65 T.C. 188 (1975)

An elective right granted to a surviving spouse to take absolute ownership of property from a life estate bequest, exercisable within a limited time, is considered a terminable interest and does not qualify for the marital deduction under section 2056 of the Internal Revenue Code because the power is not exercisable “in all events.”

Summary

In *Neugass v. Commissioner*, the Tax Court addressed whether a bequest granting a surviving spouse a life estate in an art collection, coupled with an elective right to take absolute ownership of specific items within six months of the decedent’s death, qualified for the marital deduction. The court held that the elective right constituted a terminable interest. It reasoned that the spouse’s ability to elect absolute ownership was not an alternative bequest but a power of appointment. Because this power was time-limited, it was not exercisable “in all events” as required by the marital deduction exception for powers of appointment. Consequently, the court disallowed the marital deduction for the elected artwork, distinguishing this scenario from permissible elections like statutory shares or alternative bequests.

Facts

Decedent’s will bequeathed his art collection to his wife, Mrs. Neugass, for life, and upon her death, to his daughter, Nancy, for life. Article Fifth (b) of the will further provided Mrs. Neugass with the option to elect absolute ownership of any items within the art collection. Mrs. Neugass exercised this election within six months of the decedent’s death, choosing to take absolute ownership of specific artworks. The decedent’s estate sought to claim a marital deduction for the value of these selected artworks. The Commissioner of Internal Revenue disallowed the deduction, arguing that the interest Mrs. Neugass received was a terminable interest and thus ineligible for the marital deduction.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency disallowing the marital deduction claimed by the Estate of Jacques Neugass. The Estate then petitioned the Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner’s determination, ruling against the Estate and finding that the interest did not qualify for the marital deduction.

Issue(s)

1. Whether the surviving spouse’s elective right to take absolute ownership of items from the art collection, within a six-month period following the decedent’s death, constitutes a terminable interest that is disqualified from the marital deduction under section 2056 of the Internal Revenue Code.

2. Whether Mrs. Neugass's election to take absolute ownership should be construed as a disclaimer of her life estate in those items, thereby allowing the property to be considered as passing directly to her from the decedent and qualifying for the marital deduction.

Holding

1. No, because the elective right was not an alternative bequest but a power of appointment that was not exercisable "in all events" due to the six-month time limitation, thus constituting a terminable interest ineligible for the marital deduction.

2. No, because Mrs. Neugass obtained absolute ownership through the exercise of the elective right (power of appointment) granted in the will, not as a result of a disclaimer of her life estate.

Court's Reasoning

The Tax Court reasoned that at the moment of the decedent's death, Mrs. Neugass was immediately granted a life estate in the art collection, a clearly terminable interest. Her subsequent election to take absolute ownership was not an alternative bequest offered at the time of death, but rather an enlargement of her pre-existing life estate through a power of appointment. The court emphasized that for a power of appointment to qualify for the marital deduction exception under section 2056(b)(5), it must be exercisable by the spouse "alone and in all events." Quoting Treasury Regulations § 20.2056(b)-5(g)(3), the court stated, "The power is not 'exercisable in all events', if it can be terminated during the life of the surviving spouse by any event other than her complete exercise or release of * * *" The six-month limitation on Mrs. Neugass's election meant the power was not exercisable in all events, thus failing the exception. The court distinguished *Estate of George C. Mackie*, noting that in *Mackie*, the spouse had a genuine election between alternative bequests at the time of death, unlike Mrs. Neugass who already possessed a life estate. Finally, the court rejected the disclaimer argument, stating that Mrs. Neugass's acquisition of absolute ownership was a result of exercising the power of appointment, not a disclaimer of her life estate, and therefore section 2056(d)(1) concerning disclaimers was inapplicable.

Practical Implications

Neugass v. Commissioner serves as a critical precedent highlighting the strict application of the terminable interest rule and the "exercisable in all events" requirement for marital deductions involving spousal powers of appointment. It underscores that elective rights to augment an existing life estate are treated as powers of appointment, not as alternative bequests available at the moment of death. Estate planners must be meticulous in drafting testamentary instruments to ensure bequests intended for the marital deduction comply with these stringent rules. Time-limited elections or powers that are not exercisable in all possible circumstances may jeopardize the availability of the marital deduction. This case emphasizes the importance of structuring spousal bequests to avoid terminable interests unless they clearly fall within statutory exceptions, and it clarifies the distinction between a limited power of appointment and a true election between alternative bequests for marital deduction purposes. Later cases and IRS rulings continue to reference *Neugass* when analyzing terminable interests and powers of appointment in the context of the marital deduction.

