For an example under current law not involving community property, consider the interaction between the generation-skipping tax and the rule against perpetuities. Under the generation-skipping tax, each taxpayer is entitled to an exemption of just over one million dollars.[25] If the taxpayer allocates the exemption to a transfer made in trust, neither distributions from the trust nor a termination of the trust will constitute a taxable event for

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their deaths and to title the assets accordingly. *But see* I.R.C. § 1014(e) (1994 & Supp. III 1997) (denying a date-of-death basis for assets acquired by the decedent within one year of death in certain circumstances).

21 *See* ALASKA STAT. § 34.77.100 (Michie 1998); *see also* Blattmachr et al., *supra* note 18, at 616-17. The statute does require that at least one trustee be, in effect, an Alaska domiciliary. *See* ALASKA STAT. § 34.77.100(a) (1998).

22 Questions have been raised as to whether property held as community property under such an opt-in approach can be viewed as constituting community property within the meaning of section 1014(b)(6). *See* Blattmachr et al., *supra* note 18, at 624-31 (arguing that section 1014(b)(6) should apply in the context of Alaska's opt-in approach but acknowledging arguments to the contrary).

23 In *Poe v. Seaborn*, 282 U.S. 101 (1930), the Court held that couples living in a community property state could split their income, whereas couples living in a common law state could not. For the purpose of permitting their residents to take advantage of this decision, some states enacted community property legislation. *See* Stanley Surrey, *Federal Taxation of the Family—The Revenue Act of 1948*, 61 HARV. L. REV. 1097, 1104 (1948).

24 *See* Surrey, *supra* note 23, at 1111.

25 *See* I.R.C. § 2631 (1994 & Supp. III 1997). Pursuant to I.R.C. § 2631(c), the exemption amount is increased for inflation after 1998. *Id.* § 2631(c). In 1999, the exemption amount is $1,010,000. *See* Rev. Proc. 98-61, 1998-52 I.R.B. 18.

generation-skipping tax purposes.[26] The longer the term of the trust, the longer the exemption will be effective and the more the family will save in transfer taxes.[27] Congress failed to include in the Code a durational limit on generation-skipping-exempt trusts, presumably on the rationale that the rule against perpetuities under state law would prevent taxpayers from unduly extending their term. Seeking to exploit this failure, various states have altered or repealed the rule against perpetuities,[28] thereby permitting taxpayers who locate their generation-skipping-exempt trust in one of these states[29] to make the trust last forever and enjoy greater tax savings.[30] Aware of Congress's failure and the states' reaction to this failure, the Treasury Department issued regulations imposing a limit on the tax savings that could be enjoyed through the use of generation-skipping-exempt trusts located in states permitting the trust to last indefinitely.[31] However, it subsequently decided to delete from the

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26 *See* I.R.C. § 2641 (1994) (creating a zero tax liability for a generation-skipping transfer where the inclusion ratio is, as determined under I.R.C. § 2642, zero); *id.* § 2642 (making the inclusion ratio zero for a transfer that is wholly exempt).

27 *See* Jesse Dukeminier, *The Uniform Statutory Rule Against Perpetuities and the GST Tax: New Perils for Practitioners and New Opportunities*, 30 REAL PROP., PROB. & TR. J. 185, 205-09 (1995).

28 Trusts designed to remain in existence for several generations (or longer) in order to maximize the effectiveness of the generation-skipping-tax exemption are presently being created in the eight states that have either abolished or substantially relaxed the rule against perpetuities: Alaska, Arizona, Delaware, Idaho, Illinois, Maryland, South Dakota and Wisconsin. *See* Steven J. Oshins, *Sales to Grantor Trusts: Exponential Leverage Using Multiple Installment Sales*, PROB. & PROP., Jan./Feb. 1999, at 46, 51.

29 *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 270, cmt. b. (permitting the trust settlor, as a general rule, to designate which state's law is to govern the validity of the trust as long as the state has some contact with the trust, such as the trustee's being domiciled in the state or trust assets' being located in the state); Frederick R. Keydel, *Revocable Trusts Revisited*, 18 INST. ON EST. PLAN. ¶ 1100, ¶ 1103.5, at 11-20 (1984) (permitting settlor to select governing law).

30 It is conceivable that non-tax considerations may be part of the motivation leading states to alter or repeal the rule. For example, the rule has been criticzed on libertarian grounds. *See* RICHARD A. EPSTEIN, TAKINGS 304 (1985); Richard A. Epstein, *Past and Future: The Temporal Dimension in the Law of Property*, 64 WASH. U.L.Q. 667, 704-05, 710-13 (1986).

31 *See* Treas. Reg. § 26.2652-1(a)(4) (as amended in 1997). Under the regulation, a person exercising a special power of appointment becomes the transferor of the appointed property for generation-skipping-tax purposes if the effect of the exercise is to postpone vesting beyond the perpetuities period as measured from the date of the creation of the power. Thus, if as a result of the exercise of a special power, vesting is deferred beyond the perpetuities period, the original transferor would no longer be viewed as the transferor. As a consequence, even though the original transferor had made the trust fully generation-skipping-tax exempt by allocating his or her exemption to it, the trust would no longer remain permanently exempt, unless the person exercising the special power allocated his or her exemption to the trust as well. *See id.* In short, the effect of the regulation was to eliminate the possibility of making a trust utilizing a special power of appointment permanently exempt through the allocation of the original transferor's exemption. *See* Pam H. Schneider & Lloyd Leva Plaine, *Generation Skipping Final Regs. Cure Many (But Not All) of the Problems in the Prop. Regs., Part II*, 85 J. TAX'N 139 (1996). In promulgating this regulation, Treasury obviously perceived that it was necessary to target special powers of appointment, for practitioners do not utilize general powers of appointment in trusts to which exemption is allocated, given that a general power would trig-

regulations the exemption-limiting concept it had adopted initially.[32] Presently, therefore, taxpayers throughout the country continue to create permanently exempt trusts by locating them in states that no longer maintain the rule against perpetuities. In implicitly relying on the rule against perpetuities under state law, Congress in effect overemphasized state law and created the opportunity for taxpayers locating their trust in the right state to enjoy a permanent generation-skipping exemption. To remedy this, a federal rule limiting the duration of exempt trusts, perhaps a rule similar to the one initially adopted by the Treasury Department, would be necessary.

Another example under current law of an overemphasis on state law (and the negative consequences of such overemphasis) arises in connection with I.R.C. § 2704(b) ("section 2704(b)"). Under that section, certain restrictions ("applicable restrictions") imposed on the taxpayer's right to liquidate his or her interest in an entity are disregarded for valuation purposes in the context of intrafamilial transfers.[33] So, for example, if a partnership agreement provides that the general partner can neither force a liquidation of the partnership nor require the partnership to liquidate his or her interest without the consent of all of the other partners, the general partner's interest could be viewed as subject to an applicable restriction, assuming all of the statutory conditions are satisfied.[34] Were it so viewed and were the general partner to die, the value of the general partner's interest in the partnership would be determined for estate tax purposes without regard to the restriction.[35] In contrast, under conventional valuation principles (i.e., in the absence of section 2704(b)), the amount included in the general partner's gross estate on account of the partnership inter-

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ger inclusion in the power holder's estate under I.R.C. § 2041 and thereby defeat the objective of allocating the exemption to the trust. I.R.C. § 2041 (1994). Also, for a trust designed to last indefinitely, the use of a special power is necessary as a practical matter in order to avoid inflexibility. In any event, the exemption-limiting provision in the regulations has been deleted. *See* T.D. 8720, 62 Fed. Reg. 27498 (1997) (to be codified at 26 C.F.R.), which is discussed *infra* at note 32.

32 *See* T.D. 8720, 62 Fed. Reg. 27498 (1997) (to be codified at 26 C.F.R.). Treasury deleted the exemption-limiting concept from the regulations apparently because of its concern that the concept would actually produce an inappropriate tax savings for taxpayers creating non-exempt generation-skipping trusts. In the case of such trusts, if the holder of a special power were to exercise it in a way that postponed vesting beyond the perpetuities period (as measured from the date of the power's creation), the power holder would become the transferor under the approach initially adopted in the regulations. This could have the effect of deferring the generation-skipping tax until a later generation, even though no portion of the trust would be subject to tax in the power holder's estate. *See* Schneider & Plaine, *supra* note 31, at 145. Treasury's decision to delete the exemption-limiting concept may also be reflective of the concern that it was invalid because of an insufficient predicate in the statute. *See id.* at 139 n.5.

33 *See* I.R.C. § 2704(b)(1) (1994).

34 *See* Treas. Reg. § 25.2704-2(d) ex. 1 (1992).

35 *See id.*

est would be reduced to reflect the restriction on the ability to liquidate contained in the agreement.[36] In short, section 2704(b) produces a higher valuation.

The statute,[37] as amplified by the regulations,[38] qualifies the applicable-restriction concept in an important way, defining the concept so that restrictions imposed under state or federal law as a default rule do not trigger the section. In other words, only restrictions that deviate from the default rule can be treated as applicable restrictions. Thus, if, in the example just posited, the default rule under state partnership law were to the effect that no partner could force a liquidation of the partnership (or the partner's interest) without the consent of all partners, the general partner's interest would *not* be viewed as subject to an applicable restriction. It would therefore be valued conventionally, that is, by taking into account the restriction's depressant effect on value. Conversely, if the default rule under state partnership law allowed a general partner unilaterally to withdraw his or her capital at any time, the provision in the agreement requiring the consent of all partners would be viewed as an applicable restriction and would be disregarded for valuation purposes (again assuming all of section 2704(b)'s requirements are satisfied).[39] Seeking to exploit the section's reliance on the partnership or corporation law's default rule, some states have enacted default rules that are favorable to taxpayers.[40] As a

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36 *See* Estate of Watts v. Commissioner, 823 F. 483, 486-87 (11th Cir. 1987) (holding that restriction on general partner's right to force liquidation of partnership resulted in discount in valuing the partner's interest for estate-tax purposes).

37 I.R.C. § 2704(b)(3)(B) (1994).

38 Treas. Reg. § 25.2704-2(b) (1992).

39 *See* Treas. Reg. § 25.2704-2(c) (1992) (providing that where an applicable restriction is disregarded, the transferred interest is valued under state law as if the restriction were not included in the entity's governing document).

40 As an example, consider the developments under section 2704(b) in connection with the right of a partner to withdraw from the partnership. Under section 603 of the Revised Uniform Limited Partnership Act, a limited partner is entitled to withdraw from the partnership and receive "fair value" for his or her interest at any time, subject to a six-month waiting requirement. REVISED UNIF. LTD. PARTNERSHIP ACT § 603 (amended 1985), 6A U.L.A. 217-18 (1995). On the other hand, the section provides that this withdrawal right is not available where the partnership agreement establishes a fixed date for the termination of the partnership. *Id.* The Internal Revenue Service maintains that section 603 establishes a default rule that permits withdrawal at any time. Thus, according to the Service, a partnership agreement containing a fixed term displaces the default rule, imposing an applicable restriction, within the meaning of section 2704(b), on the right of the limited partners to liquidate their interests. *See, e.g.*, Tech. Adv. Mem. 98-42-003 (July 2, 1998); Priv. Ltr. Rul. 97-30-004 (July 25, 1997) (applicable restriction found because agreement contained a fixed term); Priv. Ltr. Rul. 97-35-003 (Aug. 29, 1997) (holding restriction applicable because agreement explicitly denied the right to withdraw at any time).

The Service's position, if sustained, would significantly undermine the discount-planning opportunities offered by the typical family limited partnership. In the typical plan, a substantial minority discount is

consequence, taxpayers seeking valuation discounts are advised by practitioners to form their entities in states that have enacted taxpayer-friendly default rules.[41] As in the case of generation-skipping-exempt trusts, it would be preferable to create a federal standard for determining the scope of acceptable tax planning.[42]

Tax-driven provisions in state law that result from the tax law's overemphasis on state law are not based upon appropriate state-level policy

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claimed in connection with the gift of the limited partnership interests. *See generally* James R. Repetti, *Minority Discounts: The Alchemy in Estate and Gift Taxation*, 50 TAX L. REV. 415, 430 (1995). If the donee can withdraw his or her capital at any time, little, if any, minority discount would be available (perhaps some discount would be appropriate given the need to wait for six months before receiving the distribution). And if section 603's withdrawal-at-any-time approach is negated by including a fixed term in the agreement, the Service will invoke section 2704(b) and tax the gift as if the withdrawal right had not been displaced. *See* Priv. Ltr. Rul. 97-30-004 (Apr. 3, 1997). Obviously aware that the Service was preparing to take this position on section 603 and the fixed-term agreement, various states have amended their partnership and/or LLC statutes to include as a default rule a prohibition on the right of members or partners to withdraw voluntarily, making it necessary to override the default rule in the governing document where the members or partners prefer to retain the right to withdraw at any time. *See* Milford B. Hatcher, Jr. & Gregory E. Kniesel, *Preferred Limited Partnerships—Now the FLPs of Choice*, 89 J. TAX'N 325, 327 (1998); Steven T. Ledgerwood, *Oklahoma LLCs v. Limited Partnerships: Choice of Entity for Valuation Discounts After 1997*, 22 OKLA. CITY U. L. REV. 611 (1997). Thus, a taxpayer seeking a minority discount for a limited partnership or similar interest would be well advised to consider forming the entity in a state that has adopted this new approach. It can also be anticipated that additional states will adopt similar legislation. *See* Lisa I. Fried, *Business Legislation: Bills Aim for Competitive Environment Here*, N.Y. L.J., Jan. 21, 1999, at 5 (indicating that legislation has been proposed in New York that would change the default rule for LLC's – under which, currently, a member can withdraw at will subject to a six-month waiting period—so that, unless the governing document provided otherwise, a member could not withdraw at will).

41 *See* Hatcher & Kniesel, *supra* note 40, at 327; Ledgerwood, *supra* note 40, at 638-39 (suggesting the use of the Oklahoma LLC because of its favorable default rule).

42 Given the resourcefulness of practitioners in creating new value-depressing restrictions, it is not surprising that section 2704(b)(4) authorizes the Treasury Department to issue regulations directing that other restrictions (presumably restrictions in addition to those defined in the statute as applicable restrictions) not be taken into account for valuation purposes. I.R.C. § 2704(b)(4) (1994). It is not entirely clear, however, that this subsection would authorize the Treasury to issue a regulation directing that a restriction embodied in a state-law default rule be disregarded, because section 2704(b)(3)(B) indicates that a restriction that is supplied by state law is not to be viewed as an applicable restriction. *Id.* § 2704(b)(3)(B). Perhaps the better reading of the statute would permit a regulation disregarding a state-supplied default rule, for section 2704(b)(3)(B) merely creates an exception to the definition of applicable restrictions and does not appear to constitute a limitation on the Treasury's authority under section 2704(b)(4). In any event, the only regulation thus far issued under section 2704(b) deals exclusively with applicable restrictions and makes clear that a default rule under state law is not to be treated as an applicable restriction. *See* Treas. Reg. § 25.2704-2 (1992).

Parenthetically, it has been suggested that the value of an interest, for transfer tax purposes, should be deemed to be no less than its pro rata liquidation value (i.e., liquidation value determined without any minority discount). *See* William S. Blatt, *Minority Discounts, Fair Market Value, and The Culture of Estate Taxation*, 52 TAX L. REV. 225, 263 (1997). Under this approach, all restrictions on the right to liquidate would be made irrelevant when determining liquidation value. *See id.*

considerations. Nor are they the product of the friction that state legislators normally face in crafting legislation.[43] Indeed, they are simply the product of an unhealthy competition among the states to create a legal environment conducive to taxpayers seeking to achieve federal tax savings.[44] When

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[43] It is also possible that an overemphasis could cause a state legislature to choose an outcome that it would otherwise reject were it to focus exclusively on state-level concerns. So, for example, a legislature considering the rule against perpetuities might, on balance, decide that its concern about encouraging an appropriate level of risk-taking, *see* Jesse Dukeminier, *A Modern Guide to Perpetuities*, 74 CAL. L. REV. 1867, 1869 (1986), outweighed its libertarian discomfort with the rule, *see* Epstein, *supra* note 30, at 703-07, and that the rule should therefore be retained. Yet, when informed about the potential for generation-skipping-tax savings, it might well decide in favor of repeal. *See* Edward C. Halbach, Jr., *Significant Trends in the Trust Law of the United States*, 32 VAND. J. TRANSNAT'L L. 531, 539 (1999) (suggesting that the tax-induced repeal of the rule is of "dubious policy merit").

Similarly, one could argue that, in the spendthrift context, the tax law's overemphasis on state law has resulted in legislation that would not have been enacted if only legitimate state law concerns had been taken into account. As a traditional matter, where a trustee is given discretion to make distributions to the grantor, the grantor's creditors can reach the trust's assets. *See* RESTATEMENT (SECOND) OF TRUSTS § 156(2) (permitting the creditors of the grantor to reach the trust's assets to the extent that, under a maximum exercise of discretion, the trustee could make distribution to the grantor). Applying the traditional rule, the courts have held that, in the case of such a discretionary trust, the corpus must be included in the grantor's estate (because of the grantor's indirect ability to gain access to the trust by undertaking debts that the trustee would be required to satisfy). *See* Estate of Paxton v. Commissioner, 86 T.C. 785, 818 (1986) (holding a discretionary trust includible in the grantor's estate under I.R.C. § 2036(a)(1) because the grantor's creditors could reach the trust's assets under Washington law); Revenue Ruling 77-378, 1977-2 C.B. 348 (ruling that a discretionary trust must be included in a grantor's estate under I.R.C. § 2038 where the grantor's creditors could reach trust assets under state law). Recently, Alaska enacted legislation eliminating the traditional rule. *See* ALASKA STAT. § 34.40.110 (Michie 1998) (providing that a grantor can secure spendthrift protection with respect to his or her interest in the trust even though the trustee has the discretion to make distributions to the grantor). Delaware has enacted similar legislation. *See* DEL. CODE ANN. tit. 12, §§ 351-376 (Supp. 1998). Thus, such a discretionary trust created under Alaska or Delaware law presumably would not be included in the grantor's estate. *See* Priv. Ltr. Rul. 98-37-007 (June 10, 1998) (transfer of property to a trust under a statute like Alaska's constitutes a completed gift for gift tax purposes because, under the statute, the grantor's creditors could not reach the trust's assets, though it should be noted that the Service explicitly declined to rule on the includability of the trust corpus in the grantor's estate, perhaps because an implied understanding between the trustee and the grantor that the trustee would make distributions to the grantor would trigger inclusion under I.R.C. § 2036 without regard to the ability of the creditors to reach the trust's assets. *See id.* It is inappropriate, however, to permit state law to be determinative in this fashion. Whether the trust is created under Alaska law or under the law of a traditional state, it would seem that the opportunity retained by the grantor to reacquire the corpus through the exercise of the trustee's discretion should make the trust subject to tax in the grantor's estate. *Cf.* I.R.C. § 677 (1994) (making the grantor subject to income tax on income that, in the discretion of the trustee, could be distributed to the grantor). In sum, this overemphasis may well account for Alaska's, as well as Delaware's, abandonment of the traditional rule and the underlying concern for creditors' rights.

[44] From a public-choice perspective, state legislation ought to be enacted where, after balancing competing interests, it is determined that a societal benefit can be achieved (beyond the mere transfer of wealth to a politically powerful group). *See* Jonathan R. Macey, *Transaction Costs and the Normative Elements of the Public Choice Model: An Application to Constitutional Theory*, 74 VA. L. REV. 471, 477 (1988). In the case of an overemphasis, costs are incurred in securing the necessary state legislation, *see id.* at 478 (discussing the deadweight social loss inherent in attempts to secure favorable legislation), even

overemphasizing state law, Congress in effect abdicates its responsibility to determine federal tax policy, allowing the states instead to control tax-policy questions indirectly. Moreover, tax-driven provisions in state law produce distortion, in that taxpayers are induced to engage in transactions that otherwise would make no sense (e.g., a non-Alaskan resident contributing property to a trust in Alaska and opting to have the trust property be treated as community property in order to secure the advantages that section 1014 makes available for community property).[45] Lastly, they create opportunities for taxpayers with sophisticated counsel to take advantage of the tax system, resulting in the inequity and tax-base distortions that such opportunities normally generate.[46]

In Part II, the question of overemphasis on state law in the context of the marital deduction's passing requirement will be considered.

II. THE MARITAL DEDUCTION: AN OVEREMPHASIS ON STATE LAW

A. Overview of the Marital Deduction's Passing Requirement

In 1948, in an attempt to create parity between couples living in common law and community property states, Congress adopted the marital deduction.[47] Under the 1948 legislation, a spouse living in a common law state could bequeath as much as half of his or her estate to the surviving spouse tax-free.[48] This arrangement created parity with couples living in a community property state, inasmuch as the 1948 legislation required only half of a spouse's community property—i.e., the amount over which the decedent spouse had testamentary control[49]—to be included in his or her estate.[50] The excluded half

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though the sole purpose for the legislation is tax-based and the legislation will not lead to any societal benefit.

45 *See* Mitchell M. Gans, *GRIT's, GRAT's and GRUT's: Planning And Policy*, 11 VA. TAX REV. 761, 812 (1992) (discussing distortion in the transfer-tax context).

46 Where the rules are susceptible to exploitation through sophisticated planning, inequity results because of the difference in tax burden imposed on taxpayers depending on whether or not they decide to engage in the favored transactions. *See* Gans, *supra* note 45, at 896 n.255 (suggesting a relationship between distortion and inequity).

47 *See* Revenue Act of 1948, Pub. L. No. 471, § 361, 62 Stat. 110, 117-21 (1948); Surrey, *supra* note 23, at 1117-25.

48 A deduction was allowed for the amount passing to the surviving spouse, but the deduction could not exceed fifty percent of the decedent's adjusted gross estate. *See* Surrey, *supra* note 23, at 1121.

49 *See id.* at 1118-25.

50 The 1948 legislation repealed prior legislation, enacted in 1942, and thereby re-enacted the pre-1942 rules. Under the 1942 legislation, in a community property state a husband (who was presumed to be the

of the community property was viewed as belonging to the surviving spouse and therefore not transferred from the decedent spouse to the surviving spouse. Because the excluded half of the community property passed from the decedent to the surviving spouse as a result of state law, and because the objective underlying the marital deduction was to equalize the tax treatment of common law and community property couples, the marital deduction was naturally made applicable only where property passed from the decedent to the spouse under state law.[51] Thus, as enacted, the marital deduction would be available, and is still available, only where the property passed from the decedent to his or her spouse under state law (either under the decedent's will or by virtue of some other legal right).[52]

Not only did the legislation provide that the property must pass to the surviving spouse in order to qualify for the deduction, but it also required, in effect, that the surviving spouse be the intended beneficiary.[53] This intent-based aspect of the passing requirement was significant in the context of will-related litigation and disclaimers.

In the case of will-related litigation, where a beneficiary other than the surviving spouse surrendered part or all of the bequest to the surviving spouse in a settlement, no deduction would be permitted for the surrendered portion because the decedent spouse failed to express an intent that the surviving spouse receive it.[54] Despite this failure, the deduction would nevertheless be permitted if it could be established that the surviving spouse was entitled to the surrendered bequest under state law.[55] Thus, even though the amount surrendered by the non-spouse beneficiary actually passed into the hands of the spouse, no deduction would be available—unless the amount surrendered reflected the allocation of rights called for under state law.[56]

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economic source of the property) was required to include all of the community property in his estate, except to the extent that it could be proven that the community property was attributable to the efforts of his wife. *See id.* at 1118.

[51] *See id.* at 1125-27.

[52] For the passing requirement under current law, see I.R.C. § 2056(a) (1994) and Treas. Reg. §§ 20.2056(c)-1 and 20.2056(c)-2 (as amended in 1994).

[53] *See* Surrey, *supra* note 23, at 1126.

[54] *See* Pub. L. No. 471, § 361(e)(3), 62 Stat. 110, 120 (1948); *see also* S. REP. NO. 80-1013, at 4-5 (1948), *reprinted in* 1948 U.S.C.C.A.N. 1163, 1226-27; Surrey, *supra* note 23, at 1126.

[55] *See* S. REP. NO. 80-1013, at 4, *reprinted in* 1948 U.S.C.C.A.N. at 1226.

[56] Making a determination as to the allocation of rights under state law can, of course, be a complicated issue. The Supreme Court eventually addressed the issue in *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), and the lower courts, as well as the Service, continue to deal with it. For a further discussion, see *infra* notes 78-125 and accompanying text.

On the other hand, where the spouse surrendered part or all of the bequest to another beneficiary, the deduction would not be available irrespective of state law, apparently because the surrendered amount did not actually pass into the hands of the spouse.[57] The deduction would be denied in these circumstances notwithstanding the fact that the decedent intended the spouse to receive the bequest. Even if it could be established that the spouse's right to retain the bequest was beyond challenge under state law, that would be of no consequence.[58] In short, once the surviving spouse surrendered the bequest, no further inquiry concerning state law would be appropriate,[59] whereas such an

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57 *See* S. REP. NO. 80-1013, at 4, *reprinted in* 1948 U.S.C.C.A.N at 1226.

58 *See id.*

59 The congressional decision, in 1948, to establish a per se rule denying the marital deduction for a bequest surrendered by a surviving spouse is perhaps understandable. After all, once surrendered, the amount bequeathed to the surviving spouse would not be included in the surviving spouse's estate. And it was certainly not clear in 1948—indeed, it is not clear today—that the surrender of a bequest in the context of settling a litigation would constitute a taxable gift. *See* United States v. Davis, 370 U.S. 65, 69 n.6 (1962) (indicating that settlement occurring in the context of a divorce would not be viewed as triggering a taxable gift absent specific provisions in the Code providing that the relinquishment of marital rights as between spouses does not constitute adequate consideration for transfer-tax purposes); Harris v. Commissioner, 340 U.S. 106, 112 (1950) (indicating that settlement of litigation ordinarily does not result in a taxable gift by virtue of the ordinary-course-of-business exception, which is now contained in Treas. Reg. § 25.2512-8 (1992)); Estate of Friedman v. Commissioner, 40 T.C. 714, 719-20 (1963) (holding that settlement agreement between surviving spouse and her stepchildren qualified under the ordinary-course-of-business exception and therefore did not result in a taxable gift); *cf.* Revenue Ruling 77-314, 1977-2 C.B. 349 (indicating that settlement agreed upon in order to avoid the cost and delay of litigation would be subject to gift tax). If Congress had permitted the marital deduction for a bequest to the spouse that the spouse surrendered, it might be possible for the surrendered portion to escape transfer tax entirely: it would not be subject to estate tax in the decedent spouse's estate because of the marital deduction; it would not be subject to estate tax in the surviving spouse's estate because it was transferred out of the estate; and, assuming the gift tax were not applicable to the surrender of a bequest in the settlement context, no gift tax would be imposed on the surviving spouse.

Moreover, even assuming the surviving spouse's surrender of the bequest could have been viewed as triggering a taxable gift, the resulting gift tax probably would not fully have offset the reduction in estate tax attributable to allowing the marital deduction in the decedent spouse's estate. Prior to the unification in 1976 of the estate and gift taxes, the structure of the gift-tax system was such that an inter vivos gift generally produced a significantly lower tax than the estate tax would produce on an identical testamentary gift. *See* Theodore S. Sims, *Timing Under a Unified Wealth Transfer Tax*, 51 U. CHI. L. REV. 34, 35 n.3 (1984). It should be noted, however, that Congress's decision to deny the marital deduction for a surrendered bequest was, in all likelihood, not driven by a concern about the opportunity available to taxpayers to exploit the discontinuity between the gift and estate tax systems. Rather, it was more likely driven by its concern that a settlement-related surrender of a bequest would not be viewed as a taxable gift and that therefore the surrendered bequest could pass into the children's, or another beneficiary's, hands completely tax-free. *See* Schroeder v. United States, 924 F.2d 1547, 1554 (10th Cir. 1991) (explaining that Congress's decision to deny the marital deduction for a bequest surrendered by the surviving spouse makes sense given the possibility that transfer tax could be avoided entirely if the rule were otherwise). Indeed, it

inquiry would be appropriate in the case of a bequest surrendered to the spouse.

In the case of disclaimers, the intent-based aspect of the passing requirement similarly precluded application of the marital deduction to a bequest surrendered by a non-spouse beneficiary to the surviving spouse by disclaimer, even though the bequest actually passed to the surviving spouse[60] under state law as a result of the disclaimer.[61] Where it was the spouse who disclaimed a bequest in favor of another beneficiary, the intent-based aspect of the passing requirement presented no such difficulty. Nevertheless, the marital deduction would not be available because the disclaimed portion did not actually pass into the hands of the surviving spouse.[62] Again, the deduction would be denied even though the decedent intended that the surviving spouse receive the bequest.

Congress did not offer any explicit justification for imposing the intent-based aspect of the passing requirement. It would seem, however, that Congress was concerned that a couple living in a common law state not be treated preferentially relative to community property couples. And because, in the case of a community property couple, the one-half exclusion rule applied only where state law conferred the right on the surviving spouse to half of the community property, it apparently made sense to Congress that no marital deduction should be available in a common law state where the property passed to the spouse only because of some post-death action voluntarily undertaken by another (i.e., an action to which the spouse had no legal entitlement at the time of the decedent's death).

In any event, in 1966, Congress revisited the intent-based aspect of the passing requirement. In doing so, however, it focused solely on disclaimers

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was not until 1976 that Congress first addressed the discontinuity between the gift and estate tax systems. *See* Sims, *supra*, at 34-35.

While Congress's decision not to allow the marital deduction for a surrendered bequest was presumably based on its concern about the potential for tax avoidance, it may inadvertently have created the potential for double taxation. Without the marital deduction, the decedent spouse's estate would be subject to tax on the property bequeathed to the surviving spouse. And if, contrary to Congress' expectation, the Service were successfully to impose the gift tax on a surviving spouse's surrender of a bequest to another beneficiary (perhaps because the ordinary course of business exception were rendered inapplicable by the presence of donative intent, *see* Treas. Reg. § 25.2512-8 (1992)), the property passing into the hands of that beneficiary would be subject to double taxation.

60 *See* S. REP. NO. 80-1013, at 4-5 (1948), *reprinted in* 1948 U.S.C.C.A.N. at 1226-27.

61 See *infra* Part II.J for a further discussion of disclaimers.

62 *See* S. REP. NO. 80-1013, at 4-5 (1948), *reprinted in* 1948 U.S.C.C.A.N. at 1226-27.

and ignored will-related litigation.[63] Emphasizing that people often fail to engage in adequate estate planning prior to death and that no policy favors punishing the surviving family for the decedent's oversight, Congress eliminated the intent-based aspect of the passing requirement insofar as it applied to disclaimers.[64] Under the 1966 amendment,[65] disclaimers became effective for marital deduction purposes when executed by a non-spouse beneficiary, as well as by the surviving spouse. In other words, unlike the approach adopted in 1948, if a non-spouse beneficiary disclaimed and the disclaimed bequest passed as a result under state law to the surviving spouse, the marital deduction would be available for the disclaimed portion. Thus, insofar as disclaimers were concerned, Congress eliminated the intent-based aspect of the passing requirement. In short, upon enactment of the 1966 legislation, property passing to a beneficiary as a result of a disclaimer, whether the beneficiary was the spouse or a non-spouse, would be viewed as passing directly from the decedent to that beneficiary for purposes of determining the availability of the marital deduction.

While the rules concerning the elements of a valid disclaimer for marital deduction purposes, and for tax purposes generally, have changed since 1966,[66] the law remains that, for purposes of the marital deduction, disclaimers are to be respected. The deduction is to be allowed for property passing into the hands of the spouse under a disclaimer and, conversely, no deduction is to be allowed for property so passing into the hands of a non-spouse beneficiary.[67] Unfortunately, however, with respect to will-related litigation, the intent-based aspect of the passing requirement, as enacted in 1948, remains intact. As will be argued, this aspect of the passing requirement constitutes an overemphasis on state law and is indefensible from a tax policy perspective. Indeed, as will also be argued, the passing requirement itself overemphasizes state law and should be changed.

63 *See* S. REP. NO. 89-1599, at 2 (1966), *reprinted in* 1966 U.S.C.C.A.N. 3112, 3113.

64 *See id.*

65 *See* Technical Amendments Act of 1966, Pub. L. No. 89-621, 80 Stat. 872 (amending I.R.C. § 2056(d) (1954)).

66 *See infra* Part II.J.

67 *See infra* Part II.J.

B. *Will-Related Litigation: The Implementing Regulations and the Supreme Court Decision in* Bosch

1. *The Regulations*

Faithful to the structure of the statute as enacted in 1948, the current regulations[68] take a bifurcated approach to the treatment of property transferred in settlement of will-related litigation. First, they adopt a per se rule denying the marital deduction where the surviving spouse surrenders a bequest in such a settlement.[69] Consistent with the statutory scheme in place since 1948, the deduction is denied without regard to the spouse's right under state law to retain the bequest.[70] This portion of the regulations simply effectuates Congress's notion that the deduction should be permitted only for property actually passing into the hands of the surviving spouse[71] and has created little difficulty for the courts in its application.[72]

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68 *See* Treas. Reg. § 20.2056(c)-2(d) (as amended in 1994).

69 *See id.* § 20.2056(c)-2(d)(1).

70 *See* Schroeder v. United States, 924 F.2d 1547 (10th Cir. 1991); Citizens & S. Nat'l Bank v. United States, 451 F.2d 221 (5th Cir. 1971); United States Trust Co. v. Commissioner, 321 F.2d 908 (2d Cir. 1963); Estate of Frost v. Commissioner, 65 T.C.M. (CCH) 2101 (1993).

71 One court has held that the regulation does not go as far as the statute requires. In *Schroeder*, the surviving spouse surrendered both an amount she would have been entitled to receive by statute and jointly titled property passing to her by operation of law. 924 F.2d at 1554. Because, according to the court, the regulation concerned only controversies related to the decedent's will, the regulation did not apply. *See id.* Nonetheless, the court held that the marital deduction could not be permitted for the surrendered statutory share and joint property because the statute itself contemplated a denial of the deduction where a surrender occurred in connection with a dispute. The court emphasized the potential for tax avoidance were the statute construed otherwise. *See id.*

72 The regulation is easy to apply in the sense that, unlike the rule applicable where a non-spouse beneficiary surrenders in favor of the spouse, it does not permit any inquiry into state law. Moreover, while it might be anticipated that the courts would have some difficulty in determining whether the spouse's surrender of a bequest is part of a settlement (triggering the regulation and resulting in a denial of the deduction) or a completely voluntary gift by the spouse (not triggering the regulation and not disqualifying the bequest for the deduction), the courts have fashioned an approach designed to minimize such difficulty. Concerned about the potential for tax avoidance inherent in a narrow construction of the regulation, *see supra* note 71, the courts have avoided the difficulty of distinguishing between settlement and gift by construing the regulation expansively and sweeping within it cases involving tranfers that might arguably be viewed as gifts. *See, e.g.*, *Schroeder*, 924 F.2d at 1554; *Citizens & Southern*, 451 F.2d at 225-26; *United States Trust*, 321 F.2d at 909-11.

Nevertheless, one could conceive of cases where the surrender of a bequest by the spouse could be treated as a gift. To illustrate a gift and the consequences of treating it as such, assume the decedent spouse's will contains a bequest to the surviving spouse of $1,000,000. If no dispute or litigation occurs after the decedent's death and the surviving spouse decides to make a gift of, say, $200,000, it would seem that the gift would not trigger the regulation and therefore would not disqualify the marital deduction. The consequence of treating the transfer as a gift, rather than applying the regulation, could be significant. If the regulation were applicable and the marital deduction denied for the surrendered portion of $200,000, that

Second, reflecting the intent-based aspect of the passing requirement, the regulations provide that where a non-spouse beneficiary surrenders a bequest in favor of the spouse as part of a settlement, the amount surrendered is not necessarily viewed as passing to the spouse.[73] They provide that the marital deduction will be permitted with respect to the surrendered portion—in other words, the surrendered portion will be regarded as passing to the spouse—only if the surrender of property or rights to the spouse reflects "a bona fide recognition of enforceable rights of the surviving spouse in the decedent's estate."[74] While the regulations go on to create a presumption in favor of such "bona fide recognition" where there has been a determination by "a local court upon the merits in an adversary proceeding following a genuine and active contest," they also indicate that a decree based on an agreement will not necessarily be accepted as a "bona fide evaluation of the rights of the spouse."[75]

This portion of the regulations, in contrast to the per se rule applicable where the spouse surrenders a bequest,[76] does not lend itself to easy application. Faced with the regulation's ambiguity concerning the level of deference owed to a state court decree, the Supreme Court established a new framework in *Commissioner v. Estate of Bosch*.[77] However, despite this new framework—indeed, because of it—uncertainty about tax consequences still hangs over the settlement of will-related litigation, as well as decrees issued in such litigation, where a bequest is surrendered in favor of the surviving spouse.

amount would be taxed immediately in the decedent spouse's estate, and at the estate's marginal tax bracket, assuming it were not covered by the unified credit. As a gift, on the other hand, the surrender of the bequest does not cause a reduction of the marital deduction. Instead, it produces a taxable gift for the surviving spouse, taxed at the surviving spouse's marginal transfer-tax bracket (with no tax currently payable if the surviving spouse' unified credit has not been fully utilized). *See* I.R.C. §§ 2501, 2503, 2505 (1994 & Supp. III 1997). For a case in which the family sought gift treatment for a surrendered bequest, see *Estate of Natkanski v. Commissioner*, T.C.M. (CCH) 55 (1992) (denying the estate the marital deduction for a bequest surrendered by the surviving spouse even though the surviving spouse reported the surrender as a taxable gift). For a suggestion that the surviving spouse ought to be permitted to elect gift treatment in order to avoid a forfeiture of the marital deduction in the decedent spouse's estate, see *infra* note 286 and accompanying text.

73 *See* Treas. Reg. § 20.2056(c)-2(d)(2) (as amended in 1994).

74 *Id.*

75 *Id.*

76 *See supra* note 72 and accompanying text.

77 387 U.S. 456 (1967).

2. *The* Bosch *Framework*

Because the availability of the marital deduction turns upon state law where a bequest is surrendered in favor of the spouse, it becomes necessary to consider how the federal courts should determine questions of state law. In *Bosch*, the question arose in the context of a decree. After the decedent's death, the family secured a state trial court decree conferring certain rights on the surviving spouse that were critical in order for the estate to qualify for the marital deduction.[78] If the Supreme Court had adopted the view that state trial court decrees were determinative of the state law question resolved in the decree, no further examination of state law would have been permitted by either the Internal Revenue Service or the federal courts. And because the state court decree conferred the necessary rights on the spouse, the estate would have been entitled to the marital deduction.

The Court took a different approach, and established a new framework for evaluating the federal tax consequences of state court decrees. It held that only a decision by a state court of last resort would be entitled to binding deference.[79] Borrowing the phrase from the 1948 Senate Finance Committee Report, the Court held that a trial court or intermediate appellate court decree would be entitled merely to "proper regard"[80]—thus permitting the Service and the federal courts to examine independently the validity of the state court's assessment of the spouse's rights.[81]

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[78] *See id.* at 458-59. The estate relied on I.R.C. § 2056(b)(5) in claiming the marital deduction. *Id.* at 458. Under this section, which applies to transfers in trust for the benefit of surviving spouse, the spouse must be given a general power of appointment for the transfer to qualify for the marital deduction. I.R.C. § 2056(b)(s) (1994). Because the spouse in *Bosch* had released the power, the availability of the deduction turned upon the validity of the release. The state trial court had ruled that the release was invalid. *Bosch*, 387 U.S. at 459. In the companion case, *Second National Bank v. United States*, 351 F.2d 489 (2d Cir. 1965), *cert. granted*, 385 U.S. 966 (1966), the deduction turned upon whether or not the marital gift was encumbered by an obligation to pay a portion of the estate tax under a state tax-apportionment statute. 387 U.S. at 458-61. In that case, the state trial court had held that the marital gift was not subject to such an obligation, a decision that, if upheld, would result in a larger deduction. *Id.*

[79] *Bosch*, 387 U.S. at 465.

[80] *Id.* (quoting the 1948 Senate Finance Committee Report for the proposition that "'proper regard,' not finality, 'should be given to interpretations of the will' by state courts and then only when entered by a court 'in a bona fide adversary proceeding'"). In an effort to give content to the phrase "proper regard," the Court indicated that an intermediate appellate decision ordinarily should be respected in the absence of convincing or persuasive reasons indicating that the state's highest court would take a different view. *See id.* The Court then went on to reason that, a fortiori, a state trial court decree should not be accepted as controlling in the federal courts. *See id.*

[81] *Id.* at 465.

Binding deference to a decision by a court of last resort is appropriate, according to the Court, because there is no better authority on questions of state law.[82] In defending such deference, the Court made no explicit reference to the notion that high-court decisions are more likely the product of a neutral evaluation—that is, based solely on appropriate state law concerns and not on the tax consequences that the parties would bear as a result of the decision—whereas a lower court might be sympathetic to the family and therefore inclined to adopt an approach that would result in a lower tax.[83] Nevertheless, it would seem that the implicit premise underlying the Court's decision to require binding deference in the case of high-court decisions was the conviction that such decisions ordinarily are not affected by the tax consequences they might generate for the parties.[84]

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82 *Id.* In reaching this conclusion, the Court relied on the legislative history, de-emphasizing a regulation that appeared to take a contrary approach. *See id.* Ironically, were *Bosch* decided today, it would not be surprising for the Court to engage in a different analysis, given the Court's increased willingness to defer to regulations and its diminished enthusiasm for legislative history. *See* Chevron v. National Resources Defense Council, Inc., 467 U.S. 837, 844 (1984); *see also* William N. Eskridge, Jr., *Legislative History Values*, 66 CHI.-KENT L. REV. 365, 366 n.7 (1990); Gregory E. Maggs, *The Secret Decline of Legislative History: Has Someone Heard a Voice Crying in the Wilderness?*, 1994 PUB. INT. L. REV. 57, 58; John F. Manning, *Textualism as a Nondelegation Doctrine*, 97 COLUM. L. REV. 673, 679 n.3 (1997); Thomas W. Merrill, *Textualism and the Future of the* Chevron *Doctrine*, 72 WASH. U. L.Q. 351, 355-57 (1994) (all discussing the Supreme Court's growing reluctance to rely on legislative history).

83 The majority explicitly rested its decision on three grounds: first, the legislative history underlying the marital deduction contemplated that a state court decree would not be binding, even where the decree had been the product of a "bona fide adversary proceeding"; second, Congress contemplated that the marital deduction would be strictly construed so that the collection of revenue would not be jeopardized by "loopholes" or "escape hatches"; and third, the rationale underlying the Court's decision in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), should apply in this context. *Bosch*, 387 U.S. at 464-65.

It is the contention of this Article that *Bosch* should be overruled by legislation. *See infra* Part III. Because the first two grounds cited by the Court for its decision in *Bosch* merely reflect its perception of congressional intent, they do not argue against such legislation. The third ground, while a policy-based concern, does not justify retaining the approach that the Court adopted. The rationale underlying *Erie*—concern about forum shopping and the inequity it can produce, *see* Gasperini v. Center For Humanities, Inc., 518 U.S. 415, 416 (1996)—is not relevant, given that federal tax disputes are resolved only in the federal courts. Nor can *Bosch* be justified by a concern about federal courts trampling on state law: a federal court resolving a tax dispute does not, by determining a state-law issue in the course of reaching its ultimate tax conclusion, trample upon state law in the same way that a federal court exercising diversity jurisdiction might were it permitted to disregard state-court decisions. *See* Bernard Wolfman, Bosch, *Its Implications and Aftermath: The Effect of State Court Adjudications on Federal Tax Litigation*, 3 INST. ON EST. PLAN. ¶ 69.203 (1969) (arguing that *Erie* rationale is not relevant in the *Bosch* context).

84 The validity of this assumption will be discussed *infra* notes 194-202 and accompanying text.

C. Settlement Agreements: Good-Faith Compromise

About a year before the Supreme Court decided *Bosch*, the Internal Revenue Service had issued Revenue Ruling 66-139.[85] In the ruling the Service, after citing *Lyeth v. Hoey*,[86] concluded that the amount passing to the surviving spouse under a good-faith settlement agreement qualified for the marital deduction. In *Lyeth*, the taxpayer had contested his grandmother's will on the grounds of undue influence and lack of testamentary capacity. The taxpayer settled the contest and claimed that the settlement proceeds should be excluded from his income as an inheritance under the predecessor of I.R.C. § 102 ("section 102"). The Court emphasized that had the contest not been settled and had the taxpayer prevailed, the amount he would have received would be excludible from income as an inheritance.[87] Concerned about maintaining parity in tax consequence between a settlement and a verdict, the Court held that the settlement amount should be treated as an excludible inheritance.[88] Given the strong policy preference for voluntary settlements, the Court's reluctance to create harsher tax consequences for a settlement than for a verdict is certainly understandable.

In the ruling, the Service applied *Lyeth*, an income tax case, in the context of the passing requirement without any discussion of the differences between the estate tax and the income tax. In *Lyeth*, the settlement payment received by the taxpayer could be viewed in one of three ways: as paid to the taxpayer by the beneficiaries designated in the will solely because of their sympathy for him; as paid to the taxpayer to avoid the cost of litigating his nuisance claim; or as paid to the taxpayer in recognition of the strength of his legal claim. While the Court expressed concern about—and then dismissed—the possibility that the taxpayer's claim was simply a nuisance suit, it did not discuss whether the settlement payment was motivated by the beneficiaries' sympathy or the strength of the taxpayer's claim.[89] In determining whether the taxpayer

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85 1966-1 C.B. 225.

86 305 U.S. 188 (1938).

87 *Id.* at 195-96.

88 *Id.* at 196-97.

89 The Court ultimately concluded that, based upon the procedural posture of the case under state law at the time of the settlement and the fact that the taxpayer indisputably had standing to contest the will, the taxpayer did not have a mere nuisance claim. *See id.* at 195-97. Parenthetically, *Lyeth* has been invoked even where the taxpayer's standing under state law to assert the settled claim was questionable. *See, e.g.*, Howard v. Commissioner, 447 F.2d 152, 156 (1971) (holding that consideration received in settlement of taxpayer's dower rights were excludible under I.R.C. § 102 even though taxpayer's status as the decedent's surviving spouse was in question).

qualified for the exclusion under section 102, the Court appropriately avoided any analysis of the beneficiaries' motivation. For, irrespective of the beneficiaries' motivation, the taxpayer would be entitled to exclude the settlement, as an inheritance if it was based on the strength of the claim or as a gift if motivated by sympathy.[90]

In contrast, where a settlement is reached with the decedent's spouse and the marital deduction is sought for the settlement payment given to the spouse, the inquiry is somewhat different. The question is whether the settlement amount should be viewed as having passed from the decedent to the spouse.[91] In answering this question, it would be helpful first to determine whether the payment was made solely because of the beneficiary's sympathy for the spouse or in recognition of the merit of the spouse's claim. In the former case, it is fairly clear that the settlement amount passes to the spouse only because of the beneficiary's volitional act and therefore should not be viewed as having satisfied the statute's passing requirement. In the latter case, on the other hand, the appropriate outcome under the statute is less clear. Some might argue that a settlement payment cannot be viewed as satisfying the statute unless it is established that the spouse's claim was enforceable and valid, whereas others might argue that a settlement payment made on the basis of the beneficiary's assessment of the claim's merit should be viewed as satisfying the statute and that the claim's actual enforceability or validity should be irrelevant. In any event, the *Lyeth* Court's tacit conclusion that it need not distinguish between a sympathy-based and a merit-based settlement payment cannot easily be integrated into the marital deduction's passing requirement.

While one might therefore question the Service's decision to invoke *Lyeth* unqualifiedly in Revenue Ruling 66-139, the ruling makes clear that it does not apply to a sympathy-based settlement. It does so by adopting a good-faith requirement, as did the Tax Court in *Estate of Barrett v. Commissionert*,[92] which the ruling also cites. In *Barrett*, the surviving husband, in anticipation of litigation, entered into a settlement agreement with his wife's estate. The estate then sought to treat the settlement payment as qualifying for the marital deduction. Relying on *Lyeth*, the Tax Court reasoned that because a payment made to the husband pursuant to a state court decree issued after a fully litigated proceeding would qualify for the marital deduction, a settlement pay-

90 *See* Commissioner v. Duberstein, 363 U.S. 278 (1960) (holding payments motivated by sympathy excludible as a gift under section 102).

91 *See supra* notes 51-52 and accompanying text.

92 22 T.C. 606 (1954), *acq.*, 1954-2 C.B 3.

ment made to avoid such litigation should similarly qualify for the deduction.[93] In reaching this conclusion, the court emphasized that the passing-requirement regulations applicable to litigations and settlements[94] had been satisfied because of its finding of fact that the agreement had been reached in good faith and in an arms-length setting,[95] thus implying that a sympathy-based settlement would not qualify for the deduction.

The *Barrett* court's premise that a payment made pursuant to a lower court decree unquestionably would qualify for the deduction was swept away by the Supreme Court's conclusion in *Bosch* that a lower state-court decree is entitled only to "proper regard." And although the Court did not cite *Barrett* or Revenue Ruling 66-139—or the foundation underlying these authorities, *Lyeth*—its holding in *Bosch* raised the question whether these authorities continued to be viable.

D. Settlement Agreements: A Logical Extension of Bosch

After *Bosch*, the courts have held quite uniformly that where a non-spouse surrenders property rights to the spouse under a settlement agreement, the *Bosch* framework applies.[96] This extension of *Bosch* into the settlement-agreement context is a logical one, the rationale being that a settlement agreement should receive no more deference than the state trial court decree at issue in *Bosch*. Thus, under these post-*Bosch* decisions, the amount surrendered to the spouse under a settlement agreement does not qualify for the marital deduction unless it is established that the spouse had an enforceable right under state law to the surrendered property at the time of the deceased spouse's death.

In *Ahmanson Foundation v. United States*,[97] the Ninth Circuit held that Revenue Ruling 66-139 was inconsistent with *Bosch* and therefore invalid.[98]

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93 *Id.* at 611.

94 Treas. Reg. § 20.2056(c)-2(d)(2) (as amended in 1994).

95 *Barrett*, 22 T.C. at 611.

96 *See* Estate of Carpenter v. Commissioner, 52 F.3d 1266, 1273 (4th Cir. 1995); Estate of Brandon v. Commissioner, 828 F.2d 493, 499 (8th Cir. 1987); Ahmanson Foundation v. United States, 674 F.2d 761, 774 (9th Cir. 1981). *But see* Citizens & S. Nat'l Bank v. United States, 451 F.2d 221, 225 n.6 (5th Cir. 1971) (citing *Barrett* but not *Bosch* and indicating in dictum that an agreement reached in good faith and in an arms-length setting should be respected); Waldrup v. United States, 499 F. Supp. 820, 823-24 (N.D. Miss. 1980) (citing *Barrett*, *Citizens & Southern*, and *Bosch*, but not considering the applicability of the *Bosch* framework in the context of a settlement agreement, and holding that whatever amount is received under a settlement agreement qualifies for the deduction as long as the spouse asserted a valid claim).

97 674 F.2d 761 (9th Cir. 1981).

After reaching this conclusion, the court observed that *Lyeth* (the authority upon which the ruling was based) could be viewed as both consistent and inconsistent with *Bosch.* They are consistent, according to *Ahmanson,* if *Bosch* is read as contemplating that the level of deference owed to a settlement agreement is identical to the level of deference owed to a decree, for the *Lyeth* Court had emphasized the need to provide equivalent tax treatment for court decrees and settlement agreements.[99] While *Bosch* itself did not address the deference issue with respect to settlement agreements, the *Ahmanson* court concluded that the *Bosch* Court could not have intended that settlement agreements be given more deference than decrees.[100] In this sense, therefore, *Bosch* and *Lyeth* are consistent. At the same time, however, *Bosch* and *Lyeth* could be viewed as inconsistent in the sense that *Bosch* permits the Service to examine independently a state lower court decree, whereas *Lyeth* would accept such a decree as a dispositive resolution of state law issues.[101]

This inconsistency could be resolved in one of two ways, according to *Ahmanson*: first, *Bosch* could be read as applying solely to the transfer tax, or even perhaps only in the more limited context of the marital deduction,[102] with

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98 *See id.* at 774. The court went on to hold that the Service was not estopped by the ruling. *See id.* Subsequently, the Supreme Court indicated that the Service is not bound by an erroneous interpretation in a pro-taxpayer revenue ruling if the ruling would "overturn the plain language of a statute." Commissioner v. Schleier, 515 U.S. 323, 336 n.8 (1995). In light of *Schleier,* one certainly could argue that the "plain language" of I.R.C. § 2056 (1994 & Supp. III 1997) does not call for a result that is at odds with Revenue Ruling 66-139 and that therefore the *Ahmanson* Court should have held the Service bound by the ruling.

99 674 F.2d at 774-75.

100 *Id.* at 774 (citing Jonathan Sobeloff, *Tax Effect of State Court Decisions: The Impact of* Bosch, 21 TAX LAW. 507, 523 (1968)).

101 *See id.* at 775.

102 It is worth noting that the issue before the court in *Bosch* concerned solely the marital deduction. In resolving the issue, the Court anologized to the *Erie* doctrine, invoked the policies underlying that doctrine, and discussed its perception that Congress intended the marital deduction to be strictly construed. Nevertheless, it placed heavy emphasis on the legislative history of the orginal 1948 marital deduction statute. *See Bosch,* 387 U.S. at 463-65; *see also supra* note 82. Indeed, the Court borrowed the phrase "proper regard" from the Committee Reports. *See supra* note 80. One might reasonably argue, therefore, that the *Bosch* proper-regard standard should be applied only in the context of the marital deduction. Indeed, *Ahmanson* intimated that *Bosch* could be read in this narrow fashion. 674 F.2d at 775. Some courts, however, have extended the *Bosch* standard into other transfer-tax contexts. *See, e.g.,* Estate of Dancy v. Commissioner, 872 F.2d 84, 85 (4th Cir. 1989) (citing *Bosch* and examining state law to determine the validity of a disclaimer executed by the decedent's executor for purposes of determining whether the disclaimed interest was includible in the decedent's estate); United States v. White, 853 F.2d 107 (2d Cir. 1988) (applying *Bosch* standard in connection with determining the amount of deductible administration expenses under section 2053); Estate of Stern v. Department of Treasury, No. IP 96-0694-C-T/G, 1998 WL 172640 (S.D. Ind. Jan. 5, 1998) (applying *Bosch* standard in connection with determining the validity of a claim against the estate under I.R.C. § 2053); Estate of Hoenig v. Commissioner, 66 T.C. 471, 476 (1976). *But see* Estate of Warren v. Commissioner, 981 F.2d 776 (5th Cir. 1993) (refusing to apply the *Bosch* standard in the context of de-

Lyeth remaining the controlling standard for all other tax purposes; second, *Bosch* could be read as completely overruling *Lyeth* and establishing a new standard applicable for both income and transfer tax purposes, under which neither a lower-court decree nor a settlement agreement would be binding on the Internal Revenue Service or the federal courts.[103] Concluding that Revenue Ruling 66-139 would not be valid under either of these alternatives, the *Ahmanson* court refused to choose between them and simply declared the ruling invalid, thereby leaving the inconsistency unresolved.[104]

In post-*Ahmanson* decisions, the courts generally have applied the *Bosch* standard in analyzing transfer-tax issues,[105] while continuing to apply the *Lyeth* standard in the context of the income tax.[106] As a practical matter, therefore, the bifurcated approach inherent in the first alternative identified by the *Ahmanson* court has evolved, with greater deference being given to lower-court decrees and settlement agreements in the income tax context[107] than in the

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termining the amount of the charitable deduction under I.R.C. § 2055). The Service, as well, has applied *Bosch* in transfer-tax contexts other than the marital deduction. *See, e.g.*, Priv. Ltr. Rul. 95-28-012 (Apr. 13, 1995) (citing *Bosch* and *Ahmanson* and ruling that a family settlement agreement did not effect a taxable gift and did not cause a trust created before September 25, 1985 to become subject to the generation-skipping tax); Priv. Ltr. Rul. 93-08-032 (Feb. 26, 1993) (citing *Bosch* and *Ahmanson* and ruling that the surrender of rights under a family settlement agreement constituted a taxable gift).

103 *See Ahmanson*, 674 F.2d at 775; *see also* George Craven, *Tax Effect of State Court Decisions: The* Bosch *Case*, 2 REAL PROP., PROB. & TR. J. 457, 462 (1967).

104 674 F.2d at 774.

105 *See supra* note 102 and accompanying text.

106 The courts routinely cite *Raytheon Production Corp. v Commissioner*, 144 F.2d 110, 114 (1st Cir. 1944), which in turn relied on *Lyeth*, for the proposition that the nature of the claim surrendered in a settlement should determine the income tax consequence. For additional discussion, see *United States v. Burke*, 504 U.S. 229, 237 (1992) (income tax consequence of damages received under settlement agreement determined with reference to the nature of the claim settled). *See also* LeFleur v. Commissioner, 74 T.C.M. (CCH) 37 (1997) (indicating that the nature of the claim settled should be determinative and focusing on the adversarial nature of the relationship between the parties); Laura Sager & Stephen Cohen, *Discrimination Against Damages for Unlawful Discrimination: The Supreme Court, Congress, and the Income Tax*, 35 HARV. J. ON LEGIS. 447, 474 (1998) (indicating that *Raytheon* is the leading case on the income taxation of damages received under a settlement).

107 It is, however, conceivable that the *Bosch* standard of review could be properly invoked in the context of an income tax issue. For example, in *Brown v. United States*, 890 F.2d 1329 (5th Cir. 1989), the Service took the position that the administration of an estate had been unduly prolonged and that therefore the estate's income was taxable to the estate's beneficiary rather than to the estate during the extended period. The taxpayer had secured a state court decree to the effect that the administration had not been unduly prolonged. *See id.* at 1341. The court held that Treas. Reg. § 1.641(b)-3(a) (1960) creates a federal standard and that therefore the question whether an estate has been unduly prolonged presents a question of federal law. *See id.* The state court decree, as well as *Bosch*, was entirely irrelevant to this analysis. *See id.* The court simply had to decide whether or not the federal standard was satisfied. But the court went on to indicate in dictum that if the regulation had instead made state law determinative, then it would have been appropriate to review the state court decree under the *Bosch* standard. *See id.* at 1341-42. So while it is con-

transfer-tax context (where the *Bosch* "proper regard" level of deference is invoked).[108]

In *Estate of Brandon v. Commissioner*,[109] where the Service invoked *Ahmanson*, the surviving spouse elected to take a share of the deceased spouse's estate under a dower statute. Because the dower statute was not gender-neutral, its constitutionality was unclear.

Instead of litigating the question, the parties reached a settlement with the surviving spouse receiving a sum of money. The estate then took the marital deduction with respect to the settlement payment, which the Service disallowed. The Tax Court, citing *Barrett*, held that the payment satisfied the passing requirement and therefore qualified for the marital deduction because the settlement constituted a good faith compromise.[110]

Before the Eighth Circuit, the Service argued that the Tax Court had erred in relying on *Barrett*.[111] Relying on *Ahmanson*, the court agreed with the Service and held that *Bosch* had implicitly overruled *Barrett*.[112] The court remanded the case to the Tax Court for a determination whether the surviving

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ceivable that *Bosch* could be applied in the income tax context where the tax law makes state law determinative, this does not suggest that *Bosch* could be applied in determining the income tax consequences of a settlement agreement. Ordinarily, in determining the income tax consequences of a settlement agreement, the tax law does not make state law determinative. *See, e.g., Lyeth*, 305 U.S. at 194 (holding that whether settlement was excludible as an inheritance was a question of federal, not state, law).

108 Some courts have taken the position that, in making the proper-regard inquiry, it is appropriate to take into account the adversarial nature of the pre-decree or pre-agreement proceedings. *See, e.g.*, Estate of Delaune v. United States, 143 F.3d 995, 1001-02 (5th Cir. 1998) (finding adversarial nature of the proceedings relevant in determining whether state court decree is entitled to deference under *Bosch*); Estate of Hubert v. Commissioner, 101 T.C. 314 (1993) (despite citing *Bosch* and *Ahmanson*, the court nevertheless indicated that the adversarial nature of the pre-agreement proceedings was relevant, although not controlling), *aff'd on other grounds*, 520 U.S. 93 (1997). Under such an approach to the proper-regard inquiry, the *Bosch* and *Lyeth* standards would appear to be rather similar. It should be emphasized, however, that in *Bosch* the majority refused to adopt the approach suggested by Justice Harlan, under which the state court decree would have been entitled to binding deference if it was the product of adversarial proceedings. *Bosch*, 387 U.S. at 481 (Harlan, J., dissenting). Thus, courts may be wrong to suggest that the majority in *Bosch* contemplated that the adversarial nature of the proceedings would be relevant to the proper-regard inquiry. *Compare Hubert*, 101 T.C. at 319-20 (stating that good faith settlements are relevant, but not binding), *with* Estate of Carpenter v. Commissioner, 67 T.C.M. (CCH) 2400, 2404-05 (1994) (citing *Hubert* only for proposition that good faith settlements are "not binding"), *aff'd*, 52 F.3d 1266 (4th Cir. 1995); *see generally* Caron, *supra* note 2, at 824-32 (reviewing cases in which the courts have taken into account the nonadversarial nature of the proceedings and pointing out that *Bosch* forecloses this approach).

109 828 F.2d 493 (8th Cir. 1987).

110 Estate of Brandon v. Commissioner, 86 T.C. 327, 335 (1986).

111 *Brandon*, 828 F.2d at 493.

112 *Id.* at 499.

spouse had a legally enforceable claim—i.e., whether the dower statute under which the spouse asserted her claim was constitutional—at the time of the decedent spouse's death.[113] Thus, the Service successfully argued in *Brandon*, on the basis of *Ahmanson*, that the settlement payment could qualify for the marital deduction only if made in recognition of an enforceable state law claim and that the good-faith nature of the settlement was irrelevant.[114]

It is worth noting that, in *Bosch*, the state court decrees resolved questions of law.[115] In contrast, *Lyeth*, *Barrett* and Revenue Ruling 66-139 concerned settlement agreements that compromised claims where issues of fact had been at stake.[116] Although this law/fact distinction might be a basis on which these authorities could be reconciled, the Service has not endorsed it. On the contrary, the Service has taken the position that the *Bosch* framework is to be utilized where questions of fact are involved, whether the issue has been resolved by a state court decree[117] or compromised by a settlement agreement.[118] Indeed, even the *Ahmanson* court, in remanding for possible fact

113 *Id.* at 500.

114 *See also* Estate of Carpenter v. Commissioner, 52 F.3d 1266, 1273 (4th Cir. 1995) (allowing the Service to invoke *Ahmanson*).

115 In *Bosch*, the issue was whether the federal court was bound by the conclusion reached in the state court decree that, as a matter of New York law, the donee of a general power of appointment did not have the authority to release the power where the trust under which it was created was revocable and the grantor was still alive. *See* 387 U.S. at 456-59. At issue in the companion case, *Second National Bank v. United States*, was the determination by the state court that the language of the decedent spouse's will was sufficiently ambiguous so as not to negate the operation of Connecticut's tax apportionment statute. *See id.* at 459-61.

116 In *Lyeth*, the settlement agreement compromised a claim based on allegations that the decedent's will had been procured by undue influence and that the decedent had insufficient testamentary capacity. 305 U.S. at 189. In Revenue Ruling 66-139, the compromised claim had been based on allegations of impropriety in the execution of an antenuptial agreement. In *Barrett*, the compromised claim had been based on allegations of undue influence and impropriety in the execution of an antenuptial agreement. 22 T.C. at 606-08.

117 *See* United States v. White, 853 F.2d 107, 113-14 (2d Cir. 1988) (accepting the Service's argument that the *Bosch* standard applies to a state court decree resolving a question of fact); Estate of Rowan v. Commissioner, 54 T.C. 633, 638 (1970) (applying *Bosch* framework with respect to questions of fact). *But see* Estate of Goree v. Commissioner, 68 T.C.M. (CCH) 123 (1994) (holding that a state trial court's finding of fact is entitled to the same kind of deferential review it would receive in the state appellate court), *action on decision*, 1996-001 (March 4, 1996) (nonacquiescence recommended by Service); Paul L. Caron, *Tax Court and Service Stake Out Positions in State Law Debate*, 71 TAX NOTES 229 (1996) (arguing that federal courts should review state court decisions for error, with the federal court giving the decision the same level of deference that a state appellate court would be required to give it).

118 *See, e.g.*, Tech. Adv. Mem. 95-30-003 (July 28, 1995) (denying the marital deduction for a settlement payment on the basis of the *Bosch* framework where the validity of the spouse's claim turned upon whether or not the spouse had in fact murdered the decedent); Tech. Adv. Mem. 92-51-002 (Aug. 27, 1992) (invoking *Ahmanson* and *Bosch* in connection with a settlement compromising claims concerning impropriety in the execution of an antenuptial agreement).

finding, appeared to acknowledge that the *Bosch* framework should be utilized to review the merits of a compromised claim even where questions of fact are implicated.[119]

Finally, although the Service refuses to revoke Revenue Ruling 66-139 explicitly, it has placed a gloss on the ruling that makes it consistent with *Ahmanson*. In Revenue Ruling 83-107,[120] a post-*Ahmanson* ruling, the Service sought to "clarify" Revenue Ruling 66-139. The ruling established a two-pronged test that must be satisfied before the Service will accept a settlement agreement: first, the amount surrendered to the spouse must be attributable to an enforceable claim under state law; second, the settlement must constitute a good faith compromise of the claim.[121] This purportedly two-pronged test is merely an adoption of *Ahmanson* in the first prong, with the second prong being superfluous. If the spouse has an enforceable claim, any compromise under which the spouse receives something of value necessarily will be viewed as having been made in good faith to the extent of the value received.[122] Thus, under Revenue Ruling 83-107, an enforceable claim is both a necessary and a sufficient condition in determining the availability of the marital deduction for payments made under a settlement. Having made enforceability determinative, the Service has in effect embraced the *Ahmanson* court's view of Revenue Ruling 66-139 as invalid.[123]

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119 *See* 674 F.2d at 775. *See generally* Wolfman, *supra* note 83, ¶ 69.205.1, at 2-15 to 2-16 (discussing the law/fact distinction).

120 1983-2 C.B. 159.

121 *See id.*

122 If the spouse were to receive an amount less than what he or she would secure through enforcement of the claim, the good faith nature of the compromise might be called into question, because the spouse might surrender more than necessary to reach resolution. That, however, would not suggest that the amount *received* by the spouse had been received other than through a good-faith settlement. *But see* Tech. Adv. Mem. 92-51-002 (Dec. 18, 1992) (intimating that a settlement can be made in good faith even where the spouse receives less in settlement than he or she would receive were the claim pursued).

123 While not acknowledging its inconsistency, the Service has, on occasion, accepted the allocation of rights effected in a settlement agreement without considering whether the state court would have reached a different resolution. *See* Priv. Ltr. Rul. 98-45-015 (Aug. 7, 1998); Priv. Ltr. Rul. 97-33-017 (Mar. 8, 1996); Priv. Ltr. Rul. 96-10-018 (Dec. 7, 1995); Tech. Adv. Mem. 93-47-003 (Aug. 5, 1993) (each involving a settlement accepted by the Service for purposes of determining the marital deduction). When the Service takes this approach, it emphasizes that the parties arrived at a settlement within a range of reasonable outcomes that the state court might have chosen and/or that the settlement was made by the parties in good faith, thus echoing Revenue Ruling 66-139 (as understood prior to the Service's clarification of the ruling in Revenue Ruling 83-107). The Service's willingness to defer to the agreement reached by the parties is understandable in light of the difficulties presented by trying to determine which of various plausible outcomes the state's highest court would adopt. It is nevertheless surprising given that the Service takes the position in litigation (as well as in Revenue Ruling 83-107 through the gloss placed on Revenue Ruling 66-139) that the enforceability of the claim is determinative.

In sum, *Ahmanson* and subsequent cases, particularly *Brandon*,[124] clarify *Bosch's* significance in two respects. First, they logically extend the *Bosch* framework so that it applies not solely to amounts received by the spouse under a decree, but also to amounts received under a settlement agreement. Second, they examine *Bosch's* scope and conclude that, while issues remain unresolved concerning *Bosch's* applicability in other tax contexts,[125] the *Bosch* framework unquestionably applies in determining the availability of the marital deduction for a bequest surrendered in favor of the spouse.

As will be argued, the passing requirement, as embodied in the statute, overemphasizes state law. Furthermore, the *Bosch* framework exacerbates this overemphasis by choosing a construction of the statute that places even greater emphasis on state law than other feasible constructions. But this critique of the passing requirement, and of the *Bosch* construction, cannot be made without first examining the changes in the marital deduction enacted by Congress in 1981.

E. The 1981 Legislation: Background

In 1981, Congress changed the marital deduction in two significant respects, altering what will be referred to as the quantitative and qualitative limitations it had created in the 1948 legislation. In making these changes, Congress adopted a new model for the marital deduction, one with particularly important implications in terms of the passing requirement. Yet Congress did not address—indeed, it still has not addressed—these implications. Before focusing on the 1981 changes, however, one must consider the 1948 legislation.

Under the quantitative limitation, the marital deduction could not exceed half of the adjusted gross estate.[126] Under the qualitative limitation, a bequest would qualify for the marital deduction only where the surviving spouse's interest was not terminable, the so-called "terminable interest" rule.[127]

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124 *See also* Estate of Carpenter v. Commissioner, 52 F.3d 1266, 1273 (4th Cir. 1995).

125 *See supra* notes 105-08 and accompanying text.

126 *See* Surrey, *supra* note 23, at 1121-22 (discussing the quantitative limitation and defining adjusted gross estate as the gross estate less certain deductions and less community property, to make certain that the marital deduction would not be permitted with respect to community property).

127 *See id.* at 1127-36. The terminable-interest rule is presently contained in I.R.C. § 2056(b) (1994 & Supp. III 1997).

As previously discussed, the quantitative limitation was designed to place couples residing in common law states in parity with those residing in community property states.[128] Under the 1948 legislation, upon the death of a spouse residing in a community property state, only half of the estate was subject to tax.[129] In the absence of the marital deduction, the estate tax would be imposed on the entire estate in the case of a spouse residing in a common law state.[130] Under the marital deduction, however, a spouse residing in a common law state could bequeath half of his or her estate to the other spouse on a tax-free basis, thus creating parity between couples living in common law and community property states.[131] As will be illustrated, the quantitative limitation could produce double taxation if the estate-planning documents were not properly structured.[132]

The qualitative limitation—the terminable-interest rule—also was based upon a concern about parity.[133] In a community property state, the community property excluded from the estate of the first spouse to die was, to the extent not consumed, included in the estate of the surviving spouse.[134] Parity required that, in the case of a couple residing in a common law state, the marital deduction be available only for a bequest that would necessarily result in estate tax inclusion, to the extent not consumed, upon the death of the surviving spouse. So, for example, whereas an outright bequest would satisfy the terminable-interest rule because the bequest would trigger an inclusion in the surviving spouse's estate, a bequest in trust providing the surviving spouse with an income interest for life, and no power of disposition over the principal, would not trigger such an inclusion and would therefore be ineligible for the marital deduction.[135]

Given its objective, it would have been appropriate, indeed preferable, for the terminable-interest rule to disqualify only those bequests not triggering an inclusion in the surviving spouse's estate. The rule as drafted, however, was overinclusive, disqualifying certain bequests even when they triggered an

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128 *See supra* note 47 and accompanying text.

129 *See* Surrey, *supra* note 23, at 1117-25.

130 *See id.*

131 *See id.*

132 *See infra* notes 138-39 and accompanying text.

133 *See* Surrey, *supra* note 23, at 1127-28.

134 *See id.* And if the surviving spouse made an inter vivos gift of the property, the transfer would, of course, be a taxable gift. *See* I.R.C. §§ 2501, 2503, 2505 (1994 & Supp. III 1997).

135 *See* Surrey, *supra* note 23, at 1128-29.

inclusion in the surviving spouse's estate.[136] To the extent that the marital deduction was denied in the case of such a bequest, double taxation was produced.[137]

Because, in the absence of proper planning, the quantitative and qualitative limitations on the marital deduction could produce double taxation, they had a substantial impact on the drafting of estate-planning documents. Typically, a spouse inclined to bequeath his or her entire estate to the other spouse instead would bequeath, because of a concern about double taxation, only half of the estate to the spouse. The other half would be placed in a by-pass trust (a trust that by its terms would preclude its corpus from being included in the surviving spouse's estate). With such a plan, the couple's wealth would not be subject to double taxation. Upon the death of the first spouse to die, half of his or her estate would be bequeathed to the spouse and, by virtue of the marital deduction, would not be subject to tax. Upon the surviving spouse's death, the unconsumed balance of this bequest would be subject to estate tax. The other half, placed in the by-pass trust, would be immediately subject to tax. Upon the surviving spouse's death, no portion of the corpus of the by-pass trust would be subject to tax.[138]

To illustrate the double taxation that would occur if the documents were drafted differently, assume the spouse in this example instead bequeathed the entire estate to the other spouse. The marital deduction would be equal to half of the estate (because of the quantitative limitation), and the other half would be immediately subject to tax. Upon the death of the surviving spouse, the

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136 In *Jackson v. United States*, 376 U.S. 503 (1964), the Court held that a support allowance paid by the estate to the surviving spouse did not qualify for the marital deduction. The fact that the amount paid to the surviving spouse would ultimately be included in her estate was, according to the Court, of no consequence. *See id.* at 509-10. In other words, the terminable-interest rule is applied to deny the deduction even where the bequest will be subject to tax in the surviving spouse's estate. *See also* Howard E. Abrams, *A Reevaluation of the Terminable Interest Rule*, 39 TAX L. REV. 1, 16-18 (criticizing the terminable-interest rule because of its potential to produce double taxation).

137 Where a bequest made to a surviving spouse does not qualify for the marital deduction, double taxation results. The property is subject to tax in the decedent spouse's estate, and, to the extent not consumed by the surviving spouse, it is subject to tax in the surviving spouse's estate as well. *See* Abrams, *supra* note 136, at 16-18.

138 To the extent that income or any corpus of the by-pass trust was distributed to the surviving spouse, double taxation would result if the spouse did not consume the distributed property before death. As a matter of planning, therefore, it is often recommended that the by-pass trust be made discretionary. While double taxation could thereby be avoided, assuming that the trustee did not make any distributions to the surviving spouse, this planning approach would disort the decedent's testamentary scheme, if one starts with the assumption, as here, that the decedent was inclined to leave his or her entire estate to the surviving spouse free of trust.

entire amount of the bequest, to the extent not consumed, would be subject to tax. Thus, the half of the estate not qualifying for the marital deduction would be subject to tax twice—once in each spouse's estate.

To illustrate the overinclusive nature of the qualitative limitation and its double-taxation potential, assume a spouse with children from a prior marriage were concerned about providing for her children as well as her spouse. If such a spouse bequeathed the entire estate in trust so that the income would be paid to the surviving spouse and the remainder would be distributed to the children upon the surviving spouse's death, double taxation would occur: no marital deduction would be available because of the terminable-interest rule, and upon the surviving spouse's death, all of the income received by the spouse from the trust, to the extent not consumed, would be subject to tax.[139]

As these examples show, the quantitative and qualitative limitations not only could produce double taxation but also had the effect of distorting estate-planning decisions. A donor inclined to give his or her entire estate to his or her spouse was discouraged from doing so. At the same time, a donor inclined to provide a bequest for his or her spouse in trust in order to protect the donor's children from a prior marriage was discouraged from doing so. In short, the marital-deduction concept that Congress created in 1948 was less than entirely satisfactory, setting the stage for the 1981 legislation.

F. The 1981 Legislation

The 1981 legislation, the Economic Recovery Tax Act of 1981,[140] was enacted against a backdrop of changing attitudes concerning marriage and an increasing rate in the incidence of divorce.[141] From the feminist perspective then becoming more prevalent, marriage was an economic partnership.[142]

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139 A marital deduction could have been secured if, under the trust, the surviving spouse were given an income interest for life and a general power of appointment. *See* I.R.C. § 2056(b)(5) (1994) (creating an exception to the terminable-interest rule for a trust with such terms). However, the difficulty with a trust containing a general power of appointment is that it would defeat the decedent spouse's purpose (to make sure that, upon the surviving spouse's death, the principal would be distributed to the children from the prior marriage) in that the surviving spouse would have complete control in selecting the appointees.

140 Pub. L. No. 97-34, 95 Stat. 172 (codified in scattered sections of 26 U.S.C.).

141 It also was enacted against a political backdrop that was hostile to the transfer-tax system generally. *See* Harry L. Gutman, *Reforming Federal Wealth Transfer Taxes After ERTA*, 69 VA. L. REV. 1183, 1200 (1983) (indicating that President Reagan had argued throughout the 1980 campaign in favor of repealing the transfer-tax system in its entirety).

142 *See, e.g.*, Bea Ann Smith, *The Partnership Theory of Marriage: A Borrowed Solution Fails*, 68 TEX. L. REV. 689, 696-98 (1990) (discussing the partnership model of marriage and how it was fashioned to in-

What this meant varied depending upon context. In the context of divorce, it meant the adoption of equitable distribution statutes, under which marital property would be divided at the time of divorce based upon various equitable considerations and not on the manner in which the couple's assets were titled.[143] In the transfer-tax context, it meant that it no longer made sense to impose a transfer tax when one spouse died and the assets titled in his or her name passed to the surviving spouse. After all, the transfer tax is designed to impact people wealthy enough to have unconsumed resources at the time of death.[144] And if married couples were to be viewed as an economic partnership or unit, it would be inappropriate to impose the tax on transfers within the unit or before the death of both spouses.[145] Upon the death of the surviving spouse, to the extent that resources remained unconsumed, the tax then would be imposed.[146] In effect, the 1981 legislation eliminated the quanitative limitation of the 1948 legislation on the principle that all of the assets titled in the name of one spouse could be applied after his or her death to the consumption needs of the other spouse without the imposition of the transfer tax.[147] As a

crease property distributions to women and to offset the economic losses sustained by women as a result of divorce).

143 *See id.*

144 *See generally* Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259 (1983) (maintaining that the function of the transfer tax is to add progression to the income tax so that the tax burden is distributed on an ability-to-pay basis). In other words, the transfer tax can be viewed as an additional layer of tax imposed on those who have an enhanced capacity to contribute to the cost of government—with capacity being measured on the basis of resources remaining unconsumed at death.

145 *See* S. REP. 97-144, at 127 (1981), *reprinted in* 1981 U.S.C.C.A.N. 105, 227-29.

146 The marital deduction gives spouses the opportunity to defer paying transfer tax until the death of the survivor. The deferral, however, has a cost that tends to negate the value that deferral normally offers: any bequest qualifying for the deduction ordinarily will produce a higher tax in the surviving spouse's estate than the savings it generates in the decedent spouse's estate because income and appreciation accruing on the bequeathed property during the surviving spouse's life must be included in the surviving spouse's estate. *See* Jeffrey N. Pennell & R. Mark Williamson, *The Economics of Prepaying Wealth Transfer Tax*, TR. & EST., June 1997, at 49.

147 Traditionally, during life one spouse could provide support for the other spouse without the imposition of the transfer tax. *See* Estate of Glen v. Commissioner, 45 T.C. 323, 335-6 (1966) (holding a transfer in discharge of the obligation to support a spouse is not subject to transfer tax); *cf.* Estate of Rubin v. Commissioner, 57 T.C. 817 (1972) (finding payment made by decedent spouse's estate to surviving spouse in discharge of a post-death support obligation does not qualify as a deduction under I.R.C. § 2053 and is therefore taxable). One can therefore view the enactment of the unlimited marital deduction as a post-death extension of the notion that providing support for a spouse is not a taxable event. Recently, the Treasury Department issued a proposed regulation in response to the decision in *Commissioner v. Estate of Hubert*, 520 U.S. 93 (1997), which addressed the effect on the marital deduction of various estate administration expenses. In doing so, it implicitly invoked the notion that the transfer of resources to the surviving spouse for consumption purposes should not be subject to transfer tax. *See* Prop. Treas. Reg. § 20.2056(b)-4, 63 Fed. Reg. 69248 (1998). In the proposed regulation, Treasury takes the position that where costs are incurred in managing investments during the estate administration of the spouse dying first

consequence, a donor inclined to leave his or her entire estate to his or her surviving spouse no longer would be subject to double taxation. This allowed a donor to implement his or her estate plan free from the distortion inherent in the quantitative limitation.[148]

and the will imposes the burden of these costs on the gift made to the surviving spouse, the marital deduction is not reduced by the amount of these costs. At first blush, it would appear that the regulation inappropriately permits a double deduction for these costs: first, a marital deduction for the full amount of the bequest to the spouse even though a portion of the bequest is used to pay these costs; and second, an administrative expense deduction under I.R.C. § 2053 (1994 & Supp. III 1997) (or a deduction on the estate's income tax return under I.R.C. § 212 (1994), if executor elects to take an income tax deduction instead of a section 2053 deduction). *See* Joseph M. Dodge, *Lifting the Shroud Obscuring* Estate of Hubert: *The Logic of the Income and Estate Tax Treatment of Estate Administration Expenses*, 3 FLA. TAX REV. 647 (1998) (suggesting that a double deduction for the same cost is made available if the marital deduction is not reduced by the amount of administration expenses burdening the marital gift).

Nevertheless, upon more careful examination, it appears that the regulation reaches the correct result, because investment management expenses incurred after the death of the first spouse should be viewed as a consumption expenditure by the surviving spouse. Where a surviving spouse receives resources from the deceased spouse and uses them for consumption purposes, transfer tax should not be imposed. The regulation reaches this result by providing that the entire amount of the bequest to the spouse is deductible under I.R.C. § 2056 (1994 & Supp. III 1997), even though a portion of the bequest is to be used by the spouse to pay for investment management expenses. In addition, an income tax deduction under I.R.C. § 212 should be permitted for the investment management expense, just as any person incurring such an expenses would be entitled to an income tax deduction. Consider, for example, the case where a spouse bequeaths money to the surviving spouse and the surviving spouse subsequently uses that money to pay a medical expense. The entire amount bequeathed to the surviving spouse should qualify for the marital deduction, and the surviving spouse should be able to take an income tax deduction for the medical expense under I.R.C. § 213 (1994 & Supp. III 1997). As is generally the case with respect to administration expenses, however, the estate can elect to deduct them on the estate tax return under I.R.C. § 2053 instead of as an income tax deduction under I.R.C. § 212. In other words, the estate can elect to surrender the income tax deduction for an estate tax deduction—the effect of the election being to give the estate the benefit of the deduction in the higher of its income- or estate-tax bracket. *See Hubert*, 520 U.S. at 140 (Breyer, J., dissenting) (suggesting that in permitting the estate to take either an estate tax deduction under I.R.C. § 2053 or an income tax deduction under I.R.C. § 212, I.R.C. § 642(g) in effect permits the estate to enjoy the deduction as against the higher of its estate- or income-tax brackets). *See* I.R.C. § 642(g) (1994 & Supp. III 1997). Thus, what appears at first blush to be an inappropriate double deduction proves to be an appropriate double deduction, given the principle that transfer tax should not be imposed on the transfer of resources to the surviving spouse for consumption purposes and the notion that consumption expenditures that would ordinarily qualify for an income tax deduction should remain deductible in this context of inter-spousal transfers.

Parenthetically, it should be noted that if the surviving spouse incurred an investment management expense, the deduction for such an expense would be somewhat limited: it would constitute a miscellaneous itemized deduction under I.R.C. § 67(b), making it subject to that section's two-percent rule and potentially subject to the alternative minimum tax. *See* I.R.C. §§ 56(b)(1)(A), 67(b) (1994 & Supp. III 1997). Given the limited nature of such a deduction, one might reasonably question the appropriateness of permitting a full estate tax deduction under I.R.C. § 2053 for investment management expenses as an alternative to an income tax deduction.

148 Unfortunately, however, a couple inclined to provide for each other on an outright basis still faces distortion, albeit of a different kind. In order to protect the unified credit of the decedent spouse, it is necessary to create in that spouse's will a so-called credit shelter (or by-pass) trust. *See* Gans, *supra* note 45,

Sensitive to the increase in divorce and the estate-planning needs of couples in second marriages, Congress modified the qualitative limitation as well in 1981. Under this modification, a donor concerned about protecting children from a prior marriage but nevertheless inclined to provide for his or her spouse could create a trust that would accomplish these goals and still qualify for the marital deduction. Congress achieved this by creating a new exception to the terminable-interest rule, the so-called qualified terminable interest property ("QTIP") exception, which permits a marital deduction for property placed in a trust that meets certain requirements, including a requirement that the trust principal be included in the surviving spouse's estate.[149] Thus, second-marriage couples inclined to create a trust of this nature no longer would be subjected to double taxation or discouraged from adopting a plan of their choice by the potential for such taxation.[150]

The changes in the quantitative and qualitative limitations share an important common theme: as a general matter, the marital deduction now is available as long as the unconsumed portion of the bequest is includible in the surviving spouse's estate.[151] Thus, the 1981 legislation effected a critical shift away from the 1948 concern about maintaining parity between community-

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at 812 n.108 (arguing that, in creating the need for a credit shelter trust, current law creates inappropriate distortions).

149 *See* I.R.C. § 2056(b)(7) (1994 & Supp. III 1997) (creating the exception); *id.* § 2044 (requiring inclusion in the surviving spouse's estate).

150 It is fair to say that the 1981 legislation is a reflection of conflicting impulses. On the one hand, the legislation's elimination of the quantitative limitation is pro-feminist. *See supra* notes 142-48 and accompanying text. On the other hand, its QTIP provision has recently been the subject of criticism by feminist scholars on the ground that it tends to encourage marital bequests to be made in trust rather than outright. *See* Mary Louise Fellows, *Wills and Trusts: "The Kingdom of the Fathers,"* 10 LAW & INEQ. J. 137, 156-59 (1991); Wendy C. Gerzog, *The Marital Deduction QTIP Provisions: Illogical and Degrading to Women*, 5 UCLA WOMEN'S L.J. 301, 305 (1995). *But see* Lawrence Zelenak, *Taking Critical Tax Theory Seriously*, 76 N.C. L. REV. 1521, 1542-48 (1998). Moreover, by increasing the unified credit, the legislation induced spouses to transfer more of their wealth to beneficiaries other than the spouse (either outright or in a credit shelter trust). *See* Sims, *supra* note 59, at 37 n.12. This is problematic from a feminist perspective because it creates an incentive to disinherit spouses at least partially, and, more generally, because it distorts. *See id.*

151 There are exceptions. Under current law, it is still possible for a bequest to be denied the marital deduction and yet result in an inclusion in the surviving spouse's estate. For example, a trust mandating that income be distributed to the spouse, but permitting invasions for the benefit of a non-spouse beneficiary during the spouse's lifetime, would not qualify for a QTIP election (or the marital deduction). *See* I.R.C. § 2056(b)(7)(B)(ii) (1994 & Supp. 1997); Priv. Ltr. Rul. 1999-03-031 (Sept. 30, 1998) (denying the deduction in these circumstances). Yet the income distributed to the spouse must be included (if not consumed) in the spouse's estate. *See id.*

property and common-law couples[152] and toward a new model tying the availability of the deduction to inclusion in the surviving spouse's estate.[153]

G. *The New Model and State Law: In Conflict*

Whereas it perhaps made sense in 1948 to require in the interest of parity that, in the case of a couple residing in a common-law state, the property pass under state law in order to qualify for the marital deduction,[154] inquiries concerning state law should be inappropriate under the new model. Property includible in the surviving spouse's estate should be deductible from the decedent spouse's estate. Whether the property finds its way into the surviving spouse's hands by operation of state law or in some other fashion should be of

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152 *See supra* Part II.A.

153 In its operation, the QTIP provision has not completely succeeded in implementing the 1981 model. Recently, the courts have held that where a QTIP trust holds a minority interest in an entity, a minority discount should be taken into account in determining the amount includible under I.R.C. § 2044 in the surviving spouse's estate with respect to the trust. The courts have permitted the discount even where the QTIP trust's interest in the entity and the interest in the entity otherwise owned by the spouse would constitute a controlling interest were they viewed as an aggregate. *See* Estate of Bonner v. United States, 84 F.3d 196 (5th Cir. 1996); Estate of Mellinger v. Commissioner, 112 T.C. 26 (1999), *action on decision*, 1999-006 (Sept. 8, 1999). The result reached in these cases violates the 1981 model: in exchange for allowing the marital deduction for a QTIP trust, the model requires the surviving spouse to include in his or her estate the bequeathed property (together with the income and appreciation it generates) as if it were bequeathed to the spouse outright. And if a minority interest in an entity were bequeathed outright to a spouse who otherwise owned an interest in the entity as well, the two interests would be viewed as an aggregate and, if constituting a controlling interest, would not be entitled to a minority discount. Thus, in permitting a minority discount in these circumstances because a QTIP is used, the QTIP provision fails to implement the model. Legislation is necessary to remedy this failure.

There is a second context in which the QTIP provision may fail to implement the model fully. Suppose, for example, that a QTIP election was made on the estate tax return of the decedent spouse. Suppose further that the trust with respect to which the election was made was not eligible for QTIP treatment but that the statute of limitations with respect to the decedent spouse's estate tax return runs before the death of the surviving spouse. Does the deduction on the decedent spouse's return preclude the surviving spouse's estate from arguing against inclusion? Or should the spouse's estate be permitted to argue against inclusion on the ground that the trust was not eligible for QTIP treatment? If the spouse's estate is permitted to argue against inclusion, the result violates the model: the marital deduction is allowed in the decedent spouse's estate and inclusion in the surviving spouse's estate is avoided. While the Tax Court initially concluded that the surviving spouse could argue against inclusion in such circumstances, *see* Estate of Shelfer v. Commissioner, 103 T.C. 10 (1994), *rev'd. on other grounds*, 86 F.3d 1045 (11th Cir. 1996), it subsequently invoked the duty-of-consistency doctrine and precluded the surviving spouse's estate from making the argument. *See* Estate of Letts v. Commissioner, 109 T.C. 290 (1997). To protect the integrity of the model, legislation should be enacted to make certain that, where the deduction is permitted in the decedent spouse's estate, inclusion is mandatory in the surviving spouse's estate. Legislation that would achieve this result has recently been proposed by the Treasury Department. *See* U.S. DEP'T OF THE TREASURY, ESCROW FUNDS AND OTHER SIMILAR FUNDS, 64 Fed. Reg. 4801-01 (1999) (to be codified at 26 C.F.R. pt. 1) (proposed Feb. 1, 1999).

154 *See supra* notes 47-52 and accompanying text.

no consequence, as long as any unconsumed portion will be subject to estate tax at the death of the surviving spouse.

While the 1981 change in the quantitative limitation did diminish the importance of title[155]—just as the equitable distribution laws then being enacted in various states made title less relevant for divorce purposes[156]—Congress did not alter the role of state law that it had established for the marital deduction in 1948. Congress apparently perceived no disjunction between its new model and the passing requirement's state-law component. There is, however, a tension between the two. Where property owned by the decedent spouse actually passes into the hands of the surviving spouse other than by virtue of state law, application of the new model would indicate that the marital deduction still should be available because the property eventually will be included in the surviving spouse's estate, if it is not consumed beforehand. But, because of the passing requirement's state-law component, no deduction is permitted in these circumstances.

Given the shift away from the concern about parity, there is no longer any justification for the passing requirement and its reliance on state law. In retaining it, Congress struck the wrong balance, creating an overemphasis on state law and, concomitantly, an underemphasis on relevant tax policy considerations. As previously suggested, whenever the balance is improperly struck in favor of state law, distortion in the tax base occurs, equity violations result and state law begins to be shaped by inappropriate policy considerations.[157]

To illustrate, assume a husband ("H") and wife ("W") were married for several years before W's death. W had been previously married and had a child ("C") in her first marriage. W has died, and her will gives her entire

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155 Prior to the 1981 amendment, title was much more important than it is now. On the death of a spouse, the tax was determined based on the assets titled in his or her name. And even though all of the assets were bequeathed to the surviving spouse, a tax could still be due because of the quantitative limitation. Thus, the tax liability was dependent upon the total value of assets that had been titled in the name of the decedent spouse. In contrast, under the 1981 legislation, as long as a sufficient portion of the assets pass to the surviving spouse, no tax is due—even if all of the couple's assets had been titled in the decedent spouse's name. The legislation, moreover, eliminated the difficult task under prior law of determining the source of the funds used to acquire the assets. *See* Gerzog, *supra* note 150, at 310 n.30.

Nevertheless, the manner in which assets are titled can still affect a couple's tax liability. Assume, for example, that the wife has $1,200,000 of assets titled in her name and that the husband has no assets titled in his name. If the husband should die first, a tax will be due at the time of the wife's death. If, however, half of the couple's assets were titled in each spouse's name, no tax would be due on either spouse's death because each spouse's unified credit would offset the tax incurred. I.R.C. § 2010 (1994 & Supp. III 1997).

156 *See supra* notes 132-33 and accompanying text.

157 *See supra* Part I.B.

estate to H. Under W's prior will, H was to receive only the minimum amount required by state law. Even though the later will is invalid because it was not executed in accordance with the statute of wills of State Y (where H and W resided), C and H enter into an agreement under which H is to receive the entire estate. As a result, H will receive $500,000 more than he would have received under the prior will. The Service determines that the later will was not properly executed and that therefore the $500,000 sum received by H under the agreement does not qualify for the marital deduction.[158] The Service also determines that C has made a taxable gift of $500,000 to H.[159]

Because the $500,000 sum does not pass to H under W's will or under state law, the passing requirement is not satisfied and the Service's position will be sustained. This will cause the $500,000 sum to be taxable in W's estate. If H should consume this money during his lifetime, it will not be subject to tax in his estate. But the tax imposed on the $500,000 sum in W's estate produces a violation of the principle that the application of one spouse's resources to the consumption needs of the other should not be subject to transfer tax.[160] If, on the other hand, H should die without having consumed this money, it will be subject to a second tax in his estate. In either case, the tax base, which, normatively, is determined on the premises that a married couple constitutes a single economic unit and that the couple's aggregate unconsumed resources should be taxed only when they are transferred out of the unit,[161] has been distorted. And treating C as having made a taxable gift on the movement of W's resources to H similarly will distort the tax base in that, normatively, no

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158 Under the Service's current analysis, the marital deduction would be denied on these facts because it does not have an enforceable claim under state law. *See supra* notes 121-23 and accompanying text. It is assumed that the agreement between C and H does not constitute a valid disclaimer under I.R.C. § 2518. This could be the case for a variety of reasons: the agreement might be made more than nine months after the decedent's death; under state law, as a result of C's disclaimer, the disclaimed interest might pass to C's child, who is unwilling to disclaim in turn the interest she would acquire as a result of C's disclaimer, thus preventing the disclaimed interest from passing to H; prior to entering into the agreement, C might have taken some action effecting an acceptance of the interest; or C might have received under the agreement with H a consideration that would taint the disclaimer. *See infra* note 265.

159 *See, e.g.*, Estate of DePaoli v. Commissioner, 66 T.C.M. (CCH) 1493 (holding that where property passes from child to surviving spouse under family settlement agreement that does not constitute a valid disclaimer, the child is deemed to have made a taxable gift), *rev'd on other grounds*, 62 F.3d 1259 (10th Cir. 1995); Priv. Ltr. Rul. 1999-08-033 (Nov. 30, 1998) (ruling that child who consents to a court decree and thereby surrenders a remainder interest in a QTIP trust to his or her parent makes a taxable gift); Priv. Ltr. Rul. 93-08-032 (Nov. 30, 1992) (ruling that surrender of rights under a family settlement agreement constitutes a taxable gift).

160 *See supra* notes 145-47 and accompanying text.

161 *See supra* notes 142-45 and accompanying text.

transfer tax is imposed on a couple's resources as long as they remain within the unit.

Closely related to distortion in the tax base is the resulting inequity. To illustrate, consider another wife ("W1") and husband ("H1"), a couple identically situated to W and H except that W1 and H1 reside in State X and that W1's will, while executed in the same fashion as W's, complies with the statute of wills in State X. W1's estate will be entitled to the marital deduction for the full amount passing to H1. As a result, none of the resources passing from W1 to H1 that are consumed by H1 will be subject to transfer tax. Nor will any of the couple's resources be subject to double taxation: all of the couple's resources remaining unconsumed in H1's estate will be subject to tax at that time. And child ("C1") will not be treated as having made a taxable gift of $500,000 to H1. In contrast, in the case of W and H, the denial of the marital deduction will lead either to the imposition of a tax on the transfer of W's resources to H, even though H uses those resources to meet his consumption needs, or to double taxation if the resources remain unconsumed—or perhaps even to triple taxation if C's taxable gift is taken into account.[162]

H. Overemphasis: Can the Resulting Discrimination Be Justified?

From the viewpoint of equity, one must ask whether the differences between these two couples warrant the substantial difference in tax outcome. In other words, can the discrimination between these couples be justified as a matter of tax policy?

1. Integrity of the Tax Base

The discrimination cannot be justified in terms of the need to maintain the integrity of the tax base. As indicated, as long as a tax is imposed whenever resources are transferred outside of the marital unit, the system works properly and the structural integrity of the tax base is not violated or distorted.[163] Because the movement of W's resources to H after W's death through C as an intermediary does not result in any of the couple's resources moving outside of the unit, there is no structural need for a tax to be imposed at W's death. As is always the case, either the surviving spouse, in this case H, will consume the

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162 Triple taxation would occur as follows: 1) upon the death of W, an estate tax would be imposed on the $500,000 sum; 2) C then would be subject to gift tax on this sum; and 3) upon the death of H, the same funds, to the extent unconsumed, would be subject to a third level of tax.

163 *See supra* notes 142-48 and accompanying text.

resources, in which case no tax will be imposed, or the unconsumed resources will be taxable upon his subsequent death. The integrity of the tax base therefore is not maintained, but rather is violated, by the denial of the marital deduction to W's estate and the resulting double, or even triple, taxation imposed on the same assets.[164]

2. *The Snapshot Conception of the Estate Tax*

The discrimination also cannot be justified on the ground that estate-tax theory requires that post-death events be ignored. It is true that, as a general rule, the estate tax is based on a snapshot view of the estate taken on the date of death and that post-death events typically are not taken into account.[165] Given that the estate tax applies to transfers made at death, it makes sense to require that the transfer be measured at the moment of death and that events occurring after death be excluded from its calculus. Some might argue that the passing requirement serves the valuable function of implementing the snapshot conception of the estate tax in the marital-deduction context. In other words, the availability of the marital deduction, the argument goes, should be determined with reference to the surviving spouse's entitlement to participate in the estate at the moment of death without regard to any post-death events. Thus, if the spouse is entitled to receive a particular amount under the deceased spouse's will or under state law because of his or her status as a surviving spouse, the entitlement accrues at the moment of death and the amount passing to the spouse qualifies for the deduction. But if the spouse receives an interest in the estate because a beneficiary under the will makes a post-death gift of it to the spouse, the spouse's entitlement does not accrue until after death and therefore the deduction should not be available.

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164 *See supra* note 162.

165 *See, e.g.*, Jackson v. United States, 376 U.S. 503, 507 (1964) (deciding that support allowance for surviving spouse did not qualify for the marital deduction because the nature of surviving spouse's interest was not determinable as of the decedent's death); Ithaca Trust Co. v. United States, 279 U.S. 151, 155 (1929) (finding that value of charitable remainder interest had to be determined based on life tenant's life expectancy at the time of decedent's death even though life tenant in fact died shortly after decedent's death); Estate of McClatchy v. Commissioner, 147 F.3d 1089, 1094 (9th Cir. 1998) (holding that selection of executor should be ignored in determining value of gross estate even where decedent's selection caused the value of an asset to increase from the value it had in the decedent's hands); Propstra v. United States, 680 F.2d 1248, 1253 (9th Cir. 1982) (holding that post-death events should be ignored in determining the deductibility of claims against the estate under I.R.C. § 2053 unless the claim had been uncertain or disputed at the time of death); United States v. Land, 303 F.2d 170, 172 (5th Cir. 1962) (holding that the value for the interest that passes is determined as of the moment of death).

The snapshot conception of the estate tax is not, however, a rigid one. It is rather, as noted, a general rule, subject to exceptions where appropriate. In a variety of contexts, post-death events are taken into account in determining the taxable estate under present law.[166] The question, therefore, is whether in any given context it is appropriate to permit an exception.

In the context of the marital deduction and its passing requirement, there has been from the outset a willingness to permit exceptions where doing so would result in disallowing or reducing the deduction. Under the 1948 legislation, as well as under current law, the deduction is not available where the surviving spouse disclaims the bequest or surrenders it in settling a will contest.[167] Presumably, the deduction is denied in these two cases on two grounds: first, the disclaimer or the settlement would ordinarily occur not long after the deceased spouse's death and could therefore be taken into account without much practical difficulty; second, the deduction should not be allowed if, ultimately, the bequest to the surviving spouse is rendered inoperative.

166 Post-death fluctuations in value are taken into account if the executor elects alternate valuation. *See* I.R.C. § 2032 (1994). The deduction for funeral and administration expenses under I.R.C. § 2053 (1994 & Supp. III 1997) is determined by the amount of expenses actually incurred and therefore depends upon post-death events. Treas. Reg. § 20.2053-1(b)(3) (as amended in 1972). Whether administrative expenses are deducted on the decedent's estate tax return under I.R.C. § 2053 or on the estate's income tax return under I.R.C. § 212 is a matter of election by the executor. *See* I.R.C. § 642(g) (1994 & Supp. III 1997). In determining the deductibility of claims against the decedent's estate under I.R.C. § 2053, post-death events are taken into account where the claim is unmatured, contingent, or contested at the time of death. *See* Estate of Smith v. Commissioner, 108 T.C. 412, 419 (1997). Casualty losses occurring during the administration of the estate are deductible under I.R.C. § 2054. *See* Estate of Meriano, 142 F.3d 651 (3d Cir. 1998). Disclaimers under I.R.C. § 2518, *see infra* notes 198-234 and accompanying text, QTIP elections (under I.R.C. § 2056(b)(7)) and the creation of a trust by a non-citizen surviving spouse in order to qualify for the marital deduction under I.R.C. § 2056(d)(2)(B), all take into account post-death events. *See* I.R.C. §§ 2056(b)(7), (d)(2)(B); 2518 (1994 & Supp. III 1997). Finally, it has been suggested that a provision in a will directing the executor to destroy an asset should be taken into account and that the gross estate should be reduced as a result. *See* Ahmanson Found. v. United States, 674 F.2d 761, 768 (9th Cir. 1981). Perhaps this approach makes sense inasmuch as the decedent's destruction of the asset at any moment before death would eliminate the asset from the gross estate. Why, in other words, should the destruction of the asset by the executor immediately after the death produce a different tax result? If the asset is destroyed, whether before death or immediately thereafter, it does not pass to any of the decedent's beneficiaries and therefore no transfer has occurred. On the other hand, it could be argued that a distinction must be made between pre- and post-death destruction. Pre-death destruction is in the nature of consumption, and assets consumed pre-death are excluded from the tax base, whereas assets remaining unconsumed at death and destroyed thereafter cannot be viewed as consumption and should therefore be included in the tax base. *See* Dodge, *supra* note 147, at 662 nn.64 & 66 (suggesting that post-death destruction of the decedent's assets should not result in exclusion from the gross estate).

167 *See supra* notes 60-62, 68-72 and accompanying text.

Over time, additional exceptions have been made that permit the marital deduction to be increased on the basis of post-death events. As indicated earlier, under the 1948 legislation, a disclaimer by a non-spouse that resulted in property passing to the spouse would not be taken into account in determining the amount of the deduction. But, in 1966, the Code was amended to require that such a disclaimer be recognized as valid for purposes of the deduction.[168]

More recently, the Internal Revenue Service took the position that the terms of a QTIP trust must be examined at the moment of death to determine if the statutory conditions for making an election have been satisfied. Based on this, the Service maintained that it would not permit the deduction in the case of a so-called contingent QTIP trust.[169] In other words, if the terms of the trust required the payment of income to the spouse only if the QTIP election were made by the executor (i.e., if the terms of the trust were in effect contingent upon the election), the trust would not be eligible for the deduction because the terms of the trust would not satisfy the statute until the executor made the election.[170] The courts, however, rather uniformly rejected the Service's position.[171] The courts apparently recognized that it would not violate policy to permit the deduction in these circumstances, inasmuch as treating the QTIP election as valid results in all of the trust's income and corpus being subject to tax[172] in the surviving spouse's estate[173] (or subject to gift tax if the surviving spouse makes a transfer during life).[174] In the face of these defeats, the Service altered its position to permit the deduction for contingent QTIP trusts.[175] Thus,

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168 *See supra* notes 63-65 and accompanying text.

169 The Service made this argument in several cases. *See* Estate of Spencer v. Commissioner, 43 F.3d 226 (6th Cir. 1995); Estate of Robertson v. Commissioner, 15 F.2d 779 (8th Cir. 1994); Estate of Clayton v. Commissioner, 976 F.2d 1486 (5th Cir. 1992); Estate of Clack v. Commissioner, 106 T.C. 131 (1996).

170 *See* I.R.C. § 2056(b)(7)(B)(ii) (1994) (providing that an election can only be made if, under the terms of the trust, the spouse is entitled to all of the trust's income and no person is authorized to distribute trust assets to a non-spouse beneficiary during the spouse's life).

171 The Tax Court initially upheld the Service's position in a few decisions. *See* Estate of Spencer v. Commissioner, 64 T.C.M. (CCH) 937 (1992), *rev'd*, 43 F.3d 226 (6th Cir. 1995); Estate of Robertson v. Commissioner, 98 T.C. 678 (1992), *rev'd*, 15 F.3d 779 (8th Cir. 1994); Estate of Clayton v. Commissioner, 97 T.C. 327 (1991), *rev'd*, 976 F.2d 1486 (5th Cir. 1992). However, it overruled those decisions after the Circuit Courts of Appeals all took a contrary position. *See* Estate of Clack v. Commissioner, 106 T.C. 131 (1996).

172 *See* Estate of Rinaldi v. United States, 38 Fed. Cl. 341, 347-8 (1997) (explaining *Robertson*, *Clayton*, and *Spencer* on this basis).

173 *See* I.R.C. § 2044 (1994).

174 *See id.* § 2519.

175 *See* Treas. Reg. § 20.2056(b)-7(d)(3)(ii) (as amended in 1999) (permitting an election for a contingent QTIP trust).

under current law, even though the terms of the trust are subject to post-death alteration by the executor, the deduction is allowed if the executor makes the QTIP election and, as a result, the right to receive income from the trust passes to the spouse.[176]

Similarly, in the case of the marital deduction where the surviving spouse is not a United States citizen, the snapshot conception is not rigidly applied. To make certain that any amount passing to a non-citizen spouse ultimately will be subject to transfer tax, the Code was amended in 1986 to provide that the marital deduction will not be available unless the bequest is made under a trust containing certain terms.[177] The statute, however, explicitly provides that if the will fails to create such a trust but instead makes an outright bequest to the spouse, the required trust (a qualified domestic trust or "QDOT") can be created by the surviving spouse after the decedent spouse's death.[178] In permitting the spouse to satisfy the statute by making a post-death alteration in the nature of the bequest, Congress apparently took the view that it was not necessary to apply the snapshot conception in this context. In other words, as long as the trust structure is in place to make certain that the non-citizen spouse will in fact pay tax on any transfer of property received from the deceased spouse, the deduction can be made available without regard to whether the trust structure is created before or after death.

In each of these cases—disclaimers, will-contest settlements, contingent QTIP trusts, and postmortem QDOT trusts created by non-citizen spouses—the determination as to whether an interest has passed to the surviving spouse is made on the basis of post-death events. In each of these cases the availability of the marital deduction depends upon whether the spouse *actually* receives the decedent's property, rather than upon the legal nature of the spouse's rights in the decedent's estate at the moment of death. If the spouse's actual receipt is determinative, the integrity of the tax base is maintained in that the deduction is available only for property that will be subject to tax upon

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176 Of course, the trust terms must otherwise satisfy the statutory conditions for making a QTIP election. *See* I.R.C. § 2056(b)(7) (1994 & Supp. III 1997). Thus, even though the election will result in the spouse's becoming entitled to receive all trust income, the deduction will not be permitted where, for example, the trustee is given the discretion to invade for the benefit of someone other than the spouse during the spouse's lifetime. *See id.* § 2056(b)(7)(B)(ii)(II) (providing that a power to appoint any part of the property to a non-spouse during the spouse's lifetime renders the trust ineligible for QTIP treatment); Treas. Reg. § 20.2056(b)-7(d)(3)(ii) (as amended in 1999) (providing that an election can be made with respect to a contingent QTIP trust as long as the terms of the trust otherwise satisfy the statute's conditions).

177 *See* I.R.C. § 2056A (1994 & Supp. III 1997).

178 *See* I.R.C. § 2056(d)(2)(B) (1994).

the spouse's later death (or earlier gift). In other words, because the integrity of the tax base is not violated, the system comfortably can take into account post-death adjustments in the amount passing to the spouse.

The discrimination between the two hypothesized couples, therefore, cannot be justified on the theory that the snapshot conception is somehow intrinsic to the estate tax and must be rigidly followed in all cases. On the contrary, just as post-death events are taken into account in order to determine the availability of the marital deduction in each of the cases discussed above, so, too, should the fact that W's $500,000 bequest actually passes to H as a result of C's post-death gift be taken into account in determining the availability of the marital deduction in W's estate.

3. *Variation in State Law as a Justification*

The discrimination outlined above[179] cannot be justified by pointing to the difference in state law. W could have been more diligent in complying with the statute of wills in State Y, or could have secured more competent counsel, in which case W's estate would be entitled to a full marital deduction and no discrimination would occur.[180] Thus, at bottom, the discrimination is attributable to the fact that W, unlike W1, was careless in executing her will, rather than to any difference in state law.

4. *Careless Planning*

Nor can the discrimination be justified on the ground that it tends to make people more careful in their planning. As will be argued,[181] concerns about inducing more careful planning do not warrant the imposition of a post-death penalty in the form of a greater transfer-tax liability. Before considering this argument, however, it should be acknowledged that encouraging people to do more careful planning is not an illegitimate goal. The statute of wills, for example, has been justified, in part, on the ground that its ceremonial requirements impress upon the testator the significance of the will-execution act and thereby tend to discourage carelessness.[182] And, as a matter of

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179 *See supra* notes 159-63 and accompanying text.

180 Nor would the possibility of double (or triple) taxation arise, as C would not be treated as having made a taxable gift to H.

181 *See infra* notes 185-93 and accompanying text.

182 *See, e.g.*, Ashbel G. Gulliver & Catherine J. Tilson, *Classification of Gratuitous Transfers*, 51 YALE L.J. 1, 5-6 (1941) (indicating that one function of the statute of wills, the so-called ritualistic function, is to avoid giving legal effect to a careless act on the part of the testator).

traditional doctrine, the statute of wills is enforced through the post-death penalty of denying probate to the will.[183] Similarly, under traditional doctrine, the state courts have been unwilling to cure mistakes made by the testator or the testator's counsel—though this reluctance has not been explicitly justified on the ground that it would induce testators to be more careful.[184]

The traditional unwillingness to provide post-death relief for pre-death carelessness is not, however, without limits. Even under the most traditional approach, courts generally will respect an agreement among surviving family members effecting the distribution of an estate, even though the dispositive scheme embodied in the agreement differs from that selected by the testator.[185] In upholding these family settlement agreements, the courts emphasize the value of family harmony and the potential for enhancing such harmony by voluntary settlement.[186] Disclaimers are another tool that state law—as well as the tax law[187]—traditionally has recognized in order to permit post-death adjustments to a failed plan.[188] Recently, the severe consequences that traditional doctrine can produce also have been the subject of substantial criticism.[189] Under the evolving approach, it is no longer appropriate to impose a harsh penalty on the decedent's family—such as denying probate or refusing to cure a mistake—merely because the decedent was careless or the decedent's counsel was unsophisticated.[190]

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183 *See, e.g.*, John H. Langbein, *Excusing Harmless Error in the Execution of Wills: A Report on Australia's Tranquil Revolution in Probate*, 87 COLUM. L. REV. 1, 3-4 (1987).

184 *See* John H. Langbein & Lawrence W. Waggoner, *Reformation of Wills on the Ground of Mistake: Change in Direction in American Law?*, 130 U. PA. L. REV. 521 (1982).

185 *See, e.g.*, Martin D. Begleiter, *Anti-Contest Clauses: When You Care Enough to Send the Final Threat*, 26 ARIZ. ST. L.J. 629, 642 (1994) (indicating that, under the family settlement doctrine, beneficiaries are able to distribute the estate as they choose); Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710, 1723-4 (1997) (indicating that family settlement agreements are liberally construed because they serve a valuable function); M.L. Cross, Annotation, *Family Settlement of Testator's Estate*, 29 A.L.R.3d 8, 97-98 (1970).

186 *See, e.g.*, Wolf v. Uhlemann, 158 N.E. 334, 340 (Ill. 1927); *In re* Gustafson, 551 N.W.2d 312, 314 (Iowa 1996); *In re* Estate of Stancik, 301 A.2d 612, 615 (Pa. 1973).

187 While the tax law long has recognized as a general matter the validity of disclaimers, *see, e.g.*, Brown v. Routzahn, 63 F.2d 914 (6th Cir. 1933), the marital deduction could not be enhanced through a disclaimer until 1966. *See supra* notes 63-65 and accompanying text.

188 *See* Joan B. Ellsworth, *On Disclaimers: Let's Renounce I.R.C. Section 2518*, 38 VILL. L. REV. 693, 757 (1993) (indicating that disclaimers are available in order to permit the family to rectify mistakes in pre-death planning).

189 *See* Langbein, *supra* note 183, at 3-8 (criticizing the strict-compliance aspect of the statute of wills); *see generally* Langbein & Waggoner, *supra* note 184 (criticizing the traditional reluctance to grant relief for mistakes made in the drafting of wills).

190 *See, e.g.*, *In re* Will of Ranney, 589 A.2d 1339 (N.J. 1991) (embracing the doctrine of substantial compliance in connection with will executions); RESTATEMENT (THIRD) OF THE LAW OF PROPERTY:

The more forgiving approach now evolving, as well as the traditional willingness to accept family settlement agreements and disclaimers, obviously reflects discomfort with a policy requiring the family to suffer on account of the decedent's carelessness or mistake. Such discomfort is understandable for several reasons. First, mistakes in planning potentially occur more often when done under the supervision of unsophisticated counsel. If the law fails to provide a post-death remedy for these pre-death mistakes, the family is required to suffer the consequences simply because the decedent selected the wrong counsel. Second, while the goal of encouraging people to engage in careful predeath planning may be a legitimate one, the question remains whether it is a sufficiently important goal to warrant the imposition of a post-death penalty on the family. Third, even assuming the goal is of sufficient importance, it is doubtful that post-death penalties can be effective in helping to achieve the goal, for people often have difficulty in confronting their own death and in making arrangements for it.[191] Moreover, given that the penalty is not imposed immediately, but rather after death, it is not very likely that the possibility of triggering the penalty will have any impact on behavior.[192] Finally, there is a sense of injustice when rules impose a penalty on one person for the act or conduct of another.[193] Thus, while the goal of encouraging people to be more careful in their planning is a legitimate one, it does not justify the post-death penalty of increased transfer-tax liability.

In short, given the absence of any policy-based justification, the discrimination between the two couples should not, as a matter of equity, be tolerated.

I. Overemphasis: Other Negative Consequences

In addition to inequity and distortion in the tax base, the passing requirement's overemphasis on state law can lead to the formulation of state law on the basis of considerations not relevant to any legitimate area of state concern. For example, various state courts have held, in construing wills and trusts, that ambiguous provisions should be interpreted presumptively in a

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DONATIVE TRANSFERS § 12.1 (Tentative Draft No. 1, 1995) (suggesting that relief be granted for mistakes in the drafting of wills where there is clear and convincing evidence as to the testator's intent).

191 *See* SIGMUND FREUD, *Our Attitude Toward Death*, *in* 4 COLLECTED PAPERS 304 (1925).

192 *See* Gerald M. Brannon, *Death Taxes in a Structure of Progressive Taxes*, 26 NAT'L TAX J. 451, 451-52 (1973) (arguing that the obligation to pay estate tax has a less significant impact on behavior than the obligation to pay income tax because the estate tax is postponed until death).

193 *See, e.g.*, Bennis v. Michigan, 516 U.S. 442, 466-68 (1996) (Stevens, J., dissenting) (arguing that it is fundamentally unfair to punish a person for a wrong committed by another).

manner that will produce a lesser tax liability.[194] While even those courts adopting this interpretative strategy may impose limits on its use,[195] it seems fairly clear that, when they do invoke it, they are motivated by a desire to minimize the family's tax burden.[196] This kind of tax-driven state law is not only the outcome of a defective lawmaking process,[197] but also leads, ultimately, to more inequity. Identically situated taxpayers will be treated differently simply because they reside in different states if, as has happened, different approaches evolve in those states on the question of whether and under what circumstances tax-minimization presumptions should be utilized.[198] In the example just considered, depending on whether State Y adopted such a presumption, W's earlier will might be construed as giving her entire estate to H, thereby permitting a full marital deduction and eliminating W's estate tax liability. However one comes out on the question of the appropriateness of tax-minimization presumptions in general,[199] there should be no serious dispute about the necessity for taking the question out of the states' domain and making it the subject of a uniform federal rule.

Ironically, the *Bosch* framework inexorably leads to validation of tax-minimization presumptions. Under *Bosch*, any state rule adopted by the state's highest court is binding on the federal courts as well as on the Service.[200] By implication, any rule adopted by the state legislature is similarly entitled to

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[194] *See, e.g.*, Simches v. Simches, 671 N.E.2d 1226, 1229-30 (Mass. 1996) (granting reformation of an instrument on the ground that it would achieve the settlor's tax-minimization objectives); *In re* Branigan, 609 A.2d 431, 436-38 (N.J. 1992) (granting reformation of will, under doctrine of probable intent, in order to give effect to the testator's imputed intent to minimize taxes); RESTATEMENT (THIRD) OF THE LAW OF PROPERTY: DONATIVE TRANSFERS § 12.2 (Tentative Draft No. 1, 1995) (permitting modification of an instrument so that tax savings can be achieved, even where reformation with respect to a non-tax issue would be denied); Marilyn G. Ordover & Charles F. Gibbs, *Correcting Mistakes in Wills and Trusts*, N.Y. L.J., Aug. 6, 1998, at 3 (indicating that, in New York, a two-tiered approach has evolved, under which the courts are much more inclined to correct mistakes that would result in higher taxes than they are to grant relief for other kinds of mistakes).

[195] *See Branigan*, 609 A.2d at 438 (embracing tax-minimization strategy in dictum, but refusing to reform power of appointment when doing so would change substantive provisions of will).

[196] In New York, for example, a two-tiered approach to construction has evolved. *See* Ordover & Gibbs, *supra* note 194, at 3. Generally, the courts are unwilling to reform wills, but where doing so will result in a tax savings for the family, they are much more sympathetic. *See id.*

[197] *See supra* notes 43-44 and accompanying text.

[198] *Compare In re* Lewis, 544 N.Y.S.2d 719 (Sur. Ct. 1989) (reforming an instrument to confer a general power of appointment on a beneficiary in order to reduce taxes) *with Branigan*, 609 A.2d at 438 (citing and disagreeing with *Lewis*).

[199] If one of the alternatives suggested by this Article were adopted, *see infra* Part III, there would no longer be a need for such a presumption.

[200] *See supra* notes 79-84 and accompanying text.

binding deference.[201] Thus, where a tax-minimization presumption is adopted, whether by a state court or by a state legislature, *Bosch* requires that it be given binding deference.

However, this outcome undermines the apparent purpose of the *Bosch* framework, which was to eliminate tax-driven state court decrees by requiring neutral evaluation of state law for transfer-tax purposes. Neutral evaluation was to be achieved, first, by making lower state-court decrees subject to independent examination in the federal courts, thereby making certain that they reflect an accurate assessment of state law, and, second, by obligating the federal courts to respect a decision of the state's highest court, on the assumption that such decisions are always based on appropriate state concerns and never based on tax considerations. Apparently, when *Bosch* was decided, the Court did not foresee that its neutral-evaluation framework could ultimately legitimize efforts by state high courts and legislatures to enact purely tax-driven tax-minimization presumptions.[202]

Another negative consequence that flows from the overemphasis on state law arises in the context of post-death settlement agreements. While the law generally favors the voluntary settlement of controversies[203]—and while this is particularly so in the context of intra-family disputes[204]—application of the *Bosch* framework, as extended to settlement agreements,[205] creates a disincentive to settle. Compromise is more easily achieved where the parties have complete information about the after-tax costs that would be incurred and the after-tax gains that would be secured through settlement.[206] Thus, the

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201 *See, e.g.*, CAL. PROB. CODE § 21522(a) (West 1991) (providing that a marital bequest should be construed so as to preserve the marital deduction).

202 Nor, apparently, did the Court foresee that a state's highest court might be willing to grant a decree on the parties' consent for the purpose of achieving a particular tax outcome. *See* Simches v. Simches, 671 N.E.2d 1226, 1228 (1996) (granting reformation in order to reduce taxes where all parties consented to the relief sought).

203 Voluntary settlements result in lower transaction costs. Also, the sense of coercion experienced by the losing party in a litigation is avoided by settlement. *See* Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 956-58 (1979) (discussing the benefits of voluntary settlement in the context of divorce litigation).

204 *See id.*; *see also supra* notes 185-86 and accompanying text.

205 *See supra* Part II.D.

206 Uncertainty as to whether the plaintiff or defendant will prevail at trial tends to impede the settlement process. *See* Robert H. Gertner, *Asymmetric Information, Uncertainty, and Selection Bias in Litigation*, 1993 U. CHI. L. SCH. ROUNDTABLE 75, 93 (acknowledging that many take the position that uncertainty decreases the likelihood of settlement, but indicating that it could increase the likelihood of settlement if the parties are risk averse); Barry Nalebuff, *Credible Pretrial Negotiation*, 18 RAND J. ECON. 198, 207 (1987) ("The reason pretrial negotiation might not lead to settlement is the uncertainty about the value of going to

parties to a dispute over the amount that the surviving spouse is entitled to receive may well find compromise more difficult to achieve because of their concern that the Service (and ultimately the federal courts) will conclude that the settlement amount is more than the spouse would have received under a proper interpretation of state law.

In addition, where the Service uses the *Bosch* framework to challenge a settlement, the very issues the parties sought to avoid litigating in the state court must be litigated in the federal court by the estate and the Service. The cost of such litigation will be borne not merely by the estate, but by the public as well though the use of judicial resources. The approach therefore necessarily produces more transaction costs than would a rule requiring the Service to accept the settlement. At a time when the transfer tax is under attack on the ground that it is too costly to administer,[207] such transactions costs become a particularly relevant concern.[208]

Moreover, where the Service successfully invokes the *Bosch* framework, double taxation results[209]—as is true whenever application of the passing requirement leads to a denial of the marital deduction for property actually passing into the surviving spouse's hands.[210] Any property received by the surviving spouse that does not qualify for the marital deduction in the decedent spouse's estate because of a failure to satisfy the *Bosch* framework is nevertheless subject to tax again in the surviving spouse's estate, to the extent not consumed.

Finally, it is worth noting that the approach adopted by the Court in *Bosch* compounds the statute's overemphasis on state law. Had the approach suggested by Justice Harlan in his dissenting opinion been adopted instead,

court."); George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 9-17 (1984) (arguing that uncertainty reduces the likelihood of settlement). Similarly, it would seem that the specter of an uncertain tax consequence could complicate the settlement process and ultimately lead to fewer settlements.

207 In the discussions concerning the 1997 amendments to the Code, the argument was made that transfer taxation should be abolished, in part because of the high costs incurred in its administration. *See, e.g.*, Martin A. Sullivan, *The Estate Tax: Just the Facts*, TAX NOTES TODAY, Apr. 15, 1997, at 72-15, *available in* LEXIS TNT file (arguing against the transfer tax system because of the high cost incurred in its administration). *But see* Charles Davenport & J.E. Soled, *Enlivening The Death-Tax Death-Talk*, 84 TAX NOTES 591, 618-25 (1999) (arguing that the costs of administering the system have been overstated).

208 Where the Service uses the *Bosch* framework to challenge a state court decree, the re-litigation of the issue in the federal courts also produces transaction costs that could be avoided were the Service required to accept the state court decree.

209 It is also conceivable that triple taxation could result. *See supra* note 162 and accompanying text.

210 *See supra* notes 159-62 and accompanying text.

whatever conclusions a state court reached in the context of a genuinely adversarial proceeding would be entitled to binding deference.[211] Had the approach suggested by Justice Douglas in his dissenting opinion been adopted, any conclusion reached by a state court—whether or not the result of a genuinely adversarial proceeding—would generally be entitled to binding deference.[212] In contrast, under the majority approach, state court conclusions are not binding unless rendered by the state's highest court.[213] Thus, because it permits a state court's determination of state law to be relitigated in federal court, the majority approach permits a denial of the marital deduction on the basis of a state-law argument in a greater number of cases than would Justice Harlan's or Justice Douglas's approach. In short, the statute itself overemphasizes state law, and the *Bosch* majority's construction of the statute, in giving state law a more important role than it would have under other possible constructions, makes a bad statute even worse.[214]

In sum, the passing requirement, as well as the *Bosch* framework, overemphasizes state law. The resulting discrimination between couples similarly situated cannot be justified.[215] And the double (or perhaps triple) taxation that the overemphasis can produce violates the model Congress created in 1981 tying the deduction to inclusion in the surviving spouse's estate.

J. Disclaimers: An Adjunct to the Passing Requirement

Any discussion of the passing requirement necessarily requires an examination of disclaimers. Disclaimers serve, in effect, as an adjunct to the passing requirement.[216] Indeed, from its inception, the marital deduction statute gave limited recognition to disclaimers,[217] and in 1966 Congress gave them full recognition in this context.[218] Under current law, a disclaimed

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211 *See Bosch*, 387 U.S. at 481 (Harlan, J., dissenting).

212 *See id.* at 470-71 (Douglas, J., dissenting).

213 *Id.* at 465 (majority opinion).

214 *Bosch*'s compounding of the statute's overemphasis on state law is exacerbated by expansion of the majority approach in *Bosch* to settlement agreements. *See supra* Part II.D.

215 The grounds offered by the Court as justification for its decision do not justify retaining the framework. *See supra* note 83.

216 Disclaimers also are used in tax contexts having nothing to do with the marital deduction. To take just one example, consider a decedent who bequeaths her entire estate to her only child and therefore fails to use the generation skipping tax exemption provided by I.R.C. § 2631 (1994 & Supp. III 1997). The child could, in effect, resurrect the exemption by a disclaimer. *See* Ellsworth, *supra* note 188, at 753.

217 *See* Pub. L. No. 471, § 361(e)(4), 62 Stat. 110, 121 (1948); *see also supra* notes 60-62 and accompanying text.

218 *See supra* notes 63-65 and accompanying text.

bequest is treated for transfer-tax purposes[219] (including the marital deduction)[220] as if it did not pass to the disclaimant but rather to the person to whom it passes as a result of the disclaimer. In permitting the decedent's family a post-death opportunity to alter the estate plan and the amount of the marital deduction, disclaimers introduce an element of flexibility into what would otherwise be a very rigid passing requirement. Disclaimers, however, have not entirely eliminated the difficulties created by the passing requirement's overemphasis on state law. This is not surprising, inasmuch as the Code's disclaimer provision itself overemphasizes state disclaimer law. As the overemphasis on state disclaimer law has diminished over the years, disclaimers unfortunately have become, as a byproduct, less effective as a tool in helping to achieve the settlement of estate-related litigation. Most significantly, despite the progress made, current tax-disclaimer law still places too much emphasis on state disclaimer law.

1. Pre-1958 Disclaimer Law

In seeking to create parity between common-law and community-property states in the 1948 legislation, Congress adopted the passing requirement and, in so doing, made state law determinative as a general matter.[221] Thus, the marital deduction was available only if the bequest passed to the surviving spouse pursuant to state law or under a provision in the deceased spouse's will that was valid under state law. Remaining faithful to this framework, Congress embraced the state-law concept of disclaimers, at least in part, by providing that a disclaimer by a surviving spouse, if valid under state law, would be respected for purposes of the marital deduction. This provision adopted for marital-deduction purposes the state law fiction that a disclaimed bequest passes directly from the decedent to the person receiving the bequest as a result of the disclaimer.[222] Thus, if a spouse disclaimed a bequest contained in the deceased spouse's will, no marital deduction would be allowed.[223] This provision created two options for a surviving spouse who was entitled to a bequest under the deceased spouse's will but who wanted to exclude the bequeathed property from his or her estate. By disclaiming the bequest, the surviving spouse could nullify the marital deduction in the

219 *See* Treas. Reg. § 25.2518-1 (as amended in 1999).
220 *See* Treas. Reg. § 20-2056(d)-2(a) (as amended in 1997).
221 *See supra* Part II.A.
222 *See* Surrey, *supra* note 23, at 1126.
223 *See id.*

deceased spouse's estate and concomitantly cause the bequeathed property to be excluded from his or her own estate;[224] alternatively, the surviving spouse could accept the bequeathed property and then, in order to prevent it from being included in his or her estate, make an inter vivos gift of it.[225]

The 1948 legislation did not, however, accept state law as determinative in all contexts. Indeed, in two instances, Congress specified that state law should be completely ignored. First, if a non-spouse beneficiary disclaimed a bequest and, as result, the disclaimed bequest passed to the surviving spouse under state law, the bequest would not be treated as passing to the surviving spouse and the marital deduction would not be allowed.[226] The marital deduction, in other words, was denied even though, as a matter of state law, the bequest was viewed as passing directly from the deceased spouse to the surviving spouse. Second, if the surviving spouse surrendered a bequest in connection with a controversy or litigation relating to the deceased spouse's will, the bequest again would be treated as not passing to the spouse and the deduction again would be unavailable.[227] Thus, a bequest surrendered by a surviving spouse in order to settle a will contest would not qualify for the marital deduction even if it could be established through a *Bosch*-type neutral evaluation[228] that the bequest was valid under state law.[229] In both cases, the consequence of rejecting state law was the denial of the marital deduction.

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224 *See id.*

225 The estate and gift tax systems were not unified until the Tax Reform Act of 1976. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, 1846-48 (codified as amended in scattered sections of 26 U.S.C.); *see also* Sims, *supra* note 59, at 34-35. Thus, in 1948, an inter vivos gift would not be included in the calculation of the donor's estate tax as an adjusted taxable gift (the adjusted-taxable-gift concept, embodied in I.R.C. § 2001(b) (1994), was enacted in 1976 in order to implement unification of the two tax systems). With the gift tax rates' being equal to 75% of the estate-tax rates and the lack of any connection between the two tax systems permitting the donor of an inter vivos gift to enjoy entry-level brackets in computing the gift tax, transfer-tax savings could be achieved even more so than under current law by making an inter vivos gift. *See* Sims, *supra* note 59, at 41 n.33.

226 *See* Surrey, *supra* note 23, at 1126 n.108.

227 *See* S. REP. NO. 80-1013, at 4-5 (1948), *reprinted in* 1948 U.S.C.C.A.N. 1163, 1226-27. This remains the rule under current law. *See* Treas. Reg. § 20.2056(c)-2(d)(1) (as amended in 1994).

228 *Bosch*, of course, had not yet been decided at the time the 1948 legislation was enacted. However, as the *Bosch* Court indicated, the 1948 legislative history contemplated that a federal court would be obliged to give only "proper regard," not binding deference, to a prior state court decision, thus establishing the notion that the federal courts would reach their own judgment about the correctness of state court decisions. *Bosch*, 387 U.S. at 464. Nevertheless, where a surviving spouse surrendered a bequest in connection with litigation, Congress contemplated that the marital deduction would be unavailable and that no inquiry would be made in the federal court concerning the spouse's right under state law to receive the bequest. *See* S. REP. NO. 80-1013, at 4-5, *reprinted in* 1948 U.S.C.C.A.N. at 1226-27.

229 In *Lyeth v. Hoey*, 305 U.S. 188 (1938), the Court accepted the parties' settlement agreement for tax purposes without making any judgment about the validity of the taxpayer's claim under state law. Perhaps,

Prior to 1948, there was neither legislation nor regulations concerning the availability or validity of disclaimers for tax purposes. The concept was purely a state-law creation. The courts, however, imported the concept into the tax law, holding that a disclaimer would be recognized as valid for tax purposes if valid under state law.[230] Thus, the viability of a disclaimer for tax purposes was made to turn on whether the disclaimant had satisfied all of the requirements imposed by state law.[231] Not surprisingly, the courts' wholesale incorporation of state disclaimer law produced non-uniform results, the availability of the disclaimer for tax purposes being dependent upon nothing more than the law of the particular state involved.[232] For example, a disclaimer by an intestate taker was not recognized for tax purposes if, under state law, such a disclaimer was not permitted.[233] If, on the other hand, a state enacted a statute, as some states did, permitting an intestate taker to disclaim, the disclaimer would be respected as valid for tax purposes.[234] In short, with no tax policy justification for differentiating disclaimers on the basis of their state-

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in taking the position that a bequest surrendered by a spouse in the context of litigation should not qualify for the marital deduction irrespective of the strength of the spouse's claim to retain the bequest under state law, Congress simply borrowed the *Lyeth* Court's approach.

[230] *See* Brown v. Routzahn, 63 F.2d 914 (6th Cir. 1933).

[231] *See id.*

[232] In 1994, in *United States v. Irvine*, 511 U.S. 224 (1994), the Supreme Court ruled that the incorporation approach that the lower courts had created before 1958 was inconsistent with the gift-tax statute and therefore invalid. *See* E. Bruce Jorgenson, Note, *Disclaimers of Interests Created Before Enactment of the Gift Tax:* United States v. Irvine, 48 TAX LAW. 553, 562 (1994) (indicating that the *Irvine* Court had abandoned the pre-1958 cases). The Court held that a disclaimer made after the 1958 regulation was promulgated but not coming within the scope of the regulation (either because the interest disclaimed had been created before the enactment of the gift tax or because the disclaimed interest had been created by an inter vivos document and the regulation appeared to be limited to transfers created by testamentary instrument) constituted a taxable gift. *See Irvine*, 511 U.S. at 240. In the absence of the regulation, the gift tax statute required that a disclaimer be treated as a taxable transfer. In reaching this conclusion, the Court pointed to the inappropriateness of blindly following the policies driving state disclaimer law for federal tax purposes. *See id.* at 238-40. In other words, the gift tax statute called for disclaimers to be treated as taxable gifts until 1958, at which time, by virtue of Treasury's decision to promulgate the regulation, disclaimers became entitled to be recognized as valid for tax purposes. Although this kind of radical change in the scope of a statute's meaning, effected by a regulation promulgated long after enactment, might once have been viewed as questionable, *see, e.g.*, National Muffler Dealers Association v. United States, 440 U.S. 472, 477 (1979) (holding that an interpretation of a statute contained in a regulation is entitled to weight where the regulation is promulgated at the time of the statute's enactment, with further inquiry necessary if the regulation is adopted later), such a view no longer would be appropriate given the deferential approach the Court now takes with respect to regulations. *See* Smiley v. Citibank, 517 U.S. 735 (1996) (holding that a regulation adopted approximately one hundred years after enactment of the underlying statute was, because of the statute's ambiguity, entitled to deference and that the regulation's interpretation of the statute was therefore valid).

[233] *See* Hardenbergh v. Commissioner, 198 F.2d 63 (8th Cir. 1952).

[234] *See* Ellsworth, *supra* note 188, at 740-41.

law validity,[235] the courts' incorporation approach represented an overemphasis on state law and resulted in the lack of uniformity typically inherent in such an overemphasis.[236]

2. *The 1958 Regulation*

While, as suggested,[237] Congress did in 1948 make reference to disclaimers in the context of the marital deduction, it was not until 1958 that the substantive elements of a valid disclaimer first became the focus of federal attention. In the leading case accepting a valid state-law disclaimer as valid for tax purposes, *Brown v. Routzahn*,[238] there was a delay of approximately eight years between the date of the decedent's death and the date that the beneficiary under the will disclaimed.[239] Despite this delay, the court held that the disclaimer, being valid under state law, was valid for tax purposes.[240] In 1958, the Treasury Department promulgated a regulation granting recognition for tax purposes of disclaimers if valid under state law.[241] In doing so, however, Treasury was concerned about the excessive delay in *Brown*[242] and, as a consequence, imposed a new and additional federal timing requirement; in order to be valid for tax purposes, the disclaimer not only had to be valid under state law but also had to be "made within a reasonable time after knowledge of the existence of the transfer."[243] Thus, under the 1958 regulation, for the first time, a disclaimer satisfying all state-law requirements nevertheless would be invalid for tax purposes if not made within the regulation's time-frame, thus ending the courts' willingness unhesitatingly to accept all disclaimers that were valid under state law.[244]

In adopting a federal timing standard, the 1958 regulation began a gradual reshaping of the connection between state disclaimer law and validity for tax purposes. However, under the 1958 regulation, given its state law compliance

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235 In 1968, the American Law Institute called for uniformity through federal standards in the disclaimer rules. *See* AMERICAN L. INST., FED. ESTATE AND GIFT TAX PROJECT 39-41 (1968).

236 *See supra* Part I.B.

237 *See supra* notes 60-62 and accompanying text.

238 63 F.2d 914 (6th Cir. 1933).

239 *Id.* at 914-5.

240 *Id.* at 916-7.

241 This regulation can now be found at Treas. Reg. § 25.2511-1(c)(2) (as amended in 1997).

242 *See* Jewett v. Commissioner, 455 U.S. 305, 315 n.17 (1982).

243 Treas. Reg. § 25.2511-1(c)(2) (as amended in 1997) (now applying only to taxable transfers creating an interest in the person disclaiming before June 1, 1977).

244 *See Jewett*, 455 U.S. at 315-16.

requirement, non-uniform results continued to occur. So, for example, under the regulation, the validity of a disclaimer for tax purposes of an intestate interest remained dependent upon its treatment under state law.[245] Ultimately, Congress defined the standards for tax-valid disclaimers in I.R.C. § 2518 ("section 2518"),[246] thereby further diminishing the overemphasis on state law inherent in the courts' incorporation approach.[247]

The 1958 regulation not only began the process of severing the connection between state-disclaimer law and tax-disclaimer law; it also began the process of federalizing tax-disclaimer law in a way that would narrow the circumstances in which disclaimers could be utilized for tax purposes. Prior to the regulation, it might have been possible to use a disclaimer in resolving an estate-related litigation.[248] But, under the regulation, at least as construed by the Supreme Court, it became more difficult as a practical matter to use

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245 The regulation did, however, tend to limit the potential for non-uniform results. To illustrate, assume that State X permitted a disclaimer to be made within five years of the decedent's death, whereas all other states required that it be made within one year of death. If, under the regulation, the Service determined that a disclaimer made in State X four years after the decedent's death was not made within a reasonable time and that it was therefore invalid for tax purposes, it could be said that the regulation had the effect of diminishing the potential for non-uniformity; disclaimants in State X would no longer be permitted to delay much longer than disclaimants in other states.

246 *See* I.R.C. § 2518 (1994).

247 *See infra* notes 254-64 and accompanying text.

248 Prior to the regulation, there was, as indicated, no federal timing requirement. In *Brown* the disclaimer was upheld as valid for tax purposes even though made eight years after the decedent's death. 63 F.2d at 916-17. As the Court in *Jewett* explicated, the critical fact in *Brown* was that the disclaimer was made prior to the estate's distribution of the disclaimed interest, thus making it valid for state law purposes and, concomitantly, for tax purposes. *Jewett*, 455 U.S. at 314. Hence, under the flexible timing approach taken by the Court in *Brown*, a disclaimer could be utilized to effect a settlement long after death.

State law, at least in the form it took prior to the promulgation of section 2518, also supported the use of disclaimers for settlement purposes. In many states, a beneficiary whose interest became the subject of litigation could defer making the decision about whether to disclaim until after the nature of the beneficiary's rights had been determined by litigation. *See, e.g.*, Keinath v. Commissioner, 480 F.2d 57, 63 (8th Cir. 1973) (referring to the Model Act to Provide for Disclaimer of Succession to Real Property proposed by the ABA and indicating that, as a matter of state law, a beneficiary should be able to defer making a decision about whether to accept or disclaim until the identity of the person entitled to receive the disclaimed interest could be established); Estate of Koplin v. Koplin, 139 Cal. Rptr. 129, 134 (Cal. Ct. App. 1977) (also referring to the Model Act and indicating that the time within which to disclaim did not start running until the interest became "indefeasibly fixed both in quality and quanitity"); *In re* Estate of Ramsey, 622 P.2d 626, 629 (Kan. 1981) (holding that a beneficiary under a will who had commenced a construction proceeding could disclaim within a reasonable time after the construction decree was issued); American L. Inst. Tax Project, Special Committee on Disclaimer Legislation, *Disclaimer of Testamentary and Nontestamentary Dispositions—Suggestions for Model Acts*, 4 REAL PROP., PROB. & TR. J. 658 (1969) (discussing Model Act); American L. Inst. Tax Project, Special Committee on Disclaimer Legislation, *Disclaimer of Testamentary and Nontestamentary Dispositions—Suggestions for a Model Act*, 3 REAL PROP., PROB. & TR. J. 131 (1968) (examining earlier version of Model Act).

disclaimers as a settlement tool. For, in the typical litigation, the dispute is not settled until long after the decedent's death. And, under the Supreme Court's construction of the regulation, timeliness is measured from the date of death.[249] Thus, unless one could successfully argue that the reasonable-time standard contained in the regulation was sufficiently flexible to accommodate a settlement-related disclaimer made long after death,[250] the regulation eliminated the possibility that a disclaimer could be used as a settlement tool in the overwhelming majority of cases.[251] So, for example, if, after the 1966 amendment,[252] a non-spouse beneficiary surrendered a bequest to the surviving spouse in order to resolve a litigated dispute in a settlement occurring long after the decedent's death, the 1958 regulation would in all likelihood prevent a disclaimer from being used to generate a marital deduction for the surrendered amount.[253]

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249 *See Jewett*, 455 U.S. at 318.

250 It could, however, be argued that the Supreme Court in *Jewett* did not adopt a date-of-death approach in the case of settlements. In *Jewett*, the disclaimer did not involve a settlement. Rather, the issue was whether the timeliness of a disclaimer of a contingent remainder should be measured from the date of death. *See id.* at 306. Indeed, in construing the regulation as requiring a date-of-death approach, the Court did intimate that a disclaimant lacking knowledge of his or her interest in the estate until a time after death might be able to disclaim within a reasonable time after learning of the interest. *Id.* at 312 (the Court emphasizing that it "seldom" would be the case that the disclaimant did not learn of the interest until after death). It could be argued that where an estate becomes the subject of litigation, a beneficiary who disclaims at the time of settlement did not have knowledge of his or her interest in the estate at the time of death and that therefore the date-of-death approach should not be invoked. In any event, as will be discussed, the date-of-death approach adopted by section 2518 is an inflexible one that does not permit an exception for settlements. *See infra* note 257 and accompanying text.

251 Another aspect of the regulation might have precluded the use of disclaimers as a settlement tool. Under the regulation, a disclaimer could not be made once the disclaimant had accepted the interest. *See* Treas. Reg. § 25.2511-1(c)(2) (as amended in 1997). Because the assertion of rights in the course of litigation could well be viewed as an acceptance, a disclaimer might not have been available to effect a settlement occurring after the commencement of the litigation. In *DePaoli v. Commissioner*, 62 F.3d 1259 (10th Cir. 1995), the court considered the validity of a settlement-related disclaimer under section 2518, which, like the regulation, renders a disclaimer unavailable where acceptance has occurred. *See* I.R.C. § 2518(b)(3) (1994). In holding the disclaimer valid, even though made after the disclaimant had commenced litigation to enforce the disclaimed interest, the court emphasized that the Service had not argued that the disclaimant had accepted the interest, thus implying that a beneficiary who commences litigation to enforce an interest may be viewed as accepting that interest and thereby precluded from disclaiming it.

252 As indicated earlier, the Code was amended in 1966 to permit a non-spouse beneficiary to disclaim and thereby make the marital deduction available for the amount passing to the spouse as a result of the disclaimer. *See supra* notes 63-65 and accompanying text.

253 If, however, it could be established that the spouse had a legally enforceable right under state law to receive the surrendered amount, the marital deduction would be permitted for the surrendered amount under *Bosch*. *See supra* Part II.B. Thus, the effect of making the disclaimer unavailable is to preclude the estate from obtaining the marital deduction in the settlement context unless the spouse's entitlement to receive the settlement amount can be established as a matter of state law.

3. *The 1976 Legislation*

In 1976, Congress expanded the approach taken in the 1958 regulation, in terms both of federalizing the tax-disclaimer standards and of narrowing the circumstances in which a disclaimer could be utilized for tax purposes. The 1958 regulation had been criticized on the ground that its emphasis on state law created the potential for non-uniform results.[254] Responding to this criticism, Congress in 1976 created uniform federal standards for determining the tax effectiveness of disclaimers in section 2518.[255] Under the section, a disclaimer is not valid for tax purposes if executed more than nine months after the transfer creating the interest, unless the disclaimant is a minor.[256] And, while under the 1958 regulation the timing standard had some flexibility that might have permitted a settlement-related disclaimer long after death, section 2518's nine-month rule has no such flexibility.[257]

The 1976 legislation also became the subject of criticism.[258] While the legislation was designed to address the non-uniform outcomes produced under the 1958 regulation, it did not entirely eliminate the potential for such outcomes. Under the legislation, a disclaimer was not valid for tax purposes unless the disclaimed interest passed to a person other than the disclaimant without any direction on the disclaimant's part.[259] The effect of this rule was to maintain the connection between tax validity and state-law validity. In other words, in order for the disclaimer to be valid for tax purposes, the disclaimed interest had to pass as a result of the disclaimer to someone other than the disclaimant by operation of state law. And if, under state law, the disclaimer was invalid or not permitted, the disclaimed interest could not pass by operation of state law and the disclaimer therefore would be invalid for tax purposes.[260] For example, if state law required that a disclaimer be made within six months of death, a disclaimer made eight months after death would be invalid for tax purposes, even though it satisfied the federal nine-month rule, because the disclaimed interest would not pass to another by operation of state law.

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[254] *See* John H. Martin, *Perspectives on Federal Disclaimer Legislation*, 46 U. CHI. L. REV. 316, 320-23 (1979).

[255] Pub. L. No. 94-455, 90 Stat. 1893 (1976) (codified as amended at 26 U.S.C. § 2518 (1994)).

[256] *Id.* § 2518(b)(2).

[257] *Id.*; *see also* Treas. Reg. § 25.2518-2(c) (1997).

[258] *See* Martin, *supra* note 254, at 323-26.

[259] *See* I.R.C. § 2518(b)(4) (1994).

[260] *See* Martin, *supra* note 254, at 323-26.

4. The 1981 Legislation

Concerned about its failure to achieve uniformity, Congress amended section 2518 in 1981.[261] Under the amendment, a disclaimer would be valid for tax purposes, even though it was invalid under state law and the disclaimed interest therefore failed to pass by operation of state law, as long as the disclaimant made a transfer of the disclaimed interest to the person who would have received it had the disclaimer satisfied state-law requirements.[262] So, under the amendment, a disclaimer made eight months after the creation of the interest where state law required that it be made within six months would be valid for tax purposes as long as the disclaimant made the necessary transfer. On the other hand, a disclaimer made ten months after the creation of the interest would be invalid for tax purposes under the amendment even if timely under state law. Although the amendment creates a trap for disclaimants who are not sufficiently careful in preparing the disclaimer document[263]—reflecting a deficiency in the amendment that should be cured by further legislation[264]—it

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261 Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, § 407 (codified at I.R.C. § 2518(c)(3) (1994)).

262 *See* Pub. L. No. 97-34, 95 Stat. 318 (1981) (codified at 26 U.S.C. § 2518 (1994)); Treas. Reg. § 25.2518-1(c)(1)(ii) (1997) (applying to interests created before 1982); *id.* § 25.2518-1(c)(3).

263 In order for a disclaimer that is invalid under state law to be saved under I.R.C. § 2518(c)(3), the transfer (to the person who would have received the disclaimed interest had the disclaimer been valid under state law) must occur within the nine-month window. Where the disclaimer document is executed within the nine-month period but is ultimately determined by the Service or the courts outside of the nine-month window to be invalid because of a failure to comply with state law, there will be no opportunity at the time of the court's or the Service's determination to make the transfer. Thus, as a planning matter, it would be prudent to include in all disclaimer documents language providing that, if the disclaimer is held to be invalid under state law, the disclaimed interest should be retained by the person who would have received it under the disclaimer. *See* Estate of Delaune v. United States, 143 F.3d 995, 1001 n.3 (5th Cir. 1998) (ruling that a disclaimer that fails to comply with state law cannot be validated under section 2518(c)(3) unless the disclaimant executes a document of transfer within the nine-month period); Estate of Dancy v. Commissioner, 89 T.C. 550, 562 (1987) (finding execution of transfer document within nine-month period necessary), *rev'd on other grounds*, 872 F.2d 84 (4th Cir. 1989); Mitchell M. Gans, *Disclaimers*, 46 INST. ON FED. TAX'N § 52.01, § 52.12, at 52-45 (1988) (suggesting that all disclaimer documents contain language effecting a transfer of the disclaimed interest in the event the disclaimer is ultimately held invalid because of a failure to comply with state law).

264 While the courts in *Delaune*, 143 F.3d at 1001 n.3, and *Dancy*, 89 T.C. at 562, in indicating that the transfer document must be executed within the nine-month post-death period, clearly read current law correctly, there is no policy justification for invalidating a disclaimer for tax purposes merely because the disclaimant failed to foresee the possibility that the disclaimer would ultimately be held invalid under state law and consequently failed to include the appropriate precautionary language in the disclaimer document. *See supra* note 263. In order to avoid punishing the disclaimant for such a lack of foresight (assuming proposals that would make state law irrelevant, such as those considered in Part III, *infra*, are not enacted), the statute should be amended to provide that a failure to comply with state law would not invalidate the disclaimer for tax purposes in circumstances such as the following: the disclaimant makes a good-faith effort to comply

in all probability did eliminate the potential for non-uniform results by establishing a federal standard.

5. Current Deficiencies

The process of federalizing disclaimer standards for tax purposes in order to achieve greater uniformity, which had begun in the 1958 regulation, was thus brought to fruition in 1981. The fact that a federal standard has been established does not necessarily mean, however, that the standard is a correct one. Indeed, two deficiencies remain in current tax-disclaimer law. First, as a practical matter the inflexible nine-month rule unfortunately renders disclaimers unavailable as a settlement tool in the overwhelming majority of cases.[265]

Second, even though tax-disclaimer standards have been federalized, current law still overemphasizes state law. If the disclaimer is to be valid for tax purposes, the disclaimed interest must pass either in accordance with state law or, where the disclaimer is not valid under state law, to the person who would have received it had it been valid.[266] Thus, the identity of the person receiving the disclaimed interest is determined by state law in all cases. In the context of the marital deduction, why should it be necessary that the disclaimed interest pass under state law to the surviving spouse? Why should

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substantially with state disclaimer law within the nine-month period; the disclaimant does not, in the post-disclaimer period, take the position that the disclaimer is invalid; and within, for example, two months of any declaration by a court of invalidity under state law, the disclaimant executes a document effecting a transfer of the disclaimed interest to the person who would have received it had the disclaimer been valid under state law.

265 If the statute were amended to create a more flexible timing rule in order facilitate the use of disclaimers in the settlement context, modification of the rules concerning consideration and acceptance would also be necessary. Under current law, either one of these rules might invalidate a disclaimer made as part of a settlement. The requirement that the disclaimant not accept any consideration in exchange for the disclaimer is not contained explicitly in the statute, which requires merely that the disclaimer be unqualified. *See* I.R.C. § 2518(b) (1994). The regulations, however, make clear that the acceptance of any consideration by the disclaimant taints the entire disclaimer. *See* Treas. Reg. § 25.2518-2(d)(1) (as amended in 1997); *see also* Estate of Monroe v. Commissioner, 124 F.3d 699, 710 (5th Cir. 1997) (indicating that a disclaimer is invalid where the disclaimant receives a bargained-for consideration). Indeed, under the regulation, it would appear that if a beneficiary entitled to receive $100 under the will disclaimed the bequest in exchange for a consideration of $1, the disclaimer would be entirely invalid. One might question why the disclaimant should not be viewed as having accepted $1 of the bequest and as having validly disclaimed the balance. *See* Treas. Reg. § 25.2518-3 (1994) (permitting partial disclaimers of discrete interests in property). In any event, a disclaimer made in connection with a settlement agreement effecting a release on the part of the disclaimant might well be viewed as invalid under current law. For a discussion of how a settlement-related disclaimer might be invalid on acceptance grounds under current law, see note 251 *supra*.

266 *See* I.R.C. § 2518(b)(4), (c)(3) (1994).

the marital deduction not be equally available where a non-spouse beneficiary disclaims a bequest and directs that it pass to the surviving spouse? Under current law, such a direction would disqualify the disclaimer.[267] As a consequence, no marital deduction would be permitted for the disclaimed interest, and the disclaimant would be treated as having made a taxable gift.[268] Were the 1981 model followed,[269] however, the marital deduction would be allowed in this context given that the disclaimed interest would eventually be subject to tax in the surviving spouse's estate. In short, the 1981 model is violated because, in requiring that the disclaimed interest pass without any direction by the disclaimant, section 2518 continues to overemphasize state law.[270]

III. ALTERNATIVES TO CURRENT LAW

A. *Overrule* Bosch

There are several alternatives that would either eliminate state law from the marital-deduction equation or diminish the present overemphasis on state law. The most modest of these alternatives would overrule *Bosch*, leaving the passing requirement otherwise intact.

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267 *Id.* § 2518(b)(4).

268 *See, e.g.*, Jewett v. Commissioner, 455 U.S. 305, 306 (1982); Treas. Reg. § 25.2518-1(b) (as amended in 1997).

269 *See supra* notes 140-53 and accompanying text.

270 Even where the marital deduction is not at stake, section 2518 places too much emphasis on state law. Given that the purpose of section 2518 is to permit the family to adjust the decedent's estate plan post-mortem without imposing a higher tax than if the decedent had made the adjustment before death, there is no justification for requiring that the disclaimed interest pass under state law. To illustrate, assume that the decedent's will bequeaths her entire estate to her daughter. Assume further that the daughter has two sons, A and B, and that she strongly prefers that her mother's estate go immediately to A. Unless the decedent's will provided that the bequest would pass to A if the daughter disclaimed or predeceased, a disclaimer by the daughter would probably result in the estate's passing under state law to A and B equally. *See, e.g.*, UNIF. PROBATE CODE § 2-603(b) (amended 1993), 8 U.L.A. 165-66 (1998) (providing that lapsed devise passes equally to deceased devisee's descendants); UNIF. PROBATE CODE § 2-801(d) (amended 1993), 8 U.L.A. 207-08 (1998) (providing that disclaimerd interest passes as though disclaimant had predeceased decedent). The only method by which the daughter could cause the estate to pass to solely to A would be by accepting the bequest and then making a taxable gift to A. With proper planning, however, the decedent could have drafted her will to provide for A without subjecting her daughter to the gift tax. By imposing the constraint of state law on this family, section 2518 limits the family's ability to achieve on the same tax basis what the decedent could have achieved, thus failing to remain faithful to its purpose. *But see* Ellsworth, *supra* note 188, at 757 (arguing that section 2518 should be repealed and that the validity of disclaimers for tax purposes should turn upon their validity under state law).

Either of two variations might be substituted for the *Bosch* framework. The first variation would give binding respect to state-court decrees, whether issued by a court of last resort or by a lower court. The allocation of rights contained in settlement agreements would be similarly conclusive. Thus, any amount actually passing into the hands of the surviving spouse under either a decree or a settlement agreement would qualify for the marital deduction, without regard to whether the pre-agreement or pre-decree proceedings were adversarial in nature and without regard to whether the decree or agreement properly interpreted state law. While this variation would not eliminate all of the cases in which Congress's 1981 model (which ties the deduction to inclusion in the surviving spouse's estate)[271] is violated, it would apply the model in all cases involving property passing to a surviving spouse under a settlement agreement or decree. This variation corresponds to the position taken by Justice Douglas in his dissent in *Bosch*.[272]

The second variation on the overrule-*Bosch* alternative, corresponding to Justice Harlan's dissent, would give binding respect to state-court decrees and settlement agreements as long as they were the product of adversarial litigation.[273] As in the first variation, the deduction would be allowed only for property actually passing into the hands of the spouse, thus again applying the 1981 model.[274] This variation, however, fails to apply the model in at least as many cases as does the first variation. It would not permit the deduction in the case of an agreement or decree found by the federal court to be the product of non-adversarial litigation, even though the property passing to the surviving spouse would be included in his or her estate. This failure makes the first variation preferable.

Both of these overrule-*Bosch* variations, however, may be susceptible to taxpayer abuse in the sense that taxpayers might create litigation in order to bring themselves within the new rule. Consider, for example, a decedent who bequeaths her entire estate to her daughter. Assume that the decedent's daughter is willing to transfer the bequeathed property to the decedent's spouse in order qualify the estate for the marital deduction. Under present law, this

271 *See supra* notes 140-53 and accompanying text.

272 *Bosch*, 387 U.S. at 466 (Douglas, J., dissenting). It should be noted that in effect the Service has adopted the approach suggested by Justice Douglas in the case of decrees issued prior to the death of the decedent. *See* Rev. Rul. 73-142, 1973-1 C.B. 405; *see also* Verbit, *supra* note 3, at 456-62 (arguing for an approach that would require the federal courts to accept as binding state court decrees on the rationale that they usually represent the state court's best judgement as to what the decedent intended).

273 *See Bosch*, 387 U.S. at 471 (Harlan, J., dissenting).

274 *See supra* notes 140-53 and accompanying text.

could be accomplished by the daughter's disclaimer (assuming that, as a result of the disclaimer, the property would pass under state law to the spouse).[275] But if the daughter had a child and that child were unwilling to cooperate by executing a disclaimer of any interest the child might become entitled to receive as a result of the daughter's disclaimer, the daughter's disclaimer would not be sufficient to secure the marital deduction.[276] Assuming one of the two overrule-*Bosch* variations were enacted, the daughter and the spouse might well be able to secure the marital deduction without the child's cooperation by bringing suit in state court and then executing a settlement agreement or securing a decree. While this technique might be somewhat more difficult to implement under the second variation (because the Service could argue that the litigation was not adversarial), one can imagine taxpayers using this technique under the first variation. Indeed, it might work even under the second variation as well if the parties could convince the federal court that the litigation was adversarial. Thus, although the two variations are designed to apply in the context of litigated disputes, taxpayers might be able to manipulate these variations and thereby secure their benefits in other contexts.[277]

B. Disregarding State Law: Actual Passing

While both of these overrule-*Bosch* variations would diminish the importance of state law, neither would entirely eliminate its role. This suggests the need to examine a less modest alternative, one that would make state law completely irrelevant. Under this alternative, the test for determining eligibility for the marital deduction no longer would focus on whether the property passed into the spouse's hands as a result of state law. Instead, the focus would be solely on whether the property actually passed into the spouse's hands so that it would be available for inclusion in the spouse's estate to the extent not consumed. Thus, if, after the decedent's death, a beneficiary

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275 *See* I.R.C. § 2518(b)(4)(A) (1994).

276 The property would fail to pass to the spouse on account of the daughter's disclaimer if, for example, the will provided that the property pass to the daughter's child in the event the daughter predeceased. *See* PAUL G. HASKELL, WILLS, TRUSTS AND ADMINISTRATION 25 (2d ed. 1993) (indicating that, under state law, the disclaimed interest passes as if the disclaimant had predeceased the decedent).

277 If either of the variations were adopted, it would be necessary to consider imposing a time limit so that it could be utilized only in connection with settlements or decrees made within some reasonable time after death. Somewhat analogously, I.R.C. § 2516 provides that a taxable gift does not occur in the divorce context where property is transferred in satisfaction of certain marital or support rights if the transfer occurs within a three-year period determined by the date of the settlement agreement. I.R.C. § 2516 (1994). The timing issue will be examined further *infra* in connection with a discussion of an alternative that would eliminate the consideration of state law entirely. *See infra* notes 278-89 and accompanying text.

transferred property bequeathed to that beneficiary to the decedent's spouse, the situation would be treated as if the decedent had bequeathed the property directly to the spouse. The estate then would qualify for the marital deduction, and the beneficiary would not be viewed as having made a taxable gift. This alternative would have the salutary effect of increasing the number of cases in which Congress's 1981 model is invoked.[278]

Although this alternative is somewhat similar to the treatment given disclaimers under present law, there is an important difference. Under present law, a disclaimer can be used to secure the marital deduction only if the disclaimed property passes to the spouse under state law, without any direction on the part of the disclaimant.[279] In contrast, under this alternative a non-spouse beneficiary would be permitted to transfer property to the spouse in order to secure the marital deduction for the estate, even though the property would pass under state law to someone other than the spouse if the beneficiary were to disclaim.[280] By completely eliminating the role of state law in this fashion, this alternative would appropriately make the marital deduction available whenever the transferred property, to the extent unconsumed, eventually would be subject to tax in the surviving spouse's estate. It also would make it easier for families to achieve the same tax savings that the decedent could have achieved, thus ameliorating the inequity of subjecting a family to a greater tax liability because of the decedent's oversight.[281]

To illustrate, in the example just considered, the daughter could make a gift of the property received under the decedent's will to the decedent's spouse. The family would be treated for transfer-tax purposes as if the gifted property had passed directly from the decedent to the spouse. Thus, the estate would qualify for the marital deduction, and the daughter would not be treated as having made a taxable gift. This could all be accomplished without the need for the cooperation of the daughter's child (cooperation that would be required under current law).

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278 For a discussion of the 1981 model, see *supra* notes 140-53 and accompanying text.

279 *See* I.R.C. § 2518(b)(4) (1994).

280 *See* AMERICAN L. INST., FED. ESTATE AND GIFT TAX PROJECT 40-41 (1968) (suggesting that a disclaimer should be valid for tax purposes even if the disclaimant selected the beneficiary to whom the disclaimed property would pass). In the United Kingdom, a beneficiary's transfer of assets by deed, if made within two years of the decedent's death, is treated as if the decedent had made the transfer. *See* Inheritance Tax Act, 1984, § 142 (Eng.).

281 *See supra* notes 188-90 and accompanying text.

Consider also how this alternative could be applied in the case of a QTIP trust created postmortem. If, in the example under examination, the daughter were concerned about the possibility that the spouse ultimately would bequeath the unconsumed portion of the gifted property to another beneficiary, the daughter might request that the property be placed in a trust providing that, upon the spouse's death, the remainder pass back to the daughter. Under present law, even if the daughter's child were willing to cooperate, this kind of trust arrangement could not be achieved through a disclaimer.[282] If, however, as a result of a QTIP election, the trust corpus would be includible in the spouse's estate, there would be no reason to deny the marital deduction for the property the daughter conveyed to the trust. Thus, giving recognition to the 1981 model, this alternative would permit a non-spouse beneficiary to convey property received from the decedent to a QTIP trust created postmortem.[283]

Similarly, a surviving spouse should be able to give property bequeathed to him or her to anyone he or she selects without triggering a greater tax liability than if the decedent had made the gift directly.[284] Under this alternative, a gift made by a surviving spouse after the decedent spouse's death would be treated as made directly from the decedent to the beneficiary selected by the spouse, with no gift tax imposed on the spouse and no marital deduction allowed in the decedent spouse's estate.[285] Unlike the change proposed with respect to gifts by a non-spouse beneficiary to a surviving spouse, this change cannot be justified by reference to the 1981 model. The model's premise—that the property will eventually be included in the spouse's estate—is not satisfied where it is the spouse who relinquishes the bequest. Rather, the justification derives from two principles: first, that the family ought to be permitted wide scope in rearranging the decedent's property in the post-death period; and

282 *See* Treas. Reg. §§ 25.2518-3, 25.2518-2(d), (e) (as amended in 1997).

283 Permitting the creation of a QTIP trust postmortem is similar to the way in which non-citizen surviving spouses are treated under present law. The marital deduction, currently, is not available for a bequest to a spouse who is not a U.S. citizen unless the bequest is made under a qualified domestic trust ("QDOT"). *See* I.R.C. § 2056(d)(2)(A) (1994). The surviving spouse, however, is permitted to create the necessary trust after the death of the decedent. *See* I.R.C. § 2056(d)(2)(B) (1994).

284 Non-spouse beneficiaries should also be permitted to utilize this alternative. So, for example, in the earlier hypothetical, *see supra* note 270, if the decedent's daughter made a gift to A, it should be treated as made by the decedent directly to A (with no gift tax imposed on the decedent's daughter).

285 It is desirable from a planning perspective to cause a forfeiture of the marital deduction where it is anticipated that the surviving spouse's marginal estate-tax bracket will be higher than the decedent spouse's or where the decedent spouse has overfunded the marital bequest (i.e., failed to bequeath the entire unified credit amount to a non-spouse beneficiary, resulting in the exposure of the surviving spouse to an unnecessary estate tax upon his or her subsequent death). *See generally* Pennell & Williamson, *supra* note 146.

second, that the family should not be penalized for the decedent's failure to plan properly.[286]

This alternative also would eliminate all of the problems created under the *Bosch* framework. Property actually received by the spouse would qualify for the marital deduction, whether received under a decree, by a settlement agreement, by disclaimer or by the kind of gift contemplated by this alternative.[287]

Adopting this alternative requires that consideration be given to the question of timing. It would seem inappropriate to permit a gift to qualify the estate for the marital deduction where the gift is made long after the decedent's death. Permitting the gift to be made over an extended period of time following the decedent's death would create perhaps too much potential for taxpayer abuse.[288] Thus, a time limit would have to be established. Perhaps the rule permitting gifts to qualify the estate for the marital deduction should apply only within a reasonable time period, for example, within one year of the decedent's death. But if such a time limit were adopted, it also would be necessary to consider litigated disputes. Where estate-related litigation occurs, such a one-year rule might prove too harsh. In most litigation of this kind, settlement or resolution through decree often occurs long after death, thus precluding the estate from qualifying for the marital deduction under the gift technique if the one-year rule were rigidly applied in this context. In order to permit families embroiled in litigation to utilize the gift technique, it would

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286 A spouse making a gift to a non-spouse beneficiary would, under this alternative, be given an election. The spouse could elect to have the gift treated either as made directly from the decedent to the beneficiary selected by the spouse, with no gift tax imposed on the spouse and no marital deduction allowed in the decedent spouse's estate, or as made from the decedent to the spouse in a marital-deduction-qualifying bequest, followed by a taxable gift from the spouse to the beneficiary. Under current law, a somewhat similar election is available. If the spouse disclaims, the gift passes under state law. The disclaimer effects a forfeiture of the marital deduction, and the spouse is not treated as having made a taxable gift. In the alternative, if the spouse does not disclaim but instead makes a gift of the property, the decedent's estate does qualify for the marital deduction, and the spouse is treated as having made a taxable gift. *See generally* Pennell & Williamson, *supra* note 146 (discussing the circumstances in which it is advisable in terms of planning to cause a forfeiture of the marital deduction). The crucial difference between the election this alternative would create and the election available under current law is that, under this alternative, there would be no state-law restriction on the spouse's ability to choose a beneficiary.

287 While under present law the marital deduction is forfeited where the surviving spouse relinquishes a bequest in connection with litigation, see *supra* notes 69-72 and accompanying text, this alternative would permit the spouse to avoid such a forfeiture by making the same election that would be available to a spouse relinquishing a bequest outside the litigation context. It would be illogical to impose a harsher tax regime on a family merely because it was embroiled in litigation.

288 *See* Jewett v. Commissioner, 455 U.S. 305, 316 n.17 (1982) (suggesting that an extension of the disclaimer period for too long would create too many estate-planning opportunities for taxpayers).

make sense to make an exception for property passing to the spouse under a settlement agreement or decree. In the case of litigation, the gift technique should be permitted as long as the gift is made within, say, three months after the administration of the estate is terminated.[289] To avoid taxpayer abuse (i.e., a non-adversarial litigation commenced, for example, three years after death for the sole purpose of utilizing the gift technique), it might be wise to limit the litigation exception to those cases where the litigation is commenced within a statutorily fixed period after death.

C. *Abolishing the Passing Requirement*

Finally, as a last alternative, it might be possible to make the marital deduction available even where no property actually passes into the spouse's hands, in effect abolishing the passing requirement. Whether or not the property generating the marital deduction actually passes to the spouse is of no consequence as long as it will be subject to tax in the surviving spouse's estate. One approach would be to make the deduction available for any bequest, even if made outright to a non-spouse beneficiary, provided that the surviving spouse agreed to pay estate tax on the bequest at his or her death.[290] There are practical difficulties with this approach, however. First, the estate of the surviving spouse may not have sufficient assets to pay the tax. While the non-spouse beneficiary could be made contingently liable for the tax, there would still be no assurance that sufficient assets would be available to pay the tax inasmuch as the non-spouse beneficiary might consume all of the bequeathed property prior to the surviving spouse's death. Second, under the theory of the 1981 model, where the marital deduction is allowed, the amount subject to tax in the surviving spouse's estate must include the income and appreciation that the bequeathed property generates from the date of the decedent's death to the date of the surviving spouse's death.[291] While this effect is easily realized

289 However, making the timing hinge on the termination of estate administration could invite litigation as to whether the administration of the estate was unduly delayed. *See* Brown v. United States, 890 F.2d 1329 (5th Cir. 1989) (litigation between the Service and the estate as to whether the administration of the estate had been unduly prolonged).

290 *But see* Zelenak, *supra* note 150, at 1543-4 (arguing against the QTIP provision on the ground that transfer tax should be imposed on the spouse who selects the ultimate transferee).

291 There are three kinds of trusts that can be utilized to secure the marital deduction: the QTIP trust, a trust under which the spouse is given an income interest for life and a general power of appointment, and an estate trust. *See* I.R.C. § 2056(b)(5), (7) (1994 & Supp. III 1997); Treas. Reg. § 20.2056(c)-2(b)(1) (as amended in 1994). In the case of each of these trusts, as well as in the case of an outright bequest, the amount bequeathed, together with the income and appreciation it generates, is included in the surviving spouse's estate.

under current law, whether the bequest to the spouse is outright or in a marital-deduction-eligible trust[292] for the benefit of the spouse, it would be difficult to realize where the decedent spouse made an outright bequest to a non-spouse beneficiary.[293]

Both of these difficulties, however, would be eliminated if the bequest to a non-spouse could qualify for the marital deduction only where made in trust. To illustrate, assume that the decedent spouse bequeathed property to her daughter in trust. If the surviving spouse agreed to include the trust corpus in his estate[294] and further agreed that any trust distributions of income or principal made to the daughter (or to anyone other than the surviving spouse) prior to the surviving spouse's death would be treated as his taxable gift,[295] there would be no reason to deny the marital deduction to the decedent spouse's estate.[296] The assets held in trust would provide a source for the payment of the estate tax at the surviving spouse's death. No portion of the bequest, the income it had generated or the appreciation that had accrued would escape tax in the surviving spouse's estate.[297]

292 *See supra* note 291.

293 For example, suppose that the decedent spouse bequeathed $1,000,000 to her daughter and the daughter had $1,000,000 of other assets as well. Assuming the daughter were to commingle her investments, it would be difficult to determine the amount of income and appreciation actually generated through investing the bequeathed sum. Moreover, the analysis might be further complicated by the daughter's consumption: any portion of the income or appreciation generated by the bequeathed sum that the daughter consumed prior to the surviving spouse's death would have to be calculated so that it could be subjected to tax in the surviving spouse's estate.

294 In 1969, the Treasury Department proposed a QTIP-like concept, under which the surviving spouse's consent would be necessary in order to qualify the estate for the marital deduction. *See* U.S. DEP'T OF THE TREASURY, TAX REFORM STUDIES AND PROPOSALS 358-60 (Comm. Print 1969); *see also* Abrams, *supra* note 136, at 21-24 (suggesting that the marital deduction be made available where the surviving spouse is given a terminable interest, provided that the surviving spouse agrees, first, to include in his or her estate an amount equal to the deduction taken in the decedent spouse's estate; and, second, to pay interest, from the date of the decedent's death to the date of the surviving spouse's death, on the amount of estate tax saved in the decedent's estate on account of the deduction).

295 As in the case of QTIP trusts under current law, the spouse could be given a right of recovery for any tax paid as against the person receiving a distribution from the trust. *See* I.R.C. § 2207A (1994 & Supp. III 1997).

296 This corresponds somewhat to scheme of the generation-skipping tax, which makes distributions to a beneficiary prior to the termination of the trust a taxable event. *See* I.R.C. § 2612(b) (1994) (defining a taxable distribution).

297 Under such a trust, no portion of the trust's assets could be utilized to support the spouse. The deduction, therefore, could not be justified by the aspect of the 1981 model concerned with permitting the decedent spouse's resources to be applied to the consumption needs of the surviving spouse on a tax-free basis. Nor could be it justified by the model's concern with double taxation; under current law, tax is imposed on the estate of the spouse creating such a trust, and no further tax is imposed with respect to the trust at the death of the surviving spouse. Rather, the deduction would be justified by the model's concern with reduc-

ing distortion: if the deduction were permitted, the extent to which the transfer-tax system discriminates on the basis of the content of a couple's testamentary scheme would be substantially diminished. Whether the decedent spouse provided for the surviving spouse or a non-spouse beneficiary, transfer tax would not be paid until the death of the surviving spouse, or the earlier distribution of trust assets to the non-spouse beneficiary, provided that the surviving spouse agreed.

It must be conceded that the suggestion that the marital deduction be allowed for a bequest to a non-spouse beneficiary could be viewed as somewhat radical. It should be emphasized, however, that the deduction would not generate any transfer-tax savings for wealthy taxpayers—though there might be some income-tax savings because of the basis provisions of I.R.C. § 1014 (1994 & Supp. III 1997), an issue that could be addressed in any legislation authorizing the deduction—and only modest transfer-tax savings for others. Concomitantly, the loss to the government that the deduction would generate in lost revenue would be minimal.

To illustrate, assume both spouses are subject to the maximum estate tax bracket (fifty-five percent). A bequest of one dollar to the daughter of the first spouse to die would generate fifty-five cents in tax savings were the deduction permitted. But this tax savings would be surrendered in the form of an additional estate tax of fifty-five cents at the death of the surviving spouse. And the value of the deferral—paying the tax at the surviving spouse's death rather than at the death of the first spouse to die—would be offset by the tax in the surviving spouse's estate on the income and appreciation accruing between the two deaths. *See* Pennell & Williamson, *supra* note 146, at 52. In the case of less wealthy taxpayers, although some savings might be enjoyed on account of the difference in marginal brackets between the two estates, the value of deferral would be offset as in the case of wealthy taxpayers. Moreover, the spouse making the transfer could, under present law, utilize the other spouse's marginal bracket for one-half of the transfer by making it as an inter vivos gift and electing split-gift treatment under I.R.C. § 2513 (with one-half of the tax being paid at the death of the first spouse to die and the other half being paid at the surviving spouse's death). *See* I.R.C. § 2513 (1994).

Given that little or no tax savings would be made available by permitting the deduction for a non-spouse beneficiary, one might question whether the premise suggested in support of the deduction, concern about distortion, in fact holds. While the value of the deduction may indeed be offset by an increased tax in the surviving spouse's estate, thus eliminating any distortion based on a desire to minimize tax liability, there is a psychological impulse against the early payment of tax that, irrespective of tax savings, can determine behavior. *See* Pennell & Williamson, *supra* note 146, at 49. Permitting the deduction for a gift to a non-spouse beneficiary would eliminate the distortion based on this impulse.

It should also be noted that, under current law, a trust for the benefit of a non-spouse beneficiary could be created with the transfer tax deferred until the surviving spouse's death. To illustrate, assume the decedent spouse makes an outright bequest to the surviving spouse. Assume further that the surviving spouse then makes an inter vivos gift in trust for the benefit of the non-spouse beneficiary. Provided that the surviving spouse is not legally obligated to create the trust (a legal obligation based, for example, on a constructive trust theory would lead to a denial of the marital deduction in the decedent's estate) and retains the power to alter somewhat the nature of the beneficiary's rights, no transfer tax is paid until the surviving spouse's death. *See* I.R.C. §§ 2036(a)(2), 2038 (1994) (providing for inclusion in the transferor's estate where the power to alter the beneficiary's rights is retained); Treas. Reg. § 25.2511-2 (as amended in 1983) (providing that no taxable gift is made where the transferor retains the power to alter the beneficiary's rights). *But see* Tech. Adv. Mem. 97-29-005 (Apr. 9, 1997) (invoking the doctrine of substance over form in the context of a transaction between two spouses and concluding, in effect, that one spouse acted as the agent of the other without any analysis as to whether or not the agent spouse had made a legally binding commitment to perform the undertaking).

The possibility that deferral could be achieved under current law through such a technique is significant in two respects. First, permitting the deduction in the decedent spouse's estate for a gift to a non-spouse beneficiary would allow taxpayers to achieve directly and simply what they now can achieve indirectly and only through sophisticated planning. Second, this technique produces its own distortion. A

Under current law, in contrast, in order to be eligible for a QTIP election, the trust must require that income be payable solely to the spouse and prohibit distributions of principal to anyone other than the spouse during the spouse's life.[298] In permitting the marital deduction for a bequest in trust authorizing income or principal distributions to a non-spouse, this alternative would have the positive effect of reducing distortion. A spouse who is inclined to place wealth in a trust authorizing such distributions but who is discouraged from doing so by the QTIP requirements no longer would be constrained by these requirements. This alternative also would have the positive effect of reducing the number of cases in which the marital deduction is inadvertently forfeited because the decedent's will contains a poorly drafted trust that fails to satisfy QTIP requirements.[299] Whereas a defective QTIP trust ordinarily produces double taxation,[300] such a result would not be possible under this alternative if

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spouse who wants to provide for a non-spouse beneficiary and who also wants to defer the tax until the surviving spouse's death must not, under current law, implement the arrangement through a legally binding estate plan. The spouse must instead rely on the good faith of the surviving spouse. To the extent that current law discourages the spouse from adopting a legally binding plan, it creates distortion that would not exist were the deduction permitted.

298 *See* I.R.C. § 2056(b)(7)(B)(ii) (1994).

299 A more limited alternative could be fashioned to deal with the double-taxation problem that can occur with a defective QTIP. Where trust distributions are in fact made by a defective QTIP to the surviving spouse, they will be subject to tax at the surviving spouse's death, if not consumed, even though no marital deduction is permitted in the decedent spouse's estate. Assume, for example, that the decedent spouse creates a discretionary trust with respect to income and principal and that the trust therefore does not qualify for QTIP treatment. *See* I.R.C. § 2056(b)(7) (1994 & Supp. III 1997) (providing that an election can be made only if the trust requires that income be distributed to the spouse annually). Even though the property conveyed to the trust will not qualify for the marital deduction in the decedent spouse's estate, any discretionary distributions in fact made will, if not consumed, be included in the surviving spouse's estate—thus producing double taxation. The credit provided for in I.R.C. § 2013, which is designed to ameliorate double taxation in certain circumstances, offers no assistance in this context. *See* I.R.C. § 2013 (1994 & Supp. III 1997) (providing for credit on previously-taxed transfers); *see also* Rev. Rul. 67-53, 1967-1 C.B. 265 (denying the I.R.C. § 2013 credit in the estate of the trust beneficiary where her interest under the trust is discretionary). To eliminate the double-taxation problem inherent in the defective QTIP, I.R.C. § 2013 could be expanded to provide the surviving spouse's estate with a credit for the portion of the estate tax previously paid in the decedent spouse's estate attributable to amounts actually distributed to the surviving spouse. While the credit would resolve the double-taxation issue, it would not be entirely satisfactory, for the payment of estate tax at the death of the decedent spouse reduces the resources available to the surviving spouse for consumption purposes.

300 If, for example, the trust failed to qualify for a QTIP election because the instrument authorized the trustee to invade for the benefit of a non-spouse during the surviving spouse's life, the income distributed to the spouse would nevertheless be included in the spouse's estate, even though no marital deduction is allowed in the decedent spouse's estate. *See, e.g.*, Priv. Ltr. Rul. 1999-03-031 (Jan. 22, 1999) (where trust required that income be distributed currently to the spouse and state-court decree reforming the trust prohibited principal invasions for the benefit of a non-spouse beneficiary during the spouse's life, trust was

the surviving spouse executed the necessary agreement and thereby secured the marital deduction for the decedent's estate.[301] In completely abolishing the passing requirement, this alternative would achieve these positive effects without violating the 1981 model. Indeed, this alternative is attractive precisely because it implements the model[302] more aggressively than does any of the other alternatives.[303]

In sum, at the very least, one of the overrule-*Bosch* alternatives should be adopted in order to eliminate the problems created by the *Bosch* framework.

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not eligible for QTIP election, even though distributed income would be taxable in the spouse's estate, because the prohibition in the decree was disregarded under *Bosch*).

301 One might argue that it is inappropriate to remove the required provisions that are protective of surviving spouses. *See* Fellows, *supra* note 150; Gerzog, *supra* note 150 (arguing that the QTIP provision is problematic because it increases the use of trusts in connection with marital bequests, thereby diminishing the protection enjoyed by surviving spouses). *But see* Zelenak, *supra* note 150. As indicated earlier, however, the current requirements can produce distortion and double taxation. *See supra* notes 158-61 and accompanying text. State law might be better suited to providing appropriate protection for surviving spouses. Whereas, for example, relevant variables like the length of the marriage can be easily taken into account in formulating the elective share, *see, e.g.*, UNIF. PROBATE CODE § 2-201 (amended 1993), 8 U.L.A. 101 (1998) (making the elective share a function of the length of the marriage), few, presumably, would maintain that the portion of the estate qualifying for the marital deduction should be made dependent upon such a variable. Given the necessity for the surviving spouse's consent, this alternative neither leaves the surviving spouse entirely without protection nor fails to respect the surviving spouse's autonomy. *See* Estate of Clayton v. Commissioner, 976 F.2d 1486, 1498 (5th Cir. 1992) (indicating that if, in enacting the QTIP provision, Congress had been concerned about providing protection for surviving spouses, it would have given the power to make the QTIP election to the surviving spouse); *see also* sources cited *supra* note 150. Indeed, in the debate over whether the transfer-tax system should be retained, the proponents do not defend the system on the ground that it provides protection for surviving spouses. *See, e.g.*, Anne L. Alsott, *The Uneasy Liberal Case Against Income and Wealth Transfer Taxation: A Response to Professor McCaffery*, 51 TAX L. REV. 363 (1996); Graetz, *supra* note 144. Nevertheless, some might argue that the need to provide protection for the surviving spouse justifies the resulting distortion and double taxation and that it is appropriate to use federal tax law (rather than state law) to encourage or provide such protection. *See* Joseph M. Dodge, *A Feminist Perspective on the QTIP Trust and the Unlimited Marital Deduction*, 76 N.C. L. REV. 1729 (1998) (rejecting as justification for the QTIP provision, first, an argument based upon a concern about distortion and, second, an argument that it is more appropriate to allow state law to control the level of protection afforded surviving spouses).

302 *See supra* note 297.

303 If the actual-passing alternative were adopted instead and the decedent spouse's will contained a trust not qualifying for QTIP treatment, no marital deduction would be permitted. In all probability, the deduction could not be secured by a post-death gift because, as a matter of state law, the beneficial interests under the trust could not be sufficiently altered so as to enable the beneficiaries to make the necessary gift to the spouse. *See* Gregory S. Alexander, *The Dead Hand and the Law of Trusts in the Nineteenth Century*, 37 STAN. L. REV. 1189, 1191 (1985) (discussing the so-called *Claflin* doctrine, under which the beneficiaries of a testamentary trust are generally unable to alter the terms of the trust). As a consequence, double taxation probably would occur, because any distribution from the trust to the spouse would be subject to tax in the spouse's estate even though no marital deduction is permitted, and the model would be violated. In contrast, under this alternative, assuming the spouse agreed to be subject to tax on the trust's assets, the model would be respected, and double taxation would be avoided.

However, an alternative that would make state law entirely irrelevant and that would therefore more aggressively implement the 1981 model would be preferable.

CONCLUSION

The marital deduction's passing requirement overemphasizes state law. This overemphasis can be cured in several ways. At the very least, *Bosch* should be overruled, while leaving the role that state law plays in the marital deduction otherwise intact. Under more ambitious approaches, state law would cease to have any relevance. Instead, the availability of the deduction would turn upon the 1981 model. As long as the unconsumed portion of the decedent spouse's property ultimately would be subject to tax at the death of the surviving spouse, the decedent spouse's estate would qualify for the deduction.