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Estate Administration--Marital Deduction--Election to Deduct Administration Expenses from Income Rather than Gross Estate, as Influencing Marital Deduction Bequest Upheld (In re McTarnahan, 202 N.Y.S.2d 618 (Surr. Ct. 1960))

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The requirement that a defendant have effective assistance of counsel in the preparation for trial [28] finds its realization in this decision. The language of the decision could be interpreted to mean that incriminating statements made in the absence of counsel after indictment will not be admitted into evidence in *any* case. However, it appears unlikely that the decision will be interpreted by the Court of Appeals quite so broadly in its future decisions on this subject. Since *Di Biasi,* the Court of Appeals in *People v. Downs,*[29] a memorandum decision, affirmed a first degree murder conviction, despite the fact that certain admissions obtained after indictment and in the absence of counsel had been received into evidence. Chief Judge Desmond alone dissented on the basis of *Di Biasi.* There are, however, a number of elements which distinguish *Downs* from *Di Biasi.* In *Downs,* the defendant had not retained counsel prior to the interrogation but had expressly waived his right to counsel.[30] He did not respond to questioning solicited by the Assistant District Attorney, but instead volunteered the statements.[31] Furthermore, at the trial he repeated substantially the same admissions he had previously made to the police and even added incriminating matter.[32] Likewise, "defense counsel's opening statement . . . revealed substantially all the salient features of the statements." [33] Under the circumstances of *Di Biasi,* statements made to police after indictment and in the absence of counsel were inadmissible, even though the defendant did not request the presence of his counsel. Under what other circumstances the principle of *Di Biasi* will be applied is a question which will have to await clarification by the Court of Appeals.

ESTATE ADMINISTRATION—MARITAL DEDUCTION—ELECTION TO DEDUCT ADMINISTRATION EXPENSES FROM INCOME RATHER THAN GROSS ESTATE, AS INFLUENCING MARITAL DEDUCTION BEQUEST. UPHELD.—Testator bequeathed to his widow a fund equal to one-half the entire value of his adjusted gross estate, all taxes to be taken

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[28] Powell v. Alabama, 287 U.S. 45, 71 (1932); People v. McLaughlin, 291 N.Y. 480, 53 N.E.2d 356 (1944).

[29] 8 N.Y.2d 860, 168 N.E.2d 710, 203 N.Y.S.2d 908, *cert. denied,* 29 U.S.L. WEEK 3111 (U.S. Oct. 17, 1960).

[30] Supplemental Brief for Respondent, pp. 2-3, People v. Downs, *supra* note 29.

[31] *Id.* at 2.

[32] *Id.* at 3.

[33] *Id.* at 5.

from the residuary.[1] The residuary was to go into trusts with the income payable for life to the son and grandson respectively, remainders to their respective issue. The will further provided that values, for all purposes, should correspond to those finally determined for federal estate tax purposes. The executors, in order to obtain an over-all tax saving and pursuant to an allowable election, chose to deduct administration expenses on the estate income tax return rather than on its estate tax return. This election enhanced the adjusted gross estate and therefore the widow's bequest, but it caused a detriment to the residuary estate. On objection by interested remaindermen of the residuary trusts, the Surrogate's Court *held* the election proper and the widow entitled to the resulting increased bequest. However, since the residuary was depleted by the increased estate taxes, the Court directed that it be reimbursed to that extent out of the income interests of all trusts.[2] *In re McTarnahan,* 202 N.Y.S.2d 618 (Surr. Ct. 1960).

The *adjusted gross estate* became a significant phrase to estate planners in 1948. At that time the Internal Revenue Code was amended[3] to provide that, in computing an estate tax, a marital deduction would be allowed in an amount equal to the value of any interest in property[4] included in the gross estate[5] which passes to the surviving spouse. However, this deduction was not to exceed fifty per cent of the *adjusted gross estate.*[6] Thus the value of the

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[1] In June 1954, a decree was entered placing the burden of paying taxes on the residuary estate. Matter of McTarnahan, 130 N.Y.S.2d 752 (Surr. Ct. 1954). See N.Y. SURR. CT. ACT § 200.

[2] *In re* McTarnahan, 202 N.Y.S.2d 618, 620 (Surr. Ct. 1960). This report, dated April 22, 1960, uses the words ". . . restoration to the residuary estate of the benefit obtained by the election to take the administration expense credit against income taxes." This wording was obviously inaccurate in light of what was said before in the opinion, and the final decree on accounting settling the account, filed Aug. 29, 1960, File #2988-1951 read as follows: "There must be restored to the principal of the estate herein accounted for *out of income* thereof the amount of federal estate taxes paid with respect to the taxable estate of the said decedent in excess of the amount of such taxes which would have been payable but for the election." (Emphasis added.) The total amount restored to the residuary as a result was $1,193.22.

[3] Revenue Act of 1948, § 361, 62 Stat. 117 (1948) (now INT. REV. CODE OF 1954, § 2056). Hereafter the Internal Revenue Code of 1954 will be cited as CODE.

[4] Certain terminable interests are not included in the deduction. CODE § 2056(b).

[5] Gross estate includes all property real or personal, tangible or intangible, wherever situated, except real property outside of the United States. CODE §§ 2031-44.

[6] CODE § 2056(c)(1). The purpose of this amendment was to equalize estate tax benefits between residents of community property states and those of non-community property states. See, *e.g.,* Garland & Garrity, *The Federal Death Tax and How To Live With It,* 30 ST. JOHN'S L. REV. 1, 28-29 (1955); Lefever, *The Marital Deduction,* 89 TRUSTS & ESTATES 644 (1950); Shove,

adjusted gross estate became the determinant of how much a testator may bequeath to his or her surviving spouse tax free, and, with the same bequest, substantially reduce the taxable estate. This adjusted gross estate is defined in the Internal Revenue Code as the value of the estate after certain expenses, including *administration expenses,* have been deducted from the gross estate.[7]

As a result of this marital deduction provision, estate planners, wishing to take full advantage of it while not knowing what the exact value of the estate would be at death, have utilized what is known as a marital deduction "formula clause." [8] It provides, in essence, that the surviving spouse is to receive fifty per cent of the adjusted gross estate. However, a serious problem concerning this bequest is posed by another provision of the Code. Section 642(g) allows executors, pursuant to certain stipulations,[9] to deduct administration expenses on the estate *income* tax return rather than, and to the exclusion of, deducting them from the gross estate for estate tax purposes.[10] By exercising this option, the executors may, depending upon the size of the estate and its income, obtain a greater tax saving for the overall estate than would have resulted had the deduction been taken from the gross estate for estate tax purposes.[11]

Marital Deduction Under the Revenue Act of 1948, N.Y.S.B.A. BULL. 156 (1948).

[7] CODE § 2056(c)(2).

[8] For an example of such a clause, see Lefever, *supra* note 6, at 707-08.

[9] Executors must file a statement to the effect that deductions claimed on the estate income tax return have not also been claimed as deductions on the estate tax return and also that they waive their right to claim them as deductions on that return. CODE § 642(g).

[10] CODE § 642(g).

[11] Assuming all other deductions and exemptions have been taken, if the gross estate were $500,000 and the estate income were $30,000 and the only remaining deduction allowable on either tax return were $5,000 in administration expenses, the following should illustrate the possible tax saving:

Deducted from Gross Estate		*Not Deducted from Gross Estate*
Gross estate	$500,000	Estate tax on $500,000 is $145,700.
Less admin. exp.	— 5,000	
	$495,000	

Estate tax on $495,000 is $144,100.

By deducting the administration expenses from the gross estate, $1,600 could be saved on the estate tax.

Deducted from Income		*Not Deducted from Income*
Income	$30,000	Income tax on $30,000 is $13,220.
Less admin. exp.	— 5,000	
	$25,000	

Income tax on $25,000 is $10,150.

However, when these administration expenses are not deducted from the gross estate, the adjusted gross estate will be increased by the amount of these expenses and the surviving spouse's marital deduction bequest increased by one-half this amount. This in turn would *reduce* the residuary estate as follows:

(1) Since the surviving spouse receives a greater amount, the residuary estate is lessened by the amount of the increment.

(2) Since the administration expense deduction is lost to the estate tax return, the estate taxes are higher. Where the estate taxes are to be paid out of the residuary (a correlative provision to formula clauses), the distributable residuary is further reduced by the amount of the tax increase.

Obviously, where the income beneficiaries are different from those interested in the remainder, several problems arise in the settling of an estate where the testator has used the formula clause and the executors have exercised the option available to them through 642(g). Some of these problems have arisen in fairly recent Surrogate's proceedings,[12] and the results may be of interest to estate planners.

In re Warms[13] involved a will which did not contain a formula clause but did provide that all taxes be paid out of the residuary estate. The executors, in the accounting, charged administration expenses to principal but deducted them on the estate income tax return to obtain the greater tax benefits. This increased the estate taxes. The contingent remaindermen of the residuary trusts contended that since income beneficiaries had benefited from the election, administration expenses should be charged to income in the accounting or, in the alternative, that as these expenses were in fact charged to principal, the principal account should at least be reimbursed with the saving which would have resulted in federal estate tax had said expenses been deducted from principal in computing that tax. The court held that these administration expenses could not be charged to income,[14] but it granted the alternative request.[15] Thus, it seems

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By deducting the administration expenses from income, $3,070 could be saved on the income tax, $1,470 more than could be saved in estate tax.

Because of the difference in the graduation of rates for income tax and estate tax, the advantage of deducting these expenses from income depends upon the size of the estate and its income.

[12] *In re* McTarnahan, 202 N.Y.S.2d 618 (Surr. Ct. 1960); *In re* Inman, 196 N.Y.S.2d 369 (Surr. Ct. 1959); Matter of Levy, 9 Misc.2d 561, 167 N.Y.S.2d 16 (Surr. Ct. 1957); *In re* Warms, 140 N.Y.S.2d 169 (Surr. Ct. 1955).

[13] 140 N.Y.S.2d 169 (Surr. Ct. 1955).

[14] The court cited *In re* Chave, 227 App. Div. 554, 238 N.Y. Supp. 678 (1st Dep't 1930), which held that general administration expenses should be payable from principal. The court in the *Warms* case stated that "the option granted by the Internal Revenue Code to the executors, even when exercised, cannot affect the propriety of the charge of administration expenses to principal." *In re* Warms, *supra* note 12, at 170-71.

[15] *In re* Warms, *supra* note 12, at 171.

the court will allow the executors to use the option and reduce income taxes, but principal is not to be penalized by the resultant increase in the estate tax.

But what of the case where the will contains a formula clause for the marital deduction bequest? If the option is exercised, will the residuary be penalized to the extent of the surviving spouse's increment?

Matter of Levy [16] concerned a will in which the testator bequeathed to his widow an amount "for which a marital deduction is or will be allowed in the computation of my net estate" [17] and which would "aggregate a sum equivalent to one-half of my adjusted gross estate." [18] The executors deducted administration expenses on the income tax return and saved the income account twenty-five thousand dollars. However, this election depleted the residuary by seven thousand dollars in additional estate taxes plus the amount of the widow's increased bequest. The residuary legatees objected to this depletion and Surrogate DiFalco sustained their contentions. He held that the residuary legatees were to receive as much as they would have if administration expenses had been deducted on the *estate tax* return and that the widow's bequest was to be reduced by the amount she gained as a result of the election. Said the Surrogate: "Thus the election has caused a different result for tax purposes than for accounting purposes. . . ." [19] An interesting shadow lurks between the lines of this quotation. It is the shadow of the estate tax collector and one must wonder what his reaction would have been if, upon reading the decision in *Levy,* he had learned that there was deducted from the taxable estate a greater amount for the widow's bequest than the widow actually received? Would he have demanded a corrected estate tax return from the executors on which the marital deduction would be an amount which the widow actually received?

These questions may never be answered because the surrogate's court has recently decided two similar cases and has apparently decided to take a different position from that taken in *Levy*. *In re Inman* [20] and the instant case both involved formula clauses, and in both the executors exercised the option available to them. In *Inman,* the testator bequeathed to his wife a trust in an amount equal to one-half of the value of the "adjusted gross estate as that term was defined in section 812(e)(2)" [21] of the Internal Revenue Code (1939). The court ordered that her bequest was to be one-half of the adjusted gross estate as computed for federal estate tax purposes and not one-half of the amount which the adjusted gross estate *would*

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[16] 9 Misc.2d 561, 167 N.Y.S.2d 16 (Surr. Ct. 1957).
[17] *Id.* at 563, 167 N.Y.S.2d at 18.
[18] *Ibid.*
[19] *Id.* at 564, 167 N.Y.S.2d at 18.
[20] 196 N.Y.S.2d 369 (Surr. Ct. 1959).
[21] *Id.* at 371.

have been had all assertible deductions been claimed in the federal estate tax return. The court also held that the formula clause did not fall within Section 125 of the Decedent's Estate Law.[22] The court gave as its reasons that the testator was obviously tax conscious and aware of the great distinction between the adjusted gross estate as defined by the Code and the net estate after paying administration expenses. "The direction in the will must be given the operative effect which the testator intended and that is that the marital trust be fixed in an amount equal to one-half the adjusted gross estate determined for tax purposes." [23]

Thus *Levy* has apparently been overruled. But in the instant case, where the will bequeathed to the widow a fund equal to one-half of the entire value of the adjusted gross estate for federal estate tax purposes, and also provided that all values should be as finally determined for estate tax purposes, Surrogate DiFalco distinguished the *Levy* case by holding that the formula clause before him more specifically provided for the determination of values than the clause in *Levy*. He then proceeded to sustain the widow's increased bequest, but directed that the residuary should be reimbursed out of income to the extent that the estate taxes were increased by the election.

Inman and the instant case fairly well establish that the surviving spouse's bequest will be allowed to stand at the amount determined by the adjusted gross estate figure on the federal estate tax return, where the formula clause specifically so provides, even if the option allowed by 642(g) of the Code is exercised. The residuary estate will then be reimbursed out of income to the extent that it was depleted by the increased estate taxes. It is submitted that, even if, as in the case of *Levy,* the testator's intention to take advantage of the maximum marital deduction is only inferred, *Inman* and the instant case indicate that the surviving spouse's bequest will be allowed to stand at the amount determined by the adjusted gross estate figure on the federal estate tax return.

EVIDENCE — WIRETAPPING — INJUNCTION AGAINST USE OF WIRETAP EVIDENCE IN STATE CRIMINAL PROSECUTION DENIED.— Petitioner, indicted by a New York grand jury, brought an action in

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[22] The attempted grant to an executor of the power to make a binding and conclusive fixation of the value of any asset for purposes of distribution or allocation or otherwise is against public policy. N.Y. DECED. EST. LAW § 125.

[23] *In re* Inman, 196 N.Y.S.2d 369, 372 (Surr. Ct. 1959).