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not sound the death knell to the spendthrift provision; rather, it is probably more accurate to interpret it as being a monument to poor draftsmanship. The spendthrift clause in that case simply did not go far enough — the clause stated that a beneficiary could not voluntarily alienate his interest, but provided no discretionary or forfeiture clause if the alienation was, in fact, accomplished. So it would appear that a well drafted spendthrift provision is still valid in Ohio. But will such a spendthrift clause have adverse tax effects on the marital deduction? It is clear from the regulations that a spendthrift provision will not disqualify a trust from the marital deduction; but a provision authorizing any person other than the surviving spouse to deprive her of her right to income will disqualify the trust for the marital deduction.46 And to have an effective spendthrift provision in Ohio, if indeed you can have one at all, would require that a person, other than the surviving spouse, must have discretionary authority over income if it is not to be subject to the claims of creditors. Thus, the type of spendthrift clause that will effect a satisfactory solution as to claims of creditors may have the unhappy effect of disqualifying a trust for the marital deduction.

III

"PECUNIARY FORMULA" MARITAL DEDUCTION BEQUESTS:
APPLICATION OF REVENUE PROCEDURE 64-19

Norman A. Sugarman*

BACKGROUND

One of the most important and controversial developments in the federal estate tax in recent years cumulated in the issuance of Revenue Procedure 64-19. Although designed to resolve a highly important technical problem, the implications and controversy over the application of Rev Proc. 64-19 are likely to exist for many years. This development rivals the 1948 enactment of the marital deduction itself in raising the question whether lawyers should re-examine all wills and trusts to determine whether they qualify for the marital deduction benefits Congress granted under the federal estate tax.

Nature of the Problem

In brief, Rev Proc. 64-19 holds that a form of pecuniary formula marital deduction bequest that apparently has been widely used does

not, in the view of the Internal Revenue Service, qualify for the marital deduction. The Rev Proc. does provide a method of correction for instruments executed prior to October 1, 1964, whereby upon the execution of additional agreements interpreting the otherwise condemned marital deduction clause, the Service will allow the marital deduction. However, this method is also not without its problems; and in any event it leaves open to the lawyer the problem of what should be done with regard to the drafting of new instruments where the marital deduction is desired.

The problem to which Rev Proc. 64-19 is directed arises in connection with both bequests and transfers in trusts where the document contains a "pecuniary formula" marital deduction gift. For convenience the problem to be discussed will be referred to in terms of bequests, although the reader should understand that the same problem and considerations apply to any transfer in trust which falls into the gross estate, where the trust instrument contains a pecuniary formula marital deduction clause.2

The genesis and nature of the problem may be illustrated by the following hypothetical example. Assume the potential estate picture is that shown in columns (A) and (B) below when the lawyer is called upon to draft a marital deduction clause.

<table>
<thead>
<tr>
<th>(A)</th>
<th>(B)</th>
<th>(C)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Estate</td>
<td>Estate Tax</td>
<td>Value at Date</td>
</tr>
<tr>
<td>Cash</td>
<td>$100,000</td>
<td>Value of Distribution</td>
</tr>
<tr>
<td>Stock X</td>
<td>$500,000</td>
<td>$800,000</td>
</tr>
<tr>
<td>Stock Y</td>
<td>$500,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>Debts and administrative expenses</td>
<td>$100,000</td>
<td></td>
</tr>
</tbody>
</table>

In this situation, the lawyer may desire or be instructed to draft a marital deduction clause to accomplish the following:

(1) To secure the maximum marital deduction, an amount equal to $500,000.

(2) To permit flexibility in the distribution of property and avoid joint interests, i.e., avoid giving the widow a half interest in both Stock X and Stock Y. To accomplish this the executor should be authorized to select assets and make distributions in kind,*

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* The author gratefully acknowledges the assistance of George L. Ford and Robert M. Brucken, members of the Ohio Bar, in the preparation of this article.


2. An example is a revocable inter vivos trust where property is to be allocated to a marital deduction trust on the death of the grantor.
such as to distribute all of the shares of one stock to the surviving spouse and other shares to other beneficiaries.

(3) To avoid a capital gains tax. This could occur, under the position taken by the Internal Revenue Service, if property which has appreciated in value from the date of death is used to satisfy a pecuniary bequest. For example if the pecuniary bequest created an obligation to pay $500,000 and the executor satisfied it by the transfer of shares of Stock X which had appreciated in value, so that only 5/8ths of the total number of shares of Stock X were necessary to satisfy the bequest, there would be a capital gain to the estate equal to the appreciation. One method of avoiding this unwanted capital gain would be to permit the executor to use values determined for estate tax purposes in valuing property distributed in kind to satisfy pecuniary bequests, so that the basis for tax purposes of the property equals the obligation being satisfied and hence no taxable gain results.

(4) To permit “post mortem tax planning.” For example, if the surviving spouse turns out not to need the marital deduction property or is otherwise assured of care and support, then as a matter of tax planning it might be best that the executor distribute to her assets which have depreciated in value, or wasting assets, so that any estate tax upon her death would be minimized. Thus in the above example, post mortem estate planning might indicate the wisdom of distributing to the surviving spouse Stock Y which at the date of distribution had a value of only $400,000 and distributing to the children Stock X which had appreciated in value, thereby causing a tax free shift in growth and equities to the next generation without, hopefully, sacrificing the immediate $500,000 marital deduction which is desired.

A marital deduction clause which evolved to accomplish the above four objectives came to have the following three principal elements:

(1) A formula providing for a pecuniary amount equal to the maximum marital deduction;

(2) Provision that the fiduciary may, or is required to, select assets in kind to satisfy the bequest, i.e., the bequest is not solely payable in cash; and

(3) Provision that the assets distributed in kind are to be valued at values determined for estate tax purposes.

A commonly used pecuniary formula clause appears in Exhibit A.

in the appendix to this article. It will be noted that the basic clause provides for the computation of the maximum marital deduction at values determined for federal estate tax purposes. This is merely an attempt to gain the maximum marital deduction and is not the evil with which the Service is concerned. The additional clause contained in item 2 of Exhibit A provides that in making distributions the estate tax values are to be used, as distinguished from values current at date of distribution. It is this additional clause in the above example which would specifically authorize the executor to distribute Stock Y to the surviving spouse, and it is this to which the Service objects.

Valuing Property

The Service is also similarly concerned in any case in which a pecuniary marital deduction clause is used and there is no direction as to the values which the fiduciary is to use in making distribution, such as that in item 1 of Exhibit A. In such case the Service is concerned that the fiduciary may use estate tax values (generally date of death) for valuing property, rather than values current at the date of distribution, with the same result as if the instrument specifically so authorized the use of estate tax values, as in item 2 of Exhibit A.

The reasons for the Internal Revenue Service's concern in such cases and its issuance of Rev. Proc. 64-19 are based on both technical grounds and tax policy. The technical grounds stated in the Rev. Proc. are that "the interest in property passing from the decedent to his surviving spouse would not be ascertainable as of the date of death, if the property available for distribution included assets which might fluctuate in value."4 This reason is barely persuasive or specific and it might better be stated as encompassing various additional grounds such as that the marital deduction is allowed only with respect to an interest which is vested in the surviving spouse at the date of death; the marital deduction is not allowable where the executor or trustee has power to divert property to a person other than the surviving spouse;5 and the marital deduction is not allowable where the interest passing from the decedent to the surviving spouse is a "terminable interest"6 — "terminable" because the fiduciary has the authority to select depreciating assets.

4. Rev. Proc. 64-19, § 2.03, at 30-31. The question of whether the condemned clause qualified for the marital deduction was earlier raised in 1 Casner, Estate Planning 783, 815 (3d ed. 1961). The issue was raised in I.R.S. field offices and referred to the National Office on "request for technical advice" about 1961.
In short, the uncertainty as to what, if anything of value may pass to the surviving spouse under the pecuniary formula clause previously described is regarded by the Service as justification for putting the estate claiming the marital deduction to proof that it is entitled, under such circumstances, to the marital deduction. Since the testamentary instrument must speak as of the date of death, the Rev. Proc. conclusively determines that no vested interest passes to the surviving spouse and the marital deduction is not allowable.

On policy grounds, the Service is alarmed at such post mortem tax planning as may have the effect of transferring property free of estate or gift tax to future generations from the surviving spouse, under a statute which exempted the property from the husband’s estate presumably because it would bear a tax on transfer from the surviving spouse. Thus Rev. Proc. 64-19 was issued to clamp down on what the Service regarded as an abuse contrary to the intention of Congress in enacting the marital deduction statute.

THE INTERNAL REVENUE SERVICE POSITION AS SET FORTH IN REVENUE PROCEDURE 64-19

There are two aspects of the Internal Revenue Service position as stated in Rev. Proc. 64-19 which are of overriding importance:

First. Rev. Proc. 64-19 condemns only a certain limited type of marital deduction clause, not all marital deduction clauses.

Second. With regard to such condemned marital deduction clause, the Rev. Proc. denies the marital deduction clause gift completely and not just in part.

The typical marital deduction clause which is condemned by Rev. Proc. 64-19 is a pecuniary formula clause which has the three elements previously described. This is illustrated by items 1 and 2 of Exhibit A. In short the prime element of such a clause which runs afoul of Rev. Proc. 64-19 is that the fiduciary is required to or may use estate tax values, without regard to values at date of distribution, in distributing assets to satisfy the bequest to the surviving spouse under a pecuniary formula or non-formula clause.

Situations to Which Revenue Procedure 64-19 Does Not Apply

It is equally important to be aware of marital deduction situations to which Rev. Proc. 64-19 does not apply. These are:

(1) A bequest solely in cash.

7. See p. 259 supra.
(2) A bequest of specific property.\textsuperscript{9} Rev Proc. 64-19 should also have no application to a bequest of a class of property, for example, "all of my real estate."

(3) A fractional share bequest.\textsuperscript{10} A fractional share bequest is illustrated in Exhibit B in the appendix to this article. Rev Proc. 64-19 specifically provides that it is not applicable to "a bequest or transfer in trust of a fractional share of the estate, under which each beneficiary shares proportionately in the appreciation or depreciation of the value of assets to the date, or dates, of distribution."\textsuperscript{11}

(4) A pecuniary bequest where under the state law or provisions of the instrument it is clear that the fiduciary must distribute assets, including cash, fairly representative of appreciation or depreciation in the value of all property available for distribution.\textsuperscript{12} Rev Proc. 64-19 does not apply to such a marital deduction situation because, of course, the Rev Proc. is directed to a situation where the surviving spouse would not fairly share in the appreciation or depreciation in property available for distribution. An example of a marital deduction provision of the type thus excepted from Rev Proc. 64-19 is found in Exhibit A with clauses 1 and 4.

(5) A pecuniary bequest where under state law or provisions of the instrument it is clear that the fiduciary must distribute assets, including cash, having an aggregate fair market value at the date or dates of distribution amounting to no less than the amount of the pecuniary bequest as determined for federal estate tax purposes.\textsuperscript{13} This type of marital deduction situation is excepted from Rev Proc. 64-19 because the surviving spouse will generally obtain no less than the dollar amount of the pecuniary bequest as determined for federal estate tax purposes. Thus even though the surviving spouse does not share in appreciation, the surviving spouse in such case is not subject to depreciation of the value of her bequest. An example of a marital deduction clause of this type is found in Exhibit A by combining items 1 and 5.

(6) A bequest where any one or more of the elements of the condemned pecuniary formula clause is absent. These elements are the ones previously referred to.\textsuperscript{14} An example is a pecuniary bequest where under the state law or provisions of the instrument it

\begin{footnotes}
\footnote{9. Rev. Proc. 64-19, § 4.01 (2), at 30, 32.}
\footnote{10. Rev. Proc. 64-19, § 4.01 (1), at 30, 32.}
\footnote{11. \textit{Ibid}.}
\footnote{12. Rev. Proc. 64-19, § 2.02, at 30, 31.}
\footnote{13. \textit{Ibid}.}
\footnote{14. See p. 259 supra; see also Rev. Proc. 64-19, § 4.01 (3) (b), at 30, 32.}
\end{footnotes}
is clear that assets selected by the fiduciary to be distributed in kind in satisfaction of the bequest are required to be valued at their respective values on the date, or dates, of their distribution.\textsuperscript{15}

Situations to Which Revenue Procedure 64-19 is Directed

The above exceptions to the application of Rev. Proc. 64-19 indicate that a careful reading of the Rev. Proc. is necessary and that it is not applicable to all marital deduction clauses. The danger, however, in the present situation is that some Service personnel and counsel may become confused to the point of considering that the only marital deduction clause that may be used in the future is that which Rev. Proc. 64-19 approves by including it in the agreements suggested by the Service to overcome the defect of the condemned pecuniary formula clause. The provision is contained in Exhibit D in the appendix to this article, and is referred to in paragraph (4) above. There are of course many other marital deduction clauses that may be used and which will continue to qualify for the marital deduction. These will be discussed later.

Another danger is that Service personnel will fail to distinguish between the various marital deduction clauses and require the agreements provided under Rev. Proc. 64-19 to be executed in all cases even though the particular instrument does not run afoul of Rev. Proc. 64-19. As will be seen later, the fiduciary has an obligation to determine the applicability of the Rev. Proc. and whether such an agreement should be executed in the light of all the circumstances, particularly the intent of the testator. Rev. Proc. 64-19 certainly does not require all marital deduction clauses to conform to a particular pattern; it merely condemns a clause which requires or may permit an unfair selection of assets by the fiduciary against the surviving spouse.

Having determined the limited type of situation to which Rev. Proc. 64-19 is directed, it should be emphasized that in such a situation, it is the Service position that no marital deduction is permitted under such a clause even though in fact there is a distribution of assets to the surviving spouse. For instance, in the example stated at the outset of this article,\textsuperscript{16} if the fiduciary distributed Stock Y to the surviving spouse and Stock X to the other beneficiaries under a pecuniary formula marital deduction clause, permitting the fiduciary to select assets for distribution at values based upon estate tax values, the Service would disallow the marital deduction completely even though in fact the surviving spouse received Stock Y which at the date of distribution had a value of $400,000. The position of the Service would be that as of the date of death the interest in property passing to the surviving spouse was not ascertainable. It

\textsuperscript{15} Rev. Proc. 64-19, § 4.01(3) (c), at 30, 32.

\textsuperscript{16} See p. 258 supra.
should be pointed out, of course, that if the same instrument contained a
cash bequest to the surviving spouse or a devise of the decedent’s resi-
dence to the surviving spouse, such cash bequest or bequest of specific
property would qualify for the marital deduction, unaffected by any
defect that would exist by reason of the pecuniary formula marital deduc-
tion clause.

The Internal Revenue Service, having thus stated its position in Rev.
Proc. 64-19, at the same time recognized that it could be creating a
hardship and condemning a marital deduction clause that may have been
innocently used on a wide spread basis. Accordingly, Rev Proc. 64-19
contains its own escape clause offering an opportunity to limit its retro-
active effect. It provides that where the Rev Proc. would otherwise be
applicable, the marital deduction will nevertheless be allowed if the fi-
duciary and the surviving spouse executed agreements to the effect that
the assets of the estate available for distribution will be so distributed
dthat the cash and other property distributed in satisfaction of the marital
deduction bequest will be fairly representative of the net appreciation
or depreciation in the value of the available property on the date or
dates of distribution. These agreements appear in Exhibits C and D in
the appendix to this article. The wisdom of signing these agreements
will be discussed later. It is clear, however, that it is the position of the
Internal Revenue Service that if the pecuniary formula marital deduc-
tion clause is of the condemned type under Rev Proc. 64-19 and if the agree-
ment is not filed with the Internal Revenue Service, the marital deduction
will be disallowed.

It should be emphasized that with respect to instruments executed
on or after October 1, 1964 the option of filing the above agreements
is not available; in such cases it is the position of the Service that the
instruments must comply with Rev Proc. 64-19 or the formula clause
marital deduction will be disallowed.

Anyone refusing to recognize Rev Proc. 64-19 or to comply therewith in
drafting marital deduction clauses does so, of course, at his own
risk. While it is impossible to point to a specific provision of the statute
and regulations directly upholding the Service’s position, the technical
grounds of the Service position must be recognized. The weakness in
the Service position, however, is that it is based on a refusal to recognize
the fiduciary’s duty of impartiality. In short, the Service in Rev Proc.
64-19 has expressed its suspicion that where the state law or the instru-
ment is not clear on the point, the fiduciary is likely to engage in post
mortem tax planning so as to “unfairly” allocate assets between the sur-
viving spouse and other beneficiaries with the view of minimizing the
second estate tax upon the death of the surviving spouse. This view,

17 Rev. Proc. 64-19, § 3.01, at 30, 31; see §§ 5.01-.02, at 30, 32-33.
that the fiduciary will not act fairly among the distributees is not of course in accordance with the general concept of the fiduciary's responsibility as a trustee. As one writer points out in a subsequent article in this Symposium, cases in which it appears the Service would apply Rev. Proc. 64-19 have been construed by the state courts as requiring a duty of fairness in distribution on the part of the fiduciary.

The Service, however, has had a long history of looking at state court decisions with a jaundiced eye and having the natural suspicion of the tax administrator that the parties may arrange their affairs for the maximum tax advantage regardless of general concepts under state law. Of course, the literature with respect to post mortem tax planning has helped to fan the Service suspicion in this area. Moreover, the Service can argue that each case must stand on its own, because in any state court proceeding the principal issue must be the intent of the particular testator, and therefore the Service cannot be bound by general principles of trust law but must look to the particular facts and circumstances pertinent to each estate.

Rev. Proc. 64-19 is the Service's attempt, through a warning for the future and an administrative procedure of agreements with respect to past transactions, to ward off controversy and litigation with unfortunate results to the taxpayers. However, the position of the Service is being litigated in the Tax Court in Estate of Daniel J Walsh. Whether this case will result in new light or more confusion under Rev. Proc. 64-19 remains to be seen and is hardly a subject of worthwhile speculation at this time.

PROBLEMS AND POSSIBLE STEPS TO BE TAKEN
IN LIGHT OF REVENUE PROCEDURE 64-19

The question of what to do in the light of Rev Proc. 64-19 may arise in three different situations, each of which presents its own considerations.

First. Where the problem is presently at hand, i.e., there is presently an estate or for other reasons the die is cast in the form of an instrument containing a condemned pecuniary formula marital deduction clause, such as one that cannot be amended.

Second. Where there is an instrument presently in effect which may be defective under Rev Proc. 64-19 but it can be amended or rewritten.

20. Generally, the I.R.S. is reluctant to accept state court decisions unless rendered in adversary proceedings. Reg. § 20.2056(e)-2(d) (1958).
Third. Where a new instrument is to be drawn and the question is what clause should be used to obtain a marital deduction in view of Rev Proc. 64-19

These three situations will now be considered.

Problem Presently at Hand

The first consideration, where the problem is presently at hand, is whether the agreements provided under Rev Proc. 64-19 should be filed.

Should the agreement be signed. Tax considerations.—From a tax viewpoint the principal reason for filing the agreements which are provided under the Rev Proc. is to assure the allowance of a marital deduction. On the other hand, it should be recognized that, if the surviving spouse files the agreement and upon a subsequent audit it is determined that she did not receive cash or other property in satisfaction of the bequest which was fairly representative of her proportionate share of appreciation in value of the property to the date or dates of distribution, the Service may take the position that she made a gift to the other beneficiaries or heirs with respect to the value which the Service claims she should have received but did not. The gift tax may be a serious problem depending upon the size of the estate involved; and a gift tax imposed upon the surviving spouse with the full benefits of the gift tax exemption and exclusions may not be a very high price to pay for the full allowance of the marital deduction in the estate of her husband.

Furthermore, income taxes cannot be ignored in considering whether to file the agreement prescribed by Rev Proc. 64-19. Under the agreement, the surviving spouse must receive her share of the assets which may result in her receiving assets productive of income, and hence incur income taxes, which the parties might otherwise desire to minimize by the allocation of such assets to other beneficiaries. Rev Proc. 64-19 is silent on this matter. In fact, the Rev Proc. states that it does not relate to any issue arising under the income tax provisions of the Internal Revenue Code. It would appear that Rev Proc. 64-19 is directed only to an allocation of assets fairly among the beneficiaries based upon value at the date of distribution and the fact that one asset may be productive

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22. In this respect, it should be pointed out that Rev. Proc. 64-19 does not prohibit post mortem tax planning. The net effect of the application of the agreements provided under the Rev. Proc. may be the same as a fractional share marital deduction bequest with a gift by the surviving spouse of part of her interest in order to reduce future estate taxes. It is noted that Rev. Proc. 64-19 does not apply the strict rule of Code § 2056(d) which disallows the marital deduction for an interest disclaimed by the surviving spouse. Cf. Issac Harter, 39 T.C. 511 (1962), acq., 1963 INT. REV. BULL. No. 34, at 6, where the marital deduction was allowed regardless of gifts by the surviving spouse.

of more income than another would not prevent the fiduciary from making a selection based upon future income being received by one beneficiary rather than another, so long as at the date of distribution the values were fairly represented. On the other hand, the caveat in Rev. Proc. 64-19 may indicate that the Service is engaging in watchful waiting to see whether any income tax abuses arise requiring it to make a further announcement.

_Fiduciary’s authority._—A fundamental question which the fiduciary must decide is whether execution of the agreement provided by Rev. Proc. 64-19 is within the fiduciary’s authority. Here the fiduciary faces the peculiar problem that if the intention of the testator or the state law is clear that the surviving spouse is to share in the appreciation or depreciation under the marital deduction formula bequest, then, by the terms of Rev Proc. 64-19 the agreement is not necessary; but if the Service insists on it, the executor could hardly complain on grounds of lack of authority. On the other hand, if the instrument is not clear and the state law in such case does not supply a clear answer excepting the instrument from Rev. Proc. 64-19, or if in fact the instrument is reasonably clear that the fiduciary is to make distributions in a manner condemned under Rev. Proc. 64-19, the agreements are then necessary to obtain the marital deduction; but in such a case the executor may be called upon to sign an agreement which may not clearly reflect the intent of the testator. The fiduciary must therefore decide whether the overriding intent of the testator was to obtain the marital deduction or whether his intent, regardless of the marital deduction consequences, was to limit the property to be distributed to the surviving spouse.

In such cases, if the agreement is not necessary there is likely to be no problem of lack of authority; but if the agreement is necessary this very fact alone may raise the question of lack of authority. It is at this point that some authorities feel the fiduciary is skating on thin ice if he acts without court approval.

The problem may be complicated by disagreements among the beneficiaries. It is conceivable that the surviving spouse may refuse to sign the agreement provided under Rev Proc. 64-19 and insist upon a distribution of property to her without regard to questions being raised by the Service as to the marital deduction. In such a case the burden of the loss of the marital deduction could substantially wipe out the interest of other beneficiaries — which of course may be the very reason a spiteful spouse might refuse to sign the agreement.

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24. The fiduciary may have other reasons for refusing to sign an unnecessary agreement, including the added costs and problems in administration that may result as discussed later herein.

Administrative problems.—The decision to sign the agreements can hardly be made without knowing what they mean. At this stage their effect in administration is not clear, but that they will have some effect is certain.

In the first place, the agreements to be signed by the fiduciary and by the surviving spouse both clearly contemplate reporting to the Internal Revenue Service as to the operations of the estate. This is bound to add to the burdens of administration. Moreover, the application of the agreements involves matters of judgment as to valuations, including valuations at the time of various distributions. Thus not only must the value of assets included in the gross estate be determined as of the date of death, as in the normal case, but estate tax problems will be multiplied many fold by reason of the fact that a valuation will be necessary every time there is a distribution. The fiduciary is subject to being second guessed by Service representatives as to the values at the time of distribution, with resulting important and unpleasant tax consequences.

Moreover, the marital deduction clause provided under the agreements, under which the surviving spouse is entitled to her share of appreciation or depreciation, is not necessarily the clause which is most desired. The agreements result in the Treasury fixing the form of the marital deduction bequest. There are several other forms for marital deduction bequests, described later, which may be preferable both as to the surviving spouse’s share and in administration. If the instrument can be construed as encompassing one of the other types of bequests this may be preferable to signing the agreement.

Timing. When should the agreement be filed?—Rev Proc. 64-19 is silent on the point of when the agreements are to be filed. Where there is already a present estate, there may have been distributions prior to the earliest date the agreements under the Rev Proc. could be filed. It is not clear what effect the Rev Proc. and the agreements have where distributions have previously been made, including situations where the surviving spouse did not share in appreciation in prior distributions. The Rev Proc. is, however, open enough to permit this to be corrected by subsequent distributions. For example, assume the adjusted gross estate is $1,000,000 at date of death, the widow and a son are each entitled to fifty per cent, and $700,000 of assets are distributed to the son at a time when the estate assets have appreciated to $2,000,000 in value. What distribution is to be made to the surviving spouse after the filing of the agreement and upon ultimate distribution of the estate? If on the date of ultimate distribution the estate assets have shrunk from $1,300,000 (the balance after the distribution to the son) to $800,000, the surviving spouse would be entitled to 10/13 ($1,000,000/$1,300,000) of the
$800,000 or $615,000 and the son would be entitled to 3/13 of $800,000 or $185,000.

Since Rev Proc. 64-19 is silent as to the date the agreements must be filed, presumably decisions as to whether and when they should be filed can be delayed until the earlier of (a) the Service is insistent on it, with disallowance of the marital deduction as the penalty for failure to file or (b) distributions are about to be made of such a substantial part of the estate that the Service may not accept the agreements if filed after such distributions, on the ground that the agreements would have no substantial application. 26

Alternatives.—This points up the alternatives that may be available to the filing of the agreements. One alternative is to do nothing until the last minute — waiting for a reversal of the Service position either through litigation or legislation. Litigation may be of doubtful help not only because of the long time that may be involved before an appellate court decision could be obtained but also because of distinguishing features that each case may have. While legislation at the federal level is unlikely, it is possible that some states may adopt legislation which will have the effect of clarifying the state law so that current values must be used in making distributions under clauses otherwise condemned by Rev Proc. 64-19. 27 This may be the surest and shortest route to a solution.

26. Rev. Proc. 64-19, § 3.01, at 30, 31, and the agreement to be executed by the Fiduciary (Exhibit D at the end of this article) both contemplate application to future distributions. On the other hand, if in fact distributions have been made as so contemplated, the agreements may not be necessary but should be accepted by I.R.S. as a basis for closing the case.

27. Mississippi recently adopted the following provision:

That whenever under any last will and testament the executor or other fiduciary, is required to, or has an option to, satisfy a pecuniary bequest to the surviving spouse of the testator, or to a trust for the benefit of a surviving spouse, by a transfer of assets of the estate in kind at values determined for federal estate tax purposes, the executor or other fiduciary shall be required to satisfy such pecuniary bequest by the distribution to the surviving spouse or trustee of either:

1) Assets having an aggregate fair market value, on the dates of distribution, not less than the amount of the pecuniary bequest or transfer in trust as finally determined for federal estate tax purposes, or

2) assets fairly representative of appreciation or depreciation in the value of all property available for distribution in satisfaction of the pecuniary bequest or transfer.

Agreement as to distribution of assets. — That the executor, trustee, or other fiduciary having discretionary powers under a last will and testament or transfer in trust shall be authorized to enter into agreements with the Commissioner of Internal Revenue of the United States of America, and other taxing authorities, to exercise the fiduciary's discretion so that the assets to be distributed in satisfaction of a bequest or transfer in trust will be selected in such a manner that cash and other properties distributed have an aggregate fair market value representative of the pecuniary legatee's or transferee's proportionate share of the appreciation or depreciation in value to the date, or dates, of distribution of all property then available for distribution in satisfaction of such bequest or transfer. It being the purpose of this act to authorize such fiduciary to enter into any agreement that may be necessary or advisable in order to secure for Federal estate tax purposes the maximum marital deduction available under the Internal Revenue Laws of the United States of America and to do and perform all acts incident to such purpose. Miss. Laws
A second alternative is to obtain a state court determination specifically construing the marital deduction clause so that its terms do not have a meaning falling within the condemnation of Rev Proc. 64-19. This may be a determination, for example, that the fiduciary in order to implement the bequest to the surviving spouse must distribute assets, including cash, having an aggregate fair market value at the date or dates of distribution amounting to no less than the amount of the pecuniary bequest or transfer as finally determined for federal estate tax purposes. This would have the effect of construing the will as having substantially the meaning of the clause contained in item 5 of Exhibit A. Whether the instrument is given this construction, or some other construction which qualifies for the marital deduction and falls outside the adverse rule of the Rev Proc. is not important since the construction determination would have the same effect; the important point for this purpose is that the instrument be construed under the state law so that the marital deduction clause is excepted from Rev Proc. 64-19.

It is not likely that the Service would contest the validity or applicability of a state court decision of this type, assuming it is honored in the actual administration of the estate by the fiduciary. This is because Rev Proc. 64-19 itself declares the marital deduction is not to be denied where the duty of the fiduciary under the applicable state law is clearly of a type excepted from the adverse rule of the Rev Proc. Moreover, the Service can hardly complain of a state court construction clarifying a marital deduction clause by agreement when the Rev Proc. itself provides for an agreement as the effective corrective device.

There is an Instrument Presently in Effect Which May be Defective Under Revenue Procedure 64-19, But it Can be Amended or Rewritten

A second situation in which the question arises as to what to do about Rev Proc. 64-19 is where the die is not yet cast but may be unless the attorney takes steps to amend or rewrite an existing instrument. In this situation a course of "wait and see" may be adopted but is more dangerous. As previously pointed out, counsel may choose presently to do nothing on the ground that a reversal of Rev Proc. 64-19, by litigation or legislation, may be forthcoming or on the ground that at the appropriate time, if necessary, a favorable construction excepting the instrument from Rev Proc. 64-19 can be obtained in the state court.

The risks in such inaction are obvious; for events, such as the client's death or incompetency, may freeze the situation without choice. However, there is the question whether the lawyer has an obligation to review

1964, S.B. 2059 (effective June 5, 1964). However, the Service has indicated that the legislation will not accomplish its purpose because it is in the alternative and gives the fiduciary an opportunity for post mortem tax planning.

28. See Appendix at p. 277 infra.
all testamentary instruments he previously drafted and has the right to notify all persons for whom he drafted such instruments, with the view of possibly amending or rewriting the instruments, if necessary, in the light of Rev. Proc. 64-19. This could impose a tremendous workload on some lawyers. It also involves the practical problem of being able to be paid for reviewing and rewriting an instrument already in effect. For the most part however the problem is similar to and can be resolved in the same way as the problem which arose in 1948 when the marital deduction statute was enacted and lawyers were faced with the fact that instruments they had previously written may or may not have provided for the benefits of the marital deduction.

A note of caution must be expressed with regard to the execution of a codicil or trust amendment. For example, a codicil of course could take the form of completely rewriting the marital deduction clause or other parts of the instrument or could take the form of a simple amendment which would add a clause to the effect that the instrument is to be construed so as to limit the fiduciary's discretion in such respects as is necessary to qualify for the marital deduction. Such a codicil is likely to be a makeshift, however, and certainly a re-examination of the entire instrument and rewriting of the basic clauses would be advisable. The type of marital deduction clauses that may be used for the future, in the light of Rev. Proc. 64-19, is discussed later.

However, attention should be called to the fact that amending an instrument or executing a codicil merely to authorize the executor or fiduciary to execute the agreement provided for under Rev. Proc. 64-19 is not likely to be helpful and may be dangerous. The agreement provided in Rev. Proc. 64-19 may be filed only in the case of instruments executed before October 1, 1964. If a person has a will with a possibly defective marital deduction clause under Rev Proc. 64-19 which was executed before October 1, 1964 — will the execution of a codicil on or after October 1, 1964 make the instrument one which is no longer susceptible of being cured by an agreement under Rev. Proc. 64-19? It is believed that it was not the intention of the Internal Revenue Service so to trick anyone into losing his right to execute an agreement under Rev. Proc. 64-19 with respect to a will executed prior to October 1, 1964. However, one author has pointed out that a codicil executed after October 1, 1964 may have just such an effect.29

be used in drafting instruments in the future. As previously stated Rev
Proc. 64-19 is directed to one type of marital deduction clause in a fairly
limited situation. It still leaves available the use of other types of mar-
tal deduction clauses.

Basically, Rev Proc. 64-19 still leaves available and requires in turn
a choice between two kinds of marital deduction formula clauses: (1) A
fractional share and (2) a pecuniary gift of a type other than that con-
demned by Rev Proc. 64-19. There are variations of clauses falling in
these two categories; but Rev Proc. 64-19 in effect requires the use of
a clause in one of these two, as distinguished from a third type previously
used, namely a pecuniary formula clause with the bequest to be satisfied
with assets valued at estate tax values. Following are types of marital
deduction clauses which continue to qualify for the marital deduction and
are excepted from Rev Proc. 64-19

Fractional share.—An example of a formula fractional share bequest
is contained in Exhibit B. The basic concept of this clause is to
give to the surviving spouse a fraction of the residuary estate, which
fraction represents the maximum estate tax marital deduction. In a true
fractional share bequest the surviving spouse will be entitled to a fraction
of each asset; but as illustrated in item 2 in Exhibit B, the executor
may be authorized to allocate and distribute specific properties rather
than undivided interests, using for this purpose current values at the date
of distribution.

The fractional share bequest is specifically excepted from the adverse
rule of Rev Proc. 64-19

In its application, the true fractional share clause will avoid the
capital gains problem that exists in the satisfaction of a pecuniary be-
quest. This type of clause also automatically provides for the equitable
sharing of appreciation and depreciation in accordance with the concept
under Rev Proc. 64-19. This of course may be an advantage or disad-
vantage to the parties, depending upon their desire to have the surviving
spouse’s interest fluctuate with appreciation or depreciation or to be fixed,
and the clause should be used with this result in mind.

As previously indicated the clause may be drawn so as to result in a
joint ownership of assets or division of assets, and again the draftsman
must keep in mind this result in determining the form of the fractional
share clause.

Pecuniary formula; amount determined by estate tax values and satis-
fied with assets valued at distribution date.—An example of this type of

30. See Appendix at p. 278 infra.
32. See authorities cited note 3 supra.
pecuniary formula marital deduction clause is found in Exhibit A with the use of the clause in item 3. The principal point of this type of a marital deduction clause is that it does provide for a pecuniary formula (dollar amount determined under a formula), as distinguished from a fractional share; but the bequest is to be satisfied with assets valued at the distribution date. It is this latter requirement which particularly takes this clause out of the adverse rule provided under Rev Proc. 64-19.

In the application of this particular pecuniary formula clause, the widow is entitled to a fixed dollar amount and increases or losses in value are shifted to other beneficiaries. This clause does have the disadvantage that capital gains may result upon the satisfaction of the dollar bequest with appreciated assets; but on the other hand capital losses could also result.

A principal advantage of this form of marital deduction clause is that it does permit flexibility in the selection of assets by the fiduciary. By the same token it requires a valuation of assets at the time of distribution. While this generally has not been a tax problem in the past, the publication of Rev. Proc. 64-19 may cause Service personnel to scrutinize the values used more closely for gift tax possibilities.

This pecuniary formula marital deduction clause illustrates, as does the prior fractional share clause, that different consequences flow with respect to the surviving spouse and other beneficiaries depending upon the particular clause used. Thus Rev. Proc. 64-19 may serve the beneficial purpose of calling attention to the fact that different clauses give different property results and, therefore, that more attention at the drafting stage should be given to determining what the testator really intends the surviving spouse to receive.

Pecuniary formula; amount determined by estate tax values, with sharing of appreciation to date of distribution.—This type of pecuniary formula marital deduction clause is illustrated in Exhibit A with the clause contained in item 4. In essence this is a type of marital deduction clause which is particularly approved by Rev. Proc. 64-19, it being the type of clause which would result from the agreement to be signed by the fiduciary as provided under the Rev Proc.

In some respects this clause is merely a variation of the fractional share clause previously described above. It is clear, however, that under this clause a selection of assets is permitted and there is no requirement

33. See Appendix at p. 276 infra.
34. Rev. Proc. 64-19, §§ 2.02, 4.01(3) (c), at 30-32.
35. See authorities cited note 3 supra.
36. See Appendix at p. 277 infra.
37. See Rev. Proc. 64-19, § 2.02, at 30, 31; the Agreement in Exhibit D at p. 279 infra.
of distribution of a prorata portion of each asset. This clause also requires a revaluation of assets at the time of distribution in order to determine that there is a proper sharing of appreciation and depreciation. In short this clause authorizes the fiduciary to select assets and thereby permits flexibility in such selection but not a preference among the beneficiaries with reference to values at the time of distribution.

Since this clause is basically the same as that provided for under the agreement prescribed in Rev. Proc. 64-19, it would be well to evaluate the use of this particular clause. The advantages of the clause with respect to flexibility and selection of assets have already been described. However, there are certain problems dependent upon the use of this clause which should be recognized. One problem is that the sharing of appreciation or depreciation must be kept in mind every time any distribution is made from the estate. Assume that the ratio determined by federal estate tax values between the marital deduction bequest and the balance of the estate, the non-marital portion, is forty to sixty per cent. Assume that the executor desires to make a distribution of $100,000 and the estate at the date of death has a value of $1,000,000 but at the date of distribution has a value of $1,100,000. In determining the distribution to be made at that time, will the executor have to distribute assets having a value of $110,000? Will the executor have to distribute forty per cent to the surviving spouse? Must the executor include appreciated assets in the distribution? If so, is not the fiduciary's discretion seriously and perhaps arbitrarily limited? While these problems may be avoided by having no interim or piece-meal distributions, is this desirable?

This clause may also open up new areas of controversy. One is that each time a distribution to the surviving spouse is made it will be necessary to revalue the assets of the entire estate; this may result in values with which the Service will not agree. Moreover, consider the effect of the timing of payments and the selection of assets to meet expenses or obligations. If appreciated assets are used to pay debts and expenses, the surviving spouse may obtain no appreciation in the remaining assets; or if depreciated assets are used to pay debts and expenses and the distribution is thereafter made to the surviving spouse, she may obtain a higher percentage of the remaining assets.

Administrative problems and methods of solving them are discussed in a subsequent article in this Symposium. Suffice it to say, this pecuniary formula clause, although given prominence by Rev. Proc. 64-19, is still somewhat of an unknown quantity.

Pecuniary formula; amount determined by estate tax values and satisfied with assets valued at estate tax values but having total value at dis-

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38. See Butala, supra note 19.
tribution not less than the amount of the marital deduction allowed for the gift.—This type of pecuniary formula marital deduction clause is illustrated in Exhibit A by the clause provided in item 5.

This type of marital deduction clause is excepted from the adverse rule under Rev. Proc. 64-19 because it is clear that the surviving spouse will generally receive assets having an aggregate fair market value at the date or dates of distribution amounting to no less than the amount of the pecuniary bequest.

This type of marital deduction clause is a variation of that previously set forth with the key fact being that the marital deduction, even though the amount is determined by estate tax values, is satisfied with assets valued, in the aggregate, at the distribution date. The difference in this particular clause is that the individual assets so used to satisfy the bequest are valued at estate tax values. The effect of the clause is that the widow receives an amount not less than the marital deduction pecuniary gift, but it may be more if the fiduciary distributes appreciated assets to her.

One advantage of this type of clause is that normally assets can be selected so that there should be no capital gain on satisfaction of the bequest, but there can be a capital loss depending on the assets selected. In short this method permits the selection of assets having total values at distribution not less than estate tax values, and therefore it permits the executor to distribute to the surviving spouse assets with the least amount of appreciation, retaining other assets with growth possibilities for other beneficiaries.42

SUMMARY

Rev. Proc. 64-19 represents a fair solution, from the Internal Revenue Service viewpoint, to a difficult problem. It seemingly permits administrative relief where otherwise hardship could result from the loss of the marital deduction under an apparently widely used clause. However in individual cases it will be necessary for the lawyer to tread carefully, to determine not only the intent of the testator but to choose skillfully the means for giving effect to that intent.

It is perhaps significant that in the more than sixteen years the marital deduction has been on the statute books, the interpretation reflected in Rev. Proc. 64-19 represents the first major upheaval in the application of the law. The long period without major problems is a tribute to the

40. See p. 273 supra.
41. See authorities cited at note 3 supra.
seeming clarity of the statute and its administration. Does Rev. Proc. 64-19 herald the beginning of a new period of scrutiny by the Internal Revenue Service and more problems ahead?

APPENDIX

Exhibit A

PECUNIARY FORMULA

1. Basic pecuniary formula language.
   If my wife survives me, I give to the following:
   An amount equal to the maximum estate tax marital deduction (allowable in determining the federal estate tax payable by reason of my death) minus the value for federal estate tax purposes of all items in my gross estate for federal estate tax purposes which qualify for said deduction and which pass or have passed in a form which qualifies for the estate tax marital deduction from me to my said wife (the words "pass or have passed" shall have the same meaning as such words shall have under the provisions of the Internal Revenue Code in effect at the time of my death) under other provisions of this will, by right of survivorship with respect to jointly owned property, under settlement arrangements relating to life insurance proceeds, or otherwise than under this pecuniary bequest. In making the computations necessary to determine the amount of this pecuniary estate tax marital deduction gift, values as finally determined for federal estate tax purposes shall control.

2. Proscribed clause.
   Add to the basic paragraph in 1 above the following sentence:
   The payment of this amount may be made wholly or partly in kind by transferring to specific securities or other personal property at values which are the same as the basis of such property in the decedent's estate.

3. Clause for gift satisfied with assets valued at distribution date.
   Add to the basic paragraph in 1 above, the following sentence:
   The payment of this amount may be made wholly or partly in kind.

43. CASNER, ESTATE PLANNING 305 (Supp. 1964) (published by Little, Brown and Company, Boston, Massachusetts)
44. This sentence is set forth in 1 CASNER, ESTATE PLANNING 815 (3d ed. 1961), as an example of a clause authorizing the fiduciary to satisfy a pecuniary gift by a distribution in kind valuing the distributed property at estate tax values. Professor Casner did not recommend that this sentence be used.
kind by transferring to specific securities or other personal property at values current at the date of distribution.45

4. **Clauses for gift with sharing of appreciation and depreciation to date of distribution.**

   Add to the basic paragraph in 1 above, the additional sentence suggested in 2 above plus the following sentence:

   The assets to be distributed in satisfaction of this bequest will be selected in such manner that cash and other property distributed will have an aggregate fair market value fairly representative of the distributee’s proportionate share of the appreciation or depreciation in the value to the date, or dates, of distribution of all property then available for distribution.46

5. **Clauses for gift satisfied with assets valued at estate tax values but having total value at distribution not less than the amount of the marital deduction allowed for the gift.**

   Add to the basic paragraph in 1 above, the additional sentence suggested in 2 above plus the following sentence:

   Such assets must have an aggregate fair market value at the date, or dates, of distribution amounting to no less than the amount of this pecuniary estate tax marital deduction gift as determined above; provided, in all other respects my Executor shall have absolute discretion as to which assets of my estate shall be distributed in satisfaction of this pecuniary estate tax marital deduction gift.47

**Exhibit B**

**Fractional Share Formula**

1. **Basic fractional share formula language.**

   If my said wife survives me, I give to the following described fractional share of my residuary estate:

   The numerator of the fraction shall be the maximum estate tax marital deduction (allowable in determining the federal estate tax payable by reason of my death) minus the value for federal

45. This clause is recommended in 1 CASNER, op. cit. supra note 44, at 815, to avoid the problem raised by the language in the sentence accompanying note 44 supra.

46. This substantially tracks the clause contained in the agreement to be executed by the executor or trustee as prescribed in Rev. Proc. 64-19. See Exhibit D. at p. 279 infra.

47. The first part of this sentence substantially tracks the language in Rev. Proc. 64-19, § 2.02, first sentence, which describes a clause excepted from the adverse ruling under the Rev. Proc.; the second part may be necessary under state law to negate any duty of the fiduciary to distribute to the widow assets fairly representative of appreciation or depreciation in the value of all property available for distribution.
estate tax purposes of all items in my gross estate which qualify for said deduction and which pass or have passed in a form which qualifies for the estate tax marital deduction from me to my said wife (the words "pass or have passed" shall have the same meaning as such words shall have under the provisions of the Internal Revenue Code in effect at the time of my death) under other provisions of this will, by right of survivorship with respect to jointly owned property, under settlement arrangements relating to life insurance proceeds, or otherwise than under this fractional share gift of my residuary estate (in computing the numerator, the values as finally determined for federal estate tax purposes shall control), and the denominator of the fraction shall be the value of my residuary estate (the value of my residuary estate shall be determined on the basis of the values as finally determined for federal estate tax purposes).  

2. **Clause authorizing non-pro rata distributions in kind.**

Include in the powers of Executor the following language:

My Executor shall have the power, when paying legacies or dividing or distributing my estate, to make such payments, division or distribution wholly or partly in kind by allotting and transferring specific securities or other personal or real property or undivided interests therein as a part or the whole of any one or more payments or shares at current values.

Exhibit C

**FORM OF AGREEMENT TO BE EXECUTED BY SURVIVING SPOUSE**

**Pursuant to Revenue Procedure 64-19**

In the event of the allowance by or on behalf of the Commissioner of Internal Revenue of a marital deduction for a pecuniary bequest or transfer in trust to me or on my behalf of $________, claimed in connection with the settlement of the Federal estate tax liability of the estate of __________, and as part of the consideration for this settlement, I hereby agree that in the event cash and other property accepted in full satisfaction of this bequest or transfer in trust is not fairly representative of my proportionate share of any net appreciation in the value, to the date or dates of distribution, of all property then available for distribution in satisfaction of such pecuniary bequest or transfer, the difference in value will be treated as a transfer or transfers by gift as of the__

48. **Casner, op. cit. supra** note 43, at 308.

49. See 1 Casner, op. cit. supra note 44, at 1285. This clause is similar to the clause recommended by Professor Casner at p. 815 of his work. See paragraph 3 of Exhibit A at p. 276 supra.
date, or dates, of distribution, and a Federal gift tax return or returns with respect to such transfer or transfers by gift will be filed if required under the gift tax provisions of the Internal Revenue Code.

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----------------------------------, Surviving Spouse of ________________

Exhibit D

FORM OF AGREEMENT TO BE EXECUTED BY EXECUTOR OR TRUSTEE PURSUANT TO REVENUE PROCEDURE 64-19

In the event of the allowance by or on behalf of the Commissioner of Internal Revenue of a marital deduction for a pecuniary bequest or transfer in trust of $__________ claimed in connection with the settlement of the Federal estate tax liability of the estate of ________________, and as part of the consideration for this settlement, I hereby agree that the assets to be distributed in satisfaction of this bequest or transfer in trust will be selected in such manner that the cash and other property distributed will have an aggregate fair market value fairly representative of the pecuniary legatee's (or transferee's) proportionate share of the appreciation or depreciation in the value to the date, or dates, of distribution of all property then available for distribution in satisfaction of such pecuniary bequest or transfer. I further agree that, within six months after the final distribution of cash and other property in satisfaction of the marital deduction pecuniary bequest or transfer in trust, I will file with the District Director of Internal Revenue, at ________________, a schedule showing the cash and other property distributed in satisfaction of the marital deduction pecuniary bequest or transfer in trust subsequent to the date of this agreement, the cash and other property available for distribution in satisfaction of the marital deduction pecuniary bequest or transfer at each date of distribution, and the fair market value of each such asset at each date of distribution.

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---------------------------------- Trustee, or

Executor of the Will of ________________