Estate of Harrison P. Shedd, Deceased, First National Bank of Arizona, Phoenix, Executor, Petitioner, v. Commissioner of Internal Revenue, Respondent, 23 T.C. 41 (1954)

For an interest in property to qualify for the marital deduction under the Internal Revenue Code, it must not be a terminable interest, and if it is a trust with a power of appointment, the surviving spouse must have a power of appointment over the entire corpus and be entitled to all income from the trust.

Summary

The Estate of Harrison Shedd contested the Commissioner's disallowance of a marital deduction. The decedent's will created a trust providing his wife with two-thirds of the income for life and a general power of appointment over one-half of the trust corpus. The Tax Court held that the surviving spouse's interest did not qualify for the marital deduction. The court determined that the interest was terminable because it would pass to other beneficiaries if the power of appointment was not exercised. Furthermore, the court found that the trust did not meet the requirements for the exception under Section 812(e)(1)(F) of the Internal Revenue Code because the surviving spouse was not entitled to all of the income and did not have a power of appointment over the entire corpus.

Facts

Harrison P. Shedd died a resident of Arizona in 1949, leaving a will that established a trust. The will directed the trustee to distribute two-thirds of the trust income to his wife, Mary Redding Shedd, and one-third to his son for their respective lives. The trust was to terminate upon the death of the survivor of two named grandchildren, with the corpus then distributed to their issue. A second codicil granted his wife a power of appointment over one-half of the trust corpus. The wife could exercise this power during her lifetime or by will; if she did not exercise the power, that portion of the corpus would be managed and distributed according to the will's original provisions. The wife exercised her power of appointment, and one-half of the residue of the estate was distributed to her. The Commissioner disallowed the marital deduction for the interest in the one-half of the residue claimed by the estate.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the estate tax and disallowed the marital deduction. The Estate of Shedd contested this determination in the United States Tax Court. The Tax Court heard the case based on stipulated facts.

Issue(s)

1. Whether the interest received by the surviving spouse was terminable within the meaning of Section 812(e)(1)(B) of the Internal Revenue Code.

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2. If the interest was terminable, whether it qualified as a “Trust with Power of Appointment in Surviving Spouse” under Section 812(e)(1)(F) of the Internal Revenue Code.

Holding

1. Yes, because the surviving spouse’s interest in the residuary estate terminated upon her death, and if she failed to exercise the power of appointment, the interest would pass to someone other than her estate.

2. No, because the surviving spouse was not entitled to all of the income from the corpus and did not have a power of appointment over the entire corpus.

Court’s Reasoning

The court addressed two primary questions. First, the court analyzed whether the interest was terminable under Section 812(e)(1)(B), which disallows a marital deduction if the surviving spouse’s interest will terminate upon the occurrence or non-occurrence of an event, and the property passes to someone other than the surviving spouse. The court determined that the interest was terminable because the wife’s interest would cease upon her death, and the unappointed portion would pass to other beneficiaries. The court rejected the estate’s argument that the power of appointment rendered the gift over void because the will explicitly granted the power of appointment along with the life estate. The court cited the rule that where a life estate is expressly created, the mere addition of a power of disposal does not render the executory limitation over void.

Second, the court assessed whether the trust qualified for the exception under Section 812(e)(1)(F). This section provides an exception to the terminable interest rule for trusts where the surviving spouse is entitled to all income and has a power of appointment over the entire corpus. The court found that the trust did not meet these requirements. Specifically, the widow was entitled to only two-thirds of the income, not all of it, and had a power of appointment over only one-half of the corpus. The court held that “an income interest in and a power of appointment over a part of the corpus of a single trust does not satisfy the requirements of section 812(e)(1)(F) as written, and therefore the deduction is not allowable.”

The court emphasized that the terms of the statute had to be met exactly. “In order to qualify for the deduction the petitioner must bring itself squarely within the terms of the statute.”

Practical Implications

This case underscores the importance of strict compliance with the Internal Revenue Code’s requirements for the marital deduction. Attorneys must meticulously draft wills and trusts to ensure that they meet all the necessary conditions. Specifically, when using a trust to qualify for the marital deduction, the trust must grant the

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surviving spouse a power of appointment over the *entire* corpus of the trust and the right to *all* income from the trust. The court's decision highlights the need for careful planning and precise language in estate planning to avoid unintended tax consequences. The case suggests that even if the testator's intent is clear, the deduction can be denied if the technical requirements of the statute are not met.

Later cases considering marital deductions have similarly emphasized the importance of meeting the specific statutory requirements. Attorneys should advise clients to create separate trusts when appropriate to ensure that the surviving spouse has a power of appointment over the entire corpus of a trust.

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