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[*Northeastern Pa. Nat'l Bank & Trust Co. v. United States*, 363 F.2d 476 (3d Cir. 1966)]

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**ESTATE TAXATION — MARITAL DEDUCTION —
SPECIFIC DOLLAR AMOUNT**

Northeastern Pa. Nat'l Bank & Trust Co. v. United States,
363 F.2d 476 (3d Cir. 1966).

The Internal Revenue Code of 1954 establishes an estate tax, the amount of which varies with the size of the taxable estate.¹ The 1954 Code is the amended product of the 1939 provisions which taxed the gross estate and allowed few deductions.² This approach was severely criticized on the basis that it gave undue benefits to citizens of community property states since it taxed only one half the community estate upon the death of one of the marital partners.³ Successive changes were made,⁴ and the 1954 Code finally allowed the deduction of any specified portion of a trust comprising up to one half the estate.⁵ Under this method up to one half of the decedent's estate can be placed in trust for the surviving spouse, the proceeds being paid at fixed intervals.⁶

Interpretation by both the courts and the Treasury Department was strict: the courts denied deductions to any estate in which the surviving spouse's interest was not absolute either in income⁷ or corpus,⁸ while the Treasury Department held that the 1954 provisions applied to only that portion of the trust which was representative of a fractional or percentile share of the estate, expressly excluding a specified payment from a non-delineated trust corpus.⁹

¹ INT. REV. CODE OF 1954, § 2001 [hereinafter cited as CODE]. The taxable estate is an aggregate figure determined from the decedent's holdings at the time of his death less allowable deductions. CODE § 2052; Treas. Reg. § 20.2051-1 (1958) [hereinafter cited as Reg.]. The deductions include "exemptions" as well as "deductions" for expenses, indebtedness, and taxes; losses; charitable deductions; and the marital deduction. CODE §§ 2052-56; Reg. §§ 20.2052-1, 20.2053-1 to -10, 20.2054-1, 20.2055-1.

² Int. Rev. Code of 1939, § 812, 53 Stat. 123.

³ S. REP. NO. 1013, 80th Cong., 2d Sess. 5 (1948).

⁴ Revenue Act of 1942, § 402(b)(1)(e)(2), 56 Stat. 942, repealed by Revenue Act of 1948, ch. 168, § 351(a), 62 Stat. 116.

⁵ Code § 2056(b)(5).

⁶ See H.R. REP. NO. 1274, 80th Cong., 2d Sess. 4 (1948). See generally Reilly v. Commissioner, 239 F.2d 797 (3d Cir. 1957).

⁷ Cf. *Starrett v. Commissioner*, 223 F.2d 163 (1st Cir. 1955); *Estate of Shedd*, 23 T.C. 41, 46 (1954), *aff'd*, 237 F.2d 345, 359 (9th Cir. 1956), *cert. denied*, 352 U.S. 1024 (1957); *Estate of Tingley*, 22 T.C. 402 (1954).

⁸ *Estate of Hoffenberg*, 22 T.C. 1185 (1954), *aff'd per curiam*, 223 F.2d 470 (2d Cir. 1955).

⁹ Reg. § 20.2056(b)-5(a) states that to comply with the Code, all of the five following conditions must be met:

(1) The surviving spouse must be entitled for life to all of the income

Two recent United States Court of Appeals decisions have dealt with the question of what is a "specific portion" of the estate for tax purposes. In each case the spouse was left a fixed monthly payment from a trust account. In each case the spouse had the right and power to pass the remainder of the trust by her last will and testament. The trustees in *Northeastern Pa. Nat'l Bank & Trust Co. v. United States*¹⁰ claimed one half the decedent's estate as being eligible for the marital deduction.¹¹ However, the Treasury Department disallowed the deduction on the ground that no specific portion of the trust was identified, defining "specific portion" as a fractional or percentile part of the entire estate.¹² The trustees paid the tax under protest and sued for a refund of one half the tax. The district court found in favor of the trustees¹³ but did not allow a deduction of the entire one half of the estate. An actuarial method was used to determine the present total value of the monthly stipend.¹⁴

On appeal by the government,¹⁵ the Third Circuit ruled that the actuarial formula "does not, in our view, isolate that part of the trust corpus from which the surviving spouse is entitled to all the income."¹⁶ In reaching this decision, the court distinguished

from the entire interest or a specific portion of the entire interest, or to a specific portion of all the income from the entire interest.

(2) The income payable to the surviving spouse must be payable annually or at more frequent intervals.

(3) The surviving spouse must have the power to appoint the entire interest or the specific portion to either herself or her estate.

(4) The power in the surviving spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The entire interest or the specific portion must not be subject to a power in any other person to appoint any part to any person other than the surviving spouse.

¹⁰ 363 F.2d 476 (3d Cir. 1966).

¹¹ CODE §§ 2056(b)5-(c)1.

¹² Reg. § 20.2056(b)—5(c) (1961).

¹³ *Northeastern Pa. Nat'l Bank & Trust Co. v. United States*, 235 F. Supp. 941 (M.D. Pa. 1964), *rev'd*, 363 F.2d 476 (3d Cir. 1966).

¹⁴ Actuarial accountancy is a procedure for computing the value of various factors in the monthly stipend over the projected life span; the life expectancy is determined by an aggregation of statistical life expectancy over a broadly based population. See Reg. § 20.2037-7. There is also included a factor representing the accrual of investment over the period of life expectancy. Since this method gives the life expectancy on an objective, non-selective basis, the Treasury Department, which uses these tables extensively, has issued a ruling that individual health factors may be included in the determination of individual life expectancy. Rev. Rule 66-307, 1966 INT. REV. BULL. NO. 42, at 74.

¹⁵ *Northeastern Pa. Nat'l Bank & Trust Co. v. United States*, 363 F.2d 476 (3d Cir. 1966).

¹⁶ *Id.* at 481.

the earlier case of *Gelb v. Commissioner*,¹⁷ in which the primary issue was the power of appointment over the remainder, the actuarial method being used to determine that portion of the trust being entitled to the marital deduction. The *Northeastern* court noted that here there were not the "factual constants" found in *Gelb*, where the surviving spouse had the income from the trust corpus for life.¹⁸ Furthermore, the court noted that its decision was contrary to the holding of the Seventh Circuit in a similar case.¹⁹

That case, *Citizens Nat'l Bank v. United States*,²⁰ dealt with a similar factual situation. The trustees claimed that an actuarial calculation could determine the "specific portion" of the trust eligible for the marital deduction. The district court had concluded that the Treasury Regulation in question²¹ was inconsistent with the statute "in so far as it would limit the statutory term 'specific portion' to 'a fractional or percentile share.'"²² The Seventh Circuit held that the use of an actuarial formula was a valid means by which the intent of Congress in enacting the provision could be fulfilled,²³ that the facts of the case were not sufficiently distinguishable from *Gelb*, and that therefore the *Gelb* doctrine should be upheld.²⁴

The courts in *Northeastern* and *Gelb* agreed with the purpose of the marital deduction as stated by Mr. Justice Goldberg in *United States v. Stapf*:²⁵

[T]he marital deduction permits a deceased spouse, subject to certain requirements, to transfer free of taxes one-half of the non-community property to the surviving spouse. . . . [T]he primary thrust of this is to extend to taxpayers in common-law States the advantages of "estate splitting" otherwise available only in community property States.²⁶

The court in *Northeastern* felt that the "specific portion" as defined in the Treasury Regulations²⁷ could not be determined by the actuarial method and that the method employed included the factor of

¹⁷ 298 F.2d 544 (2d Cir. 1962).

¹⁸ 363 F.2d at 484.

¹⁹ *Ibid.*

²⁰ 359 F.2d 817 (7th Cir. 1966).

²¹ Reg. § 20.2056(b)—5(c).

²² 359 F.2d at 819.

²³ *Id.* at 821.

²⁴ *Ibid.*

²⁵ 375 U.S. 118 (1963).

²⁶ *Id.* at 128.

²⁷ Reg. § 20.2056(b)—5.

fund dissolution,²⁸ which had been "in no way . . . contemplated by the decedent."²⁹

Moreover, relying on the principle that the value of the trust was to be computed at the time of the decedent's death,³⁰ the court asserted that the use of a fixed rate of interest was "unreal"³¹ as the sum determined was not demonstrative of actual market conditions. The actuarial system used the investment rate as a constant, and the *Northeastern* court felt this alone guaranteed the failure to determine a *specific* portion.³² The majority opinion specifically noted the Seventh Circuit decision in *Citizens Nat'l Bank*, but no attempt was made to justify the conflict between the circuits.³³ The court merely stated that "we have been unable to conceive of a method to compute the 'specific portion' of the trust corpus."³⁴

The dissent in *Northeastern* argued that there was valid precedent for the use of an actuarial method, since the intent of Congress was remedial — to balance the inequitable position of the community property states vis-à-vis the common law states — the term "specific portion" is to be interpreted liberally; thus, the dissent concluded, "specific portion" was ascertainable "after a reasonable calculation."³⁵

*Citizens Nat'l Bank*³⁶ was argued in substantially the same manner as *Northeastern*. However, the former case rejected the government's argument that the portion determined by the actuarial method was not a "fractional or percentile share" within the qualifications of the Code owing to the effect of economic fluctuation on the portion of the trust corpus concerned.³⁷ The majority ruled that the method proposed by the trustees was proper and that the

²⁸ The concept of "fund dissolution" is related to the actuarial formula because in order to arrive at the prescribed monthly payment, the trust corpus must be so invaded that it will be completely extinguished upon the death of the surviving spouse.

²⁹ 363 F.2d at 482.

³⁰ *Jackson v. United States*, 376 U.S. 503, 508 (1964).

³¹ 363 F.2d at 482.

³² *Id.* at 482-83. The court stated:

[A]n investment constant . . . has no place in a problem where the very real income variations turn the issue of the allowance of the marital deduction. Indeed, the use of such a constant is absent from the regulations dealing with the "specific portion" issue, whereas it may be found in the regulations in formulas geared to different problems.

³³ *Id.* at 484.

³⁴ *Ibid.*

³⁵ *Id.* at 487.

³⁶ *Citizens Nat'l Bank v. United States*, 359 F.2d 817 (7th Cir. 1966).

³⁷ *Id.* at 820.

intent of Congress should not be defeated by an unduly limited interpretation of the terms.³⁸

In *Gelb* the government argued that "there is no certainty that the value" of the entire corpus "will be the same on the date of the surviving spouse's death as it was on the date of the decedent's death."³⁹ The court realized that the surviving spouse would therefore not bear the risk of any change in market conditions, but this was said to be the intent of Congress in enacting the statute. Because the language of the statute, speaking of a "specific portion" rather than a "fractional or percentile share" demonstrated the intent to differentiate the two terms, the contention of the Treasury Department was held to be incorrect.⁴⁰

The variety and frequency of the actuarial method's use by the Treasury Department and others⁴¹ does much to persuade one of its validity as a means of computing the marital deduction. The method is designed to spread the risks and variances over a sufficiently wide base so that their effect is negligible. As was indicated in *Gelb*, "the United States is in business with enough different taxpayers so that the law of averages has ample opportunity to work."⁴²

If it is conceded that some form of computation is proper, the question becomes which method best determines the specific portion from the given dollar amount. In both cases a method first suggested in *Gelb* was used.⁴³ There the government argued that the discount rate used in this calculation could not be determined adequately since the rate would fluctuate with economic conditions,

³⁸ *Id.* at 821.

³⁹ *Gelb v. Commissioner*, 298 F.2d 544, 550 (2d Cir. 1962).

⁴⁰ *Ibid.*

⁴¹ When the charitable deduction provision was added to the estate tax, Revenue Act of 1918, ch. 18, § 403(a) (3), 40 Stat. 1098, the actuarial method was almost universally accepted in determining the value of deductions. 298 F.2d at 551 n.7. The method was used to compute the actual value of charitable gifts subject to life estates. See *Commissioner v. Sternberger*, 348 U.S. 187, 190-92 (1955); *Merchants Nat'l Bank v. Commissioner*, 320 U.S. 256, 259 n.6 (1943). It was used where a life tenant had died before the case came to court. *Ithaca Trust Co. v. United States*, 279 U.S. 151 (1929).

In addition, the actuarial method has been used to determine the value of a remainderman's estate where the vested remainderman had died before the life beneficiary, *William Korn*, 35 B.T.A. 1071 (1937). The actuarial tables have also been used to value gifts of remainder interests. *Betty Dumaine*, 16 T.C. 1035 (1951); *Henry F. Du Pont*, 2 T.C. 246 (1943). And, the method has been used to value life estates and annuities. *F. J. Sensenbrenner*, 46 B.T.A. 713 (1942).

⁴² 298 F.2d at 552.

⁴³ *Id.* at 551. *Northeastern Pa. Nat'l Bank & Trust Co. v. United States*, 363 F.2d 476, 484 n.17 (3d Cir. 1966); *Citizens Nat'l Bank v. United States*, 359 F.2d 817, 820 (7th Cir. 1966).

and a slight change in the interest rate will greatly vary the cost, that is, the basic fund needed to produce the desired income.⁴⁴ In effect, this would appreciate or depreciate the trust corpus. Since the term "specific portion" must relate to some larger, fixed sum it is possible that the sum would be greater than the permissible amount, thus violating the specific limits of the statute. The issue is whether this interpretation of the language comports with the true intent of Congress.⁴⁵ The Third Circuit in *Northeastern* would accept the government's argument, one which apparently violates the intent of Congress.⁴⁶

The better view is expressed by the Seventh Circuit in *Citizens Nat'l Bank*. The actuarial method has admitted faults, but it does permit a specific portion to be established from a fixed monthly payment. The value of the estate would be determined at the time of death, and both the government and the taxpayer would share equally the chances of a quixotic economy. The fact that at some point in time this computation must be established without the constant worry of what might happen in the future has prompted this statement: "We cannot wait, like 'Monday morning quarterbacks,' to see what actually happened but must concern ourselves with what *could* have happened."⁴⁷ Use of the actuarial formula is consistent with the language and intent of Congress as expressed in the statute.⁴⁸

LARRY B. FAIGIN

⁴⁴ Stabert, *Assumptions as to Actuarial Methods*, 41 TAXES 11, 12 (1963).

⁴⁵ 359 F.2d at 820.

⁴⁶ 363 F.2d at 487.

⁴⁷ *Bookwalter v. Lamar*, 323 F.2d 664, 670 (8th Cir. 1963).

⁴⁸ 363 F.2d at 488.