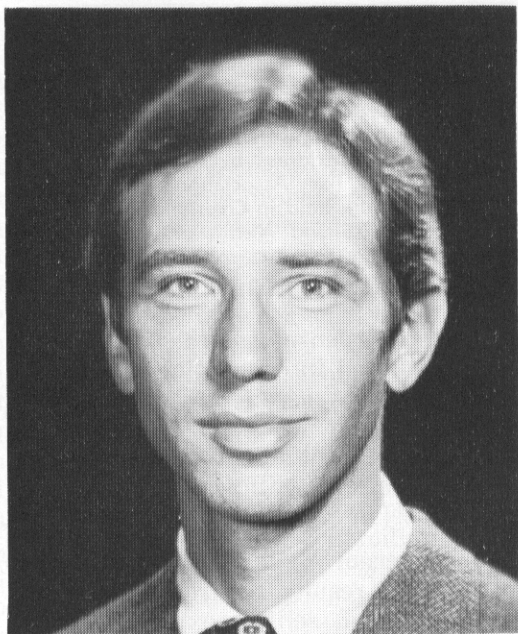


Estate Tax Deductions And Credits —

THE EFFECT OF EVENTS OCCUR-
RING SUBSEQUENT TO DEATH

By EDWIN W. HECKER, JR.



Much attention has been given to items includible in a decedent's gross estate for federal estate tax purposes. Equally important, however, are deductions and credits—items that reduce the gross amount taxable. The amount or even the availability of a deduction may depend upon events occurring subsequent to the decedent's death. Some deductions, such as the administrative expenses discussed in the first section of this article, by their very nature are dependent upon such events. Other deductions, however, are not so dependent. Recent cases concerning both the deduction for claims and the marital deduction attempt to come to grips with the difficult question of timing. That is, should the deduction be fixed as of the date of the decedent's death or should events occurring subsequently be taken into account? Similar issues involving the choice between what happened and what might have happened may arise with respect to the estate tax credit for the tax on prior transfers.

There have been a number of recent

developments in this area. The purpose of this article is to collect and discuss certain of these developments that seem particularly relevant to the Kansas probate practitioner.

DEDUCTION FOR EXPENSES INCURRED IN THE SALE OF ESTATE ASSETS

Section 2053(a)(2) of the Internal Revenue Code ("Code") provides that the taxable estate is determined by deducting from the gross estate, *inter alia*, such amounts for administration expenses "as are allowable by the laws of the jurisdiction . . . under which the estate is being administered."¹ Section 20.2053-3(a) of the Treasury Regulations ("Regulations") states that deductible administration expenses are those *necessarily* incurred in the collection of assets, payment of debts and distribution of property. Expenses not essential to settlement of the estate, but incurred for the individual benefit of the heirs or devisees are not deductible.² Section 20.2053-3(d)(2) specifically pro-

1. INT. REV. CODE of 1954, Sec. 2053(a)(2).

2. Treas. Reg. Sec. 20.2053-3(a).

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vides that expenses, such as brokerage fees, incurred in connection with the sale of estate assets are deductible "if the sale is *necessary* in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution."³

Two recent cases have reached conflicting results regarding the deductibility of selling expenses, the primary focus being on the language of the Regulations requiring necessity. *Estate of Smith*⁴ involved a sculptor who died owning 425 pieces of large, abstract, metal sculpture, constituting 93 percent of his estate. Prior to his death Smith had executed an agreement with a gallery which provided that the gallery would market Smith's work in return for a commission of one-third of the net proceeds. After Smith's death his executors began a gradual liquidation of his estate, and pursuant to the agreement, paid the gallery over \$1,500,000 in commissions. In approving the executors' annual accountings, the state probate court allowed all of these commissions. However, the Internal Revenue Service ("Service") and the Tax Court refused to allow a deduction under section 2053(a)(2) to the extent the commissions were in respect of sales exceeding the aggregate amount of

debts, expenses and taxes payable by the estate. The rationale of the Tax Court was that the language in section 2053(a), regarding allowability of the expenses under state law, was merely a threshold, and not an exclusive, test. The condition imposed by the Regulations, that the sale be necessary to pay debts, expenses, or taxes, or to preserve or distribute the estate, must also be satisfied. The court felt the Regulation was intended to preserve the integrity of the estate tax by limiting deductibility to expenses necessarily incurred during administration. Thus expenses arising from liquidation of assets to pay debts, expenses and taxes were necessary and deductible. But, sales netting cash in excess of the amount required to satisfy these items were not necessary and could not be deducted.

Although the estate did not argue the invalidity of the Regulation, the five dissenting Tax Court judges took it upon themselves to state that it was invalid because it imposed a limitation on deductibility (necessity) not prescribed by the Code. This point was pressed by Smith's executors on appeal, but the Second Circuit both affirmed the Tax Court and avoided the issue of validity of the Regulation, on the following analysis. The applicable state law required expenses to be "necessary" as a condition to being charged against estate assets. While normally the state's interest in supervising its fiduciaries will coincide with the federal interest in taxing passage of the estate, this may not always be the case. The state court proceeding was an uncontested allowance of accountings by the probate court. In these circumstances a federal court may reexamine the state court's allowance of expenses. In making this examination the Tax Court was not refusing to follow state law, but was making a *de novo*

3. *Id.* Sec. 20.2053-3(d)(2) (emphasis added).

4. 57 T.C. 650 (1972), *aff'd*, 510 F.2d 479 (2d Cir.), *cert. denied*, ___ U.S. ___ (1975); *accord*, *Payne v. United States*, 2 CCH FED. EST. & GIFT TAX REP. Par. 13,059 (M.D. Fla. 1975); *Hibernia Bank v. United States*, 2 CCH FED. EST. & GIFT TAX REP. Par. 13,102 (N.D. Cal. 1975) (interest on loans).

inquiry into whether the state court, in fact, followed it. Viewed in this way, the Tax Court was not enforcing conditions in addition to those imposed by state law. Therefore, it was unnecessary to decide whether the Regulation was intended to deny a deduction for expenses allowable under state law, and, if it was, whether it would be invalid.

The dissenting judge would have held the Regulation invalid. He felt that state law was the touchstone of deductibility, and the state probate court allowed the selling expenses with respect to all sales. Although the state statute used the word "necessary," it was clear that the Tax Court was erroneously interpreting necessity solely from a federal point of view.

The taxpayer and dissenting judge in *Smith* relied heavily on *Estate of Park v. Commissioner*,⁵ a case holding the Regulations invalid on similar but even harder facts. In *Park* the decedent died owning certain real estate which her will devised to her four sons. They did not want the land and requested the administrator with will annexed to sell it. This was accomplished, and the expenses incurred in connection with the sale were shown in the administrator's accounting, which was allowed by the state probate court. As in *Smith*, however, the Service and the Tax Court disallowed the section 2053(a)(2) deduction on the ground that the expenses were not necessary for administration of the estate, but rather, were incurred for the personal benefit of the devisees. On appeal to the Sixth Circuit, the administrator directly challenged the validity of the Regulations relied on by the Tax Court. The Sixth Circuit upheld the contention of the administrator and allowed the deduction, principally on the ground that prior

Sixth Circuit cases had recognized the primacy of state law under section 2053(a). Here, the state law contained elaborate provisions regulating the conduct of fiduciaries, and the selling expenses were specifically allowed by the probate court. Therefore, the expenses were deductible for federal estate tax purposes. The court also noted that any attempt to distinguish between a sale that is necessary for the estate and one that is for the individual benefit of the devisees is purely an artificial and unwarranted exercise.

Inherent in the conflict between *Smith* and *Park* is the problem of distinguishing the controlling effect of *state law* from the controlling effect of a *state court decision* involving the very facts at issue in the federal tax litigation. This distinction was the focus of the Supreme Court's opinion in *Commissioner v. Estate of Bosch*,⁶ which involved the validity of a release of a general power of appointment. The Court held that "where the federal estate tax liability turns upon the character of the property interest held and transferred by the decedent under state law, federal authorities are not bound by the determination made of such property interest by a state trial court."⁷ The Court reasoned that the underlying substantive rule is based on state law and the state's highest court is the best authority on its own law. If the decision is only that of an inferior state court, however, the federal court must in effect act as a state court and make its own determination as to state law. In this connection, the federal court need only give "proper regard" to the decisions of state trial and intermediate courts.

A number of cases, including two in the Tenth Circuit, have held or

5. 475 F.2d 673 (6th Cir. 1973), *rev'g*, 57 T.C. 705 (1972).

6. 387 U.S. 456 (1967).
7. *Id.* at 457.

assumed that *Bosch* is applicable to cases involving section 2053(a).⁸ Since this section of the Code mandates only that state law, and not necessarily the decision of a lower state court, is controlling, these decisions seem correct. Therefore, the Second Circuit's decision in *Smith* also seems theoretically correct. It seems completely incorrect, however, to characterize the Tax Court's opinion in *Smith* as a de novo inquiry into the test of necessity under state law. It is clear from the opinion that the Tax Court was almost entirely preoccupied with the federal test embodied in the Regulations. For this reason, the Second Circuit should have remanded the case rather than affirming it.

In light of the Tenth Circuit cases applying the *Bosch* rule to section 2053, and the provisions of the Kansas Probate Code allowing every fiduciary his "necessary" expenses,⁹ it seems likely that a result similar to *Smith* could be reached regarding the deductibility of selling expenses in a Kansas estate. This result would be particularly unfortunate from the estate's point of view, since selling expenses are the only type of administration expense that may be deducted on the estate tax return and also used to offset gain on the estate's income tax return.¹⁰ Thus it would seem advisable, in a case where it is clear in advance that a distribution in kind is not desirable, to include a direction to sell in the testator's will.

DEDUCTION FOR CLAIMS

There have been a number of fairly recent developments relating to the effect that events occurring subse-

quent to the decedent's death have on the estate tax deduction for claims. Section 2053(a)(3) of the Code grants a deduction for claims against the estate that are allowable under state law.¹¹ Regulation section 20.2053-4 limits the deduction to claims that: (1) are personal obligations of the decedent; (2) are in existence at the time of his death; (3) are enforceable against his estate; and (4) in the case of promises or agreements, were contracted bona fide and for full and adequate consideration in money or money's worth.¹² Revenue Ruling 60-247¹³ provides that no deduction will be allowed for claims that have not or will not be paid because the creditor waives payment, fails to file his claim within the time limit provided by local law or otherwise fails to enforce payment.

The theory of this Ruling, that only claims actually paid or payable qualify for the deduction, recently was challenged in *Estate of Hagmann*.¹⁴ In that case the decedent, at the time of his death, had over \$54,000 in bona fide debts outstanding. No claims were filed against his estate, however, and the debts were barred by a nonclaim statute similar to that contained in the Kansas Probate Code.¹⁵ The estate nevertheless took a deduction for the debts under section 2053(a)(3). The Service disallowed this deduction, and its position was sustained by the Tax Court and the Fifth Circuit.

Hagmann's estate contended that since the debts were bona fide, personal obligations of the decedent and were enforceable at the time of his death, they were deductible regardless of the fact that subsequent events rendered them unenforceable. The

8. *Kasishke v. United States*, 426 F.2d 429 (10th Cir. 1970); *First Nat'l Bank of Amarillo v. United States*, 422 F.2d 1385 (10th Cir. 1970); *Underwood v. United States*, 407 F.2d 608 (6th Cir. 1969); *First Nat'l Bank of Fort Worth v. United States*, 301 F. Supp. 667 (N.D. Tex. 1969); *Estate of Lewis*, 49 T.C. 684 (1968).

9. KAN. STAT. ANN. Sec. 59-1717 (1964).
10. INT. REV. CODE of 1954, Sec. 642(g); Rev. Rul. 71-173, 1971-1 CUM. BULL. 204, rev'g, Rev. Rul. 56-43, 1956-1 CUM. BULL. 210.

11. INT. REV. CODE of 1954, Sec. 2053(a)(3).

12. Treas. Reg. Sec. 20.2053-4.

13. Rev. Rul. 60-247, 1960-2 CUM. BULL. 272.

14. 60 T.C. 465 (1973), *aff'd per curiam*, 492 F.2d 796 (5th Cir. 1974).

15. KAN. STAT. ANN. Sec. 59-2239(1) (Supp. 1974).

estate relied primarily on *Ithaca Trust Co. v. United States*,¹⁶ a 1929 Supreme Court decision that established the general principle that the estate of a decedent is to be determined, as far as possible, at the date of his death. Also supporting the estate's position is the fact that section 2053 specifically requires payment as a condition of deductibility only in two circumstances, neither of which was applicable to the case at bar.¹⁷ The Tax Court, however, felt that the purpose of Congress in enacting section 2053 was to impose the estate tax only on the net value of the estate passing from the decedent. It was never intended that debts that could not reduce the value of the estate be deductible. The court noted that to allow a deduction for debts that had become unenforceable and that would never be paid would be to exalt form over substance.

Hagmann seems to make sense from a tax policy standpoint and probably also comports with congressional intent. As is the case with administrative expenses, the major test for deductibility of claims is their allowability under state law. Here, the state nonclaim statute barred the decedent's debts from being allowable charges against his estate. Therefore, disallowance of the deduction was proper.¹⁸

The estate's tax problems are multiplied by the Tax Court's decision in *Estate of Bankhead*,¹⁹ which held that if a debt is barred by a nonclaim statute, the estate usually will realize income from the cancellation of its indebtedness. The combined result of *Hagmann* and *Bankhead* is that the

estate tax liability will be increased through loss of the section 2053(a)(3) deduction, and the estate's income tax liability will be increased through inclusion of the cancellation of indebtedness income. It is possible that this increase in combined taxes could exceed the amount of the voided debt. In such a case it would be economically advantageous for the estate to pay the barred debt. Fortunately, this seems possible in Kansas if express authority is contained in the decedent's will. The proviso to the Kansas nonclaim statute states that provisions of a decedent's will requiring payment of a claim exhibited after expiration of the time limit shall control over the statutory bar.²⁰ Although the proviso uses the term "requiring" it would seem permissible for the will to make waiver of the nonclaim bar discretionary with the executor. This approach would give the executor after-the-fact flexibility to determine whether the increase in income and estate taxes caused by unenforceability of the debt is substantial enough to make waiver prudent. It is well established in Kansas that absent authority in the will, the executor has no power to waive the bar of the nonclaim statute.²¹

A problem somewhat the converse of *Hagmann* is brought out by Revenue Ruling 75-177.²² This Ruling involved the situation of a valid claim that was not formally filed with the probate court, but was presented informally to the executor within the statutory time limit, and was paid by the executor with the approval of the estate's beneficiaries. The state probate code required the filing of all claims, and there was case law to the effect that a fiduciary could be surcharged for payment, within the stat-

16. 279 U.S. 151 (1929).

17. INT. REV. CODE of 1954, Secs. 2053(b), (c)(2).

18. The Tax Court recently reaffirmed its willingness to consider the effect of post-death events on deductions under Sec. 2053(a)(3) in *Estate of Courtney*, 62 T.C. No. 39 (1974) and *Estate of Conard*, 2 CCH FED. EST. & GIFT TAX REP. Par. 8671 (T.C. Memo. 1975) (involving Kansas nonclaim statute).

19. 60 T.C. 535 (1973); see INT. REV. CODE of 1954, Sec. 61(a)(12).

20. KAN. STAT. ANN. Sec. 59-2239(1) (Supp. 1974).

21. In re *Estate of Hill*, 162 Kan. 385, 176 P.2d 515 (1947).

22. Rev. Rul. 75-177, 1975 INT. REV. BULL. No. 19 at 21.

utory time limit, of valid but unfilled claims. Based upon this background the Service ruled that the claim in question was not "allowable" under state law, and therefore was not properly deductible under section 2053(a)(3), even though actually paid. The Service's position seems to be that approval of the estate's beneficiaries is immaterial in this context because, at most, it can give rise to affirmative defenses in a surcharge action, but cannot make an informally presented claim "allowable." Revenue Ruling 75-24²³ makes it clear, however, that if state law actually recognizes unfilled and informally presented claims, the deduction will be available.

These Rulings seems particularly important for the Kansas probate practitioner. The general statutory rule is that all claims against the estate must be exhibited by the filing of a petition for their allowance with the probate court.²⁴ There are two major exceptions to this rule: claims not exceeding \$200, if verified and approved in writing by the executor or administrator;²⁵ and exhibition by revival or commencement of an action.²⁶ A possible third exception may be derived by implication from the power of an executor to pay reasonable funeral expenses before letters testamentary are granted.²⁷ Outside of these narrow areas, however, there seems to be no authority for a Kansas fiduciary to pay a claim that has not been filed with the probate court. Conversations with several members of the Bar indicate that the practice of paying informally presented claims may be widespread. Although the author is not aware of any Kansas case surcharging a fiduciary for payment, within the statutory time limit, of a valid but unfilled

claim, the practice seems risky at best. Unless Revenue Ruling 75-177 is successfully challenged, this practice may result in the loss of substantial estate tax deductions. Finally, it should be emphasized that the Kansas Simplified Estates Act, passed as a part of the 1975 Probate Code amendments, does not alleviate this problem. While section 32 of the Act dispenses with court supervision of payment of claims,²⁸ that section and section 31(b) make it clear that the general filing requirements will apply to simplified as well as supervised estates.²⁹ Thus simplified administration should not be confused with informal administration.

MARITAL DEDUCTION

The marital deduction is another area in which issues may arise regarding the propriety of taking into account events that occur subsequent to the testator's death. *Estate of Wycoff v. Commissioner*³⁰ is an important Tenth Circuit case raising such an issue in the context of section 2056(b)(4)(A). This section provides that for purposes of the marital deduction, in valuing the interest passing to the surviving spouse, "there shall be taken into account the effect which the [federal estate tax], or any estate, succession, legacy, or inheritance tax, has on the net value to the surviving spouse of such interest" ³¹ Clearly, the effect of this provision is that if taxes actually are paid out of property otherwise qualifying for the marital deduction, the deduction must be reduced and the overall estate tax burden correspondingly increased. *Wycoff*, however, raises the question whether the deduction also must be reduced if taxes could have been paid from the marital portion of the estate even though in

23. Rev. Rul. 75-24, 1975 INT. REV. BULL. No. 3 at 35.

24. KAN. STAT. ANN. Sec. 59-2237 (Supp. 1974).

25. *Id.*

26. KAN. STAT. ANN. Sec. 59-2238 (1964).

27. *Id.* Sec. 59-704.

28. KAN. STAT. ANN. Sec. 59-3204 (Supp. 1975).

29. *Id.*; *Id.* Sec. 59-3203(b).

30. 506 F.2d 1144 (10th Cir. 1974), cert. denied, ___ U.S. ___ (1975).

31. INT. REV. CODE of 1954, Sec. 2056(b)(4)(A).

actuality they eventually were paid from the nonmarital portion. Or, phrased differently, it addresses the question whether events occurring subsequent to the testator's death may be considered for purposes of section 2056 as they are for purposes of section 2053.

A substantial portion of Wycoff's estate consisted of stock in closely-held corporations. His will created a formula pecuniary marital trust and a residuary trust. The will directed that, if practicable, the close corporate stock should be allocated to the residuary trust, presumably to avoid having the surviving spouse participate in the business. The will also directed that all death taxes be paid out of the residuary trust *unless* the executor, in the exercise of his sole discretion, decided that these taxes could more prudently be paid from any assets in the estate, without regard to what property was or was not allocated to the marital trust. This latter clause presumably was included to give the executor discretion to avoid liquidation of the testator's close corporate holdings. Although the executor had discretion to apply marital trust assets to payment of death taxes, *in fact*, all taxes were paid from the residuary trust, and this action was approved by the state probate court. Nevertheless, the Tenth Circuit affirmed the decision of the Tax Court reducing the marital deduction by an amount equal to a portion of the death taxes that *could* have been paid from the marital trust.

The court gave two alternative grounds for its holding, one based on section 2056(b)(4)(A) and one based on section 2056(b)(5). With respect to section 2056(b)(4)(A), and in answer to the executor's contention that the actual source of payment should control, the court

noted that in determining whether an interest qualifies for the marital deduction, tax consequences are determined as of the date of the decedent's death. Since at that time, the executor could have used assets allocable to the marital trust to satisfy death taxes, section 2056(b)(4)(A) must apply. The court recognized the formula marital gift as indicative of an intent to maximize the marital deduction. It was unwilling, however, to hold that the offending portion of the tax clause was so repugnant to the overall scheme of the estate plan as to be ineffective. The court probably is on fairly strong ground regarding the testator's intent. The very presence of the proviso in the tax clause, coupled with the allocation of the close corporate stock to the nonmarital trust, seems to indicate an intent that the marital deduction be maximized if possible, but *not* at the expense of liquidating or relinquishing control over the family business.

With respect to section 2056(b)(5), the court noted that the marital trust, in order to qualify under the exception to the terminable interest rule, had to give the surviving spouse a life estate and a general power of appointment over the remainder. Section 2056(b)(5) specifically requires that the trust include "no power in any other person to appoint any part of the interest . . . to any person other than the surviving spouse" ³² Considering the state and federal governments to be "persons," the court held that the power of the executor to pay death taxes out of marital trust assets was a power in another person to appoint part of the interest to a person other than surviving spouse. Therefore, to the extent death taxes could be paid from the marital trust, it did not

(Continued on Page 185)

³². *Id.* Sec. 2056(b)(5).

Tax Deductions & Credits

(Continued from Page 149)

qualify for the deduction under section 2056(b)(5).

While unfortunate from an estate planner's point of view, the result reached by the court appears correct. Both statutory provisions at issue are contained in section 2056(b), which deals with a number of problems concerning terminable interests. Although the language of subsection (b)(4)(A) is ambiguous, subsection (b) taken as a whole seems to be concerned primarily not with what actually occurs but with what might occur based on facts as they exist at the date of the decedent's death. Thus, subsection (b)(1), setting forth the general rule disqualifying terminable interests, speaks in terms of the occurrence of an event or contingency that will cause the interest of the spouse to fail. The very nature of a contingency is something that may or may not occur. Subsection (b)(2) provides that if a marital bequest may be satisfied out of assets that include nondeductible terminable interests, the deduction must be reduced by the aggregate value of these assets. The effect of this subsection is to reduce the marital deduction whether or not the "tainted" assets are in fact used to satisfy the bequest. Subsection (b)(3) provides that if the interest of the spouse is terminable only on death with the decedent in a common disaster or on failure to survive the decedent by a period not exceeding six months, the interest nevertheless will qualify for the marital deduction if the condition does not in fact occur. The fact that Congress included this specific, narrowly limited exception with respect to certain conditions that do not in fact occur indicates that in all other

cases it is the possibility and not the actuality that is important.

The Regulations also stress that the marital deduction is to be determined as of the date of the decedent's death and is to be reduced by death taxes "payable," not necessarily paid, out of the spouse's interest.³³ In addition, a long line of judicial authority supports this general reading of section 2056(b).³⁴ Finally, the position of the *Wycoff* court with respect to section 2056(b)(5) is consistent with the Service's view that a fiduciary's administrative powers may constitute a power in another person to shift beneficial enjoyment away from the surviving spouse.³⁵

Regardless of whether one agrees or disagrees with the result in *Wycoff*, its message is unmistakable. All wills and trusts drafted by Kansas lawyers must require, without exception, that death taxes be paid only from the nonmarital portion of the available assets if maximization of the marital deduction is desired.

CREDIT FOR TAX ON PRIOR TRANSFERS

Section 2013 of the Code permits a credit for part or all of the estate tax paid with respect to the transfer of property to the decedent from a person who died within ten years before or two years after the decedent.³⁶ The purpose of the credit is to alleviate the cumulative effect of two estate taxes imposed with respect to the same property in a relatively short period of time. There is no requirement, however, that the prop-

33. Treas. Reg. Secs. 20.2056(b)-4(a) and (c)(4).

34. *E.g.*, *Jackson v. United States*, 376 U.S. 503 (1964); *Bookwalter v. Lamar*, 323 F.2d 664 (8th Cir. 1963); *United States v. Mappes*, 318 F.2d 508 (10th Cir. 1963); *Starrett v. Commissioner*, 223 F.2d 163 (1st Cir. 1955).

35. IRS News Release IR-665 (1964), quoted in 1 CCH FED. EST. & GIFT TAX REP. Par. 2081.48 (explaining Rev. Proc. 64-19, 1964-1 CUM. BULL. 682); 1 CCH FED. EST. & GIFT TAX REP. Par. 2081.093; see Rev. Rul. 69-56, 1969-1 CUM. BULL. 224.

36. INT. REV. CODE of 1954, Sec. 2013.

erty be included in the transferee's gross estate. For this reason it has long been recognized that the credit will be available in cases where the transferor merely creates a life estate in the transferee. The rationale seems to be that the life estate may increase the size of the life tenant's gross estate either directly, by means of income accumulations, or indirectly, by freeing other property from being called upon to meet lifetime needs.

The amount of the credit is based on the value of the property in the transferor's estate. The problem of valuing life estates essentially is one of determining the transferee's life expectancy as of the date of the transferor's death. A troublesome question that has been the subject of three fairly recent cases is whether this life expectancy should be the transferee's actuarial life expectancy or his actual life expectancy. As will be seen, this problem is practically, if not analytically, analogous to the marital deduction problem discussed above.

Regulation section 20.2013-4(a) provides that the life estate is to be valued "as of the date of the transferor's death on the basis of recognized valuation principles (see especially §§20.2031-7 and 20.2031-

10)."37 Both of these latter sections provide that the value of a life estate is to be determined on the basis of actuarial tables set forth therein. In 1966 the Service promulgated Revenue Ruling 66-307 which provides that while the actuarial tables normally will control, "if it is known on the valuation date that a life tenant is afflicted with a fatal and incurable disease in its advanced stages, and that he cannot survive for more than a brief period of time, the value of the life or remainder interest should be determined by reference to such known facts . . ."38 This Ruling, which would permit departure from the actuarial tables in certain instances, has recently come under attack.

*Merchants National Bank of Topeka v. United States*³⁹ involved a life tenant whose health was so precarious on the date of the transferor's death that her doctor predicted she had only a few months to live, a prediction that ultimately proved accurate. In its original opinion the court held it was improper to depart from the actuarial tables in *any* case. The court stated that the Regulations were unambiguous, were promulgated by the Treasury, and mandated use of the tables in all cases. One of the main purposes of the tables was to eliminate uncertainty and avoid the necessity of a lengthy, complicated and expensive proof of actual life expectancy in every case. The court construed the Service's position to be that the tables simply are evidence of life expectancy, subject to being overcome by other evidence. The court felt acceptance of this position would make the Regulations meaningless and would open "the proverbial can of worms." On rehearing, the court adhered to its original view

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37. Treas. Reg. Sec. 20.2013-4(a).

38. Rev. Rul. 66-307, 1966-2 CUM. BULL. 429.

39. 73-1 U.S.T.C. Par. 12,917, modified on rehearing, 369 F. Supp. 1080 (D. Kan. 1973).

that exclusive use of the actuarial tables would be the better practice but was convinced the weight of authority was to the contrary. Therefore, it determined that life expectancy was a question of fact and that summary judgment for the taxpayer should be denied.

In *Mercantile-Safe Deposit & Trust Co. v. United States*,⁴⁰ the life tenant died less than four weeks after the transferor's death. The court delineated three possible approaches to the effect of the actuarial tables. First, the tables should not be given controlling effect in any case. The court noted, however, that even the Service conceded this approach would be improper and contrary to the essential purpose of the tables. Second, the tables must control in every case. This was the rule advocated by the taxpayer. This approach, however, had been rejected by the Fourth Circuit in *Estate of Lion v. Commissioner*,⁴¹ and thus could not be adopted by a district court sitting in that circuit. Third, the tables ordinarily will control, but resort may be made to extrinsic evidence in exceptional cases where it was unmistakable, at the time of the transferor's death, that the transferee's life expectancy was radically shorter than that predicted by the tables. This was the rule adopted in *Lion* and which controlled the case at bar. The court found the rule inapplicable to the facts, however. Although the transferee had kidney and liver problems due to semi-alcoholism, she did not have an incurable fatal disease, and actually died from a totally unrelated stroke. Therefore, the court rendered judgment for the taxpayer, granting the full credit based on the transferee's life expectancy determined under the actuarial tables.

Continental Illinois National Bank

40. 368 F. Supp. 743 (D. Md. 1974).
41. 438 F.2d 56 (4th Cir. 1971).

*v. United States*⁴² is somewhat similar. Here, the life tenant had cancer of the colon and died one month after the transferor. Her life expectancy at the transferor's death, computed under the tables, was six years. The district court had held for the taxpayer on alternative grounds: Revenue Ruling 66-307 was invalid; or assuming, arguendo, that Revenue Ruling 66-307 was valid, it was inapplicable to the facts of the case. The Seventh Circuit decided the case on the basis of the latter ground and affirmed the district court.

The court read the Ruling to apply, by its own terms, only when two conditions are met: it is known as of the valuation date that the life tenant has a fatal and incurable disease in its advanced stages; and that he cannot survive for more than a brief time. It was clear that the first condition was satisfied by advanced cancer of the colon. The same could not be said, however, of the second condition. The court construed "brief" to be an absolute rather than relative term and equated it with something imminent or close at hand. Three experts had testified regarding the life tenant's actual life expectancy, and their estimates ran anywhere from six months to possibly two years. The district court found, on the basis of this conflicting testimony, that the life tenant could have lived for one year and that such a period was not "brief." This finding was not clearly erroneous. Therefore, even assuming the validity of Revenue Ruling 66-307, it was inapplicable.

This valuation controversy seems especially important because it could result in a "heads I win, tails you lose" proposition for the Service. The court in *Mercantile-Safe Deposit & Trust Co.* ventured the opinion that

42. 504 F.2d 586 (7th Cir. 1974), cert. denied, ___ U.S. ___ (1975).

either the government or the taxpayer could invoke the "exceptional case" theory to take the valuation question out of the actuarial tables. As a practical matter, however, the theory may be a one-edged sword available only to the government. In cases involving section 2013, the longer the transferee's life expectancy the greater the credit. However, it would be an exceptional case indeed in which one could unmistakably predict, as of the date of the transferor's death, that the transferee's life expectancy was radically longer than that computed under the tables.

In cases arising under sections 2037 and 2042(2) of the Code,⁴³ certain property may be included in a decedent's gross estate even though he has transferred it away during his lifetime if he has retained a reversionary interest which, immediately before his death, exceeded five percent of the value of the property. In such a case it would be to the estate's advantage to take the question out of the actuarial tables and show that the decedent had a shorter than average life expectancy. But predictably, and on rather weak grounds, Revenue Ruling 66-307 expressly restricts its own scope to preclude its application to cases arising under sections 2037 and 2042(2).

Therefore, it is submitted that the hesitancy of the courts, under one guise or another, to wholeheartedly espouse this doctrine is well-founded. Even though the District Court for Kansas adopted the rule that departure from the tables may be proper in some cases, *Mercantile-Safe Deposit & Trust Co.* and *Continental Illinois National Bank* indicate that, having won on the law, the Service still faces some hard battles on the facts.

CONCLUSION

One may note the lack of consistency shown by the cases regarding the estate tax significance of events occurring subsequent to death. This inconsistency is most apparent in a comparison of the *Hagmann* and *Wycoff* cases. In *Hagmann* a deduction under section 2053 was disallowed because events occurring subsequent to the testator's death had to be considered. In *Wycoff* a deduction under section 2056 was partially disallowed because events occurring subsequent to the testator's death could not properly be considered. It is submitted, however, that both cases are correct and that this inconsistency is inherent in the differing natures of the various deductions granted by the Code.

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43. INT. REV. CODE of 1954, Secs. 2037 and 2042(2).