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RECENT DEVELOPMENTS

Testamentary Option To Purchase Realty Can Be Exercised Under Anti-Lapse Statute by Heirs of Beneficiary— *Tuecke v. Tuecke**

Testator devised his farm to his son and two daughters. The son, who predeceased his father, was bequeathed an option to purchase the daughters' two-thirds interest in the farm for a specified amount. Over the objection of the daughters, the heirs of the son sought to exercise the option under an anti-lapse statute.¹ The trial court concluded that the son's heirs had inherited the right to purchase. On appeal to the Supreme Court of Iowa, *held*, affirmed. An option to purchase is a valuable property right inheritable under an anti-lapse statute.

The common-law rule that a bequest lapses when the beneficiary predeceases the testator² is altered by anti-lapse statutes, which create a presumption that the testator would have preferred that the bequest be distributed to the heirs of the beneficiary.³ The presumption, however, does not seek to overcome indications that the testator

* 131 N.W.2d 794 (Iowa 1964) (hereinafter cited as principal case).

1. "If a devisee die before the testator, his heirs shall inherit the property, unless from the terms of the will, the intent is clear and explicit to the contrary." IOWA CODE ANN. § 633.273 (1964).

2. See generally 6 PAGE, WILLS §§ 50.10-13 (Bowe-Parker ed. 1962).

3. See generally Bordwell, *The Statute Law of Wills—Death of Devisee or Legatee Before Testator*, 14 IOWA L. REV. 428 (1929); Mechem, *Some Problems Under Anti-Lapse Statutes*, 19 IOWA L. REV. 1 (1933).

All but four states—Hawaii, Louisiana, New Mexico, and Wyoming—have anti-lapse statutes. See ALA. CODE tit. 61, § 16 (1958); ALASKA STAT. § 13.05.190 (1962); ARIZ. STAT. ANN. § 14-133 (1956); ARK. STAT. ANN. § 60-410 (Supp. 1965); CAL. PROB. CODE § 92; COLO. REV. STAT. ANN. § 153-5-10 (1963); CONN. GEN. STAT. REV. § 45-176 (1958); DEL. CODE ANN. tit. 12, § 2313 (1953); D.C. CODE ANN. § 19-110 (1961); FLA. STAT. § 731.20 (1963); GA. CODE ANN. § 113-812 (1959); IDAHO CODE ANN. § 14-323 (1948); ILL. REV. STAT. ch. 3, § 49 (1963); IND. ANN. STAT. § 6-601(g)(2) (1953); IOWA CODE ANN. § 633.273 (1964); KAN. GEN. STAT. ANN. § 59-615 (1949); KY. REV. STAT. §§ 394.440, 410 (1962); ME. REV. STAT. ANN. tit. 18, § 1008 (1964); MD. ANN. CODE art. 93, § 354 (1964); MASS. GEN. LAWS ANN. ch. 191, § 22 (Supp. 1964); MICH. COMP. LAWS § 702.11 (1948); MINN. STAT. § 525.203 (1961); MISS. CODE ANN. § 660 (1956); MO. REV. STAT. § 474-460 (1959); MONT. REV. CODES ANN. § 91-139 (1964); NEB. REV. STAT. § 30-228.03 (1964); NEV. REV. STAT. § 133.200 (1963); N.H. REV. STAT. ANN. § 551.12 (1955); N.J. REV. STAT. § 3A:3-13 (1951); N.Y. DECED. EST. LAW § 29; N.C. GEN. STAT. § 31-42 (Supp. 1963); N.D. CENT. CODE § 56-04-20 (1960); OHIO REV. CODE ANN. § 2107.52 (Page 1954); ORLA. STAT. tit. 84, § 142 (1961); ORE. REV. STAT. § 114.240 (1963); PA. STAT. ANN. tit. 20, § 180.14(8) (1950); R.I. GEN. LAWS ANN. § 33-6-19 (1956); S.C. CODE ANN. § 19-237 (1962); S.D. CODE § 56.0232 (1939); TENN. CODE ANN. § 32-306 (1955); TEX. PROB. CODE § 68 (1956); UTAH CODE ANN. § 74-1-35 (1953); VT. STAT. ANN. tit. 14, § 558 (1958); VA. CODE ANN. § 64-64 (1950); WASH. REV. CODE § 11.12.110 (1959); W. VA. CODE ANN. § 4054 (1961); WIS. STAT. § 238.13 (1963).

desired that the gift be valid only if the beneficiary survived him.⁴ Nevertheless, in the principal case the court applied the statutory presumption without examining the survivorship characteristics of options. Such an examination would have made it substantially more difficult for the court to allow the heirs to exercise the option.

One line of authority the court should have considered holds that testamentary options are personal as a matter of law, and are therefore incapable of exercise after the optionee's death.⁵ The court could have rejected this authority on one of two grounds. The holdings are either inadequately supported⁶ or based on the mistaken idea that the optionee has no rights with respect to the property before exercising the option.⁷ A second line of authority bases the question of survivorship on testamentary intent.⁸ Because of the difficulty of interpreting intent, these decisions provide no certainty that an option will be held to survive. An examination of the testator's intent in the principal case would have forced the court to resolve the question of whether a testator normally intends to benefit his children's heirs at the expense of his own children. The amount to be paid by the son's heirs in exercise of the option was less than two-thirds of the fair market value of the farm.⁹ The effect of the decision, therefore, is that the son's heirs acquire the farm, while the daughters receive less than a proportionate share of its value.

Even if it can be said that the testator intended to benefit his son's

4. The statutes merely change the common-law rule that all bequests, regardless of the inheritability of the property, lapse upon the beneficiary's predeceasing the testator. 6 PAGE, *op. cit. supra* note 2, § 50.10, at 77. They do not create a survivable interest where none was intended. Therefore, if a bequest is not intended to survive the beneficiary's death when the beneficiary outlives the testator (in which case the anti-lapse statutes do not apply), the statutory presumption should not cause the same bequest to survive when the beneficiary happens to predecease the testator.

5. See *Valley Bank & Trust Co. v. Williams*, 46 Ariz. 20, 46 P.2d 645 (1935); *Ludwick's Estate*, 269 Pa. 365, 112 Atl. 543 (1921); *Adams v. Adams*, 95 W. Va. 187, 120 S.E. 590 (1923); *Mohn v. Mohn*, 148 Iowa 288, 126 N.W. 1127 (1910) (dictum); *Brown v. Brown*, 53 N.M. 379, 208 P.2d 1081 (1949) (dictum). See also 1 JARMAN, WILLS 73 (7th ed. 1930).

6. Some of the cases made no attempt to support, either by citation of authority or by policy arguments, the statement that options are personal. See, e.g., *Valley Bank & Trust Co. v. Williams*, *supra* note 5; *Brown v. Brown*, *supra* note 5. Other cases have cited and relied upon a statement in 40 CYCLOPEDIA OF LAW AND PROCEDURE 1973 (1912), which refers to election between the will and a statutory share, rather than to options. See, e.g., *Ludwick's Estate*, *supra* note 5; *Adams v. Adams*, *supra* note 5.

7. See, e.g., *Mohn v. Mohn*, 148 Iowa 288, 126 N.W. 1127 (1910), citing *Conn v. Tonner*, 86 Iowa 577, 53 N.W. 320 (1892), which adopted this view. In fact, purchase options carry with them legally protected rights not to have the property destroyed or conveyed to a third party with notice during the life of the option. See 1A CORBIN, CONTRACTS § 272, at 579 (1963).

8. See, e.g., *Lucas v. Scott*, 239 Fed. 450 (9th Cir. 1917); *Stern v. Stern*, 410 Ill. 377, 102 N.E.2d 104 (1951); *Miller v. Farmer's Bank*, 312 Ky. 321, 227 S.W.2d 429 (1950); *Parker v. Seeley*, 56 N.J. Eq. 110, 38 Atl. 28 (Ch. 1897); *Boshart v. Evans*, 55 Pa. (5 Wharton) 551 (1840); *Skelton v. Younghouse*, [1942] A.C. 571. See also 1 JARMAN, WILLS 68 (8th ed. 1951).

9. Principal case at 795.

heirs at the expense of his own children, the court completely overlooked a serious problem posed by the Rule Against Perpetuities. Options without any time limit are invalid under the Rule as contingent interests which might fail to vest within lives in being plus twenty-one years.¹⁰ Courts seek to remove will options from the operation of the Rule by construing them to be personal to the optionee, for if the option is personal it extends only to one life in being and thus cannot exceed the perpetuities period.¹¹ However, the court in the principal case could not have used this means of avoiding the Rule because in holding that the unexercised option could be exercised by the heirs of the optionee, the court had already decided that the option was not personal. Thus, to allow the heirs of the son to exercise the option, it appears that the court must hold the option non-personal for the purpose of inheritability and yet personal to avoid the Rule.¹² Because of the obvious inconsistency of such a position, it would seem that a proper application of the Rule in the principal case would have invalidated the heirs' exercise of the option.

A tax problem not readily apparent in the principal case further illustrates the questionable value of options as testamentary devices. Generally, the basis of purchased realty from which taxable gain is measured is cost,¹³ but the tax basis of inherited realty is its fair market value at the date of the testator's death.¹⁴ Therefore, if the realty increases in value while held by the testator, it will be in-

10. See, e.g., *Maddox v. Keeler*, 296 Ky. 440, 177 S.W.2d 568 (1944); *Eastman Marble Co. v. Vermont Marble Co.*, 236 Mass. 138, 128 N.E. 177 (1920); *Barton v. Thaw*, 246 Pa. 348, 92 Atl. 312 (1914); *Skeen v. Clinchfield Coal Corp.*, 137 Va. 397, 119 S.E. 89 (1923); *Woodall v. Bruen*, 76 W. Va. 193, 85 S.E. 170 (1915). *Contra*, *Todd v. Citizens' Gas Co.*, 46 F.2d 855 (7th Cir.), cert. denied, 283 U.S. 852 (1931); *Keogh v. Peck*, 316 Ill. 318, 147 N.E. 266 (1925); *Hollander v. Central Metal & Supply Co.*, 109 Md. 131, 71 Atl. 442 (1908).

For criticism of the view that the Rule applies to testamentary options, see SIMES & SMITH, *FUTURE INTERESTS* § 1244, at 159 (2d ed. 1956); Berg, *Long-Term Options and the Rule Against Perpetuities*, 37 CALIF. L. REV. (2 pts.) 1, 235, 236-57 (1949); Leach, *Perpetuities in a Nutshell*, 51 HARV. L. REV. 638, 660 (1938).

11. E.g., *Weitzmann v. Weitzmann*, 87 Ind. App. 236, 161 N.E. 385 (1928); *In re Hauser's Will*, 50 N.Y.S.2d 709 (Surr. Ct. 1944); *Mattern v. Herzog*, 367 S.W.2d 312 (Tex. 1963).

12. An alternate approach might have been to construe the option as exercisable only within a reasonable time, such as the length of time required to probate the estate. See, e.g., *Ashmore v. Newman*, 350 Ill. 64, 183 N.E. 1 (1932); *Abens v. Kennedy*, 314 Ill. 35, 145 N.E. 100 (1924). There is nothing in the principal case, however, to indicate that the testator intended to limit the beneficiary to a reasonable time. If the option is inherited by the heirs, there would seem to be no reason to limit them either. In addition, the reasonable-time construction is questionable in view of the generally asserted proposition that the Rule applies whenever a contingent interest might possibly fail to vest within the perpetuities period. See, e.g., *Lilley's Estate*, 272 Pa. 143, 116 Atl. 392 (1922); SIMES & SMITH, *op. cit. supra* note 10, § 1228.

13. INT. REV. CODE OF 1954, § 1012

14. INT. REV. CODE OF 1954, § 1014.

herited with a stepped-up basis, thereby reducing the potential tax liability. However, courts have consistently denied an optionee the more favorable basis, holding that even though an option is inherited, the property subject to the option is purchased, and thus acquires a basis equal only to the amount paid in exercise of the option.¹⁵ In the principal case, the potential tax advantage of the stepped-up basis was lost, since the basis of the interest in the farm obtained by the son's heirs is the amount for which it was purchased under the option, rather than its fair market value.¹⁶

Alternatives to the testamentary option which accomplish the same result and yet avoid its disadvantages are a devise of the property on condition subsequent that money be paid, and a devise subject to a charge in favor of the persons to receive payment from the devisee. The choice to be made by the draftsman will depend on the effect the testator desires to accord the devisee's failure to make payment. If the testator wishes to give other heirs a right of entry to defeat the interest of the non-paying devisee, the draftsman should make payment a condition subsequent.¹⁷ If the testator wants the devisee to retain his interest even if he fails to make payment, a charging clause imposing a lien on the interest in favor of the person to whom the money is to be paid should be used.¹⁸ Either alternative would vest an immediate,¹⁹ traditionally inheritable interest²⁰ that

15. *Kalbac v. Commissioner*, 298 F.2d 251 (8th Cir. 1962); *Valleskey v. Nelson*, 271 F.2d 6 (7th Cir. 1959), *affirming* 168 F. Supp. 636, *cert. denied*, 361 U.S. 960 (1960) (E.D. Wis. 1958); *Mack v. Commissioner*, 148 F.2d 62 (3d Cir.), *cert. denied*, 326 U.S. 719 (1945).

16. It has been forcefully argued that since the optionee surrenders not only the amount paid in exercise of the option but also the market value of the option, the cost (and thus the basis) of the property acquired by option should include both. If this argument were accepted, the stepped-up basis would not be lost. The cost basis under § 1012 of the Internal Revenue Code would be identical to the stepped-up basis under § 1014, for the market value of property subject to an option is theoretically equivalent to the amount paid in exercise of the option plus the market value of the option. The argument, however, was reluctantly rejected when first raised in *Mack v. Commissioner*, *supra* note 15. The argument was raised again in *Kalbac v. Commissioner*, *supra* note 15, but since it was presented for the first time on appeal, the circuit court did not consider the question.

17. *SIMES & SMITH*, *op. cit. supra* note 10, § 151.

18. See *Thompson v. Thompson*, 175 S.W.2d 885 (Mo. 1943); *Friesz v. Friesz*, 344 Mo. 698, 127 S.W.2d 714 (1939); *In re Simard*, 98 N.H. 454, 102 A.2d 508 (1954); 6 *PAGE*, *op. cit. supra* note 2, § 51.4.

A draftsman who wishes to make payment a condition subsequent should make this explicit, since courts prefer to construe gifts requiring the payment of money by the beneficiary as subject to charges rather than conditions. See, *e.g.*, *Schrader v. Schrader*, 158 Iowa 85, 139 N.W. 160 (1912).

19. See *Horn Estate*, 351 Pa. 131, 40 A.2d 471 (1945) (vested fee subject to divestment gives devisee right to interim rents). Compare *Estate of Bosse*, 246 Wis. 252, 16 N.W.2d 832 (1944) (options give no right to profits until exercised).

20. *I.e.*, a fee simple on condition subsequent, or subject to a charge. See 2 *POWELL, REAL PROPERTY* ¶ 180 (1950).

does not violate the Rule Against Perpetuities.²¹ Moreover, for tax purposes the courts appear willing to regard a vested interest subject to conditions or charges as taken by inheritance, thereby allowing a stepped-up basis.²²

21. GRAY, RULE AGAINST PERPETUITIES § 205 (4th ed. 1942).

22. See, e.g., *Kalbac v. Commissioner*, 298 F.2d 251, 254 (8th Cir. 1962): "No doubt, if [testator] . . . had realized the tax consequences to petitioners of granting them in his will an option to buy at a low price the stock of his Company, he would instead, have left the stock to them outright, subject perhaps to a lien or charge in favor of his estate . . ." See also *Valleskey v. Nelson*, 168 F. Supp. 636 (E.D. Wis. 1958), *aff'd*, 271 F.2d 6 (7th Cir. 1959), *cert. denied*, 361 U.S. 960 (1960) (implying that any vested interest would fall within what is now § 1014).