Section 2056 (b) (5): An Apparent or Real Exception to the Terminable Interest Rule

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SECTION 2056(b)(5): AN "APPARENT" OR "REAL" EXCEPTION TO THE TERMINABLE INTEREST RULE?

I. Introduction

Section 2056 of the 1954 Internal Revenue Code provides for a deduction from the decedent's gross estate for property passing to his or her surviving spouse. This provision was designed to alleviate the disparity in estate tax burdens between residents of community property and common law jurisdictions. While the basic policy of the marital deduction has always been tax equalization, the courts have taken various approaches and constructions in the course of its application.

The vast majority have strictly construed the statute and regulations. Recently, however, some courts have reanalyzed the historical development of the marital deduction and the congressional intent underlying its enactment. The result has been a more flexible approach and application of the § 2056 provisions. In particular, § 2056(b)(5), the life estate with power of appointment exception to the terminable interest rule, has been favorably applied for the taxpayer. The analysis below traces the transition from the treatment of § 2056(b)(5) as a very narrow and tightly drawn exception to a restatement of the basic policy and rationale behind the marital deduction.

In part the disparate treatment of § 2056(b)(5) can be traced to differing judicial thought concerning the congressional purpose in the enactment of the marital deduction itself. Immediately after enactment, prevalent judicial opinion supported the view that the provisions were designed to equate as near as possible estate taxes between community property and common law states.

"Virtual ownership" characterized the type of property interest that the surviving spouse was required to receive in order to qualify for the deduction. The courts, reluctant to expand the deduction beyond this type of interest, strictly interpreted the statute. Yet, the statutory provisions and relevant legislative history did not support this narrow construction. Only recently have these sources been seen as supporting a more liberal interpretation.

Modern thinking on the subject, developed within the last two decades, argues that Congress intended to liberalize and extend the exclusion of marital transfers from the taxable estate in enacting § 2056; accordingly, restrictive interpretations of the marital deduction provisions are not warranted. This view recently garnered support from the Supreme Court and its significance to the life estate with power of appointment exception (§ 2056(b)(5)) will become apparent in the discussion below.

1 INT. REV. CODE of 1954, § 2056.
3 INT. REV. CODE of 1954.
4 For a general discussion of congressional purpose in enactment of marital deduction provisions see 4 MERTENS, LAW OF FEDERAL GIFT & ESTATE TAXATION § 29.01 (Supp. 1972) [hereinafter cited as MERTENS].
5 Id.
In a larger context, it can be said that the metamorphosis which has occurred in the general marital deduction provision is fast becoming evident in its component parts, specifically § 2056(b)(5). This particular provision has also received dissimilar and at times conflicting treatment by the courts. On the one hand the Commissioner of Internal Revenue and most courts have taken a strict constructionist approach to the exception, requiring inflexible and precise compliance with the statutory exception and its subsequent regulations. For example, in *Estate of May v. Commissioner* the surviving spouse was given a life interest in the residuary estate with "the right in the sole discretion of my said wife to invade and use the principal not only for necessities but generally for her comfort, happiness and well-being." A marital deduction was disallowed because the statute required the power of appointment to be exercisable in all events. Since New York case law required the wife to use good faith in exercising power, it was therefore held not exercisable in all events.

At the other end of the spectrum, *Estate of Mittleman v. Commissioner* allowed a deduction where the testator created a trust of the residuary estate "[t]o provide for the proper support, maintenance, welfare and comfort" of his wife. The Commissioner and Tax Court had determined that the trust failed to qualify because the spouse did not have the right to the entire income from the trust. Reversing, the appellate court stated: "We hold . . . that where a testator intends to create a trust qualifying for the marital deduction, ambiguities in his will should, if possible, be resolved in favor of success in that endeavor." Cases such as *Mittleman* are, then, indicative of a judicial shift in interpreting § 2056(b)(5) as a strict, "real" exception to a more liberal, "apparent" exception to the terminable interest rule.

Indeed, it is submitted that the differing conceptions of § 2056(b)(5) can best be understood in the context of determining whether the provision is a "real" or an "apparent" exception to the terminable interest rule. This article will explore the historical and legislative background of the marital deduction in an attempt to analyze the nature and scope of § 2056(b)(5). Case analysis will be used to further analyze the competing theories and to indicate the potential practical ramifications of each.

II. Background

A. The General Framework for Analysis

The use of a "real" and "apparent" exception framework in subsequent analysis stems in part from *Mittleman* where the court characterized § 2056(b)(5) as "an apparent—though hardly a real—exception to the terminable-
interest rule. Throughout this discussion the real versus apparent dichotomy is used in an analogous manner to the usage of the two concepts in the law of evidence, i.e. real versus apparent exceptions to the hearsay rule. Section 2056 (b)(5) will be designated as an apparent exception in the sense that it is not technically an exception to the terminable interest rule, but something outside and independent of the terminable interest rule itself. The consequences of such a conceptualization are far reaching. Overly restrictive Treasury regulations curtailing the availability of the deduction are not applicable. Practically, the taxpayer may save thousands of tax dollars. Moreover, inartfully drawn bequests which do not comply with the highly technical regulations may alternatively qualify for the deduction if § 2056(b)(5) is conceptualized as an apparent as opposed to real exception.

The real exception approach, on the other hand, dictates that those property interests which fall within § 2056(b)(5) are genuine terminable interests for which only a carefully circumscribed statutory exception is available. If § 2056(b)(5) is properly a real exception, strict statutory construction and carefully drafted regulations limiting the availability of the deduction are appropriate.

B. History of the Marital Deduction

Prior to 1942, residents of community property states enjoyed a distinct estate tax advantage over their common law counterparts. In community property states each spouse is considered the fee simple owner of one-half of the community wealth. Thus, only one-half of the community property is included in the gross estate of the first spouse to die; taxation of the survivor’s one-half is deferred until his or her death. Comparatively, in common law states one spouse typically owns the vast majority of property. This fact combined with sharply progressive estate tax rates resulted in a significantly higher tax on transfers in common law states than on transfers of similar size in community property states. Accordingly, Congress enacted legislation in 1942 designed to produce a more equitable result.

The 1942 Revenue Act included ameliorative estate tax provisions intended to eliminate the advantage enjoyed by community property residents by requiring the entire amount of community property to be included in the gross estate of the first spouse to die. While a significant step toward equalization, the legislation failed to be the expected panacea. Transfers made in community property states frequently incurred more or less taxation than did comparable transfers in common law jurisdictions for various reasons. For example, if the husband in a common law state bequeathed a life estate to his wife, with the remainder over to the children, at his death the entire estate is taxed, but at the wife’s death

15 Id.
16 See, e.g., Bittker, Federal Income Estate and Gift Taxation 1106-13 (3d ed. 1964) [hereinafter cited as Bittker].
18 See Revenue Act of 1942, adding §§ 811(d)(5), 811 (e)(2), and 811(g)(4) to Int. Rev. Code of 1939. See also Mertens, supra note 4, at § 29.01.
19 Bittker, supra note 16, at 1107.
there is no tax on the cessation of her life estate. Conversely, if a husband in a community property state was to bequeath his one-half interest in the community property under an identical arrangement, the entire community property may be included in his gross estate, and on the death of his wife, one-half the community property is also included in her estate. Thus, the common law couple is subject only to a single transfer tax, whereas the community property couple pays two transfer taxes.\[^{21}\] Additionally, burdensome tracing problems were encountered since the 1942 statute exempted that portion of property "as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse." \[^{22}\]

Dissatisfaction with the 1942 estate tax provisions led to their repeal in 1948 and enactment of what is essentially the current marital deduction.\[^{23}\] Congress, reiterating its goal of equalization, reversed its approach and directed the new law at common law jurisdictions. As a corollary to "income-splitting" between spouses in common law states, "estate-splitting" was devised as a means of placing the two systems in parity.\[^{24}\] Basically, the newly formulated marital deduction allowed the common law testator to transfer up to one-half of his adjusted gross estate to his spouse free from estate taxes. Predictably, however, Congress enacted exceptions to this general rule.

C. The Terminable Interest Rule

At the time the 1948 deduction was enacted, Congress was aware that perfect geographic equality was unattainable.\[^{25}\] Obviously, the inherent differences in the forms of ownership and manner of passing property between the community and separate property systems precluded this result. However, in a congressional attempt to achieve approximate equality, the deduction required that interests in property pass outright to the surviving spouse—the so-called "terminable interest" rule.\[^{26}\] The rule provides that the marital deduction is unavailable for those interests that terminate after a lapse of time, or on the occurrence or nonoccurrence of an event, and then pass from the surviving spouse to a third party.\[^{27}\] This portion of the statute attempts to achieve substantial quantitative and qualitative equality between the community property and common law states. Quantitatively, the rule is designed to insure equal taxation; qualitatively, to equalize the nature of interests entitled to this beneficial tax treatment.

1. Quantitative Equality

In community property states surviving spouses are entitled to their share

\[^{21}\] Id.
of community property outright. The tax consequences are apparent: if the property is given away, it is subject to gift tax; if control of the property is retained until death, the estate tax is applicable.\textsuperscript{28} Thus, in all cases other than consumption this property will be taxed in some form during the life of the surviving spouse or at her death. Conversely, the possibility of completely avoiding any tax would exist in common law jurisdictions if terminable interests qualified for the deduction. For example, if the survivor was given a life estate with a remainder to others, the property would qualify for the deduction and escape taxation in the survivor’s estate. Thus, substantial quantitative equality is accomplished only by disqualifying the marital deduction in such a case.\textsuperscript{29}

2. Qualitative Equality

Qualitatively, a decedent in a community property state cannot by will or other means effect the surviving spouse’s interest in community property.\textsuperscript{30} A husband, for example, cannot leave his wife with only a life estate in her one-half of the community property as she already owns a fee interest. Allowing a marital deduction for terminable interests would permit a common law resident a wider choice of dispositions upon which the same tax advantages would accrue. In effect the common law resident would be able to place limitations on his widow’s interest and still enjoy tax treatment as favorable as that of community property.

D. Exceptions to the Terminable Interest Rule

1. Apparent Exceptions

To understand the terminable interest rule it is necessary to distinguish the surviving spouse’s interest in the property from the property itself. The terminable nature of the underlying property is not determinative of whether a deduction will be allowed.\textsuperscript{31} For example, if the husband owned a patent and bequeathed to his wife the entire interest, the value of the patent would qualify for the marital deduction even though the patent itself will eventually terminate on the lapse of time.\textsuperscript{32} In terms of estate taxation the result would be the same in a community property jurisdiction. Thus, this example can be considered an “apparent,” nonreal exception to the terminable interest rule because the rule was not designed for, nor does it apply to, this type of situation.

\textsuperscript{28} See generally, \textsc{Stephens, Maxfield & Lind, Federal Estate and Gift Taxation} § 2056 (1974) [hereinafter cited as \textsc{Stephens}].

\textsuperscript{29} For a general discussion of quantitative and qualitative equality in an estate tax context see 19 \textsc{St. L. Rev.} 468 (1967).

\textsuperscript{30} An exception to this statement is of course the widow’s election. For a discussion of the impact of the widow’s election upon the marital deduction see 19 \textsc{St. L. Rev.} 468, 470-71 (1967).

\textsuperscript{31} A terminable property interest passing to the surviving spouse will be nondeductible if and only if: (1) the survivor’s interest in the property is terminable; (2) the decedent has also given an interest in the property to another; and (3) upon the termination or failure of the survivor’s interest, another person may come into possession or enjoyment of the property by way of his interest. \textsc{See Stephens, supra} note 28, at 5-94.

\textsuperscript{32} Similar examples of terminable types of property qualifying for the marital deduction are contained in Treas. Reg. § 20.2056(b)-1 (1958).
2. Legislative Provisions: “Real” Exceptions

Congress enacted three exceptions to the terminable interest rule. The first accommodates common disaster and early death clauses in many wills, allowing an interest contingent on limited survivorship to qualify. The remaining two exceptions are similar in nature. The second exception made an allowance where life insurance or annuity payments are coupled with a general power of appointment in the surviving spouse. Equitable life estates coupled with a general power of appointment comprised the third legislative exception. This provision in particular has been a source of considerable misunderstanding and voluminous litigation. Numerous requirements limit the availability of this section. The interpretation of these requirements in turn bears upon the characterization of whether the provision is a real or apparent exception of the terminable interest rule.

III. Section 2056(b)(5): A Real Exception to the Terminable Interest Rule?

As indicated above, two distinct theoretical approaches can be taken to

33 INT. REV. CODE of 1939, § 812(e)(1)(D) (now INT. REV. CODE of 1954, § 2056(b)(3)) provides that an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if:
A) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent’s death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and
B) such termination or failure does not in fact occur.

34 INT. REV. CODE of 1939, § 812(e)(1)(G) as amended by INT. REV. CODE of 1954, § 2056(b)(6) provides:
In the case of an interest in property passing from the decedent consisting of proceeds under a life insurance, endowment, or annuity contract, if under the terms of the contract such proceeds are payable in installments or are held by the insurer subject to an agreement to pay interest thereon (whether the proceeds, on the termination of any interest payments, are payable in a lump sum or in annual or more frequent installments), and such installment or interest payments are payable annually or at more frequent intervals, commencing not later than 13 months after the decedent’s death, and all amounts, or a specific portion of all such amounts, payable during the life of the surviving spouse are payable only to such spouse, and such spouse has the power to appoint all amounts, or such specific portion, payable under such contract (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), with no power in any other person to appoint such amounts to any person other than the surviving spouse—shall not be considered a nondeductible interest because of the terminable interest rule.


36 See generally, Note, supra note 7.

37 The following five conditions had to be met to qualify a life estate with power of appointment interest for the marital deduction:
(1) the surviving spouse had to be entitled to all the income from the entire interest;
(2) the income had to be paid annually or at more frequent intervals;
(3) the surviving spouse had to have the power to appoint the entire interest to either herself or her estate;
(4) the power in the surviving spouse had to be exercisable by her alone and in all events;
(5) the interest could not be subject to a power in any other person to appoint any part to any person other than the surviving spouse.

INT. REV. CODE 1939, § 812(e)(1)(F); see note 36 supra.
§ 2056(b)(5) and related exceptions to the terminable interest rule. The first categorizes the life estate and power of appointment provision as a real exception to the rule. "Real" is used in the sense that if a statutory exception were not provided, a life estate plus a general power of appointment would be barred from qualifying for the deduction as a terminable interest. The most persuasive argument supporting this thesis is that Congress specifically chose to label and include this interest as an exception to the terminable interest rule. More fundamentally, however, this theory is supported by the assumption that Congress enacted 2056(b)(5) solely to prevent prejudicing a long-established common law method of estate planning. In essence a nondeductible terminable interest was made deductible for this reason. Legislative history of the original 1948 exception supports this contention. "Among the exceptions to this terminable interest rule is the recognition of one of the customary modes of transfer of property in common law States. The deduction is applicable where the decedent or donor creates a trust..."

Furthermore, one's conceptualization of an exception is partly dependent upon the characterization and perceived scope of the general rule. The argument in favor of § 2056(b)(5) as a real exception is partially based on the assumption that Congress' primary purpose in enacting the terminable interest rule was to effectively approximate qualitative and quantitative equality between common law and community property systems.

When this emphasis on quantitative and qualitative equality is combined with Congress' intent to use § 2056(b)(5) as a means of preserving an established common law method of estate planning, it becomes obvious that Congress intentionally confined the scope of the exception. This approach dictates that Congress intended to preserve a viable estate planning device, the equitable life estate combined with a general power of appointment, while also insuring that common law residents would receive as few advantages as possible over residents of community property states. The stringent income and power of appointment requirements tied to the exception can be viewed as the manifestation of this congressional effort. Commentators and courts alike have seen these prerequisites as insuring the preservation of substantial equality because the widow receives virtually all of the rights of a fee simple owner like her community property counterpart. Read in this light, § 2056(b)(5) is a "real" exception to the terminable interest rule and justifies, as well as necessitates, a strict interpretation and application of its requirements. One court has inadvertently summarized this approach by stating, "a taxpayer must bring himself squarely within the marital deduction statute or suffer the consequence."

38 INT. REV. CODE of 1939, § 812(e)(1)(F).
39 S. REP. No. 1019, supra note 17, at 28.
40 Id.
41 See generally, MERTENS, supra note 4; RABIN, supra note 23; STEPHENS, supra note 28.
42 Estate of Jerome Mittleman, 42 P-H TAX CT. MEM. DEC. ¶73,112 at ¶73,113 (1973), citing Estate of Allen Weisberger, 29 T.C. 217 (1957).
IV. Section 2056(b)(5): An Apparent Exception to the Terminable Interest Rule?

A. An Emerging View

While the dominant judicial trend has been to treat § 2056 as a real exception, the apparent exception theory has recently gained support. Basically, this approach reasons that § 2056(b)(5) falls outside of the sphere of the terminable interest rule and is merely a restatement of the underlying principles of the marital deduction, rather than a real exception to the rule. Inclusion of the provision is merely a congressional attempt to clarify the scope of the terminable interest rule and an attempt to prevent its overextension.

The apparent exception theory assumes that Congress’ intent in enacting the marital deduction was primarily one of achieving quantitative equalization, subordinating qualitative equality. Congress merely intended to insure equal taxation as opposed to requiring the same types of interests be passed to the survivor. Marital deduction literature is replete with this idea of quantitative tax equalization through the so-called two-stage payment of taxes procedure. Specifically, the marital deduction, by allowing the husband to pass up to one-half of his estate to his widow tax free, sought to duplicate the situation existing in community property jurisdictions. The central theme is the complete taxation of all the assets during the lives of the spouses; the terminable interest rule is used to prevent any escape during the second stage. Again, legislative history can be cited in support of this contention.

This provision [§ 2056(b)(5)] is designed to allow the marital deduction for such cases where the value of the property over which the surviving spouse has a power of appointment will (if not consumed) be subject to either the estate tax or the gift tax in the case of such surviving spouse.

This statement, standing alone, certainly manifests Congress’ intent to achieve quantitative tax equality. If the central purpose was in fact to achieve this type of equality, a more liberal interpretation of § 2056(b)(5) is warranted. The certainty of taxation in the survivor’s estate, while not determinative, should strike the balance in favor of the taxpayer on interpretive questions relating to the fulfillment of § 2056(b)(5)’s income and power of appointment requirements. Statutory amendments since the original enactment of the life estate with power of appointment provision buttress this approach.

47 Such an approach would be based upon a concept of a tax at least once every generation. Difficult problems in utilizing this approach such as determining the time at which the property would be taxed are treated in Sugarman, Estate and Gift Tax Equalization—The Marital Deduction, 36 Calif. L. Rev. 223 (1948).
B. Legislative Developments

Legislative developments provide a strong inference that Congress, in general, has favored the liberal quantitative approach and thus the "apparent" exception route. It will be recalled that the original life estate exception was limited to equitable as opposed to legal life estates. Furthermore, the surviving spouse had to be entitled to all the income from the trust and had to have a power of appointment over the entire corpus in order to qualify for the exception. Judicial construction of these requirements led to the disqualification of any interest which did not strictly comply. In response to this strict judicial interpretation Congress in 1954 revised the exception to permit the qualification of legal life estates, and extended the exception to interests granting the right to income and power of appointment over a specific portion of the property passing. Apparently Congress had decided to go beyond its previously stated intention of merely allowing an exception for the established common law trust method of estate planning. Precise qualitative equality, always unfeasible, appeared subordinated in favor of liberality and flexibility in estate planning.

While the 1954 legislation expanded the boundaries of § 2056(b)(5), the quantitative equality dimension was left basically intact. Also, a 1958 Treasury Regulation, under the guise of maintaining qualitative equality and the real exception approach, attempted to severely curtail the 1954 legislation. In essence, the Regulation disqualified interests passing to the surviving spouse where only the right to a fixed-dollar amount of the income or power of appointment over a fixed dollar amount was granted. In a far-reaching decision, which will be analyzed more fully below, the Supreme Court in overruling this regulation, considered congressional intent as it related to the marital deduction.

V. Judicial Interpretation of § 2056(b)(5)

A. An Overview

An analysis of decided cases involving the life estate with power of appointment provision reveals that it has been construed both as a real and as an apparent exception to the terminable interest rule. Perhaps as an outgrowth of the principle that virtual ownership of property was a prerequisite to the deduction, the dominant judicial approach has been to strictly construe and apply

48 INT. REV. CODE of 1939, § 812(e)(1)(F).
49 Id.
50 See generally Stephens, supra note 28.
51 The INT. REV. CODE of 1954, § 2056(b)(5).
52 See Stephens, supra note 28, at 5-106.
53 See note 39 and accompanying text supra.
54 See note 25 and accompanying text supra.
the statutory provisions and regulations dealing with § 2056(b)(5). Generally, a contested deduction in this area has more often been denied than allowed. Recent decisions, however, suggest that the judicial shift which abolished the virtual ownership requirement and favors liberal construction may begin to have a similar effect on the component parts of the general rule. Consequently, a judicial reevaluation of congressional intent in favor of a more liberal and flexible application of § 2056(b)(5) may be forthcoming.

B. Judicial Treatment of § 2056(b)(5) as a Real Exception to the Terminable Interest Rule

As previously outlined, § 2056(b)(5) is being referred to as a real exception to the terminable interest rule in the sense that if it were not for this exception, the life estate with power of appointment interest would be a nondeductible terminable interest. A basic premise of this theory is that Congress intended the terminable interest as a means of attaining near perfect qualitative and quantitative equality between the two property systems. From the time of its original enactment, the courts have in effect construed § 2056(b)(5) as a real exception to the terminable interest rule by demanding strict compliance with its provisions. Departure from the statute or its regulations, no matter how slight, was not tolerated. Examples of cases in which the courts have narrowly interpreted and applied the income and power of appointment requirements are abundant.

_Estate of Allen L. Weisberger_ involved two trusts, the entire income from which was given to the surviving spouse subject only to maintenance and support payments to her son. The trustee was given uncontrolled discretion as to when the payments were to be made and was to consider the amount of other income the son was receiving. The son was beneficiary of two additional trusts producing a combined net income of $49,000 annually. The circumstances made it clear that there was no possibility of receiving income from either of his mother's trusts. Relying on the remoteness rule applicable to charitable deductions, the wife unsuccessfully argued that the possibility of the son receiving any income from the trusts was so negligible that it should not bar the applicability of the marital deduction. The court, after referring to legislative history stating "the surviving spouse, by reason of her right to income and a power of appointment is the virtual owner of the property," concluded that § 2056(b)(5), unlike the charitable deduction provision, did not itself create a deduction. Rather, the court indicated that the exception merely rendered the terminable interest rule inoperative and allowed a deduction for what was otherwise a nondeductible

58 See generally, Anderson, _Understanding the Marital Deduction_, 1 P-H Tax Ideas 13,005 (1973) [hereinafter cited as Anderson].
60 See note 15 and accompanying text supra.
61 See generally, 19 STAN. L. REV. 468 (1967).
62 See Anderson, supra note 58, at 13,005.3.
63 Id.
64 29 T.C. 217 (1957).
65 Id. at 221 (citations omitted).
terminable interest. 66

In Commissioner v. Estate of Ellis, 67 the husband had created a trust from which the widow was to receive the entire income for life. She was to receive no less than $5,000 a year, even if invasion of the corpus were necessary, and she alone was to decide such necessity. The court disallowed a marital deduction because state law limited the power of invasion by employing a good faith standard and, therefore, the widow lacked a power exercisable in all events as required by the statute. 68 Again, this stringent interpretation was supported by reliance on the virtual ownership assumption:

[W]e are not unmindful of the legislative history of the marital deduction and the purpose for which it was enacted. But it appears that Congress looked to an absolute ownership of the surviving spouse in the community-property state as the test and that anything less should not be granted the deduction unless it comes squarely within a strict construction of subparagraph (F) [§ 2056(b)(5)]. 69

More recently, the court in Estate of May v. Commissioner 70 disallowed a marital deduction where the surviving wife had been given a life estate in a trust and the right to invade the principal not only for necessities but also for her comfort, happiness and well-being. Even though the power of invasion was within the sole discretion of the wife, a common law good faith limitation on the power was held sufficient to bar the deduction 71 because the power was not exercisable in all events. The taxpayer unsuccessfully relied on legislative history in an attempt to persuade the court that Congress intended that interests which would be taxable as general power of appointments should also be deductible under § 2056(b)(5). The court explicitly rejected the argument that the disallowance of the present deduction coupled with taxation in the spouse’s estate constituted an unfair double tax contrary to congressional intent reflected by the legislative history. Judge Tuttle dismissed this argument:

We know of no rule of construction that permits the court to resort to legislative history or to other sections not necessarily correlated with the one under scrutiny to determine the meaning of language which is as clear as is that of Section 812(e)(1)(F) [§ 2056(b)(5)]. 72

The majority clearly maintained that § 2056(b)(5) was a real exception to the terminable interest rule and required strict compliance.

The above decisions are typical of a large body of case law characterizing § 2056(b)(5) as a real exception to the terminable interest rule. While in each case the results can be supported by a literal reading of statutory language and the principle that deductions are a matter of legislative grace requiring strict
compliance, the equities and the general policy of the marital deduction seem to favor the taxpayer. Double taxation of a common law couple's property because of a strict insistence on qualitative equality is at loggerheads with the very purposes underlying the marital deduction itself. The statute and legislative history indicate that qualitative equality is of secondary importance when compared with quantitative equality. Yet, by giving qualitative equality a controlling importance, numerous common law couples are denied the tax advantages which automatically accrue under the community property system. Equality of estate taxation could better be achieved by insuring quantitative equality while subordinating the importance of the inherently unattainable qualitative equality. Furthermore, unreasonable and overly technical interpretation of the statute tends to frustrate the already difficult process of estate planning.

C. Judicial Treatment of § 2056(b)(5) as an Apparent Exception to the Terminable Interest Rule

The foundation for treating § 2056(b)(5) as an apparent exception was laid in Northeastern Pennsylvania National Bank & Trust Co. v. United States. The decedent's will created a residuary trust from which a trustee was directed to pay out of the income and corpus a monthly stipend to the widow. The surviving spouse was also given a general testamentary power of appointment. The executor of the estate claimed that since the wife was entitled for life to all the income from a specific portion of the corpus and also had a general power of appointment over it, the specific portion should be allowed as a deduction. The Commissioner of Internal Revenue rejected this argument since the widow's right to income was not expressed as "fractional or percentile share" of the trust corpus as required by a treasury regulation. In setting aside the regulation in controversy, the Supreme Court comprehensively considered congressional intent as related to the marital deduction. Without explicitly categorizing § 2056(b)(5) as an apparent exception to the terminable interest rule, the Court's opinion at least supports this theory.

The Government, pursuing a "real" exception approach, argued in favor of the percentile or fractional share regulation as a proper means of preserving the qualitative and quantitative equality of estate taxation between common law and community property jurisdictions. It was argued that congressional intent favored limiting the deduction to cases in which the surviving spouse received "virtual ownership" of the interest equivalent to that received in community property states. The disputed regulation was considered necessary because only if the common law spouse's interest was expressed as a fractional or percentile share could it be subjected to the same economic fluctuations as would community property. It was argued that if a specific portion could qualify for the marital deduction the advantage of a common law resident would be increased: a community property widow, owning a fee simple, faces the possibility

74 Id. at 216.
75 Id. at 222.
76 Id. This view is also expressed in 19 STAN. L. REV. 468 (1967).
that a declining market may dissipate the value of her interest while the holder of a fixed interest is immune to these risks. In part the Commissioner relied on a phrase in the 1948 Senate Finance Committee Report to support the proposition that Congress had intended the deduction to apply only where the survivor was the "virtual owner" of the property. The Supreme Court summarily rejected this argument by stating: "Obviously, Congress did not intend the deduction to be available only with respect to interests equivalent to outright ownership, or trusts would not have been permitted to qualify at all."

More importantly, the Court proceeded to articulate its interpretation of congressional intent which substantially coincides with the "apparent" exception theory elaborated previously.

Congress' intent to afford a liberal "estate-splitting" possibility to married couples, where the deductible half of the decedent's estate would ultimately—if not consumed—be taxable in the estate of the survivor, is unmistakable. Indeed, in §93 of the Technical Amendments Act of 1958, 72 Stat. 1668, Congress made "The more realistic rules of the 1954 Code" apply retroactively to the original enactment of the marital deduction in 1948, and opened the statute of limitations to allow refunds or credits for overpayments. Plainly such a provision should not be construed so as to impose unwarranted restrictions upon the availability of the deduction.

As recognized in the minority opinion, Northeastern represents a significant shift in judicial interpretation of the marital deduction. The majority opinion gave renewed emphasis to the legislative history section dealing with quantitative as opposed to qualitative equality, and Congress' liberal intent in providing the deduction. In effect Northeastern initiated the treatment of §2056(b)(5) as an apparent exception to the terminable interest rule.

A comparison of the May case with Guiney v. United States highlights the various judicial approaches taken to §2056(b)(5). It will be recalled in May that the life estate with power of appointment deduction had been disallowed where the property was certain to be taxable as a general power of appointment within the surviving spouse's gross estate. A contrary result was reached in Guiney where the court under similar circumstances found that the power of appointment complied with §2056(b)(5). The husband had made a bequest to trustees for his surviving wife for life, with a testamentary power of appointment; the bequest complied with a standard formula clause to determine the property qualifying for the deduction. With regard to the power of appointment the following language was placed in the will: "However, I want to make it clear that I am giving my wife a general power of appointment over this trust in order that one-half of my estate may qualify for the marital deduction..."

According to the Commissioner of Internal Revenue, the wife's interest

79 Id. at 221 (footnote omitted).
80 425 F.2d 145 (4th Cir. 1970).
81 See notes 70-72 and accompanying text supra.
82 425 F.2d 145, 147 (4th Cir. 1970).
failed to qualify for the deduction under § 2056(b)(5) because by state law the wife could not appoint the trust principal to herself or her estate.\textsuperscript{83} The relevant Maryland law substantiated the Commissioner's position. Maryland precedent indicated that an unrestricted general power of appointment could only be created by expressly using language to the effect that the donee may exercise the power for his own benefit or for the benefit of his creditors.\textsuperscript{84} Otherwise, the power was limited as not being exercisable in favor of the donee's creditors. Thus, it appeared that as the good faith limitation under New York law had precluded a deduction in May, applicable Maryland law would be a bar in Guiney. Interestingly, however, the Guiney court sidestepped Maryland precedent by citing a liberal trend in finding general powers of appointment among recent Maryland cases. The Court concluded that the language used in the will went far beyond any language previously adjudicated under Maryland law and did in fact amount to an unrestricted power of appointment. More crucial for present purposes, however, the court in dicta suggested that a general power of appointment, taxable in the survivor's estate under § 2041, was significant in determining whether the power complied with the § 2056(b)(5) requirements.\textsuperscript{85} Unlike May, the court connected the two provisions and implicitly gave some weight to the possibility of double taxation in reaching its decision. Furthermore, the testator's intent in qualifying for the marital deduction was explicitly mentioned, buttressing a liberal application of the marital deduction. While Guiney did not expressly categorize § 2056(b)(5) as an apparent exception to the terminable interest rule, there are indications to this effect.

In Friedman v. United States,\textsuperscript{86} the question was whether an income trust with power of the life tenant to appoint qualified for the marital deduction. By the terms of the trust the entire income from the trust property did not have to be paid annually to the surviving spouse. Only such part of it as was necessary to provide for her "support, comfort and happiness" after taking into consideration the income from her separate estate was required to be paid. The will lacked any intent to take advantage of the marital deduction.

The Government claimed that the language of the will in respect to the trust and disposition of the income constituted a nondeductible terminable interest outside of § 2056(b)(5). Specifically, the wife was argued not to be entitled to all the trust income as required by the statute but only such part as the trustees deemed necessary for her support, comfort, and happiness.\textsuperscript{87} It was further contended that the trust failed to qualify because the will failed to provide for the payment of income annually or at more frequent intervals.\textsuperscript{88} The executors, on the other hand, maintained that the trust was within the income requirements of § 2056(b)(5)\textsuperscript{89} and cited the following portion of a Treasury regulation:

\begin{footnotesize}
\begin{enumerate}
\item Id.
\item Id. at 148-49.
\item Id. at 149-50.
\item Id. at 486.
\item Id.
\item Id.
\end{enumerate}
\end{footnotesize}
The spouse is entitled for life to all the income... if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust.90

Ultimately the questions of income entitlement and distribution were answered in the taxpayer's favor. On the issue of whether the wife was entitled to all the trust income the court cited Estate of Todd where it was held that the discretion of the trustees to withhold income was overridden by the "necessity of accomplishing the purpose of the trust" which qualified for the marital deduction.91 The distribution question was resolved by an analysis of Georgia law which provided that if the trust instrument is silent as to frequency of distribution of income, trustees shall distribute the income at least annually.92 Again while Friedman did not categorize § 2056(b)(5) as an apparent exception, its liberal construction of the testator's language is consistent with an apparent exception approach.

Estate of Mittleman v. Commission93 is factually similar to Friedman. The testator had created a trust of the residuary estate "to provide for the proper support, maintenance, welfare and comfort" of his wife, "for her entire lifetime." The Tax Court sustained the Commissioner's determination that the income requirements had not been met.94 In reversing, the appellate court examined the testator's will in full context, including extrinsic circumstances, and concluded the wife was entitled to all the income with the proceeds under state law being required to be paid annually or at more frequent intervals.95

The Mittleman opinion elaborated on ideas that were implicit in the Friedman case. Specifically, rules of construction were discussed in terms of the congressional intent underlying the marital deduction. The court cited the Northeastern case concerning Congress' intent to afford a liberal estate-splitting possibility to married couples where the decedent's estate would—if not consumed—be taxable in the estate of the survivor. The court continued by stating:

So, in interpreting a will ostensibly within this policy, courts should give due weight to the testator's desire to secure the marital deduction... We hold... that where a testator intends to create a trust qualifying for the marital deduction, ambiguities in his will should, if possible, be resolved in favor of success of that endeavor.96

The liberal construction used in Mittleman and its predecessors signals a judicial shift in treatment of § 2056(b)(5). Reanalysis of Congress' intent in enactment of the marital deduction stimulated in part by the Northeastern case has been an impetus. Furtherance of the conceptualization of § 2056(b)(5) as an apparent exception to the terminable interest rule appears to be desirable,
if only for the purpose of giving effect to what appears to be congressional intent. Similarly this conceptualization will advance rather than frustrate the testator's intent. In the absence of congressional action it will be up to the judiciary to evolve or to erase the emerging theory.

VI. Conclusion

A framework of "real" versus "apparent" has been used as a means of analyzing the life estate with power of appointment exception to the terminable interest rule. The choice of approach has significant ramifications for interpretation and application of § 2056(b)(5). A reasonable reading of the legislative history of the relevant acts provides some support for each approach. While tax equalization is the obvious goal of the marital deduction, a primary congressional emphasis on qualitative or quantitative equality, or both, is difficult to discern from the legislation.

The "real" exception approach has been favored by the courts. The northeastern case, however, may be a precursor of significant future judicial development of the "apparent" theory. Resolution of the latent ambiguities involved could best be accomplished by congressional clarification of the statutes.

For the estate planner the apparent exception theory, at its present stage of development, provides little solace in a troublesome area. Scrupulous consideration of relevant statutory materials and judicial decisions together with pains-taking drafting remain the prudent approach. On the other hand, the practicing attorney who is faced with the task of salvaging a deduction would do well to keep in mind § 2056(b)(5) as an apparent exception to the terminable interest rule.

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