Future Interests in Estate Planning

Harry Haines
FUTURE INTERESTS IN ESTATE PLANNING

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I. INTRODUCTION

The use of life estates, estates for terms for years and other future interests with broad variations involving powers of appointment, whether special or general, and internal restraints is very common in estate planning. Recent developments in both federal and Montana laws require the lawyer to review his understanding of the legal principles involved in the use of future interests in estate planning. In the most recent legislative session for the State of Montana, changes were made in the law which directly affect the portion of a future interest subjected to tax. In the Tax Reform Act of 1976, the concept of the "generation-skipping tax" was introduced. The purpose of this article is not to present an exhaustive study of the use of future interests in estate planning, but rather to highlight the use of future interests in view of the recent changes under the federal and Montana laws.

II. FEDERAL LAW

A review of the most common general principles of federal estate tax law relating to future interests will be helpful before going into a more detailed analysis of generation-skipping tax provisions. To simplify discussion, the life estate and its attributes will be used. In general, the property to which a life estate attaches will be included in the gross estate of the creator of the life interest if the creator is the deceased. Whether the property interest which is the subject of the life estate is exposed to federal estate tax is dependent upon two factors: (1) the identity of the life tenant, and (2) the power which the life tenant is given over the corpus of the life interest. If the life tenant is the surviving spouse of the deceased,

* J.D., University of Montana, 1964; L.L.M., New York University, 1966. The author gratefully acknowledges the research assistance of David P. Gorman, but accepts sole responsibility for the content of this article.

2. R.C.M. 1947, § 91-4414 (Supp. 1977). Note the general broadening of the exemptions allowed to the surviving spouse, especially in subsection (3).
4. For an excellent general discussion of Montana inheritance tax laws as they existed prior to the most recent changes see Wold, The Montana Death Taxes, 31 Mont. L. Rev. 133 (1970).
5. I.R.C. § 2036.
the life interest can qualify for the marital deduction, if appropriate powers are given to the surviving spouse. The requirement is, generally, that the surviving spouse must possess a general power of appointment over the corpus of the trust which exists either during the surviving spouse’s lifetime or at the surviving spouse’s death. If the general power of appointment exists, and the other factors required for marital deduction purposes are present, the property to which the life estate interest attaches can pass tax-free to the spouse to the extent of the allowable marital deduction. However, upon the surviving spouse’s subsequent death, the property subject to the life estate becomes taxable.

If anyone other than the surviving spouse is the life tenant, and enjoys a general power of appointment over the assets subject to the life interest, no deduction is created in the estate of the creator of the life interest and it will be taxed immediately. Likewise, due to the fact that a general power of appointment exists in the life tenant, the property within the life interest will be taxed again at the death of the life tenant.

In the absence of a general power of appointment, if the power to use the corpus to which the life interest attaches is limited to an ascertainable standard such as support, health or maintenance, or to a specific power to invade to the extent of $5,000 per year, or five percent of the aggregate value of the assets, whichever is greater, the property to which the life estate attaches will be subjected to estate tax in the estate of the creator of the life interest, whether the life tenant is the surviving spouse or not. In this case, the life interest would not qualify for the marital deduction as it is a “terminable interest.” However, in this instance, no further estate tax would result upon the death of the life tenant and the property could pass on to successive estates.

The same result as in the case of a power to invade based upon

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9. Id.
10. The reason the property is included in the estate of the second spouse to die is the possession of the general power of appointment. Inclusion is required by I.R.C. § 2041.
11. The only deduction allowable to the recipient of a life interest is that of the surviving spouse, I.R.C. § 2056, unless a charity qualifying under I.R.C. § 2055 is involved.
12. I.R.C. § 2041. In this case it is obvious that no generation-skipping is occurring and the tax impacts occur at the death of each individual.
15. I.R.C. § 2036.
17. The leading case is Williams v. United States, 41 F.2d 895, 897 (Ct. Cl. 1930). See also Rev. Rul. 66-20, 1966-1 C.B. 214, 216.
an ascertainable standard would occur if only a special power of appointment was coupled to the life estate. In this case, the life tenant could appoint to someone other than the life tenant's estate or to a special group exclusive of the life tenant. Again, the property to which the life estate attaches would be subject to tax in the creator's estate but would not be subject to tax upon the subsequent death of the life tenant.

Based on these general principles, it can be seen that prior to the enactment of the generation-skipping tax, federal estate tax could be avoided for substantial periods of time by transferring property in trust for successive generations using life estates. Ordinarily no tax would be imposed so long as a beneficiary currently enjoying income did not possess a general power of appointment, although the beneficiary currently enjoying income could possess the various powers indicated above, which were either limited by an ascertainable standard, or were considered to be special powers. An overall limitation as to the duration of such an arrangement was established by the common or statutory law by means of the Rule against Perpetuities, while restrictions on property within the trust were subjected to the rules governing restraints on the power of alienation.

In an effort to restrict the avoidance of tax by the use of future interests, Congress introduced the new tax known as the "generation-skipping tax" in the Tax Reform Act of 1976. The House Committee Report on the Tax Reform Act of 1976 states, in its discussion of generation-skipping transfers:

[T]he committee bill provides generally that property passing from one generation to successive generations in trust form is to be treated, for estate tax purposes, substantially the same as property which is transferred outright from one generation to a successive generation.

18. Treas. Reg. § 20.2041-1(c)(1)(a) or (b) (1958).
22. Under I.R.C. § 2622 Congress delegated to the Secretary the authority to draft regulations to implement the generation-skipping tax. At the time of writing of this article regulations have not been published on the generation-skipping tax. Heavy reliance is placed upon the Joint Committee on Taxation's explanations in determination of congressional intent. The Joint Committee on Taxation's General Explanation is an excellent discussion and provides many examples to explain the meaning of the statutory provisions. Some of these examples are incorporated in this article. It is the author's recommendation to read the General Explanation in studying the generation-skipping tax for two reasons: (1) it is clearer than the statutory law; and (2) the delegation of authority to the Secretary to create regulations is limited to the purposes of the chapter, which will be determined by reference to the General Explanation.
The provisions relating to the generation-skipping tax are extremely complex. They introduce a new set of terms, phrases and definitions. The problems created by these provisions can best be analyzed within a sequential framework:

1. Is a generation-skipping trust present?[^24]
2. Has there been a generation-skipping transfer[^25] and if so, 
   a. is it a taxable distribution[^26] or 
   b. is it a taxable termination[^27]
3. Do exceptions to the imposition of tax apply?[^28]
4. If the first three conditions are satisfied, when is the tax imposed?[^29]
5. Who is the "deemed transferor"?[^30]
6. How is the tax computed?[^31]
7. Who is liable for the tax?[^32]
8. Who is responsible for return filing?[^33]


A generation-skipping trust is a trust designed to provide for the splitting of benefits between two or more generations younger than the grantor's generation.[^34] A simple example of this is a transfer in trust to pay income to the grantor's child for life, remainder to the child's issue. The arrangement does not have to be a technical trust.[^31] It can include arrangements involving life estates and remainders, estates for years, insurance and annuities, and split interests.[^36]

In order to determine whether two or more generations younger than that of the grantor are enjoying benefits, the first step is to assign persons to generations by the rules set forth in the Code.[^37] The assignment is based upon a family relationship to the grantor.^[38]

[^24]: I.R.C. §§ 2611(b), 2611(d).
[^25]: I.R.C. § 2611(a).
[^26]: I.R.C. § 2613(a).
[^27]: I.R.C. § 2613(b).
[^28]: I.R.C. §§ 2613(b)(5), (6), (7); 2613(e).
[^29]: I.R.C. § 2613(b)(2).
[^30]: I.R.C. § 2612.
[^31]: I.R.C. § 2602.
[^32]: I.R.C. § 2603.
[^33]: I.R.C. § 2621(c).
[^34]: See generally I.R.C. § 2611(b).
[^35]: I.R.C. § 2611(d)(1).
[^36]: I.R.C. § 2611(d)(2).
[^37]: I.R.C. § 2611(c).
or in the absence of such a relationship, by age. Therefore, a child of the grantor would be a member of a younger generation. An individual married to the child would be in the same generation as the child.

In the absence of rules regarding family relationships, individuals are assigned to generations based upon their age in relation to the grantor's birthdate. If the individual is born not more than twelve and one-half years after the date of the grantor's birth, such individual is assigned to the grantor's generation. If the individual is born more than twelve and one-half years but not more than thirty-seven and one-half years after the date of the birth of the grantor, the individual is assigned to the first generation younger than the grantor and similar rules apply for every twenty-five year period thereafter.

Perhaps the best way to highlight the rules is by way of example. If a gift is given outright to a grandchild, it will not be a generation-skipping transfer because a single, not two or more generations younger than the grantor, is enjoying the benefits of the property. Likewise, a gift in trust to "A" for life, remainder to "B", may or may not be a generation-skipping trust. If "A" is the grantor's mother and "B" is the grantor's sister, it is not a generation-skipping trust because two or more beneficiaries younger than the grantor are not enjoying the benefits of the trust. If in that example, "A" is the spouse of the grantor and "B" is the grantor's child, it is not a generation-skipping trust because there is only one generation younger than the grantor involved. However, if in the example, "A" is the child of the grantor and "B" is the grantor's grandchild, there is a generation-skipping trust because there are two or more beneficiaries younger than grantor enjoying the benefits of the trust.

2. Generation-Skipping Transfer.

Once you have determined that a generation-skipping trust is involved, you must determine whether a generation-skipping transfer has occurred. A "transfer" means "any taxable distribution or taxable termination with respect to a generation-skipping trust or trust equivalent." The generation-skipping tax will not be imposed if you do not have a generation-skipping trust. Likewise, it will not

39. I.R.C. § 2611(c)(6).
40. Id.
41. I.R.C. § 2611(c)(5)(A).
42. I.R.C. § 2611(c)(5)(B).
43. I.R.C. § 2611(c)(5)(C).
44. I.R.C. § 2611(a).
45. Id.
be imposed if you do not have a generation-skipping transfer.

Because a "transfer" means "any taxable distribution", we must define a taxable distribution. In general, a taxable distribution will take place when principal or corpus is distributed to a beneficiary.\textsuperscript{46} The beneficiary must be younger than the grantor's generation and there must be another younger generation beneficiary who belongs to a generation older than the distributee.\textsuperscript{47} By way of an example, if we have a trust to "A" for life, remainder to "B", and "A" is the child of the grantor and "B" is the grandchild, if the trust allows distribution to corpus to "B", the grandchild, and such a distribution is made, it is a taxable distribution. If in the same trust above, a corpus distribution is made to the child "A", it is not a taxable distribution because there is no older generation than the child enjoying the benefit of the trust who is younger than the grantor.

In an effort to anticipate transfers attempting to circumvent these rules, the Joint Committee referred some problems to the Service to develop regulations. One of the problems suggested was a trustee extending loans to a grandchild subject to repayment terms. In such situations, if the loans were deemed true loans, no principal distribution would take place and no taxable distribution would occur. In this specific area, the Internal Revenue Service is to provide regulations to determine if the loan can be deemed "substantially equivalent to a distribution".\textsuperscript{48} Another problem anticipated by the Joint Committee was a trust instrument which defined an item commonly deemed corpus to be income.\textsuperscript{49} A complete knowledge of the Montana Uniform Principal and Income Act\textsuperscript{50} and the definition of income contained in Section 643(b) of the Internal Revenue Code will be helpful to the practitioner involved in this issue. Regulations covering various situations can be anticipated.\textsuperscript{51} Attempts to make income distributions to members of a younger generation and corpus distributions to a member of the older generation enjoying the trust were also anticipated. This possi-

\textsuperscript{46} I.R.C. § 2613(a)(1).
\textsuperscript{47} Id.
\textsuperscript{49} Id.
\textsuperscript{50} R.C.M. 1947, §§ 67-1901 to 1916.
\textsuperscript{51} It must be kept in mind that, for purposes of the determination of federal income taxation of estates and trusts, the local or state law definition of income is the first step. It cannot be overemphasized that in the computation of income taxation for estates and trusts, and, as a corollary, whether a corpus distribution has been made under the generation-skipping rules, the Uniform Principal and Income Act will be the key.
A "transfer" is not limited to being a "taxable distribution", but can also be a "taxable termination". Usually a taxable termination will occur upon the expiration of an interest of a beneficiary who belongs to a generation older than any remaining beneficiary. For example, in the trust to "A" for life, remainder to "B", if "A" is the grantor's nephew and "B" is the nephew's issue, the death of "A" would be a taxable termination. But, if the trust were for the benefit of "A" for life, then for the benefit of "B" for life, remainder to "C" where "A" is a child, "B" is a grandchild and "C" is a great-grandchild, if "B" dies before "A", there is no generation-skipping transfer because there is a termination of the future interest. The same result would appear to apply under Montana law.

If a taxable distribution and a taxable termination occur at the same time, the termination takes precedence over the distribution so that there is no duplication of tax.

3. Exceptions to Imposition of Tax.

Assuming that a generation-skipping trust exists and either a taxable distribution or termination has occurred, we must determine if any exceptions to the imposition of tax apply. One of the easiest exceptions to understand is the grandchild exclusion. So long as the value of property transferred to the grandchildren of a single child does not exceed $250,000, no tax applies. If a trust provides for the payment of income for the grantor's son and daughter, remainder to their respective issue, any property distributed to the daughter's children upon her death would be excluded to the extent its value at the time of transfer did not exceed $250,000; a like exclusion of $250,000 would be available upon distribution of the son's share to his children at his death.

There are several important points to be made with regard to the grandchild exclusion. The first is that the limitation of $250,000 is determined at the child's level. The number of grandchildren involved is irrelevant. In other words, if there is only one child, the applicable exclusion is $250,000. If there are two children, the appl-
icable exclusion would be $250,000 per child or a total of $500,000. In this last example, the exclusion, however, still is limited to a per child determination, so that if $300,000 were given to the grandchildren of one child and $200,000 were given to the grandchildren of the second child, $50,000 would be exposed to a generation-skipping tax upon the death of the first child and no exposure to tax would occur upon the death of the second child.

The second point to note under the grandchild exclusion is that if one parent creates a trust for children and another parent adds properties to the same trust, the exclusion does not change.60 The exclusion remains at $250,000 per child even though two persons of older generations are contributing property to the trust. It also must be remembered that if the trust runs to the grantor's child for life, remainder to anyone other than grandchildren the exclusion does not apply because it is for the benefit of the grandchildren only. Furthermore, the exclusion applies to both a taxable distribution and to a taxable termination involving a generation-skipping trust.

Another exception to the imposition of tax is one that has been previously noted. Income distributions are not subject to the generation-skipping tax.61 Local law (i.e. Montana Principal and Income Act) is determinive of what constitutes "income" for Federal tax purposes.62

Another exception to the imposition of tax which can have definite planning capabilities is one where the grantor of a trust grants a special power of appointment to a member of a younger generation.63 For example, if the grantor of a trust granted to his son a power to allocate income or principal among the lineal descendants of the grantor, but not to the son himself, the holder of the power has no beneficial interest in the trust. The holding of such a power will not attract a generation-skipping tax. However, if the draftsman of the trust instrument does not select his language carefully, an unintentional generation-skipping tax exposure can be created. By way of example, if in a non-marital trust, the grantor of the trust named his surviving spouse and son as co-trustees, then granted to the surviving spouse and the son the power to appoint principal among the lineal descendants of the grantor, if the son died before the surviving spouse, the death of the son would constitute a "taxable termination" and the property would be subjected to the possibility of a generation-skipping tax upon the death of the surviv-

60. Id.
61. I.R.C. § 2613(e). See also I.R.C. § 2613(a)(1).
62. See I.R.C. § 643(b).
63. I.R.C. § 2613(e).
ing spouse. The reason for this is that the son is a "beneficiary" who has an "interest" and a "power" in the trust, as such he qualifies as a "younger generation beneficiary". The lineal descendants who enjoy the remainder interest upon the death of the wife, if there is a generation younger than the son, would then be exposed to generation-skipping tax liability.

Finally, the new law provides that, if a transfer deemed taxable has already taken place, a subsequent transfer of the same property among members of the same generation will not subject them to another tax. By way of example, assuming that the grandchild exclusion is exceeded, if a trust is created which provides income for life to a son, then a life interest in the son's child, with a successive life interest in the grantor's daughter, with a remainder to the grantor's daughter's child, the death of the son would constitute a taxable termination. The subsequent death of the daughter would not constitute a taxable termination to the extent that the value of her interest which terminated had previously been subject to tax upon the death of the son. Under the rule cited, this is due to the fact that the daughter and son belong to the same generation and the exception therefor applies.

4. Time of Imposition of the Tax.

To this point in our discussion, we have assumed that we have found a generation-skipping trust, that we have found a taxable transfer, and that we have found no exceptions to the imposition of tax. We must now determine if the imposition of the tax may be delayed by other rules.

If there are two or more beneficiaries in the same generation enjoying a trust share, the imposition of tax is delayed until the last beneficiary dies, unless there are definable shares initially. As an example, if a grantor creates a trust providing for the sprinking of income among the grantor's three children, "A", "B" and "C", during their lives, then to distribute the corpus of the trust to the great-grandchildren upon cessation of the life income interest, there is no tax imposed until the death of the last survivor of "A", "B" and "C". The tax is postponed in this instance, but upon the death of the last survivor of "A", "B" or "C", there is a taxable termina-

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64. I.R.C. § 2613(c)(3).
68. I.R.C. § 2613(b)(7)(B).
69. I.R.C. § 2613(b)(2).
tion as to all three. In the absence of a will or trust provision to the contrary, the portion transferred is deemed to be transferred pro rata so that the trust would be divided into three equal shares.\footnote{70} This will be important later when we discuss the computation of the tax in regard to the “deemed transferor”.

If, in the foregoing hypothetical, the trust establishes that each child is to receive an undivided one-third share allocated into a separate trust share, remainder over to great-grandchildren upon the death of the child for whom the share was established, even though there may be three children participating in the trust there is no delay in the taxable termination because each separate share is determinable and a taxable termination takes place upon the death of each child or life tenant.\footnote{71}

A delay in the imposition of tax may also take place if a younger generation beneficiary dies before an older generation beneficiary younger than the grantor.\footnote{72} If a trust is created for the joint lives of the grantor’s child and the child’s daughter, remainder to the daughter’s issue, if the daughter dies first, the termination does not take effect until the child himself dies. This would be a joint life situation using both the lives of the child and grandchild as the lives in being. A tax would be subsequently imposed on the termination of the child’s interest. The amount of the tax is then deducted from the value of the trust assets and the tax which had been postponed at the death of the daughter would then be imposed.

5. **Deemed Transferor.**

We now assume that all prior determinations are satisfied. The determination must now be made whom the “deemed transferor” is. A deemed transferor is “... the parent of the transferee ... who is more closely related to the grantor than the other parent of such transferee ...”.\footnote{73} This determination is important because the person identified as the “deemed transferor” is the person used to determine which tax rate is used to compute the tax.\footnote{74} A deemed transferor need not be a participant in the trust.

As an example, if the trust is for the benefit of the grantor’s grandchild for life with the remainder to the grantor’s great-grandchild, the grandchild is the deemed transferor when the trust property passes to the great-grandchild. If the trust is for the benefit of the spouse of the grantor’s grandchild for life, remainder to the

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\footnote{70}{I.R.C. § 2613(b)(3).}
\footnote{71}{I.R.C. § 2613(b)(2)(A). \textit{See} General Explanation, 570.}
\footnote{72}{I.R.C. § 2613(b)(2)(C).}
\footnote{73}{I.R.C. § 2612.}
\footnote{74}{I.R.C. § 2602(a).}
great-grandchild, the grandchild, not his spouse, is the deemed transferor because the grandchild is more closely related to the grantor than his spouse. When the grandchild’s spouse dies, the value of the trust property is added to the grandchild’s taxable transfers for purposes of determining the tax rate. 75

As another example, in a trust for the benefit of the grantor’s nephew for life, then to the nephew’s son for life with remainder to the grantor’s great-grandchild, the nephew would be the deemed transferor upon his death, but upon the death of the nephew’s son, the grantor’s grandchild (the great-grandchild’s parent) would be treated as the deemed transferor because no ancestor of the great-grandchild was a younger generation beneficiary under the trust. 76


The rate schedule used to determine the tax is the same rate schedule used for the estate and gift tax in effect on the date of transfer. 77 Tax is computed in much the same manner as the gift tax under prior law. In other words, the amount of tax is determined by applying the unified tentative tax rate against the fair market value of the property transferred by the deemed transferor 78 after adding all prior generation-skipping transfers, 79 all prior taxable gifts, 80 if any, and the amount of the decedent’s taxable estate, if he has died. 81 A tentative tax is computed on the total value of these transfers. Then a tax is recomputed on all but the current transfer, the net being the generation-skipping tax.

Although a prior generation-skipping transfer is involved in the computation of the generation-skipping tax on subsequent transfers, a prior generation-skipping transfer is not taken into consideration in determining the transfer tax rates applicable to subsequent gifts by the deemed transferor or to determine his estate tax. In other words, the generation-skipping transfer tax is not totally integrated into the gift and estate taxes. However, if the deemed transferor dies at the same time that the generation-skipping transfer occurs, or within nine months thereafter, a partial integration into estate tax occurs in that the maximum marital deduction under

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75. General Explanation, 576.
76. General Explanation, 576-77.
77. I.R.C. § 2602(a)(1).
Section 2056 is increased,82 and deductions comparable to those provided by Sections 2053 and 2054 are allowable in determining the amount of the generation-skipping tax.83 Any unused portion of the unified credit under Section 2010(a) may be applied against the generation-skipping tax.84 Appropriate credit against the generation-skipping tax for state death taxes is allowable with limitations,85 and charitable deductions are available if applicable.86 An interesting twist also allows the trustee to elect its own alternative valuation for purposes of determining the generation-skipping transfer tax.87 If the transfer occurs within the three year period immediately preceding the deemed transferor's death, the generation-skipping tax is determined, for purposes of determining the applicable rate, as if the transfer had occurred after his death.88

7. Liability for Tax.

In general, the trust document should usually specify responsibility for tax payments. It should further specify the source from which the tax payments are made. Updating the clauses in existing trusts appears desirable, but remember that if an increase in the amount of the generation-skipping transfer occurs, the protection of grandfather clauses might be lost89 as hereinafter discussed. As previously stated, the deemed transferor is the person we use to determine the rate of the tax.90 However, the deemed transferor is not responsible for the payment of the tax. In the absence of trust provisions, in the case of taxable distributions, there is personal liability in the distributee.91 In the case of a taxable termination, there is

82. I.R.C. § 2602(c)(5)(A).
83. I.R.C. § 2602(c)(5)(B).
84. I.R.C. § 2602(c)(3).
85. I.R.C. § 2602(c)(5)(C). There is a potential problem with regard to the inheritance tax credit due to the fact that the Montana inheritance tax laws, in general, tax future interests at the time of creation rather than when the deemed transferor dies. A technical reading of I.R.C. § 2602(c)(5)(C) would indicate that a credit for inheritance tax paid is allowed "in respect of any property included in the generation-skipping transfer." If a number of years pass between the creator's death and the death of the deemed transferor, it is very likely that the trust assets would consist of entirely different property at the time of the generation-skipping transfer than that which was taxed under Montana law at the creator's death. If I.R.C. § 2602(c)(5)(C) were applied literally, it would preclude the application of the inheritance tax credit because of the change in property subject to tax. To avoid such an inequity, regulations analogous to those concerning the federal gift tax credit, which makes provision for taxation of property where the donee has disposed of the original property before the donor's death, would be helpful.
86. I.R.C. § 2602(c)(2).
87. I.R.C. § 2602(d).
88. I.R.C. § 2602(e).
89. See infra, n. 101.
90. I.R.C. § 2603(a). The personal liability of the distributee is limited under
personal liability in the trustee.\textsuperscript{92} It should be kept in mind that a generation-skipping tax may be computed long after the deemed transferor's death. By way of example, if the deemed transferor is participating in a right to income along with other members of the same generation in a trust where the separate shares cannot be determined, and he dies first, the generation-skipping tax is not computed until the death of the last life tenant. Obviously in this situation, records necessary to compute accurately the generation-skipping tax may not be available until such time. Procedures are outlined in the committee report whereby the Internal Revenue Service is required to provide the deemed transferor's marginal tax rate for purposes of the computation.\textsuperscript{93} The trustee is allowed to rely upon the marginal tax rate so supplied by the Internal Revenue Service and escapes tax liability if the tax turns out to be incorrect.\textsuperscript{94}

8. \textit{Return Filing.}

The filing of returns for the generation-skipping transfer is to be governed by regulations which have not yet been issued. However, the statute does provide guidelines for developing these regulations. A distributee will generally be responsible for filing a return in the case of a taxable distribution\textsuperscript{95} and the trustee will be responsible for filing a return in the case of a taxable termination.\textsuperscript{96} The return will be due on or before the ninetieth day after the close of the taxable year in which a taxable transfer occurred, if the transfer occurred before the death of the deemed transferor.\textsuperscript{97} If the transfer occurs at the same time as, or after the death of the deemed transferor, it is due on or before the ninetieth day after the last date prescribed by law for filing the estate tax return of the deemed transferor, or on the day which is nine months after the day on which transfer occurred, whichever is later.\textsuperscript{98}

In general, the provisions on generation-skipping transfers apply to all generation-skipping transfers made after April 30, 1976.\textsuperscript{99} There are exceptions. An irrevocable trust in existence on April 30, 1976 is subject to the terms of the new law, but only to the

\textsuperscript{92} I.R.C. § 2603(a)(3) to the extent of "an amount equal to the fair market value (determined as of the time of distribution) of the property received by the distributee in the distribution."

\textsuperscript{93} I.R.C. § 2603(a)(1)(A).

\textsuperscript{94} General Explanation, 579.

\textsuperscript{95} I.R.C. § 2603(a)(1)(A)(ii).

\textsuperscript{96} I.R.C. § 2621(c)(1)(B)(i).

\textsuperscript{97} I.R.C. § 2621(c)(1)(B)(ii).

\textsuperscript{98} I.R.C. § 2621(c)(1)(B)(ii).

extent that corpus was added to the trust after April 30, 1976. In the case of a decedent dying before January 1, 1982, if a transfer is made pursuant to a will or revocable trust which was in existence on April 30, 1976, the transfer will not be subject to the Act if no amendments made after April 30, 1976, have the effect of increasing the generation-skipping transfer. In the case of an incompetent testator or grantor of a revocable trust, the 1982 date is extended for a two-year period following the date on which he regains his competence. In effect then, all trusts which are irrevocable, in existence as of April 30, 1976, and to which additional funds are not added, are grandfathered and not subject to the new law. All wills and trusts in existence prior to April 30, 1976 which are not changed thereafter are grandfathered, provided that the decedent dies before January 1, 1982.

III. MONTANA LAW

Montana inheritance tax laws which affect the portion of a future interest taxed, were changed in the 1977 legislative session. Montana has traditionally imposed inheritance taxes in generation-skipping transfers. The important date to remember is July 1, 1977 because the new rules go into effect for estates of decedents dying on or after that date.

Let us compare the former Montana law to the federal rules and then highlight the changes made by the most recent Montana legislative assembly. If we use the example of the life interest with a general power of appointment in the surviving spouse, under the old Montana law there is no marital deduction created by use of the general power of appointment. Rather, the property in the life estate is treated, consistent with federal law, as passing to the spouse, but receives no special treatment other than the benefit of the use of the higher exemption available to the surviving spouse. If, on the other hand, the life tenant’s power to invade is limited to an ascertainable standard or a special power of appointment, an actuarial determination is made and an inheritance tax is paid on both the life estate and the remainder interest. Upon the subse-
quent death of the life tenant, or of the remainderman, no further inheritance tax would be due or payable. The reason is that the inheritance tax is imposed upon the privilege of receiving the property interest, and is therefore a liability owed by the beneficiary of the property, not by the estate as under federal law.107

The greatest change in these provisions which came about in the most recent legislative assembly was the amendment to Section 91-4414(3) which now states: "The clear value of one-half of the property distributed or passing to decedent’s surviving spouse is exempt." The Montana Supreme Court in Board of Equalization v. Power,108 defines what the statutory phrase "clear value" means:

... in our view the term is self-explanatory without further definition. Market value by its very language simply means value on the open market, i.e., the price which a buyer willing but not obliged to buy would pay a seller willing but not obliged to sell, both having full knowledge of all pertinent facts affecting value. 'Clear' as used in the phrase 'clear market value' is synonymous with the word 'net,' i.e., the market value after allowable deductions.

Based upon the interpretation given by the Montana Supreme Court, and the statutory exemption added by the amendment to Section 91-4414, certain conclusions can be reached.

In the case of a life estate coupled with a general power of appointment, no special consequences took place under the old Montana inheritance tax law, while under the new law one-half of the property "distributed or passing to decedent’s surviving spouse is exempt" from inheritance tax.

Two specific points should be made here. First, we are talking about an exemption from inheritance tax rather than a deduction as under federal law. Second, we are considering an exemption of one-half of the property distributed or passing to the surviving spouse as the surviving spouse’s net distributable share. In that regard, the recent case of In re Estate of Baier,109 which was decided by the Montana Supreme Court on August 15, 1977, is of decided interest. The estate in that case consisted of both joint property and property owned outright. In the estate, debts owing were secured by joint tenancy properties. The Personal Representative for the estate had deducted in full the obligations which were secured by the joint

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empowered to value future or contingent estates upon application of the Department of Revenue. Currently the Department of Revenue uses the American Experience Table to make actuarial determinations, and will make application to the Commissioner of Insurance only if it cannot apply the Table.


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tenancy property, while excluding one-half of the joint tenancy properties by means of the authority granted in Section 91-4405. The Department of Revenue argued that since the joint tenancies were includable only to the extent of one-half by statute, that the debts which related to the joint tenancy properties should also be deductible to the extent of one-half. In holding in favor of the estate, and against the Department of Revenue, the Court cited the Power decision which defined the phrase "clear market value" and stated that where the creditors have the right to enforce the entire obligation jointly and severally, the full amount of the deductions are allowed rather than merely one-half.110

Applying the principles of both the statute and the case law to the fact situation involving the life estate with a general power of appointment, it appears that all joint and several debts are fully deductible under Montana inheritance tax principles in arriving at the net distributive share passing to the surviving spouse.111 The exemption then available to the surviving spouse is one-half of the net distributable share so passing.112 In addition, the personal exemption for the surviving spouse was increased from $25,000 to $40,000113 and the personal exemption so stated is applied against the highest rate of inheritance tax rather than the lowest rate as under the old law.114

As an example, if the entire estate of the decedent, after all allowable deductions, consists of $200,000 and his will creates a life estate in the wife, coupled with a general power of appointment, remainder over to his children should the power not be exercised, the difference in tax impact of the new law as compared to the old is substantial. Under the old law, the distributive share taxed to the surviving spouse before her personal exemption is considered would be $200,000. Against the $200,000 net distributive share would be applied the $25,000 personal exemption, but that $25,000 exemption would be applied against the lowest tax rate, 2%. The balance of $175,000 would be subjected to tax as follows:

<table>
<thead>
<tr>
<th>Taxable Rate of</th>
<th>Exemption</th>
<th>Rate of</th>
<th>Total Tax Due</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>$25,000</td>
<td>2%</td>
<td>$12,000</td>
</tr>
<tr>
<td>25,000</td>
<td>0</td>
<td>4%</td>
<td>1,000</td>
</tr>
<tr>
<td>50,000</td>
<td>0</td>
<td>6%</td>
<td>3,000</td>
</tr>
<tr>
<td>100,000</td>
<td>0</td>
<td>8%</td>
<td>8,000</td>
</tr>
</tbody>
</table>

110. Id. at ___, 567 P.2d at 946.
Considering the same facts as above, except that the decedent dies after July 1, 1977, the net distributable share to the surviving spouse would again be $200,000 of which $100,000 would be exempt from inheritance tax. The tax would be computed as follows:

<table>
<thead>
<tr>
<th>Exemption</th>
<th>Taxable Share</th>
<th>Rate of Tax</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>$25,000</td>
<td>2%</td>
<td>$500.00</td>
</tr>
<tr>
<td>Second</td>
<td>25,000</td>
<td>4%</td>
<td>1,000.00</td>
</tr>
<tr>
<td>Next</td>
<td>50,000</td>
<td>6%</td>
<td>600.00</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>$2,100.00</td>
</tr>
</tbody>
</table>

As you can see from this simple example, there is a net tax savings of $9,900 if the decedent dies on or after July 1, 1977.

The exemption which is created in the surviving spouse has even more significance when viewed in connection with life interests. As indicated in the previous discussion, if a life estate is created with no general power of appointment, remainder over to children, an actuarial determination is made to determine the value of the life interest and the value of the remainder interest. If the life tenant is a surviving spouse, the portion of the life estate valued under the actuarial determination, and attributable to her is part of her net distributable share. Obviously then, one-half of the net distributable share would be exempt from tax under the new law. This result is contrary to the federal rule where no deduction would be allowed the surviving spouse because of the "terminable interest rules" under the marital deduction.115

To again compare the old and the new law, let us take the same estate consisting of a net distributable share of $200,000, and assume that the surviving spouse is given a life interest with no general power of appointment, remainder over to a single child. For these purposes, assume that the surviving spouse is 60 years of age. Under the American Experience Table,116 the factor for the surviving

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115. See I.R.C. § 2056(b).

116. American Experience Table with Interest at 5 Percent with Craig’s Extension Below Age 10.
spouse would then be 8.94928. Applying the formula against the life interest, 5% of $200,000 would be $10,000 times the factor for the

117. The formula for application of the American Experience Table is:
1. Multiply the net distributive share of the property in the estate subject to the life interest by 5%.
2. Determine the age of the life tenant.
3. Multiply the factor from the American Experience Table corresponding to the age of the life tenant by the figure arrived at in step 1.
4. Subtract the amount determined in step 3 from the total value of the property subject to the life interest.

The figure arrived at in step 3 is the value of the life interest. The figure arrived at in step 4
surviving spouse, so that the life interest value for Montana inheritance tax purposes would be $89,492.80. The value of the remainder interest to the child would then be $110,507.20. Under the old law, the inheritance tax for the surviving spouse would be computed as follows:

<table>
<thead>
<tr>
<th>Exemption</th>
<th>Taxable Share</th>
<th>Rate of Tax</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $25,000</td>
<td>25,000</td>
<td>2%</td>
<td>0</td>
</tr>
<tr>
<td>25,000</td>
<td>0</td>
<td>4%</td>
<td>1,000</td>
</tr>
<tr>
<td>39,492.80</td>
<td>0</td>
<td>6%</td>
<td>2,369.57</td>
</tr>
<tr>
<td>Total Tax Due</td>
<td></td>
<td></td>
<td>$3,369.57</td>
</tr>
</tbody>
</table>

Under the old law, the inheritance tax for the child, assuming the child to be an adult, would be computed as follows:

<table>
<thead>
<tr>
<th>Exemption</th>
<th>Taxable Share</th>
<th>Rate of Tax</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $25,000</td>
<td>2,000</td>
<td>2%</td>
<td>460</td>
</tr>
<tr>
<td>25,000</td>
<td>0</td>
<td>4%</td>
<td>1,000</td>
</tr>
<tr>
<td>50,000</td>
<td>0</td>
<td>6%</td>
<td>3,000</td>
</tr>
<tr>
<td>10,507.20</td>
<td>0</td>
<td>8%</td>
<td>840.57</td>
</tr>
<tr>
<td>Total Tax Due</td>
<td></td>
<td></td>
<td>$5,300.57</td>
</tr>
</tbody>
</table>

Under the new Montana law, applying the same facts, the inheritance tax for the surviving spouse would be computed as follows:

- Total value of net distributive share $89,492.80
- Less: Exemption of one-half $44,746.40
- Net distributive share $44,746.40
- Less: Exemption for surviving spouse $40,000.00
- Taxable Share $4,746.40
- Rate of Tax 2%
- Total Tax Due $94.92

The inheritance tax for the remainder interest would also change and be computed as follows:

<table>
<thead>
<tr>
<th>Exemption</th>
<th>Taxable Share</th>
<th>Rate of Tax</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $25,000</td>
<td>0</td>
<td>2%</td>
<td>500</td>
</tr>
<tr>
<td>25,000</td>
<td>0</td>
<td>4%</td>
<td>1,000</td>
</tr>
<tr>
<td>50,000</td>
<td>0</td>
<td>6%</td>
<td>3,000</td>
</tr>
<tr>
<td>10,507.20</td>
<td>7,000.00</td>
<td>8%</td>
<td>244.05</td>
</tr>
<tr>
<td>Total Tax Due</td>
<td></td>
<td></td>
<td>$3,744.05</td>
</tr>
</tbody>
</table>

The effective tax reduction, considering both life tenancy and remainder interests, therefore is $4,831.17.
Several points can be made relative to the change in the exemptions under the Montana inheritance tax laws. The first is that the Montana inheritance tax laws speak in terms of exemptions rather than deductions, as under federal estate tax law. The second point is that the exemption available to the spouse indirectly benefits the remainderman in a life estate situation, since only one-half of the life estate valued interest would be subjected to Montana inheritance law. The overall reduction of the properties of the estate necessary to pay the inheritance tax is reduced and thereby the remainderman's interest is increased. This is true even though the life tenant's interest as to the corpus of the tenancy is limited. The third point is that due to the fact that the inheritance tax is paid upon creation of the life estate and remainder interest under Montana law, no further reassessment of any inheritance tax will take place upon the subsequent death of the life tenant. This clearly distinguishes the Montana inheritance tax from the generation-skipping tax under federal law which can be imposed at a future time as previously discussed.118

Keep in mind that the exemption of one-half of the net distributable share is only an exemption available to a surviving spouse and is not available to the children or other heirs of a decedent. Moreover, although the legislature in its recent session did increase the exemption available to children of a decedent,119 it took away some of those benefits by taxing in full joint tenancies held between parent and child, rather than taxing them at one-half their value, as under the old law.120

IV. Conclusion

The use of future interests in estate planning can involve complex decisions based on distinctions of application under federal and state laws. There are still problems of interpretation which arise, and it will be some time before a complete understanding of the impact of the law, especially of the generation-skipping tax, is reached. As the federal statute itself notes, heavy reliance will be placed upon regulations to be issued by the Internal Revenue Service interpreting the generation-skipping provisions. It would appear that the coordination of the generation-skipping tax and the Montana inheritance tax may involve some difficulties. By way of example, under Montana inheritance tax laws, taxes due other governmental agencies, such as the federal estate tax and presumably the

118. See explanatory text to note 85.
generation-skipping tax, are deductible in determining the Montana inheritance tax. If the generation-skipping tax is determinable in the future and the Montana inheritance tax is determinable immediately on the future interests, because of the difference in the nature of the taxes, the fact situation can arise that the Montana inheritance tax will be paid without benefit of the deduction for the generation-skipping tax, although the generation-skipping tax would reduce the overall amount transferred to subsequent generations.