Coordination of PPT Credit and QTIP Marital Deduction Planning: A Practical Perspective*

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INTRODUCTION

In the administration of the estate of a married individual, the tax professional may be confronted with the difficult task of evaluating the merits of whether to make a qualified terminable interest property (QTIP) ' election to defer all estate tax until the death of the survivor or to elect to pay some estate tax in the predeceased spouse's estate with a view toward obtaining a credit for property previously taxed (PPT Credit) at the survivor's death.' The QTIP election qualifies the property for estate tax marital deduction treatment in the estate of the first spouse to die, whereas the PPT Credit can allow an estate tax credit to the surviving spouse's estate with respect to property subject to estate tax in the predeceased spouse's estate. This article evaluates and illustrates the inter-relation between the operation of the PPT Credit and the marital deduction provisions of the federal estate tax.

MARITAL DEDUCTION PLANNING

Under *§2056,* spouses who are U.S. citizens or residents may make unlimited testamentary transfers to or for the benefit of each other so as to avoid federal estate taxes at the death of the first spouse to die, and thereby preserve estate assets for the full enjoyment of the surviving spouse. Beginning in 1982, the QTIP election has been available as a means to secure marital deduction treatment for a trust providing all income to be distributed to the surviving spouse for life. Consequently, a typical estate plan, after disposing of property covered by the available *$600,000* exemption equivalent under the unified credit' (often by disposition in a credit shelter trust for the surviving spouse),` will provide for the balance of the predeceased spouse's estate assets to pass in a QTIP trust. Estate taxes can thereby be deferred until the death of the surviving spouse, at which time the QTIP trust assets are subject to estate tax.'

It is generally accepted by estate planning professionals that there are two fundamental disadvantages with complete deferral of estate tax through marital deduction treatment. First, all appreciation in the marital deduction property is subject to estate tax at the survivor's death. Second, under the progressive federal estate tax rates, the marital deduction property is likely to be subject to a higher tax in the survivor's estate' Where disposition of marital deduction property is made in a trust eligible for QTIP treatment,' the predeceased spouse's executor is typically given discretionary power to make or not make, in part or in whole, the QTIP election.' This provides for flexibility in appropriate circumstances for an acceptable level of estate taxes to be incurred in the predeceased spouse's estate.

Nonetheless, in actual practice, estate planning professionals and their clients typically arrive at the decision to make a QTIP election which will fully

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§2056(b)(7). All section references are to the Internal Revenue Code *of* 1986, as amended, and the regulations thereunder, unless otherwise stated.

' §2013.

§2010.

See generally, D. Westfall & G. Mair, Estate **Planning** Laws and Taxation, ¶13.04(1) (Warren, Gorham & Lamont, Inc., 2d ed. 1989); Manning, *Estate* ***Planning*** 28-39 (P.L.I. 1988); Lerns, The Marital Deduction 41-70 (P.L.I. **1984).**

§2044.

[6] A detailed **examination of** the **advantages** and **disadvan**tages of deferral *is* set forth in Llewellyn, Levin & **Richmond,** ***Computing the Optimum Marital Deduction:*** *Is* ***a*** *Zero-Tax* ***Formula*** *Appropriate?* 24 Real Prop. Prob. & Tr. L. J. 330 **(1989).** See also 239 T.M., ***Estate*** *Tax* ***Marital Deduction.*** **'** The three other methods of disposition to secure marital deduction treatment are: 1) outright; 2) a general power of appointment trust under §2056(b)(5); and 3) an estate trust. See generally 239 T.M., at A-32 ***et seq.; R. Covey,*** Marital Deduction and Credit Shelter Dispositions and the Use *of* Formula Provisions 137-158 (U.S. Trust 1984). Absent disclaimer by the survivor (or the survivor's estate), marital **deduction** treatment *is* **mandatory** for these three types of disposition. *La Sala Est. v. Comr.,* 71 T.C. 752 (1979); Rev. *Rul.* 59-123, 1959-1 C.B. 248.

' 239 T.M., at A-12. The **QTIP** election may be **made** in **part** or in whole. Prop. Regs. §20.2056(b)-7(b), 49 Fed. Reg. 21,350 **(1984) (proposed** May 21, **1984).** For an **examination of** technical **tax** concerns **involving partial QTIP** elections, ***see*** 239 T.M. at A-46 ***et seq.***

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defer all federal estate tax until the survivor's death.' In considering this decision, however, the tax professional must also take into account a third tax disadvantage in complete deferral — the potential PPT Credit in the survivor's estate to the extent that the QTIP election is not made. This third consideration may sometimes be less obvious, but in some situations it can, on account of the potential tax impact of the PPT Credit, be the most important consideration presented in connection with the administration of a decedent's estate, particularly when spouses die with-in a relatively short time of each other.[10]

THE PPT CREDIT

Section 2013 allows the PPT Credit on account of property subjected to federal estate taxes in an earlier decedent's estate with respect to federal estate taxes in the estate of a subsequent decedent who received that property from the earlier decedent." There **is a** phase-out of the PPT Credit, known as the percentage reduction,[12] which causes a 20% reduction of the PPT Credit for every two-year interval which passes between the two deaths, with a complete phase-out after 10 years." For the estate of a decedent leaving a surviving spouse, the PPT Credit is particularly important on account of its potential availability against federal estate taxes payable at the survivor's death with respect to a life income interest in property held in trust created by the predeceased spouse which does not qualify for the marital deduction." Accordingly, the predeceased spouse's executor may choose to seek to obtain a PPT Credit for the surviving spouse's estate by refraining from making a QTIP election and thus incurring federal estate taxes in the predeceased spouse's estate. For PPT Credit purposes, the value of the property transferred is the survivor's life estate in the non-QTIP property, computed on the basis of actuarially recognized valuation principles, except that the actuarial tables are disregarded if the survivor is "known to have been afflicted ... with an incurable physical condition that is in such an advanced stage that death is clearly imminent," as enumerated in Rev. **Rul. 80-80.** [13] Commencing May

Klug, ***The QTIP Election*** *vs.* ***The Credit*** *for Tax on* ***Prior*** *Transfers,* Prob. & Prop. (July/Aug. 1990), at 27, 27.

[10] In addition to Klug, *supra,* other significant more recent articles on this subject matter are Redd, *When and How to Take Maximum Advantage of the Credit for Prior Transfers,* 12 Est. Plan. 162 (1985); Mulligan, *When the Credit for Prior* ***Transfers may be More Valuable than the Marital Deduction.*** 52 J. Tax. 26 (1980). The relative importance of this topic in estate administration has increased as a result of The Economic Recovery Tax Act of 1981 (ERTA), P.L. 97-34 for two reasons. First, §403(a)(1)(A) of ERTA eliminated the restrictions in the amount of the limitations of the marital deduction, previously fixed at fifty (50%) percent of the adjusted gross estate. §2056(c) (1976) (repealed). Under the pre-ERTA law, a substantial estate tax was almost always required in any larger estate, and the surviving spouse typically could be expected to resist any reduction of the 50% maximum marital deduction. Where the taxable property was disposed of in a manner which might make a PPT Credit available to the estate of a surviving spouse, there were before ERTA fewer occasions to consider any option directed toward securing even greater PPT Credit. Second, §403(d)(1) of ERTA added the QTIP election as an additional method for marital deduction treatment pursuant to §2056(b)(7). The addition of the **QTIP** election under ERTA allows greater ease in post-mortem fine-tuning of the marital deduction selection in estate administration, which prior to ERTA could only be accomplished by disclaimer. *See infra* note 31. In addition, by virtue of the discretionary nature of the QTIP election, ERTA placed new and significant fiduciary duties under the legal representative of the estate of the predeceased spouse in considering the extent to which the estate should or must secure the marital deduction through the QTIP election. *See* Ascher, *The Quandary of Executors Who Are Asked to Plan the Estates of the Dead: The Qualified Terminable Interest Property Election* 63 U.N.C. L. Rev. 1, 26-47 (1984).

" The PPT Credit under §2013 is calculated to be the lower of two "limitations": (1) the federal estate tax paid by the first estate with respect to the transferred property (computed at an average tax rate in the first estate), known as the "first limitation" under Regs. §20.2013-2; or (2) the tax paid by the second estate with respect to the value for the transferred property as fixed in the first estate (computed at a marginal rate applicable in the second estate), known as the "second limitation" under Regs. §20.2013-3.

[12] Regs. §20.2013-1(a)(3). An excellent summary of the operation of the PPT Credit is set forth in R. Stephens, G. Maxfield, S. Lind & D. Calfee, Federal Estate Taxation, 113.05 (Warren Gorham & Lamont, Inc., 6th ed. 1991). A more detailed overall analysis of the PPT Credit is contained in 130 T.M., *Estate Tax Credit for Tax on Prior Transfers.*

" §2013(a). The **PPT** Credit is **only available** for federal estate taxes (excluding pursuant to §2013(g) any excess retirement accumulation tax imposed by **§4980A(d))** and is not available for any gift tax paid (except pursuant to §2013(b) gift taxes creditable against estate tax for pre-1977 transfers included in the transferor's gross estate) or any generation-skipping transfer tax paid. A special PPT Credit was enacted by §5033(a)(1) of the Technical and Miscellaneous Revenue Act of 1988, P.L. 100-647, with respect to qualified domestic trust property **disposed** of for the benefit of a **surviving spouse who** is not a **citizen** of **the United** States. §2056(d)(3). There is no PPT Credit for federal gift tax purposes. §2613(b)(2) provides only a limited credit for **generation-skipping** transfer taxes paid on a prior **generation-skipping** transfer at the same (or lower) generational level, and there is no credit for generation-skipping transfer tax purpose for any such tax paid with respect to a **generation-skipping** transfer **imposed** at a **higher** generational level or for any estate tax or gift tax, regardless of the period of time between the taxable events.

Regs. §20.2013-4(a).

J' 1980-1 C.B. 194, 195. Another area of concern involves state law or survivorship clause provisions which deem one spouse to survive the other in the event of simultaneous death. There is a line of cases from the early 1970's which held that no PPT Credit is allowed to the estate of the spouse deemed to **survive.** *Old Kent* ***Bank*** *and Trust Co. v. U.S.,* 292 F. **Supp.** 48 (W.D. Mich. 1968), rev'd on other grounds, 430 F.2d 392 (6th Cir. **1970);** *Lion* ***Est.*** *v.* ***Comr.,*** 438 **F.2d 56** (4th Cir. 1971), cert. denied, 404 U.S. 870 (1971) (holding that the wife's life estate under the husband's estate plan had no value where the husband and the wife were "hurtling to their deaths in the same airplane crash"). The law on this point seemed to be settled until a Louisiana federal district court decision held that there is a PPT Credit for a Louisiana usufruct in a simultaneous death situation, but this **decision has been** re-

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1, 1989, the value of the survivor's life estate is calculated under Notice *89—60*[16] on the basis of the monthly interest rate under *§7520* in effect at the predeceased spouse's death. In the typical situation where Rev. Rul. *80-80* does not apply, an amount equal to the full actuarial value of the life estate is deemed to be represented in the assets included in the gross estate of the survivor, and estate taxes paid in the predeceased spouse's estate proportionate to the actuarial value of the life estate are applied through the PPT Credit to reduce the survivor's federal taxes."

The Howard Est. Case

The recent case *of Howard Est. v. Comr.,*[1e] illustrates the fundamental concerns involved in planning for the use of the PPT Credit for married persons. While the Tax Court's decision in *Howard Est.* was reversed on appeal, the facts of this case nonetheless demonstrate how important the PPT Credit can be when spouses die within a relatively short time of each other.

In *Howard Est.,* the husband (a California resident) died in *1983,* survived by his wife (then age *65)* and their three children. His estate plan gave outright to the children property tied to the 1983 unified credit amount, which provided an exemption equivalent of *$275,000.* The balance of his property passed in a trust for his wife to receive net income for her life. The husband's estate filed an estate tax return nine months after his death, which elected QTIP treatment for the entire trust property. That return reported no federal estate tax due and showed trust property of approximately $1,125,000 as qualifying for the marital deduction as QTIP.

Mrs. Howard unexpectedly died in 1984 only a few weeks after the return was filed, leaving net property of her own valued at roughly $1,300,000. The same three children were beneficiaries equally of her property as well as the trust remainder created by her husband. When the time came to file Mrs. Howard's federal estate tax return, her return reported only her own property of $1,300,000 as subject to federal estate tax. Her estate tax return took the position that the trust created for her benefit under Mr. Howard's estate plan was not eligible for QTIP treatment be-cause she was not entitled to undistributed income at her death. On audit, the IRS disagreed, and tax litigation commenced. In the meantime, an amended estate tax return was filed for Mr. Howard consistent with the position taken in Mrs. Howard's estate showing no marital deduction for the trust property." Table I is derived from the facts presented in *Howard Est.* and shows the difference in tax results between the position argued by the IRS (Case 1) and the position argued by the taxpayers (Case 2). One objective of the taxpayers in *Howard Est.* was to obtain the benefit of the husband's lower marginal estate tax rates available if the QTIP election was not effective. On the basis of the figures in Table I, the saving in the marginal rate would have favored the children by *$85,750* if their position prevailed.[20] But more important than marginal rates in potential additional tax saving was the PPT Credit. If Mrs. Howard's estate had prevailed on the no-QTIP argument, the PPT Credit against federal estate taxes in her estate, based on the actuarial value of Mrs. Howard's life income interest in the net trust proper-

versed on appeal. *Carter Est. v. U.S.,* 91-1 USTC ¶60,054 (5th Cir. 1991), rev'g *Carter Est. v. U.S.,* 90-1 USTC ¶60,003 (E.D. La. 1989). *See also Marks Est. v. Comr.,* 94 T.C. 720 (1990), holding that a PPT Credit *is* not available for a Louisiana usufruct in a simultaneous death situation. 239 T.M., at A-17, n. 58 argues against the result in those cases on the grounds that their holdings are based on "valuation hindsight" which is inappropriate for the purposes of §2013.

[16] 1989-1 C.B. 700. For an overview of §7520 and Notice 89-60, *see* McCoy, *IRS Actuarial Valuation Tables—The New Look,* Tax Mgmt. Est., Gifts & Tr. J. (May-June 1989), at 86.

" Rev. Rul. 75-550, 1975-2 C.B. 357, explicitly states that there *is* no tracing of property from the predeceased spouse's estate to the survivor's estate of the purpose of the PPT Credit computed with respect to a life estate. *See also* Rev. Rul. 70-292, 1970-1 C.B. 187, Under the deduction for tax on prior transfers available under §812(c) of the Internal Revenue Code of 1939, tracing was required. The legislative history of the Internal Revenue Code of 1954 states that this requirement was removed from §2013 to "remove the difficult task of tracing the property." H.R. Rep. No. 1337, 83d Cong., 2d Sess. A309 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 121 (1954). For an analysis of pre-1954 law concerning federal estate taxation of prior transfers, *see generally* Rudick, ***The Estate** Tax **Deduction** for **Property Previously Taxed*** 53 Colum. L. Rev. 761 (1953).

[1]910 F.2d 633 (9th Cir. 1990), rev'g 91 T.C. 329 (1988).

" Notice 89-4, **1989-1 C.B. 624 established** a **procedure** in response to the conflict **that arose** between **the *Howard* case** and Prop. Regs. §20.2056(b)-7(c)(1) in the treatment of "stub" income, that is, undistributed income in a QTIP trust at the surviving spouse's death. The proposed regulation states that income interest does not fail the QTIP requirement if stub income is not required to be distributed to the surviving spouse or the surviving spouse's estate. Pursuant to Notice 89-4 a settlement procedure was established. This procedure allows a taxpayer to file a closing statement with the estate tax return executed by all parties with an interest in the trust to ensure that the marital deduction is allowed where the surviving spouse does not have a right to stub income. Notice 90-64, 1990-28 I.R.B 11 extended the settlement procedure through December 31, 1990.

'Comparing the total taxes for both estates, and making allowance for the PPT Credit in Case 2, the saving in the marginal tax rate is computed as follows:

	Case 1	Case 2	
PPT Credit	$ 0	$150,421	
Total Taxes		892,750	656,579
	$892,750	$807,006	

The difference between $892,750 and $807,000 is $85,750, i.e., the saving in the marginal rate.

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ty, would have been $150,421.[21] Accordingly, the total amount at stake in *Howard Est.* was the combination of the marginal tax rate saving and the PPT Credit saving, which together amounted to $236,171.

Case *3* of Table I shows the tax results if the taxpayers prevailed in *Howard Est.,* with one basic change from its facts being that the credit shelter disposition is assumed to pass in a life income trust for the surviving spouse instead of passing outright to the children. The result is a larger net trust fund for the wife, with the PPT Credit correspondingly greater — $186,653 for Case *3* as compared to $150,421 for Case *2.* In bottom line dollars, the difference in tax is *$36,232* on account of the change in the manner of the credit shelter disposition. This can be a more important dollar item in larger estates (with a higher marginal tax rate than in *Howard Est.)* and in more recent years (with the unified credit increased to an exemption equivalent of *$600,000).*[22]

What about a credit shelter trust which sprinkles income among surviving spouse and children — would the surviving spouse's estate receive a PPT Credit for a trust of this kind? What about a credit shelter trust with a provision that the survivor's income interest terminates upon remarriage? There are several cases and IRS rulings concerning PPT Credit treatment for trusts having those kinds of provisions. The case law on balance has held that, if the instrument is clear, either explicity or through valid inference, that the survivor is to be the primary beneficiary and that the trustee's managerial powers over the trust are within a defined standard (so that it is likely that the survivor will actually receive an ascertainable portion of the net income), **then the** *PPT* Credit is available.'

The important planning point is that, if planning for the PPT Credit may be more important in a particular family situation — say, if one spouse is in chronic poor health — a remarriage [24] or sprinkling [23] provision might well be avoided in cautious drafting of a credit shelter trust.

The "Optimum" Marital Deduction

In Table II, the dollar stakes are substantially increased beyond the tax amount in controversy in *Howard Est.* Table II assumes the husband dies in *1991* with net estate property of *$5,000,000.* His will leaves a preresiduary credit shelter trust of $600,000 for his wife to receive net income for life. His residuary estate passes in a trust eligible for QTIP treatment to the extent his executor, in his executor's discretion, makes a QTIP election. The wife dies in *1992* before her husband's federal estate tax return is filed, leaving net estate property of $1,300,000. Both spouses' wills direct all of their property to pass to their children, equally, at the death of the survivor of them. At the time of the husband's death, the wife is 71 years old and the monthly interest rate is 10%, so that the percentage value of the wife's life estate is approximately *62.5%* under Notice *89-60.*

Table II shows the results based upon how much of a marital deduction is elected in the husband's estate.[26] Case 1 assumes that QTIP treatment is elected for his entire residuary estate, so that no PPT Credit is available to the survivor's estate. The result is that total net assets passing to children at the wife's death are *$3,717,000.* Case *2* assumes no marital deduction and that a PPT Credit is available to the wife's estate; resulting in a tax saving of *$333,400.* The tax saving is even greater still in Case *3,* where a marital deduction of $1,328,900 results in the children's after-tax inheritance of *$4,476,455.*[27] This marital deduc-

[2'] Mrs. Howard was age 65 at her **husband's** death, when the valuation table interest rate was 6%, thus producing a life estate factor of approximately 55.8% which, when applied against the husband's net trust property, yielded a present net value of her life estate of approximately $433,000 for PPT Credit purposes.

u Often a governing instrument will **contain** substantial outright cash or specific legacies to certain individuals (other than the surviving spouse), particularly for children of a predeceased spouse in a second marriage situation. For PPT Credit planning purposes, deferral of these legacies until the death of the survivor is typically desirable.

[22] ***See Weinstein Est.*** *v. U.S.,* 820 F.2d 201 (6th Cir. 1987); *Boryan Est. v. U.S.,* 690 F. Supp. 459 (E.D. Va. 1988), aff'd on other grounds, **884** F.2d 767 (4th Cir. **1989);** *Lloyd Est. v. U.S.,* 650 F.2d 1196 (Ct. Cl. 1981); Rev. Rul. 75-550, 1975-2 C.B. 357; Rev. Rul. 70-292, 1970-1 C.B. 187. Tax professionals must be aware of a case involving the estate of William Wraith, *Holbrook v. U.S.,* 575 F.2d 1288 (9th Cir. 1978), where the court held a PPT Credit was not available for a trust income interest where the trustees' discretionary investment powers were so broad as to prevent the income interest from being susceptible to valuation. On account of the ***Holbrook*** decision, care should be taken in drafting governing instruments that no overly broad investment powers are applicable to a credit shelter trust property or to trust property which is eligible for QTIP treatment but for which the executor may refrain from making the QTIP election.

[24] *See* PLR **8830055.** ***But see*** Rev. **Rul. 85-111, 1985-2** C.B. **196.**

[23] ***See Pollock*** *Est. v.* ***Comr.,*** 77 T.C. **1296 (1981).**

[26] In **the computations** for Table II it is **assumed** that the governing instrument directs all death tax **apportionment** in the **predeceased** spouse's estate **against** the **portion** of the trust **property** for which no QTIP election is **made.** ***See*** **239 T.M., at A-48 for a discussion of tax apportionment considerations affecting the partial QTIP election.**

[27] Case 3 produces a net savings of $426,055 over the Case 2 figure, where there is no marital **deduction.** There is an even greater savings in Case 3 ($759,455 over the Case 1 figure) where a full marital deduction is used, and the reason for this huge savings for the most part is in the PPT Credit for Case 3 of $545,877, with the rest of the **savings accounted** for in the use of husband's lower marginal rates. The PPT Credit figures in Case 2 and and Case 3 are calculated on the basis of the "second limitation" under Regs. §20.2013-3 with reference to marginal federal estate taxes paid in the wife's estate. *See,* ***supra*** **note 11. Regardless whether the "first limitation" or the** "second limitation" is operative in a particular situation, the amount of the PPT Credit in the survivor's estate must vary depending on the amount of marital **deduction (and hence** the

tion figure of $1,328,900 *is* the "optimum" figure which produces the lowest aggregate federal and state taxes in both spouses' estates, resulting from the most efficient use of the marital deduction in concert with the PPT Credit.[28]

Central to this analysis *is* the assumption that non-QTIP property will be eligible for the PPT Credit, even though, in the discretion of the predeceased spouse's executor, QTIP treatment might have been available. While there *is* no express IRS authority on this point, the PPT Credit should not be disallowed on account *of* the discretionary nature *of* the QTIP election.[29] In an abundance *of* caution, a tax professional may have sufficientrtime to seek a private letter ruling confirming the availability *of* PPT Credit where the spouses' deaths are close to each other. For comfort, a *1985* technical advice memorandum '° expressly permits the PPT Credit for assets passing to a nonmarital trust as a result *of* a disclaimer by a surviving spouse of assets which would otherwise have been marital deduction assets. In drafting, a cautious approach might be for the governing instrument to be crafted to allow for a disclaimer by the survivor (or the survivor's executor) to generate estate taxes in the predeceased spouse's estate, with the disclaimed property passing into a trust which provides a life income interest for the survivor but *is* ineligible for QTIP treatment by specific direction in the governing instrument."

Table III shows the effect on the PPT Credit when the surviving spouse has a "5 and 5" power over the non-QTIP trust property, that *is,* a noncumulative annual right in the surviving spouse to withdraw from trust principal the greater of $5,000 or 5% of trust principal.[32] In addition to a life income interest, the actuarial value of a "5 and 5" power also *is* eligible for PPT Credit treatment in the survivor's estate.[73]

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amount of estate tax) in the predeceased spouse's estate. As a general rule, the first limitation is typically operative where the taxable estate (including QTIP property) of the survivor is greater than the taxable estate of the predeceased spouse, because the marginal rate of federal estate taxation in the survivor's estate is typically greater than the average tax rate in the predeceased spouse's estate. On the other hand, where the predeceased spouse's average tax rate of federal estate tax is greater than the survivor's marginal rate of tax, the second limitation typically is operative. The second limitation is operative in all the examples set out Tables in this article with the exception of Case 2 in Table III and in the three cases in Table V, where the first limitation applies.

[21] The **aggregate death taxes** in Case 3 under the "optimum" marital deduction are $537,455 lower than the aggregate taxes which would be generated **through** use of a typical "equalization" clause operative under the husband's estate plan in the event his wife were to die within six months of his death. *See generally, J.* Manning, *supra,* at 52-53; Llewellyn, Levin & Richmond, *supra;* at 337-338. To derive the optimum marital - deduction figure, essentially a trial and error method under a series of computations is used to identify the point at which no other marital deduction figure produces lower aggregate death taxes. The tedious mechanical process by which the tax professional may derive this optimum figure can be greater eased through the use of a computer program which automatically calculates the PPT Credit **available** for a surviving spouse's life estate, such as is contained in the separate worksheet for this purpose in the ***Estate** Tax **Spreadsheet*** **(BNA Software** 1990.2) authored by Hewitt A. Conway, Esq. That computer program tracks the calculation method with reference to Schedule Q (and its worksheet) to Form 706 (Rev. *July* 1990) for PPT Credit **computation.**

' In the simultaneous **death** situations **addressed** in ***Carter*** *Est. v. U.S., 91-1* USTC **¶60,054 (5th** Cir. ***1991),*** and ***Marks Est.*** *v.* ***Comr.,*** **94** T.C. 720 **(1990), the court** opinions do not indicate that the IRS made any argument that a decision by the predeceased spouse's executor to refrain from electing QTIP electment for a Louisiana usufruct for QTIP treatment, as permitted under §2056 (b)(7)(B)(ii)(I) prevents the PPT Credit in the survivor's estate. There is pre-ERTA authority under *La Sala Est. v. Comr.,* 71 T.C. 752 (1979) and Rev. Rul. 59-123, **1959-1** C.B. **248,** that a **surviving spouse's estate** is not entitled to the PPT Credit on property qualifying for marital deduction in the predeceased spouse's estate but for which the marital deduction was waived. That authority should not be extended to property eligible for QTIP treatment but for which the predeceased spouse's executor, in proper exercise of fiduciary discretion, rerains from making a QTIP election. *See* R. **Convey,** ***supra*** **note** 7, at 174-175. ***But see*** 130 T.M., at A-17.

"TAM 8512004. In a related context, *Rolin Est. v. Comr.,* **588** F.2d **368 (2d** Cir. **1978)** held that a disclaimer on **behalf** of the survivor's estate of a general testamentary power of appointment over a trust which would, but for the disclaimer, have qualified for the marital deduction under §2518(b)(5), was effective to prevent marital deduction treatment in a situation where the disclaimer was made in order to reduce the survivor's taxable estate, which was larger than the predeceased spouse's estate without regard for the marital trust property. *See A.* Brand & W. LaPiarra, Disclaimers in Estate Planning 148-149 (Am. Bar. Assn. 1990).

" See 130 T.M., at A-16. One **disadvantage** with the disclaimer approach is that the survivor may not accept the interest disclaimed or any of its benefits in advance of making the disclaimer. §2518(b)(3). Another **disadvantage** lies in potential state law restrictions (including a requirement of court **approval)** upon disclaimer by **the survivor's executor.** ***See, e.g.,*** N.Y.E.P.T.L. §2-1.11; Fla. Stat. §733.801(2)(b). *See also* **Fullerton,** ***When Can a Fiduciary Disclaim Property on Behalf of Another,*** 17 Est. **Plan.** 272, 273-274 **(1990). Where an outright marital deduction bequest is sought to be reduced in order to** obtain the PPT Credit for the **survivor's** estate, a disclaimer on behalf of the survivor is the sole **available** method and can only **achieve** this end if the **disclaimed proper**ty then passes into a trust **providing** a life **income interest** (which might be a §2010 credit shelter trust) for the survivor. See 130 T.M., *at* **A-16.** This **kind of disclaimer presents certain technical problems in addition to the concerns involving** §2518(b)(3) and potential state law restriction outlined **above.** See 239, T.M., **at** A-10 *et. seq.* For a **discussion suggesting** use of six month surviving clause with the respect to the PPT Credit in the survivor's estate, see 130 T.M., at A-17.

[32] ***See*** **§§2041(b)(2) and 2514(e).** While a "5 **and** 5" **power typically** may present a tax **disadvantage** on **account** of inclusion of the property subject to the survivor's withdrawal right in the survivor's gross estate, that tax **advantage** may be largely minimized by drafting the **governing** instrument to allow its exercise only if the survivor is alive on the last day of **the calendar year.** *See D.* **Westfall** & G. **Mair,** ***supra,*** ¶15.02[3][d]; Parr, "Using Lapsing **Five-and-Five** Power to Save Estate Taxes Over Two Transfers," 12 Est. Plan. 220, 221 (1985).

" Rev. Rul. 79-211, 1979-2 C. B. 319. Theoretically, the survivor could be granted an annual noncumulative right to

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The "5 and 5" power is assumed to be exercised by the surviving spouse, regardless of whether it is or is not, and its present value is then computed on the assumed declining principal balance over the years of the survivor's life expectancy." Table III assumes the same scenario as in Table II, except that there is also a "5 and 5" power added to the non-QTIP trust in the optimum marital deduction setting. The most efficient or "optimum" marital deduction figure is $1,334,400 and is set out in Case 1 of Table III. This figure is slightly higher than the optimum marital figure for Table II, but, on account of the presence of the "5 and 5" power, the tax saving is $89,776, compared against Case 3 of Table II. For comparison, Case 3 of Table III sets out tax results for the slightly lower ($1,328,900) optimum marital figure used in Case 3 of Table II, assuming a "5 and 5" power is present.

The examples so far involve cases where the spouses die within a short time of each other and the 100% PPT Credit applies. Where the survivor dies before the expiration of time for filing the federal estate tax return for the predeceased spouse (i.e., nine months from date of death), the decision regarding use of the PPT Credit can be based strictly on a mathematical comparison (to the extent valuation uncertainties are not presented) in making the QTIP election in the predeceased spouse's federal estate tax return. Moreover, pursuant to Regs. §20.6081-1(a), an extension of time to file the estate tax return may be granted up to six months upon a showing of cause. This becomes significant if an extension of time is obtained and the surviving spouse dies within the extension period, because the QTIP election could then be made to secure the maximum benefit of the PPT Credit in the survivor's estate. Accordingly, it is prudent to apply for an extension whenever a valid reason (independent of PPT Credit concerns) is presented in order to have a longer period (i.e., *up* to 15 months from date of death) [35] to wait and see which decision seems most appropriate for the QTIP election at the end of this period." No similar extended period is available for determining the marital deduction by means of disclaimer, which must be made within nine months of death."

Percentage Reduction Considerations

If the survivor is alive and in good health when the predeceased spouse's federal estate tax return becomes due, the situation is usually much more difficult and presents a quandary for the predeceased spouse's executor. It must be taken into account that the survivor may live beyond the 10-year PPT Credit phase-out period, meaning no PPT Credit might ever be allowed. Another important factor is the survivor's income stream and the impact of paying estate taxes up front in the predeceased spouse's estate. The survivor might be willing to allow the trust property to be reduced by taxes to some degree; however, the larger the total death tax figure is, the greater is the concern regarding the extent to which the survivor's annual income level will be reduced on account of those death taxes. For larger estates, the potential difference in the highest rate of tax is also an important factor, at least until 1993 under present law. The maximum estate tax rate applicable to the survivor's estate after 1992 is scheduled to be 50%, rather than the top 55% rate applicable against the predeceased spouse's estate in 1991 or 1992 (assuming Congress does not eliminate the 1993 phase-out of the higher rates).[18]

Table IV assumes, under the same fact situation as Table II, that the optimum marital deduction is selected and, assuming for illustration purposes no fluctuation in valuation of the survivor's estate assets, shows the results of the operation of the percentage reduction with the passage of time between the spouses' deaths. An 80% credit is shown in Case 1 for

withdraw a greater portion of trust corpus than permissible under a "5 and 5" power, resulting in a greater combined actuarial value for the life estate and enhanced withdrawal right and accordingly a potentially greater PPT Credit. As a practical matter, however, a withdrawal right greater than a "5 and 5" power typically will cause a taxable gift to occur upon its lapse each year to the extent provided under §2514(c). One commentator has suggested an approach by which a taxable gift may be avoided by granting the survivor a testamentary power of **appointment. Covey,** ***Recent Developments*** *Concerning Estate, Gift and Income Taxation* — 1990, 25 Inst. on Est. Plan., at 212 (1991). Another approach to avoid the taxable gift is by annual exercise of the enhanced withdrawal right to the extent the lapse would otherwise exceed the "5 and 5" limit specified in §2514(e). However, both approaches would cause trust property which would otherwise escape estate tax in the survivor's estate to be subjected to estate taxation at the survivor's death, which is typically undesirable unless the survivor's death is anticipated in the near term.

PLRs 8830055, 8209054, 8029082 and 7837070 involve situations in which the IRS calculated the PPT Credit with respect to the combined value of a life income interest and "5 and 5" withdrawal right. The Appendix to this article sets forth the method derived from those rulings for the calculation of the combined value of the life income interest and "5 and 5" withdrawal right. *BNA Estate Tax* ***Spreadsheet,*** *supra, con*tains a computer worksheet for immediate calculation of the PPT Credit for the combined value of the life estate and "5 and 5" power to produce **the** tax **results** automatically **without** the extensive manual calculations otherwise necessary.

" Under §6081, an extension of time **may** be **granted** for **up** to six months upon a showing of good and sufficient cause that it is impossible or impracticable to file a reasonably complete return within nine months. Regs. §20.6081-1(a).

" One commentator suggests that an extension request stating that the executor requires additional time to ascertain the manner in which he should discharge his fiduciary duty with respect to the **QTIP** election and stating any other reasons should satisfy Regs. §20.6081-1. Covey, *supra* note 33, at 213-214.

" §2518(b)(2).

" §2001(c)(2)(D).

deaths between two and four years apart, a 40% credit is shown in Case 2 for deaths between six and eight years apart, and a complete phase-out of the PPT Credit is shown in Case 3 for death more than 10 years after the predeceased spouse's death. These cases demonstrate that, where the survivor is in good health and reasonably expected to live past the 10-year PPT period, there is good reason, on account of the higher tax costs to the husband's estate, to keep the marital deduction well below the optimum point."

One good dollar cut-off point for the elected QTIP marital deduction amount is where the federal estate tax rate jumps from 45% to 49%, which is at a taxable estate of $2,000,000.'[0] Table V shows the results in the same basic fact situation as Table II if a $3,000,000 marital deduction is used to fix the husband's taxable estate at $2,000,000. Case 1 assumes an 100% PPT Credit; Case 2 assumes only a 40% PPT Credit; and Case 3 assumes survival by at least 10 years, with no PPT Credit available. Case 1 shows that if, after the federal estate tax return is filed, the wife unexpectedly were to die within the first two-year period, there would still be a sizable PPT Credit of $305,563. This is $239,314 less than the PPT Credit for the optimum marital deduction figure shown in Case 3 of Table II. However, the tax cost in the husband's estate under Case 1 is $588,000, which is $879,105 lower than for Case 3 in Table II, which shows tax results for the optimum marital deduction. If the surviving spouse were to have a "5 and 5" power over nonmarital deduction property, the tax results where a $3,000,000 marital deduction is used (assuming a 100% PPT Credit is available) are set out in Case 2 of Table III.

Not to be lost sight of in this analysis is the fundamental fiduciary duty of the predeceased spouse's executor to minimize taxes with respect to the predeceased spouse's estate. It is desirable for the governing instrument to give broad authority to the executor to make a partial QTIP election expressly for the purpose of incurring taxes, with a view toward reducing the aggregate tax burden in both estates."

This kind of authority should avert any question about the propriety of a partial QTIP election which the predeceased spouse's executor may make directed toward PPT Credit considerations for the survivor's estate. Of course, a careful executor may take steps to obtain family backing before making a final decision to incur the taxes. Securing beneficiaries' approval is prudent practice, even when the death of the surviving spouse occurs within the time for filing the federal estate tax return of the predeceased spouse and the beneficiaries of the two estates are substantially similar, because valuation changes upon a federal estate tax audit may affect the calculation of the optimum marital deduction.[42]

Second Marriages and Separate Beneficiaries

The preceding analysis of Tables II through V assumed that the ultimate beneficiaries are the same under both the husband's and wife's estate plans. But when the ultimate beneficiaries of the spouses' estates are different, an important matter is how and to what extent those separate beneficiaries share in the PPT Credit. This is important for couples (particularly older couples) in second or third marriages when each spouse has separate children. In most cases, because the PPT Credit is a credit against the federal estate tax of the surviving spouse, it is the survivor's own property which first receives the benefit of the PPT Credit, and any remaining credit is then applied against the taxes on the property held in the QTIP trust created by the predeceased spouse. This result is dictated by the federal estate tax apportionment rules concerning QTIP property under §2207A, providing that, absent a contrary direction in the survivor's will, QTIP property is subject to the highest tax rates applicable to the survivor's gross estate on a marginal federal estate tax basis. Under §2207A, the QTIP

" For the life estate PPT Credit, the passage of time gradually reduces the significant overall tax saving available where the spouse's deaths are close together. Not only does the percentage reduction operate for every two-year interval between deaths, but also, during those years, the survivor's estate is benefitted by the income interest—the income is paid to the survivor and, to the extent it is not consumed, becomes the survivor's own estate property, meaning that, in a substantial way, the life estate then becomes reflected in the survivor's gross estate.

a §2001(c)(1).

See Ascher, ***supra*****, at 26-49** for a discussion of the fiduciary law concerns (including the duty to treat beneficiaries impartially and the duty of loyalty) and for suggested language addressing those concerns for inclusion in the predeceased spouse's governing instrument to provide fiduciary guidance and administrative flexibility. For a discussion of the estate planner's responsibilities in the area of reviewing projected estate tax computations with clients to take into account partial QTIP election possibilities, ***see*** **Boyle, Houghton** & Moses, *Estate Planning* ***Software: Brain*** *Transplant* ***for the Estate Planner***, 23 Inst. on Est. Plan., at **B1-7 (1988).**

" The possibility of audit changes may, as a practical mat-ter, **prevent** exact **fine-tuning** of the **optimum** marital **deduc**tion, because the QTIP election must be filed before final estate tax valuation figures are fixed in the predeceased spouse's estate, and valuations for the survivor's estate typically can only be roughly estimated. As a separate point, it is possible (although rare) that, in an estate tax audit focusing on valuation of several items in the predeceased spouse's estate, a compromise figure for tax liability may be fixed without a definite valuation assigned to each of the contested items—however, such an audit result is to be **avoided** if the effect would be to cause life estate **property** for which a **PPT Credit** may be available go without a definite value. *See 130 T.M.,* at A-10. Selection of **alternative valuation** in **the predeceased** spouse's estate does not prevent the PPT Credit where the survivor dies within the six month alternate **valuation** period. Rev. Rul. 81-118, 1981-1 C.B. 453.

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property bears federal estate taxes equal to the amount by which the total actual federal taxes exceed the amount of federal taxes which would have been imposed had there been no QTIP property in the survivor's gross estate. Accordingly, the survivor's beneficiaries would enjoy more benefit from the PPT Credit than would the predeceased spouse's beneficiaries. With respect to the Table V situation, the wife's separately computed federal estate tax on a taxable estate of $1,300,000 (before taking into account. the PPT Credit) would be roughly $225,000. Against that figure in Case 1 of Table V—100% PPT Credit under death within two years — would be applied a portion of that PPT Credit, which would reduce the actual amount of the federal taxes against the wife's property to zero. This means that the wife's beneficiaries would not bear any burden of federal estate tax on the net property passing to them from her estate. The beneficiaries of the husband's QTIP trust property would receive the benefit of the remaining portion of the PPT Credit—approximately $80,000. On one level, this may appear to be a strange result, considering that the QTIP property is more than twice the size of the wife's own property but receives the benefit of less than one-quarter of the PPT Credit amount. On another level, however, this result is consistent with the basic rationale for the allowance of the PPT Credit for a life estate, in that the survivor's own property is deemed for PPT Credit purposes to be composed of income received from the non-QTIP trust property, and it is the federal tax on that property which is eligible for the PPT Credit. Another consideration is that the trust property 'in husband's estate for which QTIP treatment was not elected — $1,400,000 of property beyond the $600,000 unified credit trust — is taxed in the husband's' estate at lower progressive rates of tax than would have applied to that property at the highest marginal rates in the wife's estate level had the QTIP election been made for this property.

STATE DEATH TAXES

One area of even greater complexity is the availability of the PPT Credit with respect to state death taxes. One example is the New York statute " providing for a New York state estate tax PPT Credit which, like the federal PPT Credit, applies with respect to a life income interest. In situations where the New York state PPT Credit comes into play, a difficult calculation becomes necessary to take properly into account its interaction with the federal PPT Credit. Of course, the New York credit only applies where the predeceased spouse's estate paid New York tax, so that it would not operate where the predeceased spouse died a resident of some other state and paid its death taxes, and afterwards the survivor moved to New York and died there.

Of particular interest are two state Supreme Court cases — *Dickinson v. Maurer"* in Florida and *Turner Est. v. Dept. of Revenue* in Washington." Both Florida " and Washington " are "pick-up" tax states which impose death taxes equal to the maximum credit against federal estate taxes allowed under §2011 for state death taxes paid. Neither case involved life estate or married couple situations but arose in the,q more ordinary situations involving an outright begdest of property to a non-spouse and then death within two years. In both cases, the level of federal taxes was so high in the first decedent's estate that the PPT Credit eliminated all federal taxes in the second decedent's estate, and also would have eliminated state death taxes, depending on the order of priority between the PPT Credit under §2013 and the state death tax credit under §2011. Both courts held that the respective state tax statutes did not impose state tax under the facts presented.

Table VI is included to show what is at stake under those court cases when their holdings are applied to the same basic fact pattern considered in Table II. It is assumed under Table VI that the wife died before the filing of the husband's federal estate tax return and that, in making the QTIP election, the husband's executor's primary goal was to minimize overall death taxes in both estates. The results from use of the optimum marital deduction in Case 3 of Table II are set out as Case 3 in Table VI, under which state death taxes are incurred, regardless of the state death tax issues involved in the two court cases. Case 1, how-ever, assumes that the wife lives in Florida or Washington and, following the court holdings, shows the results if the marital deduction is reduced to the point of completely eliminating total federal and state tax-es. That is the point where overall death taxes are the

" N.Y. Tax Law §959, **providing a** New York PPT Credit to be determined in a manner similar to §2013. A number of states by statute make allowance for property which, comparable to the federal PPT credit, *is* subjected within a specified period prior to the decedent's death to inheritance or estate taxes in another decedent's estate. The allowance may be in the form of a credit for tax on prior transfers or a deduction or exemption for previously taxed property. Jurisdictions which by statute provide for a credit include the following: Arizona, California, Colorado, District of Columbia, Hawaii, Idaho, Kentucky, Montana, Nevada, New York, North Carolina, Oklahoma, Oregon, Puerto Rico, South Carolina, Tennessee, Texas, Virginia, Washington, and Wisconsin. Jurisdictions which provide for a deduction are Delaware, Iowa, Mississippi, *Ohio,* Utah, and West Virginia. Kansas and Minnesota by statute provide exemptions. Inher. Est. & Gift Tax Rep. (CCH) All States, at 111330 **and** 1772 (1990).

" 229 So.2d 247 (Fla. 1969).

" 724 P.2d 1013 (Wash. **1986).**

"Fla. Const., Art. *VII,* §5(a); Fla. Stat. §198.02 (1990).

" Wash. Rev. Code §83.100.010 *et seq.* (1990). In 1988, the **Washington** State Legislature revised Chapter 83.100 ***et seq.,*** Wash. Rev. Code **(1988),** but those revisions do not adversely affect the ***Turner*** **holding.**

lowest, and, at that point, the total after-tax inheritance for the children would be increased by *$95,689,* as against Case 3. Case *2* shows what happens when the wife lives in a pick-up tax state yet to confront this issue. The marital deduction is fixed at the same figure as in Case 1, but the state death tax PPT Credit issue is ultimately decided against the wife's estate. The state taxes shown for Case *2* are large — $111,185 — but those state taxes can be credited against federal taxes under §2011. The net effect is that total death taxes in Case *2* are only $15,496 more than in Case 3 (where the higher *$1,328,900* optimum marital deduction figure, as calculated under Table II without respect to state death taxes is used). Table VI demonstrates that, when the state death tax law is not certain and a particular close order of death situation may allow opportunity to assert an aggressive position, the potential upside on a relative basis is much higher — *$95,689* under Case 1 — than the potential downside — $15,496 under Case *2.* Great care must be taken in this area, however, when deaths are more than two years apart, because technical aspects of the application of the percentage reduction suggest that, even in Florida and Washington, the two court decisions might be limited to the 100% PPT Credit context."

GST EXEMPTION TRUST PLANNING

Table VII takes into account how estate planning for use of the $1,000,000 generation-skipping transfer (GST) exemption "' from generation-skipping transfer tax relates to PPT Credit considerations. Table VII is drawn again from the basic facts in Table II, and Case I in Table VII shows what the effect is if the husband's will establishes a "dynasty" GST exemption trust in the initial amount of $1,000,000, with income payable to his children commencing immediately upon his death, with the balance of his estate assets (after payment of estate taxes generated by the generation-skipping transfer exemption trust) passing in trust to pay income to his wife.[SO] Case 1 shows that, where there is created a $1,000,000 GST exemption trust to pay income immediately to children, the aggregate estate taxes are *$229,034* more than under the optimum marital figure in Case 3, which is the same as Case 3 of Table II and for which it is assumed that income for all nonmarital deduction property is to be paid to the survivor. Case *2* assumes that the trust to pay income to the children is in the initial amount *of $600,000* — tied to the available unified credit under §2010 — and shows aggregate estate taxes which exceed the aggregate taxes in Case *3* by $137,254. The principal planning point is that, when it may be anticipated that spouses may die within a relatively short time *of* each other, a considerable tax advantage may result if the "dynasty" trust provides for a life estate in the surviving spouse"

CONCLUSION

This article covers the primary considerations involved in coordination of the PPT Credit and QTIP election in planning for and administration of large estates. Additional considerations may be presented in particular client situations, warranting special examination separate and apart from the PPT Credit/QTIP election analysis." Notwithstanding whatever extraor-

" The crux of the tax law issue is the priority in the application of the unified credit and the PPT Credit under §2013(c)(1)(A), which directs that for the purpose of the "second limitation," the PPT Credit be calculated "... *after* deducting the *[credit]* [§2011] ... ." This issue is not presented with respect to non-resident citizens whose estates are not subject to state death tax.

" §2631.

SO A "dynasty" trust typically refers to a longterm trust which *is* structured to avoid transfer tax through several generations, sometimes for as long as permitted under the rules against perpetuities. *See D.* Westfall & G. Mair, Estate Planning Law and Taxation, 117.18(i) (2d **1989);** Bloom & Dukeminier, "Perpetuities Reformers Beware: The USRAP Tax Trap," 25 Real Prop., Prob. & Tr. J. 203, 209 (1990); ***See** generally,* J. Manning, *supra,* at 282-291; Blattmachr & Pennell, "Adventures in Generation-Skipping or How We Learned to Love the Delaware Tax Trap," 24 Real Prop. & Tr. J. 75 (1988). For an excellent examination of concerns involving the allocation of the **generation-skipping** transfer exemption, *see* **Plaine, *The Million Dollar Question Under the Generation-*** *Skipping Transfer Tax,* 24 Inst. on Est. Plan. §3, at 3-51, (1990). Cases 1 and 2 in Table VII assume that no death taxes are apportioned against the separate trust providing income for descendents but rather that all death taxes are apportioned against the portion of the balance of the predeceased spouse's property eligible for QTIP but for which no QTIP election is made. The reason for that kind of tax apportionment in Case 1 *is* to utilize the full amount of the predeceased spouse's available generation-skipping transfer exemption for the "dynasty" trust (or, in Case 2, the **full unified credit amount).** *See* J. Pennell, ***supra,*** at A-48; **Report of the** Committee **on Plan**ning and Drafting, "Death Tax Clauses in Wills and Trusts: Discussion and Sample Clauses," 19 Real Prop., Prob. & Tr. J. 495, 508 (1984). The disposition in Case 2 is typically found in an estate plan where the governing instrument makes provision for a separate trust eligible for QTIP treatment to be created in an amount equal to the difference between the GST exemption and unified credit (i.e., $400,000 in Table VII), for which a so-called "reverse QTIP" election may be made pursuant to §2652(a)(3) with provisions for those two separate trusts to be combined at the survivor's death to be held in a longterm trust for descendents. *See J.* **Manning,** ***supra,*** at **288-289. The** figures for Case 2 **assume that,** on **account of** PPT Credit considerations, no QTIP election was made for that separate $400,000 trust fund.

" ***See, supra*** **note** 22 and **accompanying** text.

" For example, deferral of estate taxes under §6166 may be of greater importance than securing a PPT Credit in an illiquid estate largely constituted by closely held business interests. *See* **Rev.** Rul. 83-15, 1983-1 **C.B.** 224 (holding that the **PPT Credit** is not available to the estate of the second decedent for federal estate taxes deferred under §6166 by the first decedent's estate until actual payment of the deferred estate taxes). Another area of special concern involves planning for substantial lifetime gifts contemplated by married persons who are elderly or

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dinary circumstances may be present in a given situation, the tax professional must give serious analysis to potential PPT Credit consequences in estate planning and administration of estates before decisions regarding marital deduction treatment are made.

in ill health, **because** under certain circumstances (particularly where a relatively close order of deaths may be anticipated in the near term) there may be an overall tax advantage if a contemplated lifetime gift—charitable or noncharitable—is deferred until after the death of one or both spouses in order that a larger potential PPT Credit may be preserved in the survivor's estate. Other special situations may be presented where a PPT Credit may be available to the estate of either spouse on account of recent inheritance from another person (such as a parent), or where the surviving spouse remarries and may make dispositive provisions utilizing marital deduction treatment in favor of his or her new spouse.

APPENDIX

Where the surviving spouse is granted a life income interest and a power to withdraw the larger of $5,000 or 5% of trust principal, the combined value of the survivor's life estate and the "5 and 5" power may be computed with reference to the formula for determining a regular single life remainder factor as reflected in Table 8OCNSMT, with some modifications. The modifications, as described below, decrease the actuarial value of the remainder interest, so that the combined value of the life estate and the 5 and 5 power is the difference between that lower actuarial value of the remainder interest and the value of the entire trust fund as finally determined for federal estate tax purposes in the predeceased spouse's estate. This computation method takes into account that, where a 5 and 5 power is present, the value of the life estate is lower than if there were no 5 and 5 power. This is because it is actuarially assumed that the size of the trust corpus is reduced each year by exercise of the 5 and 5 power, thereby lowering the value of each year's income interest. This computation method corresponds with the calculations made by the IRS in PLRs 8830055, 8209054, 8029082, and 7837070 and is to some degree different from (although in principle similar to) the computation method set out in Mulli*gan, supra,* at 30, n. 15. Also instructive in a related context is Rev. Rul. 75-550, 1975-2 C.B. 357 (setting out a calculation of the value of a life estate with allowance for assumed annual trust corpus invasions of $100,000).

The formula for determining a regular single life remainder factor is as follows:

Range
xto109

(1 + Z) ,(t + 1) [(i _ Ix + + 1) _ (1 . . 1 x ¹/

` ` t . **0 Where:**

x . Age of **ate tenant**
i . Interest Rate loeartnt)
v . 1/(1+i)
Ix . **Mower** of **persons axing at age x as ut forth in Table 80CNSMT**

Katzenstein, *Applying the Section 7520 Valuation Rules (with Tables),* 4 Prac. Tax Law. 83, 93 (1989). By way of explanation, "i" represents 120% of Feder-al midterm rate. The portion of the formula to the right of the sigma sign must be summed for all ages between the initial age of the life tenant and age 109 (which is the end point of the Lx mortality tables) and then multiplied by "1 + i/2". The double bracket on the right of the formula represents probability that death may occur in each year of the summation. The denominator where indicated is the initial Lx for the age of the life tenant and remains constant in each year. "Lx + t" denotes increase in Lx every year by one age, beginning with the initial age. "Lx + t + 1" denotes increase in Lx every year, beginning with the age one year older than the initial age. To compute a regular remainder factor without a 5 and 5 withdraw-al right, the remainder factor in each year (starting with the initial age) is computed, the factors are summed up, and the total is multiplied by "1 + i/2."

Certain modifications are required to compute the remainder factor for a trust over which a 5 and 5 power is granted. The first step is, using the annual regular remainder factor, to multiply that factor each year by the amount remaining in the trust in each year, after the withdrawal. That total is then summed up and multiplied by "1 + i/2." However, one additional initial modification is required for the first year, because there is an actuarial assumption that the 5 and 5 withdrawal amount will be withdrawn in the middle of the first year. This assumption is carried out by taking the first year's 5 and 5 amount, dividing it by 2, with the resulting quotent then being further divided by "1 + i/2" to represent the amount of the first year withdrawal.

The following tables assume that the husband is the predeceased spouse and the wife is the surviving spouse.

TABLE I

Husband - Year of Death: 1983	Case 1	Case 2	Case 3
"Adjusted Gross Estate"	1,400,000	1,400,000	1,400,00
Less: QTIP Election	(1,125,000)	-0-	-0-
Taxable Estate	275,000	1,400,00	1,400,00
Federal Tax	-0-	375,500	375,500
State Tax	-0-	58,000	58,000
Total Taxes	-0-	433,500	433,500
Net Assets (other than QTIP Trust)	275,000	966,500	966,500
Wife - Year of Death: 1984			
Taxable Estate	2,425,000	1,300,00	1,300,00
Federal Tax Before PPT Credit	759,950	321,900	321,900
Less: PPT Credit	-0-	(150,421)	(186,653)
Net Federal Tax	759,950	171,479	135,247
State Tax	132,800	51,600	51,600
Total Taxes	892,750	223,079	186,847
Net Assets	1,532,250	1,076,92	1,113,15
Total Taxes in Both Estates	892,750	656,579	620,347
Net Assets in Both Estates	1,807,250	2,043,42	2,079,65

TABLE II

Husband - Year of Death: 1991	Case 1	Case 2	Case 3
"Adjusted Gross Estate"	5,000,000	5,000,00	5,000,00
Less: QTIP Election	(4,400,000)	-0-	(1,328,900
Taxable Estate	600,000	5,000,00	3,671,10
Federal Tax	-0-	**1,806,40**	1,220,91
State Tax	-0-	391,600	246,194
Total Taxes	-0-	2,198,00	1,467,10
Net Assets (other than QTIP Trust)	600,000	2,802,00	2,203,99
Wife - Year of Death: 1992			
Taxable Estate	5,700,000	1,300,00	2,628,90
Federal Tax Before PPT Credit	2,108,200	225,400	751,974
Less: PPT Credit	-0-	(225,400)	(544,877)
Net Federal Tax	2,108,200	-0-	207,097
State Tax	474,800	51,600	149,343
Total Taxes	2,583,000	51,600	356,440
Net Assets	3,117,000	1,248,40	2,272,46
Total Taxes in Both Estates	2,583,000	2,249,60	1,823,54
Net Assets in Both Estates	3,717,000	4,050,40	4,476,45

TABLE III

Husband - Year of Death: 1991	Case 1	Case 2	Case 3
"Adjusted Gross Estate"	5,000,000	5,000,00	5,000,00
Less: QTIP Election	(1,334,400)	(3,000,00	(1,328,900
Taxable Estate	3,655,600	2,000,00	3,671,10
Federal Tax	1,218,458	488,400	1,220,91
State Tax	245,622	99,600	246,194
Total Taxes	1,464,080	588,000	1,467,10
Net Assets (other than QTIP Trust)	2,201,520	1,412,00	2,203,99

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Wife - Year of Death: 1992			
Taxable Estate	2,634,400	4,300,000	2,628,900
Federal Tax Before PPT Credit	754,405	1,499,800	751,974
Less: PPT Credit	(634,543)	(362,547)	(634,566)
Net Federal Tax	119,862	1,137,253	117,408
State Tax	149,827	313,200	149,343
Total Taxes	269,689	1,450,453	266,751
Net Assets	2,364,711	2,849,547	2,362,149
Total Taxes in Both Estates	1,733,769	2,038,453	1,733,856
Net Assets in Both Estates	4,566,231	4,261,547	4,566,144

TABLE IV

Husband - Year of Death: 1991	Case 1	Case 2	Case 3
"Adjusted Gross Estate"	5,000,000	5,000,000	5,000,000
Less: QTIP Election	(1,328,900)	(1,328,900)	(1,328,900)
Taxable Estate	3,671,100	3,671,100	3,671,100
Federal Tax	1,220,911	1,220,911	1,220,911
State Tax	246,194	246,194	246,194
Total Taxes	1,467,105	1,467,105	1,467,105
Net Assets (other than QTIP Trust)	2,203,995	2,203,995	2,203,995

Wife - Year of Death	1994	1998	2002
Taxable Estate	2,628,900	2,628,900	2,628,900
Federal Tax Before PPT Credit	748,107	748,107	748,107
Less: PPT Credit	(432,808)	(216,404)	-0--
Net Federal Tax	315,299	531,703	748,107
State Tax	149,343	149,343	149,343
Total Taxes	464,642	681,046	897,450
Net Assets	2,164,258	1,947,854	1,731,450
Total Taxes in Both Estates	1,931,747	2,148,151	2,364,555
Net Assets in Both Estates	4,368,253	4,151,849	3,935,445

TABLE V

Husband - Year of Death: 1991	Case 1	Case 2	Case 3
"Adjusted Gross Estate"	5,000,000	5,000,000	5,000,000
Less: QTIP Election	(3,000,000)	(3,000,000)	(3,000,000)
Taxable Estate	2,000,000	2,000,000	2,000,000
Federal Tax	488,400	488,400	488,400
State Tax	99,600	99,600	99,600
Total Taxes	588,000	588,000	588,000
Net Assets (other than QTIP Trust)	1,412,000	1,412,000	1,412,000

Wife - Year of Death	1992	1998	2002
Taxable Estate	4,300,000	4,300,000	4,300,000
Federal Tax Before PPT Credit	1,499,800	1,419,800	1,419,800
Less: PPT Credit	(305,563)	(122,225)	-0-
Net Federal Tax	1,914,237	1,297,575	1,419,800
State Tax	313,200	313,200	313,200
Total Taxes	1,507,437	1,610,775	1,733,000
Net Assets	2,792,563	2,689,225	2,567,000
Total Taxes in Both Estates	2,095,437	2,198,775	2,321,000
Net Assets in Both Estates	4,204,563	4,101,225	3,979,000

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TABLE VI

Husband — Year of Death: 1991	Case 1	Case 2	Case 3
"Adjusted Gross Estate"	5,000,000	5,000,000	5,000,000
Less: QTIP Election	(854,807)	(854,807)	(1,328,900)
Taxable Estate	4,145,193	4,145,193	3,671,100
Federal Tax	1,431,994	1,431,994	1,220,911
State Tax	295,862	295,862	246,194
Total Taxes	1,727,856	1,727,856	1,467,105
Net Assets (other than QTIP Trust)	2,417,337	2,417,337	2,203,995
Wife — Year of Death: 1992			
Taxable Estate	2,154,807	2,154,807	2,628,900
Federal Tax Before PPT Credit	663,855	552,670	751,974
Less: PPT Credit	(663,855)	(552,670)	(544,877)
Net Federal Tax	-0-	-0-	207,097
State Tax	-0-	111,185	149,343
Total Taxes	-0-	111,185	356,440
Net Assets	2,154,807	2,043,622	2,272,460
Total Taxes in Both Estates	1,727,8 56	1,839,041	1,823,545
Net Assets in Both Estates	4,572,144	4,460,959	4,476,455

TABLE VII

Husband — Year of Death: 1991	Case 1	Case 2	Case 3
"Adjusted Gross Estate"	5,000,000	5,000,000	5,000,000
Less: QTIP Election	(1,035,800)	(1,231,000)	(1,328,900)
Taxable Estate	3,964,200	3,769,000	3,671,100
Federal Tax	1,351,633	1,264,574	1,220,911
State Tax	276,677	256,376	246,194
Total Taxes	1,628, 3,10	1,520,950	1,467,105
Net Assets (other than QTIP Trust)	2,335,890	2,248,050	2,203,995
Wife — Year of Death: 1992			
Taxable Estate	2,335,800	2,531,000	2,628,900
Federal Tax Before PPT Credit	626,878	708,150	751,974
Less: PPT Credit	(328,273)	(409,581)	(544,877)
Net Federal Tax	**298,605**	**298,569**	207,097
State Tax	125,664	141,280	**149,343**
Total Taxes	424,269	**439,849**	356,440
Net Assets	1,911,531	2,091,151	2,272,460
Total Taxes in Both Estates	2,052,579	**1,960,799**	1,823,545
Net Assets in Both Estates	4,247,421	4,339,201	4,476,455

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