Estate of Bond v. Commissioner, 104 T. C. 652 (1995)

The value of real property devised to a surviving spouse qualifies for the marital deduction even if conditioned on surviving distribution, while personal property does not, based on the state law governing the vesting of property interests.

Summary

Edwin L. Bond's will left his residual estate to his wife, Ruth, provided she 'survived distribution'. The IRS challenged the estate's marital deduction claim, arguing the bequest created a terminable interest. The Tax Court held that under Washington law, real property vests immediately upon the testator's death, thus qualifying for the marital deduction. However, personal property, which does not vest until distributed, was deemed a terminable interest and disallowed from the deduction. The case underscores the importance of state law in determining property interests for federal tax purposes.

Facts

Edwin L. Bond died in 1988, leaving a will that bequeathed his residual estate to his wife, Ruth B. Bond, if she 'survived distribution' or 'survived distribution of her share of the remainder of my estate'. Over 90% of Bond's estate was in real property, managed personally by him. Ruth was dependent on Edwin for support. The will appointed Ruth as personal representative with unrestricted nonintervention powers, indicating a preference for minimal court involvement in estate distribution. The IRS challenged the estate's claim for a $1,446,387 marital deduction, disallowing $1,139,735 related to the residual estate.

Procedural History

The Estate of Bond filed a Federal estate tax return and claimed a marital deduction. The IRS issued a notice of deficiency disallowing a significant portion of the claimed deduction. The estate filed a petition with the U. S. Tax Court, which heard the case on its merits after initially considering a motion for summary judgment by the estate. The Tax Court issued its opinion on May 30, 1995.

Issue(s)

1. Whether the bequest of the residual estate to Ruth B. Bond, conditioned on her surviving distribution, created a terminable interest under Section 2056(b)(1) of the Internal Revenue Code, disqualifying it from the marital deduction.
2. Whether the value of the real property devised to Ruth B. Bond qualifies for the marital deduction under Washington law.

Holding

1. Yes, because the bequest of personal property created a terminable interest as it

did not vest until actual distribution, which was not required within six months, thus not qualifying for the marital deduction.
2. No, because the real property vested immediately upon Edwin L. Bond's death under Washington law, and thus was not a terminable interest, qualifying it for the marital deduction.

Court's Reasoning

The Tax Court analyzed the will's language within the context of Washington law, where real property vests immediately upon the testator's death without the need for administration or a decree of distribution. The court cited *Estate of Carlson v. Washington Mut. Sav. Bank* to interpret 'survive distribution' as actual distribution, which for real property occurred at death. For personal property, the court found that distribution was not required within six months, creating a terminable interest. The court also considered Bond's intent as evident from the will's provisions for nonintervention powers, indicating an intent for immediate vesting of real property. The court rejected the estate's argument for reforming the will based on Wash. Rev. Code Ann. sec. 11. 108. 060, finding no evidence of intent to qualify the bequest for the marital deduction.

Practical Implications

This decision highlights the critical role of state law in determining whether property interests qualify for the marital deduction. Estate planners must carefully consider state law regarding the vesting of real and personal property when drafting wills to ensure desired tax outcomes. The ruling suggests that in states like Washington, where real property vests immediately, testators can condition bequests on 'surviving distribution' without jeopardizing the marital deduction for real property. However, for personal property, such conditions may create terminable interests, affecting estate tax planning. Subsequent cases applying this ruling would need to analyze the specific state law governing property interests. The decision also underscores the need for clear intent in wills to avoid unintended tax consequences.