Requirements For The Federal Estate Tax Marital Deduction

§2.1 SEVEN ESSENTIAL REQUIREMENTS FOR THE FEDERAL ESTATE TAX MARITAL DEDUCTION

Seven requirements must be met for an interest to qualify for the federal estate tax marital deduction:

1. The decedent must be legally married at the time of his or her death;
2. The person to whom the decedent is legally married at the time of his or her death must survive the decedent;
3. The surviving spouse must be a U.S. citizen (or the property must be held in a QDOT (discussed in Chapter 5));
4. The interest passing to the surviving spouse must be includable in the decedent’s U.S. gross estate;
5. The interest must “pass” to the surviving spouse;
6. The interest received by the surviving spouse must be a deductible interest; and
7. The value of the interest passing to the surviving spouse must be at its “net value.”

§2.2 LEGALLY MARRIED REQUIREMENT

The validity and the existence of marriage is a question of state law, such as common law marriages. Marriage continues until a final divorce or dissolution decree is entered by the court. Marriner S. Eccles v. Commissioner, 19 T.C. 1049 (1953), aff’d on other grounds, 208 F.2d 796 (4th Cir. 1954). See also, Defense of Marriage Act, 28 U.S.C. §1738c. Because federal law does not recognize same-sex marriages, the marital deduction is not available for same-sex couples. 1 U.S.C. §7 states that “[i]n determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word ‘marriage’ means only a legal union between one man and one woman as husband and wife, and the word ‘spouse’ refers only to a person of the opposite sex who is a husband or a wife.” [Emphasis supplied.]

§2.3 SURVIVORSHIP REQUIREMENT FOR SPOUSE

In the absence of a contrary provision in the governing instrument, state law will determine survivorship if both spouses die simultaneously.

§2.3(a) Simultaneous Death Act

Under the Uniform Simultaneous Death Act, each spouse is presumed to have survived the other, which results in each estate receiving one half the joint property.

Practice Point: To avoid under-utilization of the applicable exclusion amount, the less-wealthy spouse (who otherwise would have insufficient separate assets to fully fund a credit shelter trust) should be presumed to have survived. See, Paragraph 7.1 of Sample MD Trust for an example of a survivorship clause.¹

§2.3(b) Six-Month Survival Condition

¹ The sample marital Deduction trust (“Sample MD Trust”) referenced throughout this book is contained in Appendix 1.
A bequest that is conditioned upon the spouse surviving up to six months after the first spouse’s death will qualify for the marital deduction. But if the bequest is contingent upon a condition that may not be determined within that six-month period, the marital deduction will not be available. IRC Section 2056(b)(3).

Practice Point: A six-month survival clause is unnecessary in a QTIP trust arrangement. This is because the grantor’s fiduciary has at least nine months from the grantor’s date of death (and up to 15 months with a six-month extension) to file the federal estate tax return and, therefore, assess the situation and determine if a partial or full QTIP election should be made.

Practice Point: When drafting a survivorship clause, do not refer to death as the result of a “common disaster” (“If my spouse and I die as the result of a common disaster”) unless it is qualified “such that it cannot be determined which of us died first.”

§2.4 U.S. CITIZEN REQUIREMENT FOR SURVIVING SPOUSE

The surviving spouse must be or become a U.S. citizen by the time the decedent’s federal estate tax return is filed. A noncitizen spouse who is in the process of obtaining citizenship must also be a U.S. resident at all times after the decedent’s death and before citizenship is granted. If the surviving spouse decides to become a U.S. citizen, a representative of the decedent’s estate should request an extension of time to file the federal estate tax return because the citizenship process will take more than nine months in most instances. In the absence of citizenship, the marital deduction is allowed only for property placed in a QDOT before the estate tax return is filed and for property governed by an applicable tax treaty.

§2.4(a) Decedent Need Not Be A U.S. Citizen Or Resident

Before 1988, the citizenship or residence status of the decedent, not of the surviving spouse, determined the availability of the federal estate tax marital deduction. If the decedent was a citizen or resident alien of the United States and, therefore, taxable on his or her worldwide assets, the marital deduction was allowed without regard to the surviving spouse’s citizenship. However, in 1988, the Technical and Miscellaneous Revenue Act of 1988 (“TAMRA”) reversed the rules. As a result of this change in the law, IRC section 2106(a)(3) now allows a marital deduction for a nonresident alien who dies after Nov. 10, 1988, and who has property situated in the United States that is included in his or her U.S. gross estate, provided the IRC section 2056 marital deduction requirements are met. But no marital deduction is allowed if the surviving spouse is not a U.S. citizen unless the qualified domestic trust exception to IRC section 2056(d) (found in IRC section 2056A) applies (as discussed in Chapter 5, below). In addition, the rules for qualified joint interests between spouses do not apply in such a situation so that joint property is includable in the estate of the spouse who supplied the consideration. IRC section 2056(d)(1)(B). See, Pvt. Letter Rul. 9551014 for a ruling applying the joint ownership rules to property acquired both before and after July 14, 1988, the effective date of the revised marital deduction rules for noncitizen spouses. Community property created under domestic or foreign law is deemed created equally by both spouses.

§2.5 INCLUDABLE IN DECEDEDENT’S GROSS ESTATE REQUIREMENT

An interest is nondeductible to the extent that it is not includable in the decedent’s gross estate. Treas. Reg. §20.2056(a)-2(b)(1). A marital deduction will not be allowed for property that is otherwise deductible as an expense, claim or loss. No double deduction is permitted. Thus, an interest cannot qualify for the marital deduction if it otherwise is deducted under either IRC section 2053 or section 2054. IRC section 2056(b)(9). For example, no marital deduction is allowed for property that passes to the surviving spouse that is used by the estate to pay the decedent’s funeral expenses.
§2.6 PASSING REQUIREMENT

Section 2056(c) of the IRC defines “passing” to include interests acquired by the surviving spouse by will, intestate succession, dower, curtesy, statutory share, right of survivorship, the exercise or default of exercise of a power of appointment, or pursuant to a life insurance beneficiary designation. The requirement generally is not satisfied if the surviving spouse’s interest is created by the action of third parties. Estate of Kenneth L. Allen, Sr. v. Commissioner, 60 T.C.M. (CCH) 904 (1990). The passing requirement also can be satisfied by designating the surviving spouse as the beneficiary of employee death benefits or any other annuity includable in the decedent’s gross estate under IRC section 2039. Treas. Reg. §20.2056(c)-1, 2, 3.

§2.6(a) Disclaimers

An interest received by the surviving spouse as a result of a third party’s qualified disclaimer under IRC section 2518 is considered to have passed to the surviving spouse. Treas. Reg. §20.2056(d)-2(b).

§2.6(b) Premarital Agreements

Payments made to a surviving spouse under the requirements of a premarital agreement are considered to have passed to the surviving spouse. Rev. Rul. 54-446, 1954-2 C.B. 303.

§2.6(c) Slayer’s Statute

Murder committed by a surviving spouse may prevent that spouse from receiving property from the estate of the decedent/victim. States differ regarding the effect of various criminal laws.

§2.6(d) Will Contests And Settlements

To qualify for the marital deduction, the amount received by the surviving spouse must be in bona fide recognition of enforceable rights in the decedent’s estate. See, Treas. Reg. §20.2056(c)-2(d)(2); Estate of G. Nelson Mergott v. United States, 2000-2 U.S. Tax Cas. (CCH) ¶60,383 (D.N.J. 2000) (denying deduction); Pvt. Letter Ruls. 200127038 and 9610018 (granting deduction). These enforceable rights must be in existence under state law at the time of the decedent’s death and cannot arise as a result of a settlement agreement. A state court decree is only determinative of issues upon which it passes in a genuine and actual controversy. See, Bel v. United States, 452 F.2d 683 (5th Cir. 1971), cert. denied, 406 U.S. 919 (1972). A court order approving an uncontested petition will not be viewed as binding by the IRS. A payment made under a consent decree or a settlement agreement not to contest the decedent’s will or trust may not be a bona fide recognition of enforceable rights of the surviving spouse. Treas. Reg. §20.2056(c)-2(d)(2). This is a gray area that is fact specific.

§2.7 THE DEDUCTIBLE INTEREST REQUIREMENT (AND THE TERMINABLE INTEREST RULE)

According to Treas. Reg. §20.2056(a)-2(b), an interest passing to a decedent’s surviving spouse is a “deductible interest” if it does not fall within one of the following categories of “nondeductible interests:” (1) a property interest not included in the decedent’s gross estate; (2) an interest deducted under IRC section 2053 (relating to deductions for expenses and indebtedness); (iii) a casualty loss under IRC section 2054; or (iv) a terminable interest under IRC section 2056(b)(1). The remainder of this section will discuss only the terminable interest rule and its impact on the marital deduction.

As part of the terminable interest rule, an interest passing from the decedent to the surviving spouse must be subject to inclusion in the surviving spouse’s gross estate, to the extent not consumed or disposed of during the surviving spouse’s lifetime. This reflects the fact that the federal estate tax is merely deferred by the marital deduction, not eliminated.