Estate of W. L. Harper, Deceased, Fred R. Veith, Coexecutor and Robert O. Edington, Coexecutor, Petitioner v. Commissioner of Internal Revenue, Respondent, 93 T. C. 368 (1989)

Property transferred to an inter vivos trust pursuant to a residuary pour-over provision in a decedent's will qualifies for the marital deduction as qualified terminable interest property (QTIP) despite the surviving spouse's election to take against the will.

Summary

W. L. Harper's estate involved a residuary pour-over to an inter vivos trust, with his surviving spouse, Florence W. Harper, as a lifetime income beneficiary. Upon Harper's death, Florence elected to take her statutory share under Kentucky law, rather than under the will. The issue before the U. S. Tax Court was whether the trust assets qualified for the marital deduction as QTIP. The court held that under both Kentucky and Ohio law, Florence's election did not affect her beneficial interest in the trust, and thus the property 'passed from the decedent' to her, qualifying for the deduction. This ruling underscores the independent nature of inter vivos trusts and their distinct treatment from testamentary trusts under state law.

Facts

W. L. Harper died testate in Kentucky, survived by his wife, Florence W. Harper. Harper's will included a pour-over provision directing the residue of his estate to an inter vivos trust he established in 1978, naming Florence as the lifetime income beneficiary. After Harper's death, Florence elected to take against the will under Kentucky law, opting for her statutory share. The estate claimed a marital deduction for the value of the property transferred to the trust, asserting it was qualified terminable interest property (QTIP). The Commissioner disallowed the deduction, arguing that the election voided Florence's interest in the trust.

Procedural History

The estate filed a petition in the U. S. Tax Court after the Commissioner determined a deficiency in estate taxes due to the disallowed marital deduction for the trust assets. The Tax Court, after considering the applicable state laws of Kentucky and Ohio, ruled in favor of the estate, allowing the marital deduction for the trust assets as QTIP.

Issue(s)

1. Whether property transferred to an inter vivos trust pursuant to a residuary pour-over provision in a decedent's will 'passes from the decedent' within the meaning of I. R. C. sec. 2056(b)(7)(B)(i)(I) despite the surviving spouse's election to take against the will.

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Holding

1. Yes, because under the applicable state laws of Kentucky and Ohio, the surviving spouse's election against the will did not affect her beneficial interest in the inter vivos trust, and thus the property 'passed from the decedent' to her as required for QTIP status.

Court's Reasoning

The court examined Kentucky and Ohio statutes to determine the effect of Florence's election on her interest in the trust. Kentucky law allows a surviving spouse to elect against a will and take a statutory share, but does not preclude additional benefits from a trust if provided by the will or inferable from it. Ohio law similarly validates pour-over trusts and treats them as separate from the will. The court relied on the Ohio Court of Appeals decision in Carnahan v. Stallman, which held that a spouse's election against a will does not affect rights under a pour-over inter vivos trust. The court also noted that the trust's minimal initial funding did not undermine its validity or independent nature. The court concluded that Florence's beneficial interest in the trust remained intact despite her election against the will, and thus the trust assets qualified for the marital deduction as QTIP.

Practical Implications

This decision clarifies that assets in an inter vivos pour-over trust can qualify for the marital deduction as QTIP even if the surviving spouse elects against the will. Practitioners should carefully consider the independent nature of inter vivos trusts when planning estates, especially in states with similar statutory provisions. The ruling may influence estate planning strategies, encouraging the use of such trusts to ensure tax benefits while allowing the surviving spouse flexibility in their election. Subsequent cases like Carnahan and Lorch have applied similar reasoning, while legislative changes in Ohio post-decision reflect an intent to clarify and possibly limit the impact of this ruling. Estate planners must stay apprised of state-specific statutory changes that could affect the application of this case.

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