Lawyer 16 (Spring 2001); Levine & Weintraub, *When Does E-Commerce Result in a Permanent Establishment: The OECD's Response*, 29 Tax Mgmt Int'l J. 220 (April 14, 2000), and Sprague & Schindler, *Another Step Towards Uniformity: Relative Consensus of the OECD TAG on Income Characterization of E-Commerce Transactions,* 30 Tax Mgmt Int'l J. (June 8, 2001).

5. **EU & VAT**

E-commerce raises significant concerns under the Value Added Tax ("VAT") system operative in the EU. The European Commission proposed important changes in the VAT system effective January 1, 2001; the focus of these changes is on-line or electronic services sold by businesses from non-EU countries to EU consumers. For U.S. sellers in what are known as B2C (business-to-consumer) transactions, these changes could result in a significant loss of a competitive advantage they previously enjoyed.

6. **Internet Tax Freedom Act (ITFA), P.L. No. 105-277, Title XI, 112**

State business taxation of e-commerce is a highly controversial issue. Currently, ITFA imposes a three year moratorium to prevent the taxation of internet access (with the exception of certain pre-October 1, 1998 taxes) and multiple or discriminatory taxes on e-commerce. Recent legislation has been introduced to extend the October 21, 2001 sunset of this moratorium (H.R. 1552). Other legislation (H.R. 2526) which would exempt various internet-related activities from state business taxes is being considered; H.R. 2526 would limit such state taxes if: (1) the company's internet site is accessed by residents of the state, (2) the company leases property in the state for less than 30 days, (3) the company only uses an internet service provider that is physically located in the state, or (4) the company's employees are physically present in the state for less than 30 days. The Senate Finance and Commerce Committees also are focusing on the question, with the Commerce Committee seeking to combine the extension of ITFA with the grant of authority to states to collect sales and use taxes for out-of-state transactions, provided the states agree to certain simplifications of their tax rates and administration. How these issues and differences between the House and Senate approaches will be resolved is uncertain.

7. **Staying Current**

Staying abreast of both U.S. and foreign developments in e-commerce taxation has become daunting. Kuntz and Peroni, U.S. International Taxation (WG&L), ¶ A1.01, footnote 34, provides a relatively current bibliography for the taxation of global e-commerce, and BNA International Inc.'s Tax Planning International E-Commerce is a specialized monthly publication that will allow you to keep up with current developments. Several issues needing Treasury guidance are addressed in Jensen, *Selected Issues in Cross-Border Electronic Commerce Transactions*, 24 Tax Notes Int'l, 157 (2001).

SURPRISE: THE MARITAL DEDUCTION IS NOT ALWAYS AVAILABLE

by Alexander Drapatsky, Chicago, IL

Section 2056 provides an unlimited federal estate tax marital deduction for qualifying dispositions of property to or for the benefit of a decedent's surviving spouse. Through optimum use of this deduction, a married couple can usually defer all federal estate transfer taxes until the death of the surviving spouse. Nevertheless, the marital deduction is not always available when it might appear to taxpayers that it should be.

In order for an estate to take advantage of the marital deduction, the property passing to the surviving spouse must: (1) be included in the decedent's gross estate, (2) actually "pass", (3) to a "surviving spouse," and (4) not be a terminable interest. The "passing" requirement is broadly defined to include interests that a surviving spouse acquired by will, intestate succession, elective share, right of survivorship, or pursuant to a beneficiary designation.

Not surprisingly, for the marital deduction to apply a marriage must exist. In a recently issued technical advice memorandum, PLR 200132004 (Apr. 25, 2001), the Service followed its traditional rule that state law will determine whether a marriage exists. The facts leading up to this TAM were that a decedent participated in a 33-year cohabitation relationship with a person of the opposite sex. During the course of their relationship, they sometimes presented themselves in public as a married couple, but they filed separate income tax returns (although some claimed married filing separately status), and there was no evidence they were ever formally married. Shortly prior to the decedent's death, his companion suffered a stroke. While she was recuperating, the decedent notified her that she was no longer welcome at his house, where she had been living for 33 years. The decedent's will did not make any provisions for his companion.

After the companion's guardians sued the estate, the parties reached a settlement, which the executrix of the estate attempted to deduct under section 2056(a), as an amount passing to a decedent's spouse. The Service disagreed, ultimately concluding that since the decedent was not married under state law, the marital deduction was unavailable.

In PLR 200132004, the Service took the position that it will look to the law of the state where the decedent resides to determine whether a marriage existed for purposes of the marital deduction. Thus, the Service will look to the highest court of that state to determine whether a particular arrangement will be classified as a

marriage. If the highest court of that state has not ruled and lower courts are in conflict, the Service will determine what constitutes a marriage in light of other rulings, if any, of the courts of that state. Under those circumstances, the Service is likely to adopt a narrow view of what type of arrangement will constitute a marriage, precisely as it did in this case.

After concluding that a common law marriage contracted in the decedent's state would not be valid, the Service went on to note that the courts of that state would uphold the validity of a common law marriage contracted in another state. It therefore became necessary to determine whether two states that the decedent and his companion visited would have viewed them as common law spouses. After a lengthy review of the law of those two states, the Service concluded that the highest court of the state in which the decedent had resided would not conclude that the decedent and his companion entered into a common law marriage while traveling in the other states.

The marital deduction may not be available even where an estate has satisfied the Service that a marriage existed. For example, in *Estate of Mergott v. U.S.*, 86 A.F.T.R. 5877, 2000-2 USTC ¶ 60,383 (D.N.J. 2000), a widow filed an action against her husband's estate and the action was settled out of court. However, under state law the widow did not have an enforceable right to settle her claims against the estate in exchange for a lump-sum payment. Therefore, the Tax Court held that the lump-sum payment to the widow was not a bona fide recognition of her enforceable rights under state law and did not qualify for the marital deduction.

Nevertheless, a surviving spouse's successful will contest does not always render the marital deduction unavailable. In PLR 200127038 (Apr. 10, 2001), a widow contested her husband's will and received a court-sanctioned settlement. The Service concluded that property passing pursuant to the settlement would be treated as passing from the decedent for purposes of the marital deduction only if the distribution represented a bona fide, arm's length, settlement of a legally enforceable claim.

What differentiates *Estate of Mergott* (which disallowed a marital deduction) from PLR 200127038 (which allowed it) is that the surviving spouse in the ruling had a legally enforceable right in the decedent's estate. Such a right can result from operation of law, a court ruling, or a court-sanctioned settlement. By contrast, in *Estate of Mergott*, the settlement occurred out of court.

Mergott reminds us that will contests can have unintended estate tax consequences. Before agreeing to a settlement, an executor should consider whether the settlement amount will qualify for the marital deduction. In this area, a little planning can produce significant savings. ■

FROM THE **EDITOR**

FROM PAGE 7

Chris' inaugural Point/Counterpoint is a spirited debate on the taxation of the foreign-source business income of U.S. corporations. Cliff Fleming, Bob Peroni and Steve Shay argue that U.S. corporations ought to be taxed on their worldwide income and that the current system, which defers taxation of the active business income derived by such corporations, ought to be repealed. At the opposite end of the spectrum, Herm Bouma argues that the current system ought to be expanded so that deferral is made permanent; that is, so that the foreign source income of U.S. corporations is never subject to U. S. tax. The debate on this question is certain to continue for some time and their discussion provides a good introduction to the important issues on each side.

The Points to Remember in this issue take us from international e-commerce to the intricacies of the estate tax marital deduction and even to income tax planning for higher education expenses. Nancy Beckner provides us with a primer on the issues we must consider if we have clients engaged in international e-commerce. Her Point provides a list of references for further guidance and should be useful to anyone with clients who are, or will be, engaged in transnational e-commerce. David Silverman introduces us to section 529 Plans, which promise to become the vehicle of choice for college saving by high bracket individuals. His Point provides us with the information we will need to decide whether investing in such a Plan is desirable, either for ourselves or for our clients. Alexander Drapatsky provides us with a glimpse into the world of unmarried co-habitants and widows who challenge their husbands' wills. His Point reminds us that sometimes the marital deduction is unavailable, leaving the estate with a tax large tax bill even though a spouse (legally or functionally) actually received the property from the estate.

Finally, I am delighted to introduce a new item. In "Spotlight on Committees" I want to feature committee work that might not be familiar to many of our members. By featuring different committees in every issue, I hope not only to give members a sense of the range of work undertaken by the Section, but also to encourage other members to join in that work. We begin by featuring the Diversity Committee and the State and Local Tax Committee, two committees that have produced best-selling publications and forged new paths by working together to co-sponsor programs with one another as well as with other groups. The range of their activities will surprise and inspire you. ■