The Uncertainty of Death and Taxes: Valuing Estate Tax Marital and Charitable Deductions After *Hubert*

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"Logic and taxation are not always the best of friends. In cases like the one before us today, they can be complete strangers. That our tax laws can at times be in such disarray is a discomforting thought."[1]

INTRODUCTION

On March 18, 1997, almost eleven years after eighty-year-old Georgia resident Otis C. Hubert died leaving $30 million to his wife and to charity,[2] the Supreme Court affirmed the decisions of the Eleventh Circuit and the Tax Court in *Commissioner v. Estate of Hubert*,[3] ruling in favor of the estate against an Internal Revenue Service ("IRS" or "Service") challenge.[4] The Court rejected the Service's argument that Treasury Regulation section 20.2056(b)-4(a) required the estate to reduce its marital and charitable deductions[5] by the amount of administration expenses[6] charged to income earned during administration on assets allocated to the marital and charitable bequests.[7] The regulation requires

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1. Commissioner v. Estate of Hubert, 117 S. Ct. 1124, 1134 (1997) (O'Connor, J., concurring) (quoting Sonneborn Bros. v. Cureton, 262 U.S. 506, 522 (1923) (McReynolds, J., concurring)).

2. *See Justices to Resolve Estate Tax Dispute; The IRS Contends that a Marietta Man's Estate Still Owes $154,000*, ATLANTA J. & CONST., Apr. 30, 1996, at A5.

3. 117 S. Ct. 1124 (1997) (7-2 decision with no majority opinion), *aff'g* 63 F.3d 1083 (11th Cir. 1995) (2-1 opinion), *aff'g* 101 T.C. 314 (1993) (15-2 reviewed opinion).

4. *See id.* The IRS issued a notice of deficiency in 1990, claiming the estate underreported its federal estate tax liability by more than $14 million. The IRS notice asserted that the property passing to Mrs. Hubert and to charity did not qualify for the marital and charitable deductions, respectively, for reasons not relevant here. The estate petitioned the Tax Court for a redetermination of the deficiency. Shortly thereafter, the estate settled other litigation in which it was involved, and the settlement agreement provided that the marital and charitable shares would pass in trust. The IRS stipulated that the nature of the trusts did not prevent them from qualifying for the marital and charitable deductions. *See id.* at 1127-28. The IRS then raised a new issue, not asserted in its notice of deficiency, contending that the marital and charitable deductions had been overstated. *See* Brief for Respondent at 6, *Hubert* (No. 95-1402). Newspapers reported that the asserted deficiency was only $154,000 by the time the case reached the Supreme Court. *See, e.g.*, Eva M. Rodriguez, *Supreme Court Rules Against IRS in Dispute Tied to Estate Taxes*, WALL ST. J., Mar. 19, 1997, at B8.

5. See *infra* text accompanying notes 72-88 for a discussion of marital and charitable deductions.

6. See *infra* text accompanying notes 68-71 for a discussion of administration expenses.

7. *See Hubert*, 117 S. Ct. at 1128.

that any "material limitations" on a spouse's right to income be taken into account when valuing a marital bequest for purposes of the marital deduction.[8]

The Supreme Court granted certiorari in *Hubert* to resolve a split between the Eleventh Circuit and the Sixth and Federal Circuits that was created when the Eleventh Circuit affirmed the Tax Court's decision in *Hubert*.[9] The Supreme Court's decision means that, when state law and a decedent's will authorize, an executor may charge administration expenses to post-mortem income allocable to marital and charitable bequests and claim an income tax deduction without reducing the value of the estate tax marital and charitable deductions, at least in some cases. In exactly which cases is still unresolved, because a majority of the Court could not agree on what constitutes a material limitation on a surviving spouse's right to income for purposes of valuing the marital deduction. The case spawned four separate opinions from the Court, with none supported by a majority of the Justices.[10]

In response to the Supreme Court's splintered decision in *Hubert*, the IRS issued Notice 97-63, "Material Limitation on Surviving Spouse's Right to Income."[11] In it, the Service asks for public comment on three alternatives for

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8. Treas. Reg. § 20.2056(b)-4 (as amended in 1994). The regulation provides as follows:

> Marital deduction; valuation of interest passing to surviving spouse.
>
> (a) *In general.* The value, for the purpose of the marital deduction, of any deductible interest which passed from the decedent to his surviving spouse is to be determined as of the date of the decedent's death [unless the estate] elects the alternate valuation method .... The marital deduction may be taken only with respect to the net value of any deductible interest which passed from the decedent to his surviving spouse, the same principles being applicable as if the amount of a gift to the spouse were being determined. In determining the value of the interest in property passing to the spouse account must be taken of the effect of any material limitations upon her right to income from the property. An example of a case in which this rule may be applied is a bequest of property in trust for the benefit of the decedent's spouse but the income from the property from the date of the decedent's death until distribution of the property to the trustee is to be used to pay expenses incurred in the administration of the estate.

Id.

9. *See Hubert*, 117 S. Ct. at 1128. The Eleventh Circuit adopted the Tax Court's decision, attaching the Tax Court's opinion as an appendix to its own and adopting it "as completely as if [it] had set it forth [t]herein." Estate of Hubert v. Commissioner, 63 F.3d 1083, 1084 (11th Cir. 1995), *aff'd*, 117 S. Ct. 1124 (1997). Thus, references to the Tax Court's opinion should be understood to encompass the Eleventh Circuit's opinion as well. The Eleventh Circuit expressly recognized that its decision brought it in conflict with the Sixth Circuit's holding in *Estate of Street v. Commissioner*, 974 F.2d 723 (6th Cir. 1992), and the Federal Circuit's holding in *Burke v. United States*, 994 F.2d 1576 (Fed. Cir. 1993). *See Hubert*, 63 F.3d at 1083. See also *infra* text accompanying notes 116-131 for a discussion of the Sixth and Federal Cireuits' cases.

10. *See Hubert*, 117 S. Ct. at 1127, 1134, 1139, 1146. Justice Kennedy wrote for the plurality and was joined by Chief Justice Rehnquist and Justices Stevens and Ginsburg; Justice O'Connor wrote a concurring opinion and was joined by Justices Souter and Thomas; Justice Scalia wrote a dissenting opinion and was joined by Justice Breyer; Justice Breyer also wrote a dissenting opinion. See also *infra* Part IV for a discussion of the points to which a majority of Justices agreed, despite writing four separate opinions.

11. I.R.S. Notice 97-63, 1997-47 I.R.B. 6.

proposed regulations that it and the Treasury Department are considering. The proposed regulations will provide definitive guidance on when the use of income from property to pay administration expenses is a material limitation on a spouse's right to income.[12]

This Note evaluates the alternatives proposed by the IRS, as well as other theories advanced by commentators. Part I provides background by detailing the facts of *Hubert* and summarizing the IRS's argument and the Supreme Court's decision in the case. Part II provides a framework for the discussion following it by describing the interrelationship of estate tax, income tax, and fiduciary accounting in the context of *Hubert*. Part III examines the rationale and evolution of the cases that resulted in the split of authority among the circuit courts. Part IV discusses the Supreme Court's decision in *Hubert*, highlighting the points that a majority of the Justices agreed to despite writing four separate opinions. Finally, Part V analyzes the various alternatives proposed for providing taxpayers with guidance. It concludes that the proposed regulations should be based on a variation of the IRS's second alternative, whereby a safe harbor amount of administration expenses may be charged to the income of a marital or charitable bequest without reducing the value of the marital or charitable deduction.

I. BACKGROUND

A. The Facts of Hubert

Shortly after Mr. Hubert's death his estate became involved in probate and civil litigation, beginning with will contests filed by Mrs. Hubert and their three daughters.[13] The contests charged that the attorney who drafted Mr. Hubert's last will and its three codicils was unfit to serve as co-executor, was an incompetent witness to the will, and had exercised undue influence over Mr. Hubert in favor of the charitable beneficiaries. The attorney was Mr. Hubert's nephew. He responded with civil suits seeking damages for slander and harm to his reputation.[14] Following negotiations between the family members and

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12. *See id.*

13. Otis Colley Hubert died June 2, 1986. He was survived by his wife, Ruth Swann Hubert; a son, Richard N. Hubert; three daughters, Marilyn Kemper, Judy Manning, and Deborah Jones; and eight grandchildren. Mr. Hubert was a graduate of Georgia Tech Evening School (now Georgia State University) and Woodrow Wilson School of Law, and served in the Navy during World War II as a lieutenant commander. After the war he and other family members formed Hubert Realty Co. Besides being a developer, real estate broker, and lawyer, Mr. Hubert was chairman of the board of the Georgia Motor Club, president of the Atlanta Jaycees, and a trustee of Shorter College. *See O.C. Hubert, Cobb Realtor, Developer*, ATLANTA J. & CONST., June 4, 1986, at E9.

14. *See* Vicki C. Irwin, Note, *Tax Law: Administrative Expenses and the Charitable and Marital Deductions—The Potentially Painful Surprise of a 642(g) Election*, 20 U. DAYTON L. REV. 501, 529 & n.235 (1994); *see also Hubert*, 117 S. Ct. at 1127.

representatives for the charities,[15] the Cobb County, Georgia Superiors and Probate Courts approved a final settlement agreement and accepted it as binding on all interested parties.[16] Four and one-half years had elapsed since Mr. Hubert's death, and $2 million in administration expenses, including attorneys' fees, had been incurred.[17]

The final settlement agreement divided Mr. Hubert's residuary estate[18] of approximately $26 million almost equally between a marital share and a charitable share.[19] The residuary marital share was payable to two trusts, a marital trust over which Mrs. Hubert had a general power of appointment ("GPA"),[20] and a qualified terminable interest property ("QTIP") trust.[21] The rest of the residue went to the charities.[22]

The agreement preserved the discretion that Mr. Hubert's will had given his estate's executors "'to charge any expenses against income or principal or apportion the same.'"[23] This discretion was in accordance with Georgia law, which authorizes the allocation of administration expenses to income instead of principal if the will so provides.[24] The executors charged about $500,000 to principal as funeral and administration expenses, and charged the remaining administration expenses to income.[25] The expenses charged to principal reduced the amount of date-of-death corpus that the beneficiaries otherwise would have received.

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15. The Georgia Revenue Commissioner and the Georgia Attorney General served as representatives for the charities. *See* Estate of Hubert v. Commissioner, 101 T.C. 314, 317 (1993).

16. On November 28, 1990, the Cobb County Probate Court entered a final order adopting the Superior Court's Order, Judgment, and Decree. *See id.*

17. *See Hubert*, 117 S. Ct. at 1128.

18. The residuary estate is "[t]hat which remains after debts and expenses of administration, legacies, and devises have been satisfied. That portion of [a] person's estate which has not otherwise been particularly devised or bequeathed. . . . Gross estate less all charges, debts, costs, and all other legacies." BLACK'S LAW DICTIONARY 1309-10 (6th ed. 1990).

19. *See Hubert*, 117 S. Ct. at 1128.

20. In a marital deduction power of appointment trust, the trust income is payable to the surviving spouse for life; she is granted the power to appoint the property to herself, her estate, her creditors, or the creditors of her estate; and no other person can be a beneficiary of the trust while she is alive. *See* I.R.C. § 2056(b)(5) (1994); Jeffrey N. Pennell, *Estate Tax Marital Deduction*, [843 Estates, Gifts, and Trusts] Tax Mgmt. (BNA) at A-42 (Aug. 5, 1996).

21. *See Hubert*, 101 T.C. at 317. In a qualified terminable interest property trust, the trust income is payable to the surviving spouse for life, but she is not granted a general power of appointment over the property. Property in a QTIP trust qualifies for the marital deduction to the extent the executor so elects on the decedent's estate tax return. *See* I.R.C. § 2056(b)(7); BLACK'S LAW DICTIONARY 1238 (6th ed. 1990).

22. *See Hubert*, 101 T.C. at 317. It is unclear whether the charities received their share outright or in trust. While the Tax Court opinion states that the charities "received the rest of the residue outright," *id.*, the Supreme Court opinion states that the charitable share was paid to a trust, *see Hubert*, 117 S. Ct. at 1128.

23. *Hubert*, 101 T.C. at 322 (quoting Mr. Hubert's 1982 will).

24. *See id.* at 324 (citing GA. CODE ANN. §§ 53-2-101, 53-15-3 (1982)); *see also Hubert*, 117 S. Ct. at 1128.

25. *See Hubert*, 101 T.C. at 322.

Accordingly, the executors reduced the marital and charitable deductions by the amount of the expenses charged to principal, and claimed estate tax deductions for funeral and administration expenses instead.[26] The executors did not deduct the administration expenses charged to income on the estate tax return. Rather, these expenses were deducted on the estate's income tax returns pursuant to an election provided by Internal Revenue Code ("Code") § 642(g). The executors did not reduce the estate tax marital and charitable deductions by the amount of the expenses deducted on the income tax returns.[27] During the period of administration the estate generated more than $4.5 million in gross income.[28]

B. The IRS's Argument

The IRS argued that the estate tax marital and charitable deductions must be reduced by the amount of administration expenses charged to estate income and deducted on the income tax returns. The IRS supported its position by citing Treasury Regulation section 20.2056(b)-4(a),[29] which states that account must be taken of any "material limitations" on a spouse's right to income when valuing a marital bequest for purposes of the marital deduction.[30] Although no similar regulation exists with respect to the charitable deduction, courts generally read the provision *in pari materia* for both the marital and charitable deductions.[31]

The regulation does not define "material limitations," but explains that such a limitation "may" exist in the case of a marital bequest in trust when income earned during administration is used to pay administration expenses.[32] The IRS interpreted the regulation as requiring a dollar-for-dollar reduction in the marital deduction *any time* administration expenses are charged to the income earned by property in the marital bequest.[33] That is, the IRS argued that any use of income to pay administration expenses is, per se, a material limitation.[34] Consequently, the Commissioner did not argue that the specific amount charged to income in *Hubert*, $1.5 million, was quantitatively material.[35] Nor did she argue that as of

26. *See* Brief for Respondent at 5-6, *Hubert*, 117 S. Ct. 1124 (No. 95-1402).

27. *See id.*

28. *See* Estate of Hubert v. Commissioner, 63 F.3d 1083, 1084 (11th Cir. 1995), *aff'd*, 117 S. Ct. 1124 (1997).

29. *See Hubert*, 117 S. Ct. at 1131.

30. Treas. Reg. § 20.2056(b)-4(a) (as amended in 1994). See also *supra* note 8 for a reproduction of the regulation.

31. *See Hubert*, 117 S. Ct. at 1139 n.1 (Scalia, J., dissenting).

32. Treas. Reg. § 20.2056(b)-4(a).

33. *See* Estate of Hubert v. Commissioner, 101 T.C. 314, 322-23 (1993).

34. *See* I.R.S. Notice 97-63, 1997-47 I.R.B. 6.

35. *See Hubert*, 117 S. Ct. at 1138 (O'Connor, J., concurring) ("It appears from the record that the Commissioner elected to marshal all her resources behind the proposition that any diversion of postmortem income was material, and never presented any evidence or argued that $1.5 million was quantitatively material.") (emphasis omitted).

Mr. Hubert's date of death, the *expected future* administration expenses were quantitatively material.[36]

C. The Supreme Court's Decision

The Supreme Court disagreed with the IRS that the regulation called for a mandatory reduction in the marital deduction *any time* administration expenses were charged to income from the marital property.[37] Instead, Justice Kennedy, writing for the plurality, agreed with the Tax Court that the regulation was "'merely a valuation provision,'" and that not *every* limitation on a surviving spouse's right to income from property would necessarily be a *material* limitation requiring a reduction in the marital deduction.[38] Writing for the concurring members of the Court, Justice O'Connor likewise found that "some financial burdens on the spouse's right to post-mortem income will reduce the marital deduction; others will not. . . . That a limitation affects the marital deduction only upon reaching a certain quantum of substantiality is not a concept alien to the law of taxation; such rules are quite common."[39] Because the IRS bore the burden of proving materiality[40] and had not argued that the specific amount of expense in *Hubert* was material, the Court found that it had no basis to overturn the Tax Court's holding for the estate.[41]

II. ESTATE TAX, INCOME TAX, AND FIDUCIARY ACCOUNTING PRINCIPLES

Although the testamentary scheme in Mr. Hubert's estate was similar to fairly common estate plans,[42] the issue addressed in the case is complex. It has caused the IRS and fiduciaries to battle,[43] commentators to debate,[44] and courts to

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36. *See id.* at 1132. The plurality embraced an estate tax valuation theory that focused on the present value of anticipated administrative expenses and anticipated income as of the decedent's date of death. *See id.* at 1129-32.

37. *See id.* at 1131, 1137-38.

38. *Id.* at 1131 (quoting *Hubert*, 101 T.C. at 324).

39. *Id.* at 1137-38 (O'Connor, J., concurring).

40. *See id.* at 1139. The IRS bore the burden of proof on all factual matters because the issue being litigated had not been asserted in its deficiency notice. *See* TAX CT. R. PRAC. & P. 142(a). See also *supra* note 4 for a discussion of the deficiency notice issued by the IRS.

41. *See Hubert*, 117 S. Ct. at 1132, 1138.

42. *See* I.R.S. Notice 97-63, 1997-47 I.R.B. 6 ("The facts in Estate of Hubert are similar to the following common fact pattern.").

43. *See* David Pratt, *Administration Expenses Charged to Post-mortem Income:* Hubert *and Beyond*, PROB. & PROP., Mar./Apr. 1996, at 19.

44. *See, e.g.*, Farhad Aghdami, *Payments Out of Postmortem Income: Impact on Estate Tax Marital and Charitable Deductions*, 49 TAX LAW. 707 (1996) [hereinafter Aghdami, *Payments*]; Pamela R. Champine, *Paying Administration Expenses Out of Income Attributable to Marital and Charitable Residuary Bequests: Double Dipping or Appropriate Accounting?*, 14 VA. TAX REV. 507 (1995); Martha W. Jordan, *The Impact on the Marital Deduction of Expenses Chargeable to Post-Mortem Income: Does* United States v. Stapf *Answer the Question?*, 21 S. ILL. U. L.J. 73 (1996); Vicki C. Irwin, Note, *Tax Law: Administrative Expenses and the Charitable and Marital Deductions—The Potentially Painful Surprise of a*

disagree.[45] The complexity results from the interaction of the estate tax laws, the income tax laws, and fiduciary accounting principles. As commentators have noted, "[t]hese three areas are independent and at times inconsistent."[46]

This Part provides a brief overview of the interrelationship between these areas in the context of *Hubert*. A basic understanding of this Part provides a framework for the discussion following it.

A. The Gross Estate

Estates of United States citizens or residents may be required to pay two kinds of tax: estate tax[47] and income tax.[48] Estate tax is an excise tax imposed upon the transfer of a decedent's property.[49] The tax base for computing estate tax is the taxable estate,[50] determined by subtracting from the gross estate certain allowable deductions.[51] The gross estate includes the date-of-death fair market value of all property, "real or personal, tangible or intangible, and wherever situated," to the extent of the decedent's interest therein.[52]

642(g) Election, 20 U. DAYTON L. REV. 501 (1994); Farhad Aghdami & David Pratt, *The Supreme Court Decides* Hubert—*Now What Do We Do?*, 86 J. TAX'N 340 (1997) [hereinafter Aghdami & Pratt, *The Supreme Court*]; Jerald David August & James J. Freeland, *S. Ct. in* Hubert *Fails to Provide Needed Guidance*, 24 EST. PLAN. 299 (1997); David A. Baker, *The Principle of the Thing*—Commissioner v. Estate of Hubert, PROB. & PROP., July/Aug. 1997, at 38; Jonathan G. Blattmachr, *Estate Tax Marital and Charitable Deductions Need Not Be Reduced by the Amount of Expenses That Would Have Gone to a Spouse or Charity*, NAT'L L.J., Apr. 28, 1997, at B4; Francis B. Brogan, Jr. & Andrew D. Painter, *Administration Expenses May Lower Other Deductions*, 21 EST. PLAN. 131 (1994); Steven C. Colburn et al., *Administrative Expenses and the Marital Deduction*, 72 TAXES 412 (1994); Charles Davenport, *A Street Through* Hubert's *Fog*, 73 TAX NOTES 1107 (1996); Mitchell M. Gans, *Will Administration Expenses Charged to Income Reduce the Marital Deduction?*, 71 J. TAX'N 90 (1989); David Pratt, *Deducting Estate Administration Expenses: Does a Section 642(g) Election Still Make Sense?*, 65 TAX NOTES 1683 (1994) [hereinafter Pratt, *Deducting*]; George L. Strobel II & Caroline D. Strobel, *The Proper Treatment of Administrative Expenses: The Debate Rages On*, 26 TAX ADVISER 228 (1995).

45. See *infra* Part III for a discussion of the cases leading up to the Supreme Court's decision in *Hubert*.

46. Scott H. Malin & Bennett S. Keller, *Planning for the Allocation of Administration Expenses to Income Under* Hubert, 84 J. TAX'N 213, 214 (1996).

47. *See* I.R.C. § 2001 (1994).

48. *See id.* § 641(a). For purposes of this Note, only tax imposed by the federal government, and not the various state governments, is considered.

49. *See* Treas. Reg. § 20.2033-1 (as amended in 1963).

50. *See* I.R.C. § 2001.

51. *See id.* § 2051.

52. Treas. Reg. § 20.2033-1 (as amended in 1963). The regulations define the gross estate as the total value of the decedent's interests described in I.R.C. §§ 2033-2044. *See* Treas. Reg. § 20.2031-1(a) (as amended in 1965). Section 2033 includes any property interest the decedent held at the time of death; § 2034 includes dower or curtesy interests of the decedent's surviving spouse; § 2035 includes property transferred in contemplation of death; § 2036 includes property transferred with a retained life estate; § 2037 includes transfers taking effect at death; § 2038 includes revocable transfers; § 2039 includes annuities; § 2040 includes joint interests; § 2041 includes general power of appointment property; § 2042 includes life insurance

Fair market value is defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."[53] Income accrued on the decedent's assets as of the date of death but as yet unpaid is included in determining fair market value,[54] but post-mortem income earned during administration of the estate is excluded.[55] Instead, post-mortem income is reported on the estate's income tax return.[56] This difference results from the concept of date-of-death valuation of the gross estate. "Brief as is the instant of death, the court must pinpoint [the estate's] valuation at this instant—the moment of truth, when the ownership of the decedent ends and the ownership of the successors begins."[57]

B. Deductions from the Gross Estate

Allowable deductions are subtracted from the gross estate to arrive at the taxable estate.[58] These include deductions for amounts that will not be passed on to any beneficiary because they were consumed during the course of administration,[59] such as funeral expenses,[60] administration expenses,[61] claims against the estate,[62] unpaid mortgages or indebtedness,[63] and theft or casualty losses incurred during settlement of the estate.[64] These also include deductions for amounts transferred to certain beneficiaries as determined by Congress,[65] including transfers for public, charitable, and religious uses,[66] and transfers to a surviving spouse.[67] The interaction of the deduction for administration expenses and the deduction for bequests to a spouse or charity is at the heart of the dispute in *Hubert*.

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proceeds; § 2043 includes transfers for insufficient consideration; and § 2044 includes certain property for which a marital deduction was previously allowed. *See* Treas. Reg. § 20.2031-1(a).

53. Treas. Reg. § 20.2031-1(b) (as amended in 1965); *accord* United States v. Cartwright, 411 U.S. 546, 551 (1973).

54. *See, e.g.*, Treas. Reg. § 20.2031-4 (1958) (explaining that the fair market value of notes includes unpaid principal plus interest accrued to the date of death).

55. *See* Bowes v. United States, 593 F.2d 272, 275 (7th Cir. 1979); Alston v. United States, 349 F.2d 87, 88 (5th Cir. 1965); Estate of Horne v. Commissioner, 91 T.C. 100, 103 (1988).

56. *See* I.R.C. § 641(a)(3) (1994).

57. United States v. Land, 303 F.2d 170, 172 (5th Cir. 1962).

58. *See* I.R.C. § 2051 (1994).

59. *See* Champine, *supra* note 44, at 516.

60. *See* I.R.C. § 2053(a)(1) (1994).

61. *See id.* § 2053(a)(2).

62. *See id.* § 2053(a)(3).

63. *See id.* § 2053(a)(4).

64. *See id.* § 2054.

65. *See* Champine, *supra* note 44, at 516.

66. *See* I.R.C. § 2055 (1994 & Supp. II 1996).

67. *See id.* § 2056 (1994).

1. Administration Expenses

It takes time, sometimes years, for the executor of an estate to collect the decedent's assets, pay any valid debts and claims against the estate, including estate taxes, and distribute the assets as directed in the decedent's will.[68] During this period of time, known as administration, the estate may incur significant expenses. These may include executors' commissions, attorneys' fees, court costs, accountants' fees, appraisers' fees, costs of storing or maintaining the estate's property, brokerage fees, and auctioneers' fees.[69] As long as such expenses are actually and necessarily incurred in the proper administration of the estate, rather than for the individual benefit of the those designated to receive the property, they are deductible from the gross estate.[70] Thus, a decedent's estate need not pay tax on dollars expended for costs of administration if such costs are claimed as deductions on the estate tax return. As mentioned earlier, Mr. Hubert's estate incurred approximately $2 million of administration expenses.[71]

2. Transfers for Public, Charitable, or Religious Uses

The amount of all bequests and other transfers made to qualifying organizations for public, religious, charitable, scientific, literary, or educational purposes is deductible from a decedent's gross estate.[72] The charitable deduction must be reduced by the amount of any death taxes required by the terms of the will or by state law to be paid out of the bequest,[73] and it is limited to "the value of the transferred property required to be included in the [decedent's] gross estate."[74]

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68. *See* ABA Section of Taxation Comments on Notice 97-63 (Apr. 1, 1998), *in* 98 TAX NOTES TODAY 73-34, Apr. 16, 1998, at ¶ 24, *available in* LEXIS, FEDTAX library, TNT file [hereinafter ABA Section of Taxation].

> The Executor has nine months after the decedent's death to file the Estate Tax Return. In many cases, a six month extension of time to file the Estate Tax Return is granted. Assuming the decedent's Estate Tax Return is not audited, an Estate Tax Closing Letter may not be received for another 12 to 18 months. Given the fact that the Executor is personally liable for the estate tax, many Executors are unwilling to finalize the estate administration process until after the Estate Tax Closing Letter is received. Once the Closing Letter is received, the Executor may need to file final accountings and Tax Returns and distribute assets from the estate. The process of finalizing the estate may take an additional six months. Consequently, in most cases, it may take up to 36 months to conclude the administration of an estate.

Id.

69. *See* Treas. Reg. § 20.2053-3 (as amended in 1979).

70. *See id.*

71. *See supra* text accompanying note 17.

72. *See* I.R.C. § 2055(a) (1994).

73. *See id.* § 2055(c).

74. *Id.* § 2055(d).

3. Transfers to a Surviving Spouse

The value of any interest in property which passes to the surviving spouse is deductible from a decedent's gross estate.[75] Like the charitable deduction, the marital deduction is limited to amounts included in determining the value of the decedent's gross estate.[76] For purposes of valuing the property interest that passes from the decedent to the surviving spouse, the Code requires that the date-of-death value of the marital bequest be adjusted to take into account the effect of any death taxes payable by the surviving spouse.[77] Additionally, the Code requires that the date-of-death value of the property interest be adjusted to take into account the amount of any mortgage or encumbrance on the property, or the amount of any obligation imposed upon the surviving spouse in connection with the passing of the property, "in the same manner as if the amount of a gift to such spouse of such interest were being determined."[78]

Congress enacted the marital deduction as part of the Revenue Act of 1948.[79] Its goal was to eliminate discrimination under the estate tax system against couples residing in common law states, as opposed to community property states.[80] This original marital deduction was limited to fifty percent of the decedent's adjusted gross estate, excluding any interest in community property.[81] In the Economic Recovery Tax Act of 1981,[82] Congress abandoned its earlier rationale for the marital deduction and adopted the view that married couples should be viewed as "one economic unit" for transfer tax purposes.[83] To incorporate this new view, Congress amended the marital deduction to allow unlimited transfers of property to a surviving spouse,[84] intending that no estate tax be incurred upon the death of the first spouse to the extent his or her property passes to the survivor.[85]

The marital deduction is not designed to provide a permanent exemption from transfer taxes, but a deferral of tax until the death of the surviving spouse. To this end, a prerequisite for obtaining the deduction is that property passing to the surviving spouse must be transferred in a manner that exposes it to tax in his or

75. *See id.* § 2056(a). However, if the surviving spouse is not a United States citizen, the marital deduction is allowed only if the property interest passing to the surviving spouse is in the form of a qualified domestic trust. *See id.* § 2056(d).

76. *See id.* § 2056(a).

77. *See id.* § 2056(b)(4)(A).

78. *Id.* § 2056(b)(4)(B); *see also* United States v. Stapf, 375 U.S. 118 (1963) (holding that no estate tax marital deduction allowed where widow gave up interest in community property in order to take under husband's will, and value of property required to be given up exceeded value of property received); Treas. Reg. § 20.2056(b)-4(b) (as amended in 1994).

79. Revenue Act of 1948, ch. 168, 62 Stat. 110, 117-21.

80. *See* S. REP. NO. 80-1013, at 2 (1948), *reprinted in* 1948 U.S.C.C.A.N. 1163, 1228.

81. *See* Revenue Act of 1948, 62 Stat. at 119.

82. Pub. L. No. 97-34, 95 Stat. 172 (codified in scattered sections of 26 U.S.C.).

83. S. REP. NO. 97-144, at 127 (1981), *reprinted in* 1981 U.S.C.C.A.N. 105, 228.

84. *See* Economic Recovery Tax Act of 1981, 95 Stat. at 301.

85. *See* S. REP. NO. 97-144, at 127.

her estate at its then current fair market value.[86] That is, the property must not be a so-called "nondeductible terminable interest."[87] This gives effect to Congress's desire to treat married couples as one economic unit for transfer tax purposes, so that property needed to support the surviving spouse is not consumed by estate taxes upon the death of the first to die.[88]

C. Credits Against Estate Tax

Once allowable deductions are subtracted from the gross estate to arrive at the taxable estate, estate tax before credits is computed. The credits most often utilized to offset estate tax are the unified credit[89] and the credit for state death taxes.[90] The unified credit allows every U.S. citizen or resident to give or bequeath the equivalent of $625,000 free of transfer tax.[91] To assure that this

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86. *See* Pennell, *supra* note 20, at A-1, -7.

87. I.R.C. § 2056(b) (1994). This section provides as follows:

> Limitation in the case of life estate or other terminable interest.
>
> (1) General Rule. Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest—
>
> (A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of sueh spouse); and
>
> (B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse . . . .

Id.

88. The estate of the first spouse to die is not subject to estate tax on the value of property consumed or disposed of during his or her lifetime. Likewise, the estate of the surviving spouse is not subject to estate tax on the value of property consumed or disposed of during the remaindcr of his or her life, whether or not it was previously subject to the estate tax marital deduction. *See* Champine, *supra* note 44, at 575 ("By taxing couples as a unit, Congress explicitly sanctioned the elimination from the estate tax base of assets consumed after (as well as before) the first decedent's death, but before the surviving spouse's death.") (parenthetical in original).

89. *See* I.R.C. § 2010 (1994).

90. *See id.* § 2011; Champine, *supra* note 44, at 522.

91. The Taxpayer Relief Act of 1997 increased the effective exemption from gift and estate tax from the $600,000 previously allowed. The increase in the effective exemption is phascd in as follows:

For Decedents Dying and Gifts Made in:	Effective Exemption
1998	$625,000
1999	$650,000
2000 & 2001	$675,000
2002 & 2003	$700,000
2004	$850,000
2005	$950,000
2006 and thereafter	$1,000,000

Taxpayer Relief Act of 1997, Pub. L. 105-34, 111 Stat. 788, 845 (codified in scattered sections of 26 U.S.C.).

amount ultimately passes to the next generation without being subject to tax in the estates of either the decedent or the surviving spouse, estate plans often utilize a "credit shelter trust," the income of which is payable to the surviving spouse during his or her life.[92] Through the combined use of the unified credit and the marital and charitable deductions, estates of any size may be able to avoid estate tax completely.[93] The issues addressed in *Hubert* are whether, and when, an estate still must pay tax, even though the decedent left everything to the surviving spouse and to charity.

D. Income Tax

Decedents' estates must pay income tax on their taxable income.[94] An estate's taxable income is generally computed in the same manner as an individual's, and encompasses income received by the estate during the period of administration.[95] Allowable deductions include trade or business expenses,[96] interest expense,[97] and expenses incurred for the production or collection of income.[98]

Common administration expenses deductible on the estate tax return, such as the fees of personal representatives, attorneys, and accountants, generally also qualify as expenses incurred for the production of income.[99] Not surprisingly, the law prevents the same expense from being deducted twice, once on the estate tax return (Form 706) and once on the fiduciary income tax return (Form 1041).[100] To this effect, Congress has granted executors the option of choosing on which return to claim the deduction.[101] The option is referred to by its Internal Revenue Code section as a 642(g) election. If an executor chooses to claim the deduction on the fiduciary income tax return, he must file a statement with the IRS stating that this amount has not and will not be taken at any time as a deduction for estate tax purposes.[102] The 642(g) election is available regardless of the actual source of

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92. *See* William P. Streng, *Estate Planning*, [800 Estates, Gifts, and Trusts] Tax Mgmt. (BNA) at A-33 (1997).

93. *See* Champine, *supra* note 44, at 523.

94. *See* I.R.C. § 641 (1994 & Supp. II 1996).

95. *See id.*

96. *See id.* § 162.

97. *See id.* § 163.

98. *See id.* § 212 (1994).

99. *See* Donna Litman Seiden & Nicholas E. Christin, *Income Taxation of Trusts & Estates*, [852 Estates, Gifts, and Trusts] Tax Mgmt. (BNA) at A-39 (1997).

100. *See* I.R.C. § 642(g) (Supp. II 1996).

101. *See id.*

102. *See* Treas. Reg. § 1.642(g)-1 (1956). The regulation provides as follows:

> Disallowance of double deductions; in general.
>
> Amounts allowable under section 2053(a)(2) (relating to administration expenses) or under section 2054 (relating to losses during administration) as deductions in computing the taxable estate of a decedent are not allowed as deductions in computing the taxable income of the estate unless there is filed a statement, in duplicate, to the effect that the items have not been allowed as deductions from the gross estate of the decedent under section 2053 or 2054 and that all rights to have such items allowed at any time as deductions under section 2053 or 2054 are waived. The statement should be filed with the return for the

payment of the administration expenses.[103] That is, "even if the terms of the will or the applicable state law require" administration expenses to be paid from principal, the executor may still choose to take the deduction on the fiduciary income tax return.[104] As discussed earlier, the executors of Mr. Hubert's estate deducted approximately $500,000 on the estate tax return as funeral and administration expenses. They deducted the remaining $1.5 million of administration expenses on the fiduciary income tax returns pursuant to the election provided by 642(g).[105]

E. The 642(g) Election—Source of the Controversy

The 642(g) election is the source of the controversy in *Hubert* and the cases preceding it. That is, if Mr. Hubert's executors had not had the choice to deduct administration expenses on the fiduciary income tax returns, they would have had to deduct them, if at all, on the estate tax return. Depending on the other available deductions, this may not have decreased the estate tax liability. It would, however, have increased the estate's taxable income, and more income tax would have been paid. The IRS argued for this result even though the law provides executors with the choice to take the deduction on the fiduciary income tax return.

As Judge Learned Hand explained more than half a century ago, "[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasary; there is not even a patriotic duty to increase one's taxes."[106] Accordingly, executors generally will choose to take the deduction where it will provide the greatest tax benefit. This will vary depending on the estate's marginal estate tax rate versus its marginal income tax rate.[107] The highest marginal estate tax rate is fifty-five percent for taxable estates over $3 million.[108] In contrast, the highest fiduciary income tax rate is 39.6% for estates with taxable income in excess of $8350.[109]

> year for which the items are claimed as deductions or with the district director for the internal revenue district in which the return was filed, for association with the return. The statement may be filed at any time before the expiration of the statutory period of limitation applicable to the taxable year for which the deduction is sought. Allowance of a deduction in computing an estate's taxable income is not precluded by claiming a deduction in the estate tax return, so long as the estate tax deduction is not finally allowed and the statement is filed. However, after a statement is filed under section 642(g) with respect to a particular item or portion of an item, the item cannot thereafter be allowed as a deduction for estate tax purposes since the waiver operates as a relinquishment of the right to have the deduction allowed at any time under section 2053 or 2054.

Id.

103. *See* Jordan, *supra* note 44, at 78.
104. Aghdami, *Payments*, *supra* note 44, at 718.
105. *See supra* text accompanying notes 13-28.
106. Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934) (citations omitted).
107. *See* Seiden & Christin, *supra* note 99, at A-39.
108. *See* I.R.C. § 2001(c) (1994).
109. *See id.* § 1(e).

Despite the potentially higher estate tax rate, the vast majority of estates will benefit more from making a 642(g) election and taking an income tax deduction, assuming the estate has taxable income against which a deduction would be useful. This would be the case for any nontaxable estate. For example, cousider the case of a decedent with a taxable estate of $625,000 or less whose unified credit is available to reduce estate tax liability to zero. Reducing the taxable estate below $625,000 would be a waste of the administration expense deduction because even without the deduction the estate would pay no estate tax.[110] Consider also the case of a married decedent. Typically, wills of married individuals with large estates will provide that upon the death of the first spouse, assets pass to a credit shelter trust to the extent of any remaining unified credit. The balance of the estate passes to a residual trust qualifying for the unlimited marital deduction.[111] Again, since no estate tax will be payable upon the death of the first spouse, deducting administration expenses on the estate tax return would waste the benefit of the deduction. In both of these cases, the personal representatives likely would make a 642(g) election and deduct the costs of administration on the fiduciary income tax returns, thereby reducing the estates' income tax liabilities. Accordingly, even nontaxable estates are able to benefit from the deduction for administration expenses.

Essentially, the IRS argued in *Hubert* that administration expenses charged to the income of a marital or charitable bequest must be *accounted for* on the estate tax return, even if they are paid from the estate's income, charged to income in accordance with state law and the decedent's will, and *deducted* on the fiduciary income tax return pursuant to the 642(g) election. The IRS approach would treat such administration expenses as nondeductible charges, effectively decreasing the marital or charitable deduction and creating a taxable estate where none had existed before.

A simple example helps illustrate the Service's position. Assume a decedent who used his unified credit during his lifetime left a $3 million estate to his wife. Assume further that the estate incurred $200,000 in administration expenses, which the executor charged to income in accordance with state law and the decedent's will. The executor then elected to deduct the expenses on the fiduciary income tax return. The IRS would calculate a taxable estate of $200,000 by

110. *See generally* U.S. Supreme Court Official Transcript, Commissioner v. Estate of Hubert, 117 S. Ct. 1124 (1997) (No. 95-1402) (Oral Argument, Nov. 12, 1996), *available in* 1996 WL 665956. Responding to a Justice's question, "Isn't the Government correct in its reply brief in simply saying that [the 642(g)] election is always of value to the estate that doesn't—that isn't large enough to qualify for the estate tax? . . . Most estates aren't big enough to have to worry about the estate tax anyway," the attorney for Mr. Hubert's estate replied, "Well, to be sure, the estate taxing is imposed on a very small sliver of the American population . . . ." *Id.* at *45-46.

111. *See* Strobel & Strobel, *supra* note 44, at 228.

requiring the administration expeuses to be *accountedfor* on the estate tax return, as follows:

Gross Estate	$3,000,000
Less: Marital Deduction	
($3,000,000-200,000)	$2,800,000
Taxable Estate	$ 200,000 [112]

The result for the estate is even worse than it appears at first blush, because of a spiraling "tax-on-tax" effect. Estate tax must be paid not only on the $200,000, but also on the dollars used to pay the estate tax. As a result, the marital deduction is further reduced, which increases the estate tax, which further reduces the marital deduction, which increases the estate tax, and so on.[113] After *Hubert*, it is settled that the payment of administration expenses is not per se a material limitation on the surviving spouse's right to income, so the above result will not be obtained in all cases. The question that remains is, "In which cases?"

III. THE ROAD TO THE SUPREME COURT: A SPLIT AMONG THE CIRCUITS

Familiarity with the rationale courts used in deciding cases leading up to *Hubert* is helpful in understanding the Supreme Court's decision. Commentators have described the lower courts' rationale and conclusions as "often . . . complex and inconsistent."[114] Nevertheless, there emerges a definite path leading to the Supreme Court's decision. It begins with all courts agreeing that marital and charitable deductions must be reduced when state law *requires* payment of administration expenses from the principal of a marital or charitable bequest.[115] When state law does not so require, courts disagreed about whether the marital and charitable deductions had to be reduced.

112. *See* Pratt, *Deducting*, *supra* note 44, at 1684 n.9.

113. *See generally* Brief Amici Curiae of the American Council on Education and United Way of America in Support of Respondent, Commissioner v. Estate of Hubert, 117 S. Ct. 1124 (1997) (No. 95-1402) (noting this phenomenon).

114. Malin & Keller, *supra* note 46, at 213.

115. *See* Estate of Roney v. Commissioner, 33 T.C. 801 (1960), *aff'd*, 294 F.2d 774 (5th Cir. 1961) (reducing the residuary marital bequest deduction where Florida law required that administration expenses be paid from the residuary); Estate of Luehrmann v. Commissioner, 33 T.C. 277 (1959), *aff'd*, 287 F.2d 10 (8th Cir. 1961) (reducing the residuary charitable bequest deduction where Missouri law required that administration expenses be paid from corpus); *see also* Alston v. United States, 349 F.2d 87 (5th Cir. 1965) (reducing the residuary charitable bequest deduction where Georgia law required that administration expenses be paid from the residuary when the decedent's will did not otherwise specify); Estate of Horne v. Commissioner, 91 T.C. 100 (1988) (redueing the residuary charitable bequcst deduetion be reduced where South Carolina law required that administration expenses be charged against principal unless otherwise provided in the decedent's will).

A. The Sixth and Federal Circuits

When state law does not require the payment of administration expenses from principal, the Tax Court's pre-*Hubert* decision, *Estate of Street v. Commissioner*,[116] gave effect to the testator's expressed intention to maximize the marital deduction by holding that administration expenses were chargeable to income. The court accomplished this by following and expanding its earlier decision in *Estate of Richardson v. Commissioner*[117] with respect to interest on deferred estate taxes, where the court had stated, without citing authority, that "[i]f the interest is chargeable against income, it will not reduce the value of the interest in the estate that passes to the surviving spouse under the will, and consequently will not reduce the amount of the marital deduction."[118]

The Sixth Circuit reversed the Tax Court's decision in *Street* with respect to administration expenses,[119] citing the court's failure to consider the effect of Treasury Regulation section 20.2056(b)-4(a) on the valuation of the marital

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116. 56 T.C.M. (CCH) 774 (1988), *aff'd in part, rev'd in part*, 974 F.2d 723 (6th Cir. 1992).

117. 89 T.C. 1193 (1987).

118. *Id.* at 1200. In *Richardson*, the decedent's will directed his executors to pay all estate and inheritance taxes out of the portion of his residuary estate left to a family trust, and not out of the portion left to his wife. *See id.* at 1194. The will was silent about interest on such taxes. The question for the Tax Court was whether the interest payable on deferred estate and inheritance taxes should be chargeable to principal or income. If chargeable to income, the court stated, the interest would not reduce the net value of the property interest passing to the surviving spouse for purposes of computing the marital deduction. *See id.* at 1200. The court examined Tennessee law and concluded that there was no provision in the law that required such interest to be charged either to principal or to income. *See id.* at 1202. Therefore, the court turned to the testator's intention and found that one of his "prime intentions" was for the estate to obtain the maximum marital deduction, which would not be possible if the interest was chargeable to principal. *Id.* at 1203. The court also noted that it "seem[ed] more natural and equitable that interest on deferred estate and inheritance taxes would be chargeable to the income from the estate produced by assets which were not used immediately to pay the taxes." *Id.* at 1202-03. Accordingly, the court held that interest on deferred estate and inheritance taxes was chargeable to income and the marital deduction need not be reduced. *See id.* at 1206.

The Tax Court followed and extended its *Richardson* holding in *Street*, again applying Tennessee law to a residuary marital bequest. The first issue in *Street* was identical to *Richardson*, and the court found its decision in that case dispositive. *See Street*, 56 T.C.M. at 776. The second issue was whether administration expenses were chargeable to principal or income. The court found it unclear whether the Tennessee Principal and Income Act, which provided that administration expenses should be paid out of income, applied to probate estates. Mentioning the testator's intention to maximize the marital deduction and a Tennessee statute that required allocation of expenses to income if it would protect the marital deduction, the court found that it was "not illogical to extend the treatment afforded interest in . . . *Richardson* . . . to other administration expenses," since under Tennessee law interest on taxes was an administration expense. *Id.* at 777.

119. *See Street*, 974 F.2d at 729. The court affirmed the Tax Court's decision with respect to interest on deferred estate taxes, and the IRS has adopted this result. *See* Rev. Rul. 93-48, 1993-2 C.B. 270. The Sixth Circuit distinguished interest from administration expenses because interest "accrues sometime after death" and, unlike administration expenses, is not expressly mentioned in Treasury Regulation section 20.2056(b)-4(a). *Street*, 974 F.2d at 729.

deduction.[120] The Sixth Circuit noted that the Tax Court had not given any consideration to the regulation, and found that the regulation "control[led] the tax treatment of administrative expenses paid from income regardless of state law or the dictates of a decedent's will."[121] The Sixth Circuit agreed with the Commissioner that the regulation required a dollar-for-dollar reduction in the marital deduction whenever administration expenses were charged to income, and was "not dependent on the vagaries of state law."[122] It reasoned that since income earned during administration increases the residue, failure to decrease the marital deduction for expenses paid from income would result in a marital deduction in excess of the amount available for distribution.[123] It failed to recognize that post-mortem income does not increase the marital deduction in the first place. The court also found support for its position in the legislative history of the marital deduction, implicitly equating administration expenses with claims against the estate.[124] If the Tax Court had failed to consider Treasury Regulation section 20.2056(b)-4(a), the Sixth Circuit had failed to consider one of its most important words: the regulation requires only *material* limitations on a spouse's right to income to be taken into account.[125]

The Court of Federal Claims followed the Sixth Circuit's *Street* decision in *Fisher v. United States*.[126] In that case, the court held that the marital deduction must be reduced by the amount of administration expenses paid out of estate income and deducted on the fiduciary income tax return regardless of Washington state law.[127] The Federal Circuit likewise followed the reasoning of the Sixth Circuit's *Street* decision in *Burke v. United States*.[128] The Federal Circuit held that "as a matter of federal law" the estate tax charitable deduction must be reduced to account for the payment of administration expenses from post-mortem income,[129] "because, for purposes of federal estate taxation, the gross estate [was]

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120. *See Street*, 974 F.2d at 727.

121. *Id.* at 728. The court followed *Estate of Roney v. Commissioner*, 33 T.C. 801 (1960), *aff'd*, 294 F.2d 774 (5th Cir. 1961), which it thought could not "be distinguished from the instant case simply because Tennessee, unlike Florida, does not have a statute which requires administrative expenses to be paid from principal." *Street*, 974 F.2d at 728. See *supra* note 115 for a discussion of *Roney*.

122. *Street*, 974 F.2d at 729.

123. *See id.* at 727.

124. *See id.* at 728. The Sixth Circuit quoted the following portion of the Senate Report:

> "the interest passing to the surviving spouse from the decedent is only such interest as the decedent can give. If the decedent leaves the residue of his estate to the surviving spouse and she pays, or if the estate income is used to pay, claims against the estate so as to increase the residue, such increase in the residue is acquired by purchase and not bequest. Accordingly, the value of any additional part of the residue passing to the surviving spouse cannot be included in the amount for the marital deduction."

Id. (quoting S. REP. NO. 80-1013, at 6 (1948)).

125. Treas. Reg. § 20.2056(b)-4(a) (as amended in 1994). See also *supra* note 8 for a reproduction of the regulation.

126. 28 Fed. Cl. 88 (1993).

127. *See id.* at 93-94.

128. 994 F.2d 1576 (Fed. Cir. 1993).

129. *Id.* at 1584.

obligated to pay those expenses."[130] The court commented that the lower court's emphasis on the allowable source of payment under Florida law "shift[ed] the focus of the case from the pertinent question."[131]

B. The Eleventh Circuit

After its decision in *Street* was reversed by the Sixth Circuit, the Tax Court again addressed the issue of administration expenses charged to income in *Estate of Hubert v. Commissioner.*[132] In a decision reviewed by the court, fifteen of seventeen judges participating in the decision chose to follow the court's earlier decision in *Richardson*[133] rather than following the Sixth Circuit's decision in *Street.*[134] The Tax Court reaffirmed the role of state law in determining federal estate tax liability. It held that Georgia law permitted the allocation of administration expenses to income earned on the marital and charitable bequests if the decedent's will so provided, and that to the extent the executors exercised their discretion in so allocating administration expenses, the marital and charitable deductions need not be reduced.[135]

The court, in an opinion written by Judge Clapp, disagreed with the Sixth Circuit that Treasury Regulation section 20.2056(b)-4(a) mandated a setoff against the marital deduction. Instead, it interpreted the regulation as "merely a valuation provision" that required material limitations on the spouse's right to receive income to be taken into account when valuing the property interest for purposes of the marital deduction.[136] Rejecting the IRS's position, the court stated that "[t]he fact that income from property is to be used to pay expenses during the administration of the estate is not necessarily a material limitation on the right to receive income," and that on the facts before it, there was no material limitation on Mrs. Hubert's right to receive income.[137]

To reach this conclusion, the court focused on the phrase in the regulation that calls for application of the same principles "as if the amount of a gift to the spouse were being determined."[138] The court looked to gift tax provisions in I.R.C. § 2523(e) and the regulations thereunder, and Revenue Ruling 69-56[139] which interprets them.[140] The Code provides that a spouse must be entitled to all

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130. *Id.* at 1582.

131. *Id.* at 1580.

132. 101 T.C. 314 (1993), *aff'd*, 63 F.3d 1083 (11th Cir. 1995), *aff'd*, 117 S. Ct. 1124 (1997). See *supra* text accompanying notes 13-28 for a discussion of the facts of *Hubert.*

133. *See Hubert*, 101 T.C. at 329. See also *supra* note 118 for a discussion of *Richardson.*

134. *See Hubert*, 101 T.C. at 328.

135. *See id.* at 324.

136. *Id.* at 324-25.

137. *Id.* at 325. In his opinion concurring in part and dissenting in part, Judge Beghe disagreed. In his view, the marital and charitable income interests were "substantially burdened and materially limited." He disagreed with the IRS's dollar-for-dollar reduction, however, and favored a present value approach. *Id.* at 348-49.

138. *Id.* at 324 (quoting Treas. Reg. § 20.2056(b)-4(a) (as amended in 1994)). See also *supra* note 8 for a reproduction of the regulation.

139. 1969-1 C.B. 224.

140. *See Hubert*, 101 T.C. at 325.

of the income from a GPA trust in order for the donor of the gift in trust to be entitled to a gift tax deduction.[141] Under Treasury Regulation section 25.2523(e)-1(f)(3), the spouse is considered to receive all of the income from the trust even if "trustees' commissions and other charges" are paid from such income, as long as the spouse is not deprived of "substantial beneficial enjoyment" of the trust property during his or her life.[142] In Revenue Ruling 69-56, the IRS determined that conferring administrative powers on fiduciaries to charge executors' fees, legal and accounting fees, custodian fees, and other administration expenses to income or to principal does not result in the "disallowance or diminution" of the marital deduction for estate or gift tax purposes.[143] The Tax Court likened the powers conferred in *Hubert* to those discussed in the Revenue Ruling.[144] Further, the court determined that "the income used to pay administration expenses [was] insubstantial compared to the lifetime of income Mrs. Hubert [would] receive from the property,"[145] and therefore she was not deprived of substantial beneficial enjoyment of the property. Accordingly, the court concluded that under the gift tax regulations she would be treated as having received all of the income, and therefore there could be no material limitation on her right to receive income.[146]

The Tax Court took issue with the Sixth Circuit's analysis of the effect of post-mortem income on the marital deduction, pointing out that income earned on estate property does not increase the marital deduction, so no corresponding decrease for expenses paid from such income is required.[147] The court distinguished between administration expenses and claims against the estate and therefore found that the legislative history of the marital deduction, cited by the Sixth Circuit, did not control.[148] The court also rejected the distinctions made by the Sixth Circuit between interest and administration expenses.[149] As for *Estate*

141. *See* I.R.C. § 2523(e) (1994).

142. Treas. Reg. § 25.2523(e)-1(f)(3) (as amended in 1994). This section is identical to estate tax regulation section 20.2056(b)-5(f)(3).

143. 1969-1 C.B. 224, 225.

144. In countless cases, the Tax Court has explained that Revenue Rulings do not have the force of law, but represent the views of the IRS National Office and are "merely statements of the Commissioner's litigating and administrative position." Norfolk S. Corp. v. Commissioner, 104 T.C. 13, 46 (1995). They do not "constitute authority for deciding a case in [the Tax] Court." Neuhoff v. Commissioner, 75 T.C. 36, 46 (1980), *aff'd*, 669 F.2d 291 (5th Cir. 1982). If Revenue Rulings merely represent a litigation strategy that the IRS will not be held to, then as a matter of sound policy they should not even be brought up. For a discussion of the difference between Revenue Rulings and Treasury Regulations, see Judge Hall's concurring opinion in Browne v. Commissioner, 73 T.C. 723, 731 (1980).

145. *Hubert*, 101 T.C. at 325.

146. *See id.* at 325-26.

147. *See id.* at 329. In his opinion concurring in part and dissenting in part, Judge Halpern disagreed. In his view, both principal and anticipated future income are included in the date-of-death value of the gross estate at their combined discounted present value. While Judge Halpern argued that "the majority is undone by its view that income earned on estate property is not included in the gross estate," he admitted in a footnote that "[i]t is true, of course, that income actually earned on such property during the period of estate administration is not included in the gross estate." *Id.* at 342-43, 351 n.5 (emphasis omitted).

148. *See id.* at 326.

149. *See id.* at 329.

of *Roney v. Commissioner*,[150] which the Sixth Circuit had followed, the Tax Court found it was not inconsistent with its result in *Hubert*, since in *Roney* it had "merely held . . . that when administration expenses are *required* to be allocated to principal, the marital deduction is reduced by the amount of those expenses."[151]

A two-to-one panel of the Eleventh Circuit affirmed the Tax Court's decision in *Hubert*, holding that the marital and charitable deductions should not be reduced by the amount of administration expenses allocated to income.[152] Agreeing with the "careful analysis" and reasoning set forth by the Tax Court, the court of appeals attached the lower court's opinion as an appendix to its own and adopted it completely.[153] The court expressly recognized that its holding brought it "in conflict with two other circuits which have decided the issue," citing the Sixth Circuit's decision in *Street* and the Federal Circuit's decision in *Burke*.[154]

IV. THE SUPREME COURT OPINIONS IN *HUBERT*

> The question presented is simple and its answer should have been equally straightforward. Yet we are confronted with a maze of regulations and rulings that lead at times in opposite directions. There is no reason why this labyrinth should exist, especially when the Commissioner is empowered to promulgate new regulations and make the answer clear.[155]

When the Supreme Court granted the Commissioner's petition for writ of certiorari in *Hubert*,[156] practitioners and the public hoped that the Court would go beyond deciding the case at hand and resolve the underlying issues.[157] That proved to be too much to hope for, given the lack of guidance in the Code and regulations for determining when a material limitation on a spouse's right to income exists. In fact, the Court produced four opinions, with none supported by a majority of the Justices. Justice Kennedy wrote for the plurality and was joined by Chief Justice Rehnquist and Justices Stevens and Ginsburg; Justice O'Connor wrote a concurring opinion and was joined by Justices Souter and Thomas; Justice Scalia wrote a dissenting opinion and was joined by Justice Breyer;

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150. 33 T.C. 801 (1960), *aff'd*, 294 F.2d 774 (5th Cir. 1961).

151. *Hubert*, 101 T.C. at 330 (emphasis added). See *supra* text accompanying notes 115 and 121 for a discussion of *Roney*.

152. *See* Estate of Hubert v. Commissioner, 63 F.3d 1083, 1083 (11th Cir. 1995), *aff'd*, 117 S. Ct. 1124 (1997). One of the two affirming judges was Senior U.S. Circuit Judge for the Seventh Circuit, Honorable Jesse E. Eschbach, sitting by designation. *See id.*

153. *Id.* at 1083-84.

154. *Id.* at 1083.

155. Commissioner v. Estate of Hubert, 117 S. Ct. 1124, 1139 (1997) (O'Connor, J., concurring).

156. Commissioner v. Estate of Hubert, 517 U.S. 1166 (1996).

157. *See, e.g.*, August & Freeland, *supra* note 44, at 299 ("[I]t was hoped that the decision would provide a 'bright-line' test for planning purposes."); *Justices to Resolve Estate Tax Dispute: The IRS Contends that a Marietta Man's Estate Still Owes $154,000*, ATLANTA J. & CONST., Apr. 30, 1996, at A5 ("The Supreme Court agreed Monday to resolve an arcane but big-money dispute over estate taxes that government lawyers say arises 'in countless cases.'").

Justice Breyer also wrote a dissenting opinion.[158] Despite writing four opinions, a majority of Justices were able to agree on a few issues.

A. Payment of Administration Expenses from Income Is Not Per Se a Material Limitation

First, as discussed earlier, seven Justices rejected the Service's argument that the marital deduction must be reduced *any time* administration expenses are charged to income from the marital bequest.[159] That is, they rejected the notion that *any* use of income to pay administration expenses is per se a material limitation on a surviving spouse's right to income. Since the IRS did not prove, or even argue, that the specific amount of expense charged to income in *Hubert* was a material limitation, the Justices agreed that there was no basis to reverse the Tax Court's decision that it was not.[160]

The plurality reached this conclusion after breaking new ground in the field of estate tax valuation. Before beginning his analysis, Justice Kennedy noted that both parties agreed that the marital and charitable deduction statutes should be read to require the same treatment, and that the Court adopted this approach. He explained that because the marital deduction statute and regulations "speak in more specific terms" about valuation, the Court's analysis would focus on those, but its holding would apply to both deductions.[161] Justice Kennedy then immediately proposed a new valuation theory for the marital deduction, one not advanced by either party, the Tax Court, any of the amici, or any previous court to have considered the issue.[162] He looked to gift tax regulations that deal with valuing the marital deduction when a spouse is given the remainder interest in a split-interest trust.[163] There, the allowable deduction is the present value of the remainder interest.[164] After acknowledging that those regulations did not control the present situation, Justice Kennedy wrote that it was "natural . . . to apply the present-value principle to the question at hand."[165] His analysis therefore began by concluding that *if* it was determined that there existed a material limitation on Mrs. Hubert's right to income, then the marital deduction should be valued by subtracting from the value of the bequest an amount equal to the present value, as of the date of death, of the income *expected* to be used to pay administration expenses.[166]

Justice Kennedy rejected the Commissioner's per se materiality and dollar-for-dollar reduction arguments and agreed with the Tax Court that Regulation section 20.2056(b)-4(a), relied upon by the IRS, was "'merely a valuation provision.'"[167]

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158. *See Hubert*, 117 S. Ct. at 1127, 1134, 1139, 1146.
159. *See supra* text accompanying notes 37-41.
160. *See Hubert*, 117 S. Ct. at 1132, 1138.
161. *Id.* at 1129.
162. *See id.* at 1144 (Scalia, J., dissenting).
163. *See id.* at 1129.
164. *See* Treas. Reg. § 25.2523(a)-1(e) (as amended in 1994).
165. *Hubert*, 117 S. Ct. at 1129.
166. *See id.* at 1129.
167. *Id.* at 1131 (quoting Estate of Hubert v. Commissioner, 101 T.C. 314, 324-25 (1993)).

He concurred with the lower court's assessment that the fact that income is used to pay administration expenses is "not necessarily a material limitation" on the surviving spouse's right to income.[168]

Justice Kennedy then looked to Regulation section 20.2056(b)-5(f)(9), which discusses the "right to income" requirement of marital power of appointment trusts. The regulation states that where an executor is authorized to delay the distribution of the decedent's assets beyond a reasonable period of administration, and where the spouse is not entitled to the income from the assets before distribution, the interest may not meet the "right to income" requirement and may not *qualify* for the marital deduction. The regulation then refers the reader to section 20.2056(b)-4(a) for valuation of the spouse's property interest "where the right to income is expressly postponed."[169] Justice Kennedy found that Mrs. Hubert's property interest did not fit this situation.[170]

He then proposed situations where payment of administration expenses from income might be deemed a material limitation on a surviving spouse's right to income. For example, a material limitation might exist where an estate's anticipated administration expenses are "material" as compared with the anticipated income, such as where the corpus of the marital bequest is small or the assets do not produce much income.[171] Justice Kennedy did not define "material" however. He then suggested that using income from bequests in trust is more likely to constitute a material limitation on a spouse's right to income than is using income from outright bequests. Justice Kennedy did not apply that rationale to Mrs. Hubert's situation, he explained, because the full value, equivalent to a fee interest, of the GPA and QTIP trusts will be includable in her estate.[172] Such is always the case with marital deduction GPA and QTIP trusts.[173] Finally, in keeping with the new "projected present value" theory of valuation, Justice Kennedy concluded that although the Tax Court did not elaborate, it might have thought the *anticipated* expenses of the estate were immaterial compared to its *expected* future income.[174]

In the concurring opinion, Justice O'Connor first looked to the Internal Revenue Code and found no guidance. She found it impossible to tell from § 2056(b)(4)(B) whether payment of administration expenses from income should reduce the marital deduction "always, sometimes, or not at all."[175] She next turned to the legislative history and agreed with the Tax Court that it was not helpful because it addressed claims against the estate and not administration expenses.[176]

Turning to Regulation section 20.2056(b)-4(a), Justice O'Connor first focused, as had the Tax Court, on the phrase requiring valuation as if "a gift to the spouse"

168. *Id.*
169. Treas. Reg. § 20.2056(b)-5(f)(9) (as amended in 1994).
170. *See Hubert*, 117 S. Ct. at 1131.
171. *Id.*
172. *See id.* at 1132.
173. *See* Aghdami & Pratt, *The Supreme Court*, *supra* note 44, at 344-45.
174. *See Hubert*, 117 S. Ct. at 1132.
175. *Id.* at 1135 (O'Connor, J., concurring).
176. *See id.*

had been made.[177] After rejecting the plurality's reliance on remainder interest valuation regulations for its new valuation theory, she discussed the Tax Court's reliance on Regulation sections 25.2523(e)-1(f)(3) and (4) and Revenue Ruling 69-56.[178] Although Justice O'Connor found that these provisions favored Mr. Hubert's estate, she found the result not "wholly satisfying," and she acknowledged that both the plurality and dissenting opinions criticized the Tax Court's approach.[179]

Finally, Justice O'Connor determined that the case hinged on the meaning of "material." Rather than debate about the dictionary definition of the word, she concluded that the Commissioner had already interpreted it in Revenue Ruling 93-48.[180] In that ruling, the Service adopted the decisions of the Tax Court in *Richardson*[181] and the Sixth Circuit in *Street*[182] with respect to interest on deferred estate taxes. The ruling provides that post-mortem interest accruing on deferred federal estate tax payable from marital and charitable bequests will not "ordinarily" reduce the date-of-death value of the bequests for purposes of the marital and charitable deductions.[183]

Justice O'Connor made the preliminary point that, in her view, interest on deferred estate taxes and other types of administration expenses should be treated the same under Regulation section 20-2056(b)-4(a). She supported this view with observations that neither expense exists at the date of death, but both "are inevitable once the estate is open," and both are uncertain in amount at the date of death.[184]

More importantly, however, Justice O'Connor found that by issuing Revenue Ruling 93-48, the Commissioner had rejected "the notion that every financial burden on a marital bequest's postmortem income is a material limitation" requiring the marital deduction to be reduced.[185] Instead, Justice O'Connor found, the Commissioner had created a test of quantitative materiality.[186] That said, the Commissioner had yet to determine when the "threshold of materiality" is crossed. In the absence of any guidance, the Tax Court's approach was as consistent with the law as any other.[187]

Finally, Justice O'Connor shared the dissents' reluctance to find the $1.5 million charge to income in *Hubert* immaterial under any standard.[188] However, because the Commissioner had argued for an all-or-nothing rule and had never argued that the specific amount of expense in *Hubert* was material, Justice

177. Treas. Reg. § 20.2056(b)-4(a) (as amended in 1994). See also *supra* note 8 for a reproduction of the regulation.

178. *See Hubert*, 117 S. Ct. at 1136.

179. *Id.*

180. *See id.* at 1137.

181. See *supra* text accompanying notes 117-18 for a discussion of *Richardson.*

182. See *supra* text accompanying notes 116-25 for a discussion of *Street.*

183. Rev. Reg. 93-48, 1993-2 C.B. 270.

184. *Hubert*, 117 S. Ct. at 1137.

185. *Id.* (emphasis omitted).

186. *See id.* at 1138; *see also supra* text accompanying note 40.

187. *See Hubert*, 117 S. Ct. at 1138.

188. *See id.*

O'Connor declined to save the Commissioner from the result of her litigation strategy, despite the "seemingly counterintuitive result" reached in the case.[189]

B. Structural Problems Exist in the Tax Court's Analysis

The second point capturing majority concurrence dealt with the Tax Court's analysis of *Hubert*. Although the Court affirmed the Tax Court's decision, six Justices rejected the approach the Tax Court used to conclude that under the regulations there could be no material limitation on Mrs. Hubert's right to income. The Tax Court, as previously explained, had relied on gift tax regulations and an IRS Revenue Ruling in determining that because Mrs. Hubert was not deprived of substantial beneficial enjoyment of the trust property, she would be treated as having received all of the income for gift tax purposes, and hence there could be no material limitation on her right to receive income.[190]

The plurality identified a "structural problem" with the Tax Court's approach,[191] and Justice Scalia (joined by Justice Breyer) concurred.[192] The language of gift tax regulation sections 25.2523(e)-1(f)(3) and (4) is identical to the language of estate tax regulation sections 20.2056(b)-5(f)(3) and (4). All of these sections relate to the "right to income" requirement of marital power of appointment trusts, defining when a spouse will be considered to have received all of the income from the trust in order to qualify the gift or bequest for the marital deduction.[193]

The problem identified by the plurality in reading the language of Regulation section 20.2056(b)-4(a) as invoking the gift tax provisions for valuation purposes is that those provisions relate to the *qualification* of an interest for the marital deduction, not the *valuation* of an admittedly already qualified interest. Because the language of the gift tax sections is identical to the language of the estate tax qualification sections, any analysis called for by the gift tax provisions at the valuation stage would necessarily already have been completed at the earlier, estate tax deduction qualification stage. Therefore, any interest that failed the earlier qualification stage would not need to be valued. Any interest that passed the earlier qualification stage, that is, any interest that was considered to provide the spouse with all of the income from the property, would never be reduced at the valuation stage. Such a reading of regulation section 20.2056(b)-4(a) renders its valuation step superfluous.[194]

189. *Id.* at 1139.

190. *See supra* text accompanying notes 136-46.

191. *Hubert*, 117 S. Ct. at 1130.

192. *See id.* at 1143 (Scalia, J., concurring, joined by Breyer, J.).

193. Treas. Reg. §§ 25.2523(e)-1(f)(3) to (f)(4), 20.2056(b)-5(f)(3) to (f)(4) (as amended in 1994).

194. *See Hubert*, 117 S. Ct. at 1130.

C. The Plurality Relied on an Irrelevant Regulation

The third point that a majority of Justices agreed to in *Hubert* was to reject as irrelevant the regulation relied upon by the plurality in formulating its projected present value theory of valuation. Justice O'Connor noted that the plurality itself admitted that the regulation was not on point, but nevertheless used it to derive a marital deduction valuation theory focused solely on anticipated income and anticipated administration expenses as of the decedent's date of death.[195] To Justice O'Connor (joined by Justices Souter and Thomas), because the regulation did no more that suggest a theory with questionable value in the context of the case, it provided no meaningful guidance.[196] Justice Scalia (joined by Justice Breyer) agreed. "[T]he regulation has no relevance. Like its counterparts in the estate tax provisions, . . . it simply provides instruction on how to value the assets comprising the gift. It says nothing about how to take account of administration expenses."[197]

D. $1.5 Million Might Be Material Under Any Standard

Fourth, a majority of Justices were apparently willing to find that $1.5 million was quantitatively material. Had the Commissioner argued this, she may have prevailed in *Hubert*. Justice O'Connor made clear her position that if the Court were considering the question of quantitative materiality de novo, she would have been "hard pressed not to find [that] amount 'material' given the size of Mr. Hubert's estate."[198] She didn't elaborate further, but apparently concluded that the "threshold of materiality" is crossed somewhere before expenses equal to five percent of the value of the gross estate are charged to the income of the marital and charitable bequests. Again, she was joined by Justices Souter and Thomas. Justice Scalia (joined by Justice Breyer) agreed with the IRS that *any* diversion of income from the marital and charitable bequests was material.[199]

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195. *See id.* at 1135-36 (O'Connor, J., concurring).
196. *See id.* at 1136 (O'Connor, J., concurring, joined by Souter and Thomas, J.J.).
197. *Id.* at 1140 (Scalia, J., dissenting) (emphasis omitted).
198. *Id.* at 1138 (O'Connor, J., concurring).
199. *See id.* at 1139 (Scalia, J., dissenting).

V. WHEN DOES A MATERIAL LIMITATION EXIST, AND HOW SHOULD IT BE VALUED?

Because the *Hubert* Court rejected the Service's argument for a standard of per se materiality, but could not agree on what the standard should be, we are currently left with the state of affairs described by Justice Scalia in his dissenting opinion. He urged deference to the Service's interpretation, because to read "material" as meaning anything other than "relevant or consequential" to the value of the spouse's property interest would be to

> leave it to the taxpayer, the Commissioner, and ultimately the courts, to guess whether a particular decrease in value is "material" enough to qualify—without any hint as to what might be a "ballpark" figure, or indeed any hint as to whether there is such a thing as "absolute materiality" (the two million dollars at issue here, for instance) or whether it is all relative to the size of the estate.[200]

The most important result of the decision for practitioners is that the IRS and Treasury Department have taken Justice O'Connor up on her invitation[201] to promulgate regulations that will fill this void and provide taxpayers and practitioners with much-needed guidance.[202] The issues that must be addressed by the regulations are first, what constitutes a "material" limitation on a surviving spouse's right to income from property, and second, if a material limitation exists, how is it taken into account in valuing the estate tax marital deduction. Numerous

200. *Id.* at 1142 (parenthetical in original).
201. *See supra* text accompanying note 155.
202. *See* I.R.S. Notice 97-63, 1997-47 I.R.B. 6.

theories have been advanced by the courts,[203] the IRS, and commentators to answer these questions.

A. The Service's Proposed Alternatives

In Notice 97-63, the IRS solicited public comment on three alternatives for proposed regulations. The proposed regulations would amend Treasury Regulation section 20.2056(b)-4(a) by providing guidance on when there exists a material limitation on a surviving spouse's right to income for purposes of valuing the marital deduction.[204] Under the first approach (the "Federal Method") the Service would distinguish between expenses that are "properly charged to principal" and those that are "properly charged to income" for purposes of regulation section 20.2056(b)-4(a).[205] The designation of an expense as one or the

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203. The opinions of the courts that considered *Hubert* offer little helpful guidance on these issues. In addressing the first question, the Tax Court majority in *Hubert* compared the actual income used to pay administration expenses to the projected lifetime income Mrs. Hubert would receive from the property and determined that the former was "insubstantial" in comparison. Estate of Hubert v. Commissioner, 101 T.C. 314, 325 (1993), *aff'd*, 63 F.3d 1083 (11th Cir. 1995), *aff'd*, 117 S. Ct. 1124 (1997). The majority did not explain how it determined the amount of income Mrs. Hubert would receive from the property during her lifetime, nor did it explain at what point the percentage of income used to pay expenses would cross the line from "insubstantial" to substantial or material. Because it concluded that no material limitation existed, the majority did not address the second issue of how such a limitation would affect the value of the marital deduction.

Like the Tax Court majority, the Supreme Court plurality never defined the point at which materiality would be reached. Although it did not determine that there existed a material limitation on Mrs. Hubert's right to income, the plurality nevertheless advanced a new theory for taking such a limitation into account. As discussed previously, Justice Kennedy suggested that if a material limitation is determined to exist, then the marital deduction should be valued by subtracting from the value of the bequest an amount equal to the present value, as of the date of death, of the income *expected* to be used to pay administration expenses. *See supra* text accompanying notes 160-68.

In his dissenting opinion, Justice Scalia explained why the plurality's theory should be rejected. It could "create[] taxable estates where none exist" because of its focus on anticipated, rather than actual, administration expenses. *Hubert*, 117 S. Ct. at 1146 (Scalia, J., dissenting). He proposed the following example loosely based on the facts of *Hubert*: A decedent left $30 million in trust to his wife. The executor anticipated a will contest and projected, as of the date of death, that the estate would incur $5 million in administration expenses. The executor determined that that amount was material and (ignoring the plurality's present-value step) reduced the marital deduction from $30 million to $25 million. To everyone's delight, the family members settled their differences and no will contest was filed after all. The estate closed quickly with virtually no administration expenses. Alas, under the plurality's approach, the marital deduction is based on estimates that ignore facts occurring after the date of death, while the regulations require deductible administration expenses to be "actually and necessarily incurred." Treas. Reg. § 20.2053-3(a) (as amended in 1979). The executor is left to explain why there is a taxable estate of $5 million subject to the fifty-five percent marginal rate when the decedent left everything to his wife. *See Hubert*, 117 S. Ct. at 1145-56. Justice Scalia's argument against the plurality's projected present value approach is convincing.

204. *See* I.R.S. Notice 97-63, 1997-47 I.R.B. 6.

205. *Id.*

other would be determinative for federal estate tax purposes, regardless of the dictates of applicable local law or the governing instrument. If income were used to pay an expense that is properly charged to principal, there would exist a material limitation on the surviving spouse's right to income, and the marital deduction would be reduced dollar for dollar by the amount of the income so used.[206]

According to the IRS, expenses that are properly charged to income would include expenses incurred in the production or collection of income,[207] such as current income taxes.[208] Expenses that are properly charged to principal would include "commonly incurred" administration expenses such as attorneys' fees, appraisers' fees, brokers' commissions, and estate and inheritance taxes.[209] Notice 97-63 states that this approach attempts to follow "reasonable estate administration practices" and would generally be easy to apply.[210]

The Service's second proposal (the "Safe Harbor Method") would allow a de minimis safe harbor amount of income to be used to pay administration expenses without constituting a material limitation on the surviving spouse's right to income. The safe harbor would be based on a percentage of the estate's gross income during the period of administration, or a specified dollar amount, or some combination of the two. If more than the safe harbor amount of income were used to pay administration expenses, a material limitation would exist and the marital deduction would be reduced dollar for dollar by such excess. Notice 97-63 recognizes that a safe harbor amount based on a percentage of the estate's income would have to be recomputed yearly, and therefore would be more difficult to apply than one based on a specified dollar amount.[211]

Under the third approach (the "Per Se Method") the regulation would be amended to state that any use of income to pay administration expenses constitutes a material limitation on the surviving spouse's right to income.[212]

B. Practitioners' Comments

The IRS received a dozen letters in response to its request for comments. For the most part the comments are very thoughtful, analytically sound, and offer viable solutions to the *Hubert* problem. However, two of them warrant little discussion because they miss the point entirely.[213] Of the remaining comments,

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206. *See id.*
207. *See* I.R.C. § 212 (1994).
208. *See* I.R.S. Notice 97-63, 1997-47 I.R.B. 6.
209. *Id.*
210. *Id.*
211. *See id.*
212. *See id.*
213. An Alabama attorney urges the Service, "in the interest of simplicity . . . [and to prevent] the estate tax law [from] becom[ing] as complicated as the income tax law," to permit administration expenses to be "paid out of either income or principal without adversely affecting either the marital deduction or the charitable deduction." Letter from Harold I. Apolinsky, Sirote & Permutt, to Internal Revenue Service (Nov. 13, 1997), *in* 98 TAX NOTES TODAY 10-13, Jan. 15, 1998, *available in* LEXIS, FEDTAX Library, TNT File. While the Treasury Department should provide guidance that can be easily understood and applied, it will

three would adopt some variation of the Federal Method,[214] six favor a Safe Harbor Method,[215] and one recommends a largely modified version of the Per Se Method.[216]

The comments also may be divided into two fundamental theoretical camps: those that would throw out the materiality question and rewrite Treasury Regulation section 20.2056(b)-4(a) on a clean slate, and those that would amend the existing regulation to answer the question of when a material limitation exists. Letters advocating the former approach were written by Professor Joseph M. Dodge of the University of Texas School of Law and by the New York State Bar Association Tax Section.[217]

1. The Federal Method

Several commentators express concern about the Federal Method, in which the IRS's distinction between expenses that are "properly charged to principal" and those that are "properly charged to income" would be determinative for federal estate tax purposes regardless of local law or the provisions of a decedent's will.[218] The commentators point out theoretical and practical problems with the Federal Method.

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not write a regulation that allows unlimited administration expenses to be charged to the income of a marital bequest without affecting the valuation of the marital deduction. Similarly, the American Institute of Certified Public Accountants ("AICPA") proposes that administration expenses that are payable out of income under the governing instrument and applicable state law should not reduce the otherwise allowable marital or charitable deductions, but that such expenses should be deductible on the fiduciary income tax returns only to the extent of net income during estate administration, excluding capital gains. The AICPA urges the Service to adopt its "simple, understandable, fair, and practical" approach, noting that because "the Supreme Court has already ruled that administration expenses payable out of income do not reduce the charitable deduction and marital deduction," its proposal "would not provide the taxpayer any greater benefit in that area than provided under current law." Letter from Michael E. Mares, Chair, Tax Executive Committee, AICPA to Charles O. Rossotti, Commissioner of the Internal Revenue Service (Jan. 29, 1998), *in* 98 TAX NOTES TODAY 29-59, Feb. 12, 1998, *available in* LEXIS, FEDTAX Library, TNT File. The AICPA states too broadly the Supreme Court's decision in *Hubert* and entirely misses the question of what constitutes a material limitation. Its proposal would extend the holding in *Hubert* such that the use of income to pay administration expenses would *never* constitute a material limitation on a surviving spouse's right to income for purposes of valuing the marital deduction. Again, the Treasury Department is not going to write such a regulation.

214. *See infra* text accompanying notes 230-41.

215. *See infra* text accompanying notes 259-70.

216. *See infra* text accompanying notes 252-57.

217. *See* Letter from Joseph M. Dodge, University of Texas School of Law to Internal Revenue Service (Feb. 2, 1998), *in* 98 TAX NOTES TODAY 54-35, Mar. 20, 1998, *available in* LEXIS, FEDTAX Library, TNT File [hereinafter Dodge]; New York State Bar Association Tax Section, Impact of Administrative Expenses on Amount of Estate Tax Deduction for Charitable and Marital Bequests, *in* 98 TAX NOTES TODAY 127-19, July 2, 1998, *available in* LEXIS, FEDTAX Library, TNT File [hereinafter NYSBA].

218. I.R.S. Notice 97-63, 1997-47 I.R.B. 6.

First, the Federal Method does not attempt to answer the question of materiality, but instead erects an "absolute rule of classification."[219] It focuses on the *nature* of particular expenses, rather than on the *level* of expenses relative to post-mortem income.[220] Further, its uniform federal standard would contravene the long-established principal and income laws of most states.[221] The constitutional questions that might be raised as a result of overriding state law have not been adequately examined or debated.[222]

Moreover, the Federal Method does not reflect reasonable estate administration practices,[223] and would add undue complications to the administration process.[224] Fiduciaries already have potentially conflicting duties to both the income and remainder beneficiaries of estates and trusts, and must balance the effects of certain tax elections between them.[225] New federal standards governing which expenses are "properly charged to principal" and which are "properly charged to income" would add further burdens to the fiduciaries' obligations.[226] Rather than providing a solution to the *Hubert* problem that is easy to administer, the Federal Method would complicate matters by creating disparities between federal tax accounting law and state fiduciary accounting law.[227] It would also run contrary to Treasury Regulation section 20.2056(b)-5(f)(4), which allows marital power of appointment ("POA") trust instruments to grant trustees the administrative power to "determine the allocation or apportionment of receipts and disbursements between income and corpus" without disqualifying the interest in trust for the marital deduction.[228] As a practical concern, the many thousands of wills that presently grant executors discretion in allocating administration expenses may have to be rewritten if the Federal Method is adopted.[229]

Even the three comment letters that favor the Federal Method modify it. Two of these recommend looking to the default provisions of the applicable state's principal and income laws to determine what level of expenses are properly

219. ABA Section of Taxation, *supra* note 68, ¶ 19.

220. *See* Frank G. Colella, Comments on Notice 97-63 (Jan. 30, 1998), *in* 98 TAX NOTES TODAY 93-24, May 14, 1998, ¶ 22, *available in* LEXIS, FEDTAX Library, TNT File [hereinafter Colella].

221. *See* ABA Section of Taxation, *supra* note 68, ¶ 13.

222. *See* Colella, *supra* note 220, ¶ 24.

223. *See* ABA Section of Taxation, *supra* note 68, ¶ 13.

224. *See* Comments of Individual Members of the American Bar Association's Section of Real Property Probate and Trust Law Concerning Notice 97-63, 1997-47 IRB 6 Relating to What Constitutes a Material Limitation on a Surviving Spouse's Right to Income, *in* 98 TAX NOTES TODAY 127-12, July 2, 1998, ¶ 19, *available in* LEXIS, FEDTAX Library, TNT File [hereinafter ABA Section of Real Property].

225. *See id.* ¶¶ 8, 19.

226. *See id.* ¶ 19.

227. *See* ABA Section of Taxation, *supra* note 68, ¶ 15.

228. Treas. Reg. § 20.2056(b)-5(f)(4) (as amended in 1994); *see also* ABA Section of Taxation, *supra* note 68, ¶ 14.

229. *See* ABA Section of Real Property, *supra* note 224, ¶ 19.

charged to principal and to income, rather than creating a new federal standard.[230] For example, if a state's default rule would charge all administration expenses to principal unless otherwise provided in a decedent's will, and a decedent's will gives the executor the discretion to allocate the expenses to principal or to income, the marital deduction would have to be reduced to the extent that expenses were charged to income in accordance with that discretion.[231] By the same token, expenses charged to income in accordance with the state's default rule would never constitute a material limitation on a surviving spouse's right to income.[232] In addition to eliminating some of the concerns about a new uniform federal law discussed previously, the proponents of this approach note that it has the advantage of looking to state laws that "are based upon the economic interests of income and remainder beneficiaries and [that] have significance that is independent of the tax law."[233] Because of their independent significance, there is little risk that the states' principal and income laws would be modified for tax purposes.[234]

The third commentator favoring the Federal Method, the New York State Bar Association Tax Section ("NYSBA"), advocates writing the proposed regulations on a clean slate, without relying "on local law distinctions between principal and income and on an undefined concept of materiality."[235] The NYSBA would modify the Service's approach in three ways. First, it would not identify expenses as "properly charged to principal" or "properly charged to income."[236] Instead, it would classify expenses as either "estate transmission expenses" or "estate investment expenses."[237] The former would include expenses incurred in connection with collecting the estate's assets, paying debts and taxes, and distributing the assets, and would always reduce the marital or charitable deduction. The latter would include expenses incurred in connection with investing, preserving, and maintaining the estate's assets during the period of

230. *See* Letter from Chair, Committee on Estate and Gift Taxation, Association of the Bar of the City of New York, to Internal Revenue Service (Feb. 24, 1998), *in* 98 TAX NOTES TODAY 54-36, Mar. 20, 1998, ¶ 7, *available in* LEXIS, FEDTAX Library, TNT File [hereinafter Committee on Estate and Gift Taxation]; Tax Section of the Florida Bar Comments on Notice 97-63 (Feb. 2, 1998), *in* 98 TAX NOTES TODAY 29-60, Feb. 12, 1998, ¶ 8, *available in* LEXIS, FEDTAX Library, TNT File [hereinafter Fla. Bar].

231. *See* Fla. Bar, *supra* note 230, ¶ 29. The only variation to this general rule that the Tax Section of the Florida Bar suggests is that expenses incurred in connection with an audit, including litigation and appeals, that are charged to income in accordance with the governing instrument, should not reduce the marital or charitable deductions even if such expenses exceed the state's default amount. This exception is needed so that an IRS challenge to an estate tax return will not cause an increase in estate tax simply because of the professional fees incurred in defending the estate's position. *See id.* ¶ 38.

232. *See id.* ¶ 29.

233. Committee on Estate and Gift Taxation, *supra* note 230, ¶ 7.

234. *See id.*

235. NYSBA, *supra* note 217, ¶ 27.

236. I.R.S. Notice 97-63, 1997-47 I.R.B. 6.

237. NYSBA, *supra* note 217, ¶¶ 30-32.

administration, and would never reduce the marital or charitable deduction.[238] The theory behind this distinction is that

> [e]xpenses that are not incurred in connection with the effort to produce a post-death investment return, diminish the value of the property passing to the estate's beneficiaries; expenses that are incurred in connection with the effort to produce such income, are intended to enhance the estate's value and should not reduce the value of such property for estate tax purposes.[239]

Second, the NYSBA would eliminate the concept of a "material limitation on a spouse's right to income" from Treasury Regulation section 20.2056(b)-4(a) and would instead move it to the regulations that address whether bequests in the form of POA and QTIP trusts qualify for the marital deduction.[240] Finally, the NYSBA would make clear that "estate investment expenses" do not reduce the marital or charitable deductions even if they are properly charged to *principal* under local law.[241]

Even with their proposed modifications, the approaches of these three commentators still suffer from many of the same ills as the Federal Method. They erect *classification* schemes for administration expenses in contravention of state principal and income laws, rather than addressing what *level* of administration expenses charged to the income of a marital bequest would be material. For the foregoing reasons, the Federal Method and all of its variations should be rejected.

2. The Per Se Method

It is not surprising that the Service included an alternative in Notice 97-63 that would administratively overrule *Hubert*, since Justice O'Connor declared in the concurring opinion that "nothing prevents the Commissioner from announcing by regulation the very position she advances in this litigation."[242] However, this alternative is clearly not favored by the practitioners who submitted comments to the IRS, for good reason.

Despite Justice O'Connor's comment, nothing in the Internal Revenue Code requires the value of the marital or charitable deduction to be reduced when a 642(g) election is made. Section 642(g) simply prevents certain expenses, such as administration expenses, from being claimed as deductions twice, once on the estate tax return and again on the fiduciary income tax return. It makes absolutely no mention of the marital and charitable deductions.[243]

Further, the controlling marital deduction Code provision, § 2056, does not even mention administration expenses. It speaks in terms of "mortgages," "encumbrances," and "obligations."[244] As Justice O'Connor herself noted, it is impossible to tell from the Code whether payment of administration expenses from income should reduce the marital deduction "always, sometimes, or not at

238. *See id.*
239. *Id.* ¶ 33.
240. *Id.* n.27.
241. *See id.*
242. Commissioner v. Estate of Hubert, 117 S. Ct. 1124, 1139 (1997).
243. I.R.C. § 642(g) (Supp. II 1996).
244. *Id.* at § 2056(b)(4)(B) (1994).

all."[245] The legislative history likewise provides no guidance about what effect administration expenses should have on the value of the marital deduction.[246]

Despite this lack of guidance in the Code and legislative history, Treasury Regulation section 20.2056(b)-4(a) requires material limitations on the spouse's right to income to be taken into account when valuing the marital deduction.[247] Fifteen of the seventeen Tax Court judges and four of the nine Supreme Court Justices who considered *Hubert* agreed that the regulation is merely a valuation provision, and that not all limitations on the spouse's right to income would be *material*.[248] Three other Supreme Court justices, including Justice O'Connor, agreed that the Commissioner had created a quantitative rule for regulation section 20.2056(b)-4(a), worthy of deference, such that a limitation on the right to receive income would affect the marital deduction "only upon reaching a certain quantum of substantiality."[249]

The Per Se Method would be inconsistent with Treasury Regulation section 20.2056(b)-4(a) as currently written, which contemplates that *some* limitations on a surviving spouse's right to income *will not* require the marital deduction to be reduced. Without the regulation as currently written, there is no basis at all for reducing the marital deduction by the amount of administration expenses charged to income. As members of the American Bar Association's ("ABA") Section of Taxation explain in their comment letter, "[t]he Supreme Court did not question this regulation's validity; rather, the Supreme Court considered the circumstances under which that regulation requires a reduction of the marital and charitable deductions."[250] The Per Se Method attempts to stretch regulation section 20.2056(b)-4(a) beyond its interpreted meaning as a valuation provision. Similar to the Federal Method, this approach avoids the issue of determining what constitutes a *material* limitation and instead erects a rule of absolute prohibition.[251] It should be rejected.

Professor Joseph M. Dodge of the University of Texas School of Law advocates an approach that would reach a result somewhat similar to the Per Se Method. Like the NYSBA, he would eliminate the concept of a material limitation on income from Treasury Regulation section 20.2056(b)-4(a) and would instead move it to the regulations that govern whether an interest in a POA or QTIP trust qualifies for the marital deduction.[252] Professor Dodge would then rewrite the

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245. *Hubert*, 117 S. Ct. at 1135 (O'Connor, J., concurring).

246. *See supra* note 124.

247. Treas. Reg. § 20.2056(b)-4(a) (as amended in 1994). See also *supra* note 8 for a reproduction of the regulation.

248. *See Hubert*, 117 S. Ct. at 1131 (plurality opinion); Estate of Hubert v. Commissioner, 101 T.C. 314, 324-25 (1993).

249. *Hubert*, 117 S. Ct. at 1138 (O'Connor, J., concurring).

250. ABA Section of Taxation, *supra* note 68, ¶ 16.

251. *See id.* ¶ 19.

252. *See* Dodge, *supra* note 217, ¶ 14.

> The "material limitation" rule doesn't belong in Reg. section 20.2056(b)-4(a). Under the current version of Reg. section 20.2056(b)-4(a), the full phrase is "material limitation upon [the surviving spouse's] right to income." The surviving spouse has an identifiable "right to income" only in the case of power-of-appointment and QTIP trusts under section 2056(b)(5) and (7). There is no

regulation so that the value of the marital deduction would be reduced by the present value of the maximum amount of future administration expenses that *might* be charged (under local law and the governing instrument) against the principal or the income of a marital bequest during a reasonable period of administration.[253] Like Judge Halpern of the Tax Court, who wrote a concurring and dissenting opinion in *Hubert*,[254] Professor Dodge argues that the date of death value of the interest passing to the surviving spouse is equal to the "present value of all future returns, both 'principal' and 'income.'"[255] Therefore, he argues, the possibility of diverting principal or income from the surviving spouse reduces the value passing and should reduce the marital deduction.[256]

Professor Dodge's comment letter is well-reasoned, his analysis of the existing statutory and regulatory framework is very thorough, and his focus on the policy behind the marital deduction when discussing what the law should be is unique among the commentators.[257] For these reasons his argument is quite convincing. However, Professor Dodge does not explain how to determine, as of the decedent's date of death, the maximum amount of future administration expenses that *might* be charged against the marital bequest. This question would be easy to answer if the governing instrument *prohibited* the executor from charging any administration expenses against the income or principal of the marital bequest. However, such a provision might be inconsistent with the executor's state law fiduciary duty to balance the interests of all beneficiaries. Even if the governing instrument allowed a fixed percentage of administration expenses to be charged to the marital bequest, rather than giving the executor discretion to determine the amount, the future administration expenses would not be known. If the marital deduction were reduced based on a fixed percentage of *projected* administration expenses, the executor would run the risk of creating a taxable estate where none exists, as explained by Justice Scalia in his dissenting opinion in *Hubert*.[258]

> separate "right to income" in an outright bequest, a bequest of an annuity, an estate trust, or a spousal remainder trust. Whether a bequest carries with it estate income (as opposed to trust income) is a question of state law; any income that "goes" with the bequest is part of the bequest.

Id. (alteration and parenthetical in original).

253. *See id.*

254. *See supra* note 147.

255. Dodge, supra note 217, ¶5.

256. *Id.* ¶ 10.

257. *See generally id.*

> It is not necessary to argue that estate administration expenses are literal "encumbrances" within scction 2056(b)(4)(B). It is only necessary to note that they reduce the "value passing" to the surviving spouse under section 2056(a) and that they do not represent waste or consumption by the surviving spouse. . . .
>
> . . . .
>
> . . . Every dollar of income used to pay administration expenses is a dollar that does not appear in the surviving spouse's estate and gift tax base. Such a result clearly violates the rationale of the marital deduction.

Id. ¶¶ 12, 19.

258. *See supra* note 203.

Because of these practical problems, the IRS and Treasury should reject this approach.

3. The Safe Harbor Method

The approach most favored by practitioners who responded to the IRS's request for comments,[259] and the one that should be adopted in proposed regulations, is the Safe Harbor Method of determining when a material limitation on a surviving spouse's right to income exists. This is the only alternative of the three proposed by the IRS that actually attempts to answer the question left open in *Hubert* by focusing on the level of administration expenses charged to income relative to the size of the marital bequest. It would also be practical, relatively easy to administer, and would provide certainty in an area where none currently exists.

While there seems to be some consensus that the regulations should adopt a Safe Harbor Method, there is disagreement about what the exact test should be. No commentator suggests that the methods proposed by the IRS in Notice 97-63, either a percentage of the actual gross income derived from the marital bequest property during administration, or a specified dollar amount,[260] should be adopted. More than one commentator expresses concern that the former test might improperly influence executors by causing them to administer estates less expeditiously, fund bequests and trusts less promptly, and alter estates' investment strategies, all with an eye toward income production.[261]

Professor Dodge, while advocating his own approach,[262] suggests that if a safe harbor method were adopted it should be based on a small percentage of the value of the marital bequest, rather than on a percentage of actual or projected income.[263] Other commentators suggest safe harbor approaches based on a sliding scale of the net value (reduced for claims, debts, and funeral expenses) passing

259. In addition to the practitioners discussed in this Part, the Safe Harbor Method is favored by two other commentators. *See* Letter from Roger M. Norman et al., Law Offices of Roger M. Norman, to Internal Revenue Service (Dec. 10, 1997), *in* 98 TAX NOTES TODAY 10-12, Jan. 15, 1998, *available in* LEXIS, FEDTAX Library, TNT File; Colella, *supra* note 220.

260. I.R.S. Notice 97-63, 1997-47 I.R.B. 6.

261. *See* Dodge, *supra* note 217, ¶ 18; Committee on Estate and Gift Taxation, *supra* note 230, ¶ 5.

262. *See supra* text accompanying notes 252-56.

263. *See* Dodge, *supra* note 217, ¶ 18. Professor Dodge suggests that income could be used to pay administration expenses as long as the amount so used did not exceed .2% of the value of the marital bequest; he reasoned that the de minimis safe harbor amount should be about 5% multiplied by an average income yield for trusts of around 4%. If that safe harbor limit were exceeded, his preferred test would be invoked and the marital deduction would be reduced by "the present value of ALL charges that might lawfully be made against the principal and income of the marital bequest." *Id.* ¶ 18 (emphasis in original).

to the surviving spouse or to charity,[264] or on state-prescribed "normal levels" of administration expenses.[265]

The most promising safe harbor tests are suggested by members of the ABA's Real Property, Probate, & Trust Law Section ("Probate Section") and members of the Estate and Gift Tax Committee of the ABA's Section of Taxation ("Tax Section"). The tests they advocate are very similar.

Members of the Probate Section suggest that the safe harbor be calculated as a percentage of the projected *lifetime* income the surviving spouse will receive from the marital deduction property. The projected income would be calculated based on the date-of-death value of the marital bequest, the surviving spouse's age, and an interest rate set by the IRS. They suggest that the safe harbor percentage should be ten to fifteen percent of the projected lifetime income.[266]

Members of the Tax Section would make a similar calculation, but would use projected income during a reasonable (three-year) period of administration. They suggest a safe harbor percentage of 33% based on *Hubert*, where administration expenses of $1.5 million were charged to the $4.5 million of income earned during administration.[267] They also suggest an additional safe harbor based on *Hubert*, whereby an amount of income equal to five percent of the value of the assets qualifying for the marital and charitable deductions could be used to pay administration expenses.[268] The executor would be able to use whichever test yields a larger safe harbor amount.[269]

Under both the Probate and Tax Sections' versions, the marital deduction would be reduced dollar for dollar by the amount of administration expenses actually charged to income in excess of the safe harbor amount, unless the executor carried his burden of proof in showing why, under the particular facts and circumstances, it was proper to charge the excess amount to income.[270] Both of these approaches are fairly straightforward. The Probate Section's method is

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264. *See* Memo from Stanley Efron and Stephen L. Hopkins to Internal Revenue Service (Feb. 3, 1998), *in* 98 TAX NOTES TODAY 39-74, Feb. 27, 1998, ¶ 15, *available in* LEXIS, FEDTAX Library, TNT File. Speeifically, the maximum amount that would be chargeable against the property passing to the surviving spouse or to charity (as reflected on the estate tax return) without affecting the amount of the marital or charitable deduction would be 2.5% of the first $1 million, 2% of the next $1 million, 1.5% of the next $1 million, and 1% of the value above $3 million. *See id.* The attorneys describe this approach as an "empirically based estimate" of reasonable estate administration expenses that "recognizes economies of scale whereby fixed costs are largely the same regardless of the size of the estate or the nature of the property passing to the spouse" or charity. *Id.* ¶ 16. It ignores the distinction between principal and income and allows an executor to determine the maximum charge against the property based on the estate tax return, regardless of the amount of income earned during administration. *See id.* ¶ 14.

265. Letter from David D. Aughtry, Chamberlain, Hrdlicka, White, Williams & Martin, to Internal Revenue Service (Feb. 4, 1998), *in* 98 TAX NOTES TODAY 39-75, Feb. 27, 1998, ¶ 3, *available in* LEXIS, FEDTAX Library, TNT File.

266. *See* ABA Section of Real Property, *supra* note 224, ¶¶ 24-26.

267. *See* ABA Section of Taxation, *supra* note 68, ¶ 26.

268. *See id.* ¶ 28.

269. *See id.* ¶ 23.

270. *See id.* ¶ 33; ABA Section of Real Property, *supra* note 224, ¶ 28.

slightly more complicated than the Tax Section's, because it does not assume a reasonable period of administration, but instead uses the surviving spouse's life expectancy to calculate projected income. The slight complication is nothing new in the tax world, and in this situation is justified because the Probate Section's approach is more tailored to the facts of individual estates.

CONCLUSION

In one sense, the Supreme Court's decision in *Hubert* did little to resolve the issue of how estate tax marital and charitable deductions should be valued when income allocable to marital and charitable bequests is used to pay estate administration expenses. Because the Commissioner argued only that *any* use of such income constituted a material limitation on a surviving spouse's right to income, the justices' rejection of this per se argument necessarily resulted in a holding for the estate, without requiring the justices to resolve the valuation issue.[271]

In a more positive sense, however, *Hubert* is an example of the collaborative model of statutory interpretation, whereby "judges play a creative role in developing the law" by interpreting the meaning of statutes through cases.[272] The *Hubert* Court began the process of collaboration with respect to Treasury regulation section 20.2056(b)-4(a) by determining that the regulation is a valuation provision,[273] and by determining that the word "material" refers to an as yet undefined "quantum of substantiality."[274] With this foundation, Justice O'Connor invited the Treasury Department and the IRS to amend regulation section 20.2056(b)-4(a) to provide taxpayers and their advisors with clear guidance about what constitutes a material limitation on a surviving spouse's right to income.[275]

In keeping with a spirit of collaboration and teamwork, Treasury and the IRS solicited comments about proposed methods of determining materiality, and many practitioners responded with thoughtful and insightful remarks.[276] The method that should be adopted in the amended regulation, a variation of one of the methods proposed by Treasury and the IRS, would allow a safe harbor amount of administration expenses to be charged to the income of a marital or charitable bequest without requiring the marital or charitable deduction to be reduced. Such a bright-line method would be easy to understand and easy to administer.[277] To be sure, whichever method is finally adopted, the real result of *Hubert* is that the new law on valuing estate tax marital and charitable deductions will be the

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271. *See supra* Part I.C.

272. William D. Popkin, *The Collaborative Model of Statutory Interpretation*, 61 S. CAL. L. REV. 541, 579 (1988).

273. *See supra* Part I.C (discussing the plurality opinion).

274. *See supra* Part I.C (discussing Justice O'Connor's concurring opinion).

275. *See* Commissioner v. Estate of Hubert, 117 S. Ct. 1124, 1139 (1997) (O'Connor, J., concurring).

276. *See supra* Part V.B.

277. *See supra* Part V.B.3.

product of current and lively public deliberation, an outcome championed by the collaborative model of statutory interpretation.[278]

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278. *See* Popkin, *supra* note 272 , at 590.