Chapter 11

PAYING ESTATE OBLIGATIONS

The obligation to pay debts, expenses, and taxes is a complex subject. It demands as much separate consideration as any dispositive provision in a will or trust. You may not expect to represent estates sizeable enough to require payment of federal estate tax, but there are state and even local wealth transfer taxes, plus income taxes incurred during estate administration, along with debts and expenses that can consume a significant portion of some decedents' wealth. This makes the provision directing payment of these liabilities an important provision in the estate plan. Yet many drafters regard this provision as boilerplate and give little individualized attention to it. This Chapter illustrates that this lack of attention is a prescription for error.

To assist readers who come to this study with varying degrees of knowledge, this discussion is organized to provide a few illustrations of why this topic is so important and how easy it is to mess up. Then follows a summary of federal and state rules regarding the time and source of payment, elaborating on what happens in the absence of other controlling principles, such as contrary will or trust provisions. Readers who are familiar with these fundamental principles may want to skip to the discussion of planning aspects of the apportionment rules, and readers who must prepare payment provisions will find that the final segment relates to drafting considerations.

Included at the very end is a sample payment provision. If you will look at page 43 and thereafter, ask yourself as you read whether a six page provision *really* is necessary! The secret is to delete what you don't need in appropriate cases. But that requires individuated attention to this topic in every estate, which is what most planners fail to do. If you treat this as boilerplate, which provisions could you safely delete? Those are the drafting issues at stake here.

Tax Payment Burden on the Residue

Under §2002 of the federal estate tax,[1] the initial obligation to pay the *entire* federal estate tax imposed on a decedent's gross estate (probate and nonprobate property alike) rests on the decedent's personal representative,

1. "The tax imposed by this chapter shall be paid by the executor." Executor is defined by §2203 to mean "the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent."

regardless of the fact that certain assets includible in the gross estate for federal estate tax purposes may not be in the possession or control of that fiduciary. This primary obligation is so extensive that any recipient of nonprobate property included in the gross estate who is compelled to pay a portion of the estate tax (for example, under transferee liability rules in §6324(a) or §6901(a)) is entitled under §2205[2] to reimbursement from the personal representative.

By virtue of the §2203 definition of executor, only "if there is no executor or administrator appointed, qualified, and acting [does] any [other] person in actual or constructive possession of any property of the decedent" become initially liable for payment of the tax. And even then the person paying the tax is entitled to reimbursement from the residue of the decedent's estate. This federal burden on the residue matches traditional common law.

To illustrate how problematic this can be, consider the following example, based on the actual result in Collier v. First National Bank, 417 S.E.2d 653 (Ga. 1992). The decedent created a revocable inter vivos trust and, because local probate procedure was not cumbersome, she also sought certain income tax advantages that were available to probate estates but not to will substitute living trusts. Thus, the decedent provided that the trust would pour back into her estate at death and be distributed from the estate to the intended remainder beneficiaries. The residue of the decedent's probate estate benefited children by a second marriage. The trust remainder went by preresiduary bequest to children of a first marriage because the trust corpus was monies inherited by the decedent from that first spouse. The decedent's will contained a traditional burden on the residue tax (and debts and expenses) payment provision that waived all rights of reimbursement.

The decedent was a domiciliary of Georgia, a state that applied the traditional common law burden on the residue rule. As a result, state law did not require apportionment of the estate tax liability among the recipients of the various assets includible in the decedent's gross estate. Nor did the decedent's will. The trust corpus that was includible in the estate passed to the children by the first marriage under the preresiduary bequest, leaving the residue of the decedent's probate estate to pay all taxes on the entire estate.

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2. Stating:

If the tax or any part thereof is paid by, or collected out of, that part of the estate passing to or in the possession of any person other than the executor in his capacity as such, such person shall be entitled to reimbursement out of any part of the estate still undistributed or by a just and equitable contribution by the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts or other charges against the estate, it being the purpose and intent of this chapter that so far as is practicable and unless otherwise directed by the Will of the decedent the tax shall be paid out of the estate before its distribution.

Not surprisingly, the children of the decedent's second marriage, as residuary beneficiaries of the estate, perceived the inequity of this plan and claimed they were entitled to reimbursement for the taxes attributable to the inter vivos trust, notwithstanding the tax payment provision in the decedent's will and its apparent waiver of all rights of reimbursement. They argued that a federal right of reimbursement (under §2207B, which is discussed at page 18) applied and that, by its express provisions, it could not be waived without making specific reference to it, which they claimed was lacking in this case.

The children of the first marriage rejoined that the §2207B right of reimbursement was not available because it applies only if property is includible in the decedent's gross estate under §2036, and they alleged that the inclusion provision was either §2033 or §2038, not §2036. The Georgia Supreme Court "resolved" the dispute by saying:

> [T]he [parties] argue that the trust assets are includable in the decedent's gross estate . . . under different sections of the Internal Revenue Code, each with different estate tax [payment] consequences.
>
> The question of whether the transfer of these assets from the decedent . . . casts tax liability on the estate or upon the trust must be answered under the Internal Revenue Code. As such, it is beyond the jurisdiction of this court.

Indeed, on that all-important issue there appears to be no direct authority. By the way, the children of the first marriage won in *Collier*, the residuary bequest to the children by the second marriage was wiped out, and the only recourse they had was to sue the drafting attorney.

In one sense the government does not care about the issue in *Collier*, as long as the property does not escape tax altogether. Rev. Rul. 75-553 involved similar facts to *Collier* and the government stated that "the trust corpus is payable to the decedent's estate and [therefore] is property of the decedent within the meaning of section 2033 and is includible in the gross estate only under that section." This caused the government to lose the opportunity to assert a lien against the trustee for transferee liability. Again under Private Letter Ruling 8940003 a trust was subject to §2033 inclusion instead of §2036 and the government lost the opportunity to assert application of §2035(a)(2) with respect to property distributed from the trust within three years of the decedent's death. Both authorities, which are directly adverse to the government's interest, nevertheless held that §2033 is the proper inclusion result, which is a strong indication that the proper inclusion provision in the *Collier* example was §2033 as well. Which would produce the "wrong" (at least a very unfair) tax apportionment result. But see Technical Advice Memorandum 9015001. On such an important question it really is notable that (to this day) we don't know the "right" answer.

In one respect the conclusion that §2033 is the proper inclusion provision is fitting because §2033 is the all-purpose inclusion rule for property owned by a decedent at death; §§2036 and 2038 are inclusion provisions designed to cause inclusion of property that §2033 does not reach. Thus, as a matter of statutory construction, it ought to be that application of §2033 precedes all other inclusion provisions. If it is adequate to cause inclusion, then no other provision applies. In the case illustrated this conclusion was asserted to be particularly apt because it would produce the same result as under local law. Although the result appears inequitable to the children by the second marriage, it is the result that would have applied had the decedent died without a will and, assuming that the estate plan was drafted with these rules in mind, presumably it represented the decedent's intent. Quaere, however, whether the documents indicate that the drafter considered this issue at all: a well crafted plan would have anticipated this issue and addressed it to state the decedent's particular intent either way, especially because the outcome (and maybe the inferred intent) appear to be inequitable.

In any event, the net result was that there was no definitive answer to the question whether §2207B applied in *Collier*. Indeed, to further illustrate how difficult this area of the law can be, §2207B was not even enacted when the trust and will were executed. As a result, the decedent's plan worked a significant and potentially unintended inequality, as did the traditional state law burden on the residue rule, yet nothing indicated that it was not the decedent's intent. And nothing changed it, which meant that the children by the second marriage effectively were disinherited, because the tax on the trust exhausted the residue.

Lest the former example be dismissed as unusual because of the pour back provision to the decedent's probate estate at death, consider that the exact same issue would arise even if the trust distributed directly to the children by the first marriage. That is true because the application of §2207B still would be in doubt. The §2207B reimbursement right would exist if the property was includible in the decedent's gross estate under §2036(a)(1) because of the retained life estate in the trust. But §2207B reimbursement would not exist if the property was includible in the decedent's gross estate under §2038(a)(1) because the trust was revocable until death.

There has not been an occasion in a federal estate tax case to question which of those two provisions applies in a garden-variety revocable trust case, the assumption being that the trust corpus is includible and, if it is not includible twice, it does not matter under which provision. Now that question may need to be answered, depending on what the decedent's tax payment provision provides and how the trust property and the balance of the decedent's estate are distributable.

The issue *was* addressed by *In re* Estate of Meyer, 702 N.E.2d 1078, 1081 n.3 (Ind. Ct. App. 1998), citing Treas. Reg. §20.2031-1(a)(2) for the proposition that there is overlap among inclusion provisions such as

§§2036 and 2038 and that property may be includible under more than one. *Meyer* stated that the trust beneficiaries' argument ("without citing to any authority") that the trust property was "more properly included" under §2038 than §2036 and, therefore, that the §2207B reimbursement right did not exist, "is without merit because the two sections are not mutually exclusive." So, the right of reimbursement *does* exist? That just shifts the *Collier* issue to whether the waiver of reimbursement provision was effective and what did the decedent *really* understand or intend. Do you doubt the drafter screwed up if these questions must be resolved by litigation?

A client does not need to have an elaborate or unusual dispositive plan to illustrate that the state law burden on the residue rule may be inappropriate or that payment provisions require deliberate consideration in even simple, commonplace estate plans. By way of example, picture the plan addressed by *In re* Estate of Maierhofer, 767 N.E.2d 850 (Ill. App. Ct. 2002). The testator intended to provide equal shares of the estate to two siblings, and bequeathed a specific property to one of them and then distributed the residue with an equalization provision designed to provide a larger share to the other sibling so that, in the end, each took equal value.

Unfortunately the residue was insufficient to accomplish the equalization (even if the second sibling took the entire residue) and was even more inadequate because the will called for payment of estate taxes, on both the preresiduary devise and the balance of the estate, all from the residue. The court rejected a pro rata tax apportionment scheme proposed by the second sibling because the clear language of the will directed payment of taxes from the residue, which put the burden disproportionately on the second sibling rather than on the siblings equally. Notwithstanding the other clear object of the will, that the two siblings emerge from probate with gifts of equal value, state law (it was a burden on the residue jurisdiction) and the document failed in that result in *Maierhofer*.

You could guarantee equality by substituting for the preresiduary devise a simple equal division of the residue, with the one sibling's share to be funded first with the specified realty. Because that property exceeded half the value of the estate, the one sibling could have been required to purchase the other's share or simply accept less than 100% ownership. Perhaps neither of those consequences was palatable to the testator. Or perhaps the estate planner never thought about them (and merely drafted what the client described without any real evaluation of the overall consequences). Imagine the second child's distress. And the subsequent malpractice suit!

Tax payment problems also can be generated simply because a client is married, because the unlimited marital deduction makes it possible to defer payment of all federal (and most states') wealth transfer tax until the death of the surviving spouse. The risk of deferral is bankrupting the surviving spouse's estate if the source for tax payment at that time is not properly specified or considered. Further, the increase in the number of second marriages requires a reappraisal of both the appropriate size of a bequest to a surviving spouse (if there are children by a prior marriage), and the proper allocation of tax liability at the survivor's death.

Issues can arise even in a single marriage situation if the decedent does not want to make the children wait until the surviving spouse's death to receive all of their inheritance. In that case there must be a source for payment of taxes in the estate of the first spouse to die, which inevitably will reduce the share left to either object of the client's bounty if taxes attributable to nonmarital bequests exceed the amount of the available unified credit.

Further, in conjunction with postmortem planning that involves the marital deduction, it is necessary to consider the source for payment of taxes caused by the surviving spouse's partial disclaimer of a marital deduction bequest, or a partial QTIP election.

It also pays to consider the unexpected. Imagine an asset or disposition about which the decedent never told the estate planner and that impacts the marital deduction and therefore the tax liability in totally unexpected ways. A fine illustration of this (albeit one that isn't likely to be encountered in just every estate plan) highlights the consequences of placing the burden of tax payment on the residue of an estate without knowing all the facts. (Indeed, is it *ever* possible to know *all* the facts?) The case involves a decedent's shadow estate plan, disposing of unknown assets to unknown beneficiaries. It was *In re* Estate of Kuralt, 981 P.2d 771 (Mont. 1999), which ultimately determined that a handwritten letter was a valid holographic will. This was not the decedent's well-crafted and fully executed document that disposed of the bulk of the decedent's wealth to the decedent's family. Instead, this was the one the decedent penned from a hospital room while dying, leaving property in Montana that the estate planner (indeed, the family) didn't know existed, to a beneficiary that neither the family nor the estate planner knew about.

In other cases the unknown asset might be an insurance policy payable to comply with some unrevealed promise or obligation (such as to support a nonmarital child, or as part of a business deal), property discovered in a safety deposit box with a handwritten note constituting a valid disposition to (or confirming a joint tenancy with) a third party, or an asset transferred inter vivos and includible in the taxable estate. All of these surprises could pass in ways that increase the gross estate for tax purposes but, because of the beneficiary, cannot qualify for the marital deduction. Disaster awaits if these items exceed the applicable exclusion amount, resulting in taxes that the estate plan unexpectedly imposes on the residue that otherwise needs to qualify for the marital deduction. Because the deduction is not available, these assets generate a tax that further eats into the property that *does* qualify for the marital deduction, which further increases the tax liability, which again consumes marital deduction property and further increases the tax, and so on. See page 16 for an illustration.

Recall that§2056(d) disallows the marital deduction if the decedent's surviving spouse is not a United States citizen (unless a qualified domestic trust is used). Unexpected discovery that the surviving spouse is not a citizen is yet another of those wake up moments that sometimes even the most careful estate planner cannot always avoid. For inexplicable reasons clients don't always reveal all the facts (even when they are asked) or they do things on the eve of dying without seeking counsel. Go figure! All of which speaks to the idiocy of placing an unknown tax burden on the residue of the estate rather than apportioning the tax to each beneficiary or asset, unless the taker or the property is specifically identified and exonerated from that liability. This is the approach followed in the sample tax payment provision at page 43.

Yet another major area of concern in the tax payment arena relates to "phantom" assets that are includible in a decedent's gross estate but not available for payment of the tax attributable to them. With respect to these, the burden on the residue rule easily can result in the probate estate being bankrupted and the decedent's estate planning objectives being totally frustrated. Imagine that your client with a nontaxable estate wins the lottery (or a very large tort judgment for injuries that eventually result in death), pushing the estate into tax trouble but with an entitlement that may not yield cash for many years.

A second source of tax on phantom assets is a §529(c)(4)(C) college saving plan "recapture" tax that is attributable to assets no longer owned. Of the limited sources for payment of the §529(c)(4)(C) estate tax, it is equitable that the donees who received the gifted assets should pay the tax generated by the property they received, as presumably they would if the decedent had died with that property includible in the gross estate and left it to the donees at death. But the funds may not exist (having been gifted to pay for college tuition). It might be necessary under state law to condition the §529 gift itself with an agreement to pay any tax incurred at death, to be certain that the estate will not be facing the phantom asset tax liability problem. Yet this may be the wrong way to resolve the problem if the gift is to fund college expenses. At a minimum it seems fair to say that, without planning at the time of the gift, the situation after death could be impossible for a personal representative to resolve as a matter of state law or practical application.

Probably the greatest concern about phantom assets and the taxes attributable to them involves retirement benefits that are includible in a decedent's gross estate under §2039 but not accessible for payment of the tax attributable to them. More severe yet is the unresolved question whether a participant's spouse has an ownership interest in a plan, either by virtue of qualified plan provisions guaranteeing a §401(a)(11) spousal annuity to the nonparticipant spouse or under community property laws that deem the account to be owned by each spouse equally.

If either source of inclusion exists and the nonparticipant spouse dies first, it is extremely unlikely that the plan would permit the nonparticipant spouse to apportion estate taxes against the plan while the participant still is alive. Indeed, it might be impossible to reach plan assets to contribute to the payment of tax even if it was the participant who died first. Potentially the marital deduction will avoid tax payment in most cases, but not always.[3] Here are real assets that are not available to pay any tax that may be attributable to them, creating the need to carefully consider the tax payment obligation of the participant and nonparticipant spouses. At the very least, a burden on the residue result may create problems and inequities. Unfortunately it may be unavoidable in this particular situation.

These issues are ignored so often by estate planners, maybe because they pose no clear answers. Please do not be the planner who included a boilerplate provision because you just didn't think about these issues. This is the single most common source of messed up plans (and probably of drafter liability), and not just with respect to taxes, although those tend to be the cases that do not settle (probably because the numbers are too large).

Procedure

Time of Payment

The time allowed to raise the necessary capital must be considered in addition to evaluating the source and liquidity of funds needed to pay debts, expenses, federal estate tax, and any state death taxes. In this respect, the date the federal estate tax return is due and the tax must be paid is most important, although it may be possible to defer payment of the tax. Under §6151(a), the tax must be paid when the return is required to be filed, which is nine months after the decedent's death,[4] unless an extension of the time for payment is secured.[5] Notice that an extension of the time for filing the return does not constitute an extension of the time for payment of the tax. A separate extension for each is required. Treas. Reg. §§20.6081-1(d); 20.6151-1(a).

Transferee Liability

The time for payment is important to more than the question of liquidity, however, because liability for payment of the tax may extend to each transferee or holder of property included in the gross estate if the tax is not paid when due. Personal transferee liability attaches to the extent of the lesser of the total tax that is due or the value of any property received or held by a transferee. In addition, if the tax is not paid when due,

3. Technical Advice Memorandum 8943006 held what §2056(b)(7)(C) now expressly confirms in most cases: a nonparticipant spouse's community property interest in a qualified plan is deemed to pass to the surviving participant spouse and to qualify for the marital deduction, but that result is not guaranteed if the nonparticipant's interest is not a function of community property laws.

4. See §6075(a). A nearly automatic six month extension to file the return is available upon request. Treas. Reg. §20.6081-1(b).

5. See §§6161 (extension for reasonable cause), 6163 (extension with respect to future interests), and 6166 (extension of the tax attributable to a qualifying business).

personal liability also is imposed on the personal representative under §2002.[6] Transferee liability imposed on any beneficiary or person in possession of includible property[7] thus is in addition to both the liability that normally attaches to the personal representative and the 10 year lien that attaches to estate property[8] and any proceeds from the sale of assets included in the estate.[9] In either case, personal liability is discharged once the tax is paid or payment is adequately secured.[10]

Extensions of Time to File or Make Payment

Extensions of time may defer liability for filing the federal estate tax return or for payment of the federal estate tax. A nearly automatic extension of a reasonable period to file the return, not to exceed six months (longer if the taxpayer is abroad), historically was granted with such regularity upon request that the government by regulation now has determined to grant it as a matter of course in most every case.[11] A similar extension of up to 12 months to pay the tax also is available upon a request that must show "reasonable cause."[12] In addition, an extension of up to 10 years to pay the tax may be granted in the discretion of the Secretary upon a showing of "undue hardship" and, if later, any installment payment under the tax deferral provisions of §6166 may be extended for up to 12 months after that installment is due.[13] Separate extensions to pay any assessed deficiency also are available upon a showing of undue hardship,[14] again in the discretion of the Secretary, but not to exceed four years.

The "reasonable cause" needed to justify an extension is illustrated under Treas. Reg. §20.6161-1(a)(1) Examples (1)-(4) as including an inability to marshal liquid assets because they are located in other jurisdictions or because litigation is required to collect them; an inability to borrow on better than disfavorable terms (in relation to returns otherwise available to the estate on its investments); and an insufficiency of funds to

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6. Effected through a lien under §6321 (based on 31 U.S.C. §192, which imposes personal liability on anyone who distributes estate property prior to satisfaction of all indebtedness to the United States), and extending to any interest or penalties on the tax, which are treated as part of the tax liability for all these lien and liability purposes. See §§6601(e)(1) and 6665(a), respectively.

7. See §§6324(a)(2) (lien) and 6901(a)(1) and (h) (transferee liability).

8. See §6324(a)(1). Property used to pay allowable expenses of administration and charges against the estate is excepted from the lien.

9. See §6324(a)(2) and Treas. Reg. §301.6324-1(a)(2)(iii).

10. See §§2204(a) (discharge of personal representative), 2204(b) (discharge of fiduciary other than personal representative), and 6325(c) (discharge of transferee liability).

11. See §6081(a); Treas. Reg. §20.6081-1(b). The automatic extension is not available with respect to Forms 706-A, 706-D, 706-NA, or 706-QDT, but the discretionary extension remains available in those cases.

12. See §6161(a)(1).

13. See §6161(a)(2). Although it would appear that the same "reasonable cause" standard is applicable, Treas. Reg. §20.6161-1(a)(2) imposes the "undue hardship" standard for the longer extensions.

14. See §6161(b)(2). See Treas. Reg. §20.6161-2(b). However, §6161(b)(3) denies the extension for any deficiency attributable to negligence, intentional disregard of rules or regulations, or fraud with an intent to evade tax.

maintain the decedent's family, pay claims against the estate, and pay the estate tax, coupled with an inability to borrow at prevailing market rates. "Undue hardship" is a higher standard, illustrated by Treas. Reg. §20.6161-1(a)(2)(ii) Examples (1) and (2) as including a farm or closely held business that constitutes a significant portion of the estate (but not necessarily enough to qualify for deferral of the tax under §6166), sufficient other funds are not readily available, and an extension of time is needed to raise the capital without having to sell the farm or business; or the only available sale to generate liquidity would be at a sacrifice price or in a depressed market.

A second automatic extension of time for payment is granted under §6166 for that portion[15] of the tax attributable to inclusion of the value of a closely held business in a decedent's gross estate. Available only to the estate of a citizen or resident of the United States,[16] deferral allows payment of the estate tax in as many as 10 equal annual installments, with the first required no sooner than five years after the time otherwise specified for payment.[17] More than 35% of the value of the decedent's "adjusted gross estate"[18] must consist of an interest in a closely held business to qualify for this extension.[19]

The election to defer estate tax under §6166 must be made before the decedent's estate tax return is due, including any extensions otherwise allowed.[20] An election to defer any deficiency assessed with respect to an estate that includes an interest in a closely held business that otherwise qualifies may be made within 60 days after notice and demand for payment of the deficiency.[21] Finally, unlike other extensions available to defer the payment of tax, the §6166 deferral may be accelerated if certain events occur, such as accumulation of estate income, failure to timely pay an installment, or certain changes in or dispositions of the qualifying business interest.[22]

Problematic about all the automatic and discretionary deferrals is that each requires the taxpayer to pay interest on the taxes deferred. In addition, although the fiduciary's personal liability for payment of the deferred tax under §6321 may be supplanted by posting a bond under §§2204 and 6165,

15 Defined in §6166(a)(2), the portion is a pro rata amount based on a comparison of the §6166(b)(5) "closely held business amount" to the §6166(b)(6) "adjusted gross estate."

16. See §6166(a)(1).

17. See §6166(a)(3).

18. Defined for this purpose in §6166(b)(6) as the gross estate reduced by all amounts that are allowable as §2053 or §2054 deductions, even if not allowed (because, for example, a §642(g) election was made to claim those amounts as income tax deductions).

19. Defined in §6166(b)(1), substantial complexity surrounds this definition and the planning that is involved in making an estate qualify for deferral under it.

20. See §6166(d). Protective elections that are dependent upon final determination of the decedent's estate tax valuation are permitted under Treas. Reg. §20.6166-1(d).

21. See §6166(h). The election is not available, however, if the deficiency was attributable to negligence, intentional disregard of rules and regulations, or to fraud with intent to evade tax. Id. §6166(h)(1) (flush language).

22. See §6166(g).

often the requirements for the bond are so onerous[23] that this alternative seems unattractive. Thus, deferral may be costly, and the personal representative may have continuing liability if deferral is selected. All this makes the concept of deferred payment of tax a troubling prospect for many estates. One worrisome possibility is that the value of estate property available for payment of the tax will decline during the deferral period to a point at which it no longer is adequate. Another is that sufficient appreciation will occur to present a serious capital gain tax liability when the property ultimately is sold to produce liquidity for tax payment.

Apportionment Options

Congress determined in §2205 that the estate tax should be a burden on the estate as a whole, not on the individual beneficiaries of the estate as is the case with most state inheritance taxes. But Riggs v. Del Drago, 317 U.S. 95 (1942), held that state law or the terms of the decedent's estate plan may alter this apportionment of the federal estate tax. Thus, the estate plan may apportion the tax burden so that the impact of credits, deductions, and the inclusion of assets falls on those beneficiaries who receive includible assets, generate credits or deductions, and so forth. With this freedom to apportion, up to six major apportionment decisions must be made, several with additional subissues that may be addressed under state law or the estate plan.

Inside Apportionment

Inside apportionment deals with the question whether taxes ought to be borne by all classes of dispositions within (inside) a probate estate. Like §2205, the firmly established common law rule provides that taxes in the probate estate are a "burden on the residue." Thus, all taxes are paid out of the residuary estate before any taxes are allocated to or payable from other dispositions, such as general, demonstrative, or specific dispositions under a will. To the extent inside apportionment is dictated, such as by the modern statutes in most jurisdictions, every taker under a will bears a share of the taxes payable, regardless of the priority or class of disposition involved, and regardless of whether the subject property is realty or personalty. Usually the share is based on a proportionate determination.

At one time the common law distinguished between personalty and realty within any class of disposition, favoring the realty by specifying that the personalty should be used first to pay debts, expenses, and taxes. Thus, for example, even in a burden on the residue apportionment, the takers of residuary personalty would be disappointed prior to the takers of residuary realty. This antiquated system has been rejected by virtually every state,

23. See Treas. Reg. §§20.2204-1(b) and 20.6165-1(a), calling for bonds not in excess of twice the tax deferred, and §§2204(c) and 6324A, which provide for a lien with respect to taxes payable in installments under §6166. See §6324A(d)(6), which provides that the government may not require the §6165 bond if the taxpayer makes the appropriate §6324A lien election.

notwithstanding that this rule was consistent with the common law abatement rules that favored realty. In some estate plans it might be wise to embrace the concept by specifying certain assets for use first or to be protected until absolutely necessary in payment of estate expenses, debts, or taxes.

Outside Apportionment

Outside apportionment stands in juxtaposition to inside apportionment within testate and intestate estates alike. It involves the issue whether taxes ought to be apportioned among the takers of probate assets (either with or without inside apportionment) and the recipients of includible *nonprobate* (outside) assets. Thus, if nonprobate property is includible in the gross estate of a decedent under any of the estate tax inclusion provisions, then outside apportionment would dictate that the recipient of that property pay that portion of the taxes (state or federal) imposed on the total estate and attributable to that inclusion (computed in one of several methods discussed in more detail below).

This form of apportionment is particularly important because the interaction of state and federal law often creates confusion or gaps in the rules that govern the tax payment obligation. Moreover, the three most valuable assets includible in most decedents' estates all are nonprobate property: insurance, retirement benefits, and a personal residence held in joint tenancy with right of survivorship. As illustrated below, it is outside apportionment to which most state apportionment statutes apply and as to which the limited federal reimbursement rules exist. However, apportionment to some forms of nonprobate property is addressed far more clearly and appropriately than it is with respect to other forms.

Equitable Apportionment

Equitable apportionment involves the question whether dispositions that generate a tax deduction or other benefit should benefit exclusively from the tax advantage, rather than having it benefit all beneficiaries of the estate.

This arises most often when property passing to a surviving spouse qualifies for the marital deduction. The equitable apportionment question can apply in an intestate estate in which the spouse takes a statutory share of the estate, in a testate estate in which the spouse rejects the decedent's estate plan in favor of a statutory forced heir share, or in a testate estate (or will substitute) involving tax apportionment to the spouse's bequest (whether as a part of the residue or some other part of the total estate). It also could apply in any estate to the extent a premarital agreement or §2053 deductible property settlement agreement creates a claim against the estate (or a disposition under the will is in satisfaction of such a contractual claim against the estate). In that case the issue is whether deductible distributions in satisfaction of the claim are subject to apportionment of taxes.

Also a source of equitable apportionment is the §2055 charitable deduction and, although less obviously so, the §2032A reduction in tax attributable to special use valuation. There may be other benefits from time to time as well (witness the §2057 orphans' deduction, and then the §2057 ESOP sale proceeds deduction, and most recently the §2057 qualified family owned business interest deduction, all subsequently repealed).

Apportionment of Rate Differentials

Closely related to equitable apportionment is whether to apportion state estate or inheritance tax rate differentials based on each beneficiary's share of the estate. For example, some states impose a tax that favors more closely related beneficiaries over distant relatives or strangers. In such a state the issue is whether any apportionment should reflect these rate differentials.

Apportionment of Credits

Similarly related is the question whether to apportion the benefit of credits available to the estate that are connected with separate identifiable properties passing to designated individuals. For example, if some property incurs more state or foreign death tax than others, the apportionment issue is whether the beneficiaries thereof should receive the benefit of any credit attributable to the tax incurred on their entitlement.

To illustrate, consider the §2013 credit for previously taxed property, which may be apportioned and can be a source of real inequity if not considered properly. For example, assume that the decedent was the beneficiary of a trust created by a parent, with a §2041 general power of appointment that generates estate tax (to avoid generation-skipping transfer tax). A §2013 credit would be available to the decedent's estate if the parent and the decedent died within 10 years of each other. If §2207 liability for the estate tax attributable to the trust is imposed on the remainder beneficiaries of the trust (as discussed at page 17), it would seem that they also should receive the benefit of that credit, but they do not under most state laws.

The decedent could match the tax liability with the credit by waiving the §2207 reimbursement entitlement or by apportioning the credit. The issue is whether the decedent's estate can afford to pay the §2041 taxes on the trust. And in a more sophisticated plan in which the generation-skipping tax might be allowed to apply in some circumstances, it would be unwise to have the two tax liabilities payable by different sources, one by the decedent's estate and the other by the trust. If the plan were otherwise, differences in the source of payment might inform the decision of which tax to incur, rather than just weighing the amount of tax incurred under the respective systems.

Apportionment to Temporal Interests

A final apportionment alternative relates to the proper method for apportioning taxes attributable to property that is split into temporal interests, such as a life estate, a term of years, or an annuity given to one individual and the remainder or reversion belonging to another.

Apportionment Among Multiple Entities

If several estate planning documents (such as a will and a revocable inter vivos funded trust or an irrevocable insurance trust) are involved, apportionment issues are compounded by the need to decide how tax payment obligations should be imposed on the multiple entities. For example, the tax payment provisions in each document could:

- provide for payment of all taxes out of the probate estate (with or without inside apportionment);
- provide for payment of all taxes from the trust corpus (similarly with or without a form of inside apportionment among several shares created thereunder);
- provide for a ratable apportionment of taxes among the several entities (with or without apportionment under each as among the respective shares thereunder);
- provide that the trust shall contribute to the payment of taxes only to the extent the probate estate is insufficient to pay all the taxes imposed on the gross estate (or vice versa, and again with questions of apportionment under each disposition);
- provide that the trustee shall pay taxes only in the discretion of the trustee (under established guidelines, and with or without apportionment);
- provide that the trustee shall pay taxes to the extent the personal representative of the decedent's estate certifies the need therefor (again under guidelines and a specified apportionment regime);
- or simply permit the trustee to purchase assets from the estate to provide needed liquidity.

Not incidentally, these decisions must take into consideration the potential for conflicts of interest and the difficulty of exercising discretion if conflicting beneficial interests and different fiduciaries are involved.

Decedent's Choice

With respect to virtually all apportionment issues it is relatively clear (but not entirely without doubt) that a decedent may alter the customary burden under state or federal law. Thus, a testamentary disposition by clear provision may expressly specify the property and the takers who will bear the tax burden. By a clear provision in a testamentary disposition the decedent also may exonerate nonprobate property from any otherwise applicable state law directive requiring outside apportionment (and, although not nearly as clearly permissible, it is relatively well established that the decedent may impose the burden for tax payment on nonprobate assets through the use of a will provision).

In advising a client as to the best apportionment approach, a number of policies or considerations might be relevant and the client's wishes need to be ascertained. For example, with respect to inside apportionment, does the client favor the particular beneficiaries over the residuary takers? The common law abatement rules presume that this is the case, and failure to permit inside apportionment is consistent with it. In reality, often the particular beneficiaries fit into one of the following categories.

First is a marital deduction bequest that the client wants to maximize, in most cases resulting in no tax at the client's death, so apportionment is a moot issue. Even if the deduction does not totally eliminate taxes, however, protection of it is served by equitable apportionment. Second are those relatively minor dispositions that most individuals place in a separate article preceding the heart of the estate plan. For example, $100 to a despised sibling, or $10,000 to a favored employee. With respect to these, the common law abatement and apportionment rules are likely to be directly contrary to the intent of the client in the sense that, if anyone should suffer for insufficient assets in the estate, it should be these takers. But third are takers of special assets (think of the grand piano or special items of jewelry) who should not be asked to generate the liquidity to pay the tax attributable to their entitlement.

With respect to outside apportionment, does the client wish to have the probate estate pay taxes generated by property over which the client might have no control? This is particularly important with respect to §2044 qualified terminable interest property that is includible in the estate of a surviving spouse, especially in second marriage or related situations in which the trust property passes to beneficiaries for whom the surviving spouse may have no affinity.

With respect to the issue of equitable apportionment involving the marital deduction (and, to a certain extent, involving the charitable deduction as well), should the deductible share bear no tax because it generated no tax? Any estate tax imposed on the estate would be generated by property that did not qualify for the deduction. Most clients will embrace the notion that the marital deduction is designed for the benefit of the surviving spouse and, therefore, that the spouse ought to be the sole beneficiary of the deduction. A similar argument could be made in favor of charity. The most persuasive argument in favor of equitable apportionment is that the deduction itself will be reduced if the marital or charitable bequest bears a portion of the taxes imposed on a decedent's estate (if equitable apportionment does not apply). See §§2055(c) and 2056(b)(4)(A). Indeed, these deductions will be reduced by the full amount of tax that *could* be paid, even if for some reason it is not.

In some cases a reduction in the deduction correspondingly increases taxes that further serve to reduce the size of the bequest (because that share is a portion of the total estate available for distribution), which further increases taxes that again reduce the deduction, ad nauseam. For example, consider the following illustration of the comparative computations of a one-third forced heir share or intestate entitlement of a 2004 decedent's surviving spouse in an estate of $2.4 million:

1/3 of *Gross* Estate (i.e., *before* taxes)		1/3 of *Net* Estate (i.e., *after* taxes)
$2,400,000	Estate	$2,400,000
800,000	Marital	782,353
1,600,000	Taxable	1,617,647
45,000	Taxes	52,941
1,555,000	Residue	1,564,706

The final result is that a net estate division produces a marital share exactly half the size of the remaining residue, preserving the one-third entitlement dictated by the elective share provision, but the method of computation generates a smaller marital deduction (by $17,647) and more taxes (by $7,941). Curiously, the residue is actually better off (by $9,706) because of it. The issue whether the elective share should be a fraction of the net estate (after taxes) or the gross estate (before taxes) is simply the equitable apportionment issue working to protect the marital share from bearing a portion of the taxes in the gross estate division but not in the net estate computation.

Similar disputes can arise in applying the concept of equitable apportionment to the charitable deduction under §2055 and the question whether any fractional or percentage division ought to be before or after taxes.

Federal Rules Applicable to Tax Apportionment

In addition to the state law just discussed, there is federal law to consider in all of this. Notice how we have turned a full circle: federal law imposes the tax, state law or the document may alter apportionment of it and now we address a second layer of federal tax rules.

Estate Tax

The general rule that distinguishes the federal estate tax from an inheritance tax is §2205. It specifies that a nonprobate beneficiary who pays any federal estate tax is entitled to reimbursement from the personal representative out of probate property, "it being the purpose and intent of this chapter that . . . unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution." This federal burden on the residue rule applies only to the extent neither state law nor the decedent's will provide otherwise. Nevertheless, it is subject in all events to four federal statutory rules that permit reimbursement for federal (but not any state) estate tax imposed on specific types of nonprobate property. That is, the residuary estate pays the tax and then may be entitled to *reimbursement* (as compared to apportionment in the first instance, which alters who pays the tax initially).

The oldest reimbursement provision is §2206. It provides a right of reimbursement for taxes paid by the estate with respect to §2042 inclusion of insurance proceeds payable to a third party. The personal representative is entitled to collect from every beneficiary of includible insurance proceeds the proportionate share of the total taxes paid by the estate that is attributable to that insurance.

Although waiver is authorized under the introductory clause of §2206, great care should be exercised to avoid inappropriate cancellation of this right. In this regard, consider *In re* Estate of Kapala, 402 N.W.2d 150 (Minn. Ct. App. 1987), in which the decedent's closely held corporation owned insurance on the life of the decedent, naming the decedent's partner as the beneficiary (it was intended to provide liquidity to perform under a buy-sell agreement when the decedent died). The insurance was includible under §2042(2) and the court found that §2206 reimbursement was not waived, notwithstanding that the buy-sell agreement provided that the surviving partner would receive all assets "free and clear of all claims of every kind." The court determined that waiver of §2206 must appear in an instrument with testamentary intent, which it found the buy-sell agreement to lack.

In some estates §2206 may be the only way to afford the taxes caused by unexpected inclusion. Care must be taken in drafting any contingent tax payment provision (for example, in an irrevocable life insurance trust) to preclude §2042(1) inclusion by virtue of that direction alone. But if for any reason the insurance is includible, either §2206 or a contingent tax clause may be essential for the estate to pay the estate tax attributable to that inclusion.

Added with the power of appointment provisions in 1942, §2207 employs virtually identical language to §2206 to grant an identical right of reimbursement for taxes attributable to property included in the gross estate under §2041. The personal representative may recover those taxes from "the person receiving such property by reason of the exercise, nonexercise or release of a power of appointment." Often this general power of appointment rule is critical because the decedent did not create the general power of appointment and the trust granting the power seldom includes a contingent tax payment provision.

Added in 1981, §2207A grants a significantly different right of reimbursement. Applying to §2044 includible qualified terminable interest property for which the §2056(b)(7) marital deduction was allowed, this right of reimbursement differs because it is an incremental rather than a proportionate entitlement. Effectively prorating all deductions and credits among all takers, §§2206 and 2207 apply to bottom line taxes imposed on a decedent's estate with respect to those portions causing inclusion under

§§2042 and 2041, respectively (and after considering the marital deduction). But §2207A permits recovery of the amount by which taxes were *increased* by inclusion of §2044 property, meaning the incremental taxes without benefit of deductions or credits available to the estate as a whole. In addition, interest and penalties attributable to §2044 property are subject to the incremental right of reimbursement. This also has no counterpart in §§2206 and 2207.

The difference between these reimbursement provisions is illustrated by Sarosdy v. Johnson, 894 S.W.2d 640 (Ky. Ct. App. 1994), in which a general power of appointment versus a qualified terminable interest property marital trust was involved. The estate was entitled to only pro rata reimbursement under §2207 rather than incremental reimbursement under §2207A, meaning that estate tax attributable to inclusion of the marital trust was payable in part from the decedent surviving spouse's own property. That estate would have passed totally free of tax (it was smaller than the applicable exclusion amount) had the marital trust not been includible, and arguably the estate should not have paid any of the estate tax that was attributable entirely to the marital trust.

To illustrate another significant issue under §2207A, assume spouses agreed that the surviving spouse would have the use of the decedent's wealth for the survivor's overlife, but that their respective shares would pass at the survivor's death to their respective beneficiaries. Incremental reimbursement under §2207A disrupts the intended equity of that plan by imposing a greater than pro rata share of the survivor's taxes on the decedent's qualified terminable interest property. Only if the survivor is willing to alter the incremental dictate of §2207A by a provision in the survivor's will would this be avoided, and the decedent cannot guarantee that the survivor will do so.

This inequity may be appropriate because otherwise the surviving spouse's unified credit would reduce the tax imposed on all the beneficiaries interested in the surviving spouse's estate tax computation, including those who take the qualified terminable interest property trust remainder (as well as the survivor's other beneficiaries). The first to die used his or her credit in most cases to shelter a nonmarital trust that favors that decedent's beneficiaries alone, so the §2207A rule may be a form of rough justice. Either way, this serious issue must be anticipated and may be addressed in drafting premarital agreements or coordinated estate plans that involve children by former marriages.

Finally, §2207B applies to taxes caused by inclusion of property under §2036. It calls for a pro rata right of reimbursement, like §§2206 and 2207, but includes interest and penalties attributable to the tax like only §2207A. Also like only §2207A, the entitlement created by §2207B may be waived by the decedent's revocable inter vivos trust as well as by a will, subject to a requirement that any waiver "specifically indicates an intent to waive" the reimbursement right. The tax simplification proposal that added this requirement to §2207A was accompanied by legislative history that almost surely will become a part of any regulations that are issued, providing that "a specific reference to QTIP, section 2044, or section 2207A" will suffice. Presumably a similar reference to §2036 or §2207B would suffice for §2207B specific intent purposes. Neither of §§2206 or 2207 includes any of these refinements.

For reasons that probably are more historical than substantive, there is no comparable federal provision for recovery of taxes attributable to nonprobate assets includible under §§2035 and 2037 through 2040, and none with respect to the estate tax aspects of §§2701 through 2704. There has been longstanding interest in a proposal to enact a provision similar to §§2207A and 2207B for the taxes caused by inclusion of §2039 retirement benefits in a decedent's gross estate. It is sensible to seek such an addition, because these benefits typically pass outside probate and often constitute a large share of the estate, risking bankruptcy of the probate estate in payment of estate taxes absent a right of reimbursement.

There has been some suggestion that the Treasury Department regards each of §§2206 through 2207B as matters properly left to state property law. Thus, it is suggested that, because these sections are not related to the imposition or collection of taxes in the first instance, the Treasury Department has no interest in adding a Code provision relating to §2039 or other nonprobate assets. This is particularly unfortunate, given the magnitude of some of these assets relative to a decedent's total estate and the assets otherwise available to pay taxes caused by their inclusion. But what it means to estate planners is that a well drafted tax payment provision must address the issues that federal law does not.

Generation-Skipping Transfer Tax Apportionment

Generation-skipping transfer tax §2603 contains its own reimbursement provision. It is an easily stated rule that, in essence, "the person with the generation-skipping property pays the tax out of that property." Like most simplifications, however, this statement is not entirely accurate.

To illustrate, assume that a decedent's will bequeaths $2 million to a grandchild. The issue is whether the decedent really meant to leave $2 million *after* the generation-skipping tax is paid from other property in the decedent's estate. Without more, the §2603 result is that $2 million is set aside and used to pay the tax as directed by §2603(b), with only the balance actually passing to the grandchild. In that case the tax (assuming no exemption or exclusion applies) would be computed (using 2004 figures) as

$$\text{[rate]} \times \text{[transfer (after tax)]} = \text{[tax]}$$
$$.48 \times \frac{\$2 \text{ million}}{1.48} = \$648{,}649$$

The grandchild would actually receive $1,351,351, which is $2 million less \$648,649 of tax.[24] If this is not the decedent's intent, then the document must clearly override §2603(b), causing a greater amount to be subject to the tax (\$2 million rather than the \$1,351,351 in this example) and causing the tax thereon to be greater (\$960,000 in 2004 rather than \$648,649). The difference in result is dramatic and should not be left to postmortem determination by litigation to determine the decedent's intent.

Summary of State Law: Silence Generates What Result?

The foregoing discussion reveals an amalgam of state and federal rules in this arena, and federal law that defers to the states in most respects (although it grants certain rights or imposes selected responsibilities that may trump state law). A number of legitimate choices might be made in determining the proper apportionment result, and conflicting results are dictated by the law in various jurisdictions in which the apportionment issues have been resolved. The following exegesis illustrates the state law results if an estate plan does not address the tax apportionment issue. If the documents are silent, in some states the issues are (partially) resolved by statute. In a declining number of states only judicial authority exists. But in a few states, on some issues, common law presumptions apply by default because statutory law is entirely silent. And from state to state (and occasionally within a given state), some of the results stated here are confused and inconsistent because the law is not uniform.

An established state dictate mandated under a state apportionment statute usually will apply unless the decedent clearly directs otherwise in an appropriate manner, whether by will, trust, or other document. The burden of proof normally is on those who challenge the state apportionment result when determining whether a decedent has provided otherwise with sufficient specificity and clarity. Thus, a direction to pay all taxes from the residue of a decedent's estate typically will cause taxes on nonprobate property to be paid from the residue in an apportionment state, although a nonspecific direction may cause litigation. For example, a general tax payment direction in a will may be read to negate apportionment, if any, only within the probate estate, leaving any state outside apportionment statute to apply with respect to nonprobate assets.

Because any effort to summarize the law in the 50 states is subject to unavoidable inaccuracies, and because the Uniform Estate Tax Apportionment Act is regarded by over 40% of the states as the best form of statutory apportionment, it is appropriate to consider its major provisions briefly here. The Act establishes rules of three major types:

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24. As illustrated in the Form 706 Estate and Generation-Skipping Tax return, another formula to make this computation (in 2004) is

$$\frac{\text{Transfer (before tax)}}{3.08333}$$

The denominator is simply 1 plus the 48% tax rate, divided by the 48% tax rate.

Inside and Outside Apportionment. First, all taxes imposed on an estate (which would include an inheritance tax only if it were a charge against the estate as a whole, which is not normally the case with an inheritance tax as opposed to an estate tax) should be pro rated among all persons "interested in the decedent's gross estate for federal estate tax purposes." This is total inside and outside apportionment, applying a straight pro rata allocation based on the size of each interested individual's entitlement as compared to the size of the total estate for federal estate tax purposes.

As to apportionment, two special rules are designed to prevent unnecessary conflicts with federal law. One special rule, equitable apportionment, may be illustrated by a simple example. Assume that a decedent's estate passes to the decedent's surviving spouse in a fashion that qualifies for the federal estate tax marital deduction but not (entirely) for the state wealth transfer tax marital deduction. The state apportionment rule is not to apply if apportionment of a state tax to the marital share would have the effect of reducing the federal estate tax marital deduction. Thus the Act preserves the federal deduction without reduction.

The other special rule specifies that federal law will control if federal and state laws differ with respect to apportionment. It appears that the rationale for this provision was addition in 1981 of §2207A, calling for incremental rather than pro rata reimbursement of taxes. The Uniform Act is simply specifying that this difference between §2207A and state law will be resolved in favor of the incremental approach under federal law.

Alteration. The second major proposition established by the Act is how allocation under the Act may be altered. Two methods are authorized: in unusual circumstances a court may alter the proportionate allocation of taxes, and a decedent may waive or alter the dictates of the Act. Under existing law waiver may be accomplished only by a provision in the decedent's will. Under a newly promulgated revision of the Uniform Act, waiver may be by a provision in a revocable trust or other dispositive instrument, rather than just by a will. Unfortunately, a specific reference to the apportionment rule being waived or altered is not required by the existing Uniform Act, meaning that broad, nonspecific will provisions can raise important interpretative questions under the Act. Under the new revision waiver requires an "express" or "unambiguous" provision (the comments refer to "explicit" and "specific" references), which may reduce conflict or dispute.

Entitlements. Third, the Act establishes the proper treatment of certain entitlements that affect the tax burden. For example, federal credits generally inure to the proportionate benefit of all beneficiaries interested in the entire gross estate, rather than to the benefit of any particular recipient of property, such as the taker of property that was previously taxed or subjected to a foreign death tax. The new revision allocates the benefit of the §§2012 and 2014 gift tax and foreign death tax credits to the takers of the property that produced those benefits, but leaves unchanged the benefit of other credits.

Alternatively, however, individual takers of interests included in the gross estate benefit from exemptions, deductions, and credits that relate specifically to "the purposes of the gift," "the relationship of any person to the decedent," or the payment of any taxes attributable to the property. Thus, the charitable and marital deductions usually inure to the benefit of the recipient of the qualifying property, this being the rule of equitable apportionment.

This rule also provides that the recipient is entitled to an adjustment in the allocation of tax to reflect any reduced rate of tax for state or other tax purposes, based on the relation of the recipient to the decedent (for example, if a state inheritance tax is paid out of the estate and recognizes more closely related individuals with a reduced rate of tax).

Equitable Apportionment

If the estate plan is silent on the issue, state law determines whether equitable apportionment is available to any portion of the estate that qualifies for a deduction in the wealth transfer tax computation. The vast majority of states embrace equitable apportionment with respect to the computation of dispositions that qualify for the marital or charitable deductions. At least to a limited extent, however, a number of states do not embrace equitable apportionment.

In addition, in most states the treatment is not certain regarding distributions in satisfaction of a contractual entitlement, such as under a premarital agreement. These dispositions should be treated in the same fashion as a charitable or marital disposition if they are deductible under §2053 as a claim against the estate. In this respect, §2043 (an estate tax consideration rule) makes certain property settlements at death deductible under §2053 if incident to a divorce and otherwise meeting the requirements of §2516 (a gift tax consideration rule).

Moreover, an analogous result may apply in a limited number of cases if claims satisfied at death arising from a premarital agreement are treated as creditor claims against the estate. Notwithstanding that they are not §2053 deductible like most creditors' claims, the recipient of property under the premarital agreement is entitled to priority in payment, along with all other creditors. And because creditors are unaffected by the amount of taxes (except to the extent the estate is bankrupt, so that not all otherwise entitled claimants are satisfied) the claimant in these cases effectively is granted equitable apportionment. Otherwise, obligations incurred incident to divorce that are satisfied out of an estate at death but that are not deductible normally are ineligible for equitable apportionment.

Apportionment of State Inheritance and Foreign Taxes

Even in states that embrace full inside, outside, and equitable apportionment, state and foreign inheritance taxes imposed directly on individual recipients of a decedent's wealth usually are not subject to apportionment in a manner that equitably allocates or apportions the burden. Thus, the decedent's estate plan must direct the estate to pay those taxes and cause those taxes to become an item subject to apportionment by virtue of that direction.

Apportionment of Fees and Expenses

Outside apportionment of fees and expenses of administration has been dictated in several cases, but this sensible extension of the general apportionment theme is not common. See Roe v. Estate of Farrell, 372 N.E.2d 662 (Ill. 1978), cited in Estate of Fender v. Fender, 422 N.E.2d 107 (Ill. App. Ct. 1981); Cloutier v. Lavoie, 177 N.E.2d 584 (Mass. 1961); *In re* Estate of McKitrick, 172 N.E.2d 197 (Ohio Prob. Ct. 1960).

Apportionment of Interest and Penalties

Many state statutes (including the original and revised Uniform Act), dictate apportionment of interest and penalties assessed along with the underlying taxes imposed on an estate. In addition, §§2207A(d) and 2207B(d) specifically dictate this result for federal tax purposes. Unfortunately, this is not a universal rule and these added items are not chargeable in the same manner as the underlying tax in some states. As illustrated by Estate of Whittle v. Commissioner, 97 T.C. 362 (1991), aff'd, 994 F.2d 379 (7th Cir. 1993), interest on estate tax is not the same as the tax itself and may be chargeable in a different manner unless the document or applicable state or federal law specifically provides for it.

Computing Various Entitlements

An issue upon which estate planning documents must focus (because many state laws are silent) is the order in which shares, taxes, and allocations are to be determined. For example, the federal estate tax is computed after all deductions are reflected, but the discussion at page 16 about whether the marital share is computed before or after payment of those taxes illustrates that it is not always clear how computations interrelate for purposes of federal tax, state tax, marital and other "forced" shares, and division of the "residue."

Thus, for example, the question may arise whether state law provides that the federal estate tax (reflecting all credits) is to be paid from or charged against the available assets, followed by any division into shares (such as the elective or intestate share as illustrated at page 16), and finally computation and payment of state death taxes based on the various shares. Alternatively, state law may compute and subtract the federal and state taxes based on the same amount in the estate, and then divide the balance as provided in the estate plan. A third alternative mechanism would be to divide the estate according to the decedent's estate plan, then compute and subtract the federal and state taxes based on the size of those shares. Each alternative can produce different results and therefore must be made clear if state law is not.

Apportionment to Nonprobate Assets

It is not universally established that a decedent's will may apportion taxes to nonprobate assets in the absence of (or contrary to) state law. Clearly a decedent's will may negate a local law calling for apportionment of taxes, instead directing payment of all taxes out of the probate estate (assuming the decedent's intent is clear). Relieving a nonprobate beneficiary of a tax burden is essentially a bequest to that beneficiary, which the decedent's will may make. But if state law contains no apportionment authority, or if state law expressly directs against apportionment, the issue is whether a decedent's will may affirmatively direct that taxes will be allocated to nonprobate assets. This is a particularly acute issue if the nonprobate disposition is an irrevocable transfer as to which the decedent relinquished all rights of control and in which the decedent included no special tax payment directive.

A similar but perhaps less severe issue is whether a decedent may direct a different form of apportionment than that permitted or directed under state law, again in situations in which a will otherwise would be regarded as ineffective to alter or amend an irrevocable nonprobate transfer. Although the authorities in this respect are not uniform, the better supported position appears to be that a sufficient nexus to require inclusion for federal estate tax purposes is a sufficient nexus to permit the decedent to require apportionment or to direct a different form of apportionment than that specified under state law. See, e.g., United States v. Goodson, 253 F.2d 900 (8th Cir. 1958); and *In re* Will of King, 239 N.E.2d 875 (N.Y. 1968); but see Warfield v. Merchants Nat'l Bank, 147 N.E.2d 809 (Mass. 1958) (citing but refusing to follow *Goodson*).

Apportionment to Temporal Interests

The law is relatively clear regarding apportionment of taxes allocable to life estates and terms of years. The Uniform Act is representative of the law in most states, specifying that taxes attributable to either temporal interest are to be paid out of corpus, not charged against the temporal interest. Although this rule appears inequitable on its face, it actually is sensible, given the fact that a reduction of corpus for the payment of taxes correspondingly reduces income to be earned thereon and effectively amortizes the tax allocable to the income interest. The rule also is administratively attractive because the present interest income beneficiary need not contribute toward the payment of taxes that might exceed any income received at the time of payment.

A different situation is presented with respect to annuities, however, because the annuity may be a guaranteed amount, payable from corpus to the extent annual income is insufficient. Thus, a reduction of corpus in payment of taxes allocable to the annuity may not cause a reduction in the amount of the annuity. Another consideration is that many annuities precede a qualified charitable remainder in situations in which taxes attributable to the lead annuity are the only taxes attributable to the entire property (because the remainder qualifies for the charitable deduction). Payment from corpus is inequitable *and* it will reduce the charitable deduction under §2055(c).

Apportionment of the tax burden with respect to annuities could be addressed in drafting any estate plan, but the vast majority of plans do not mention it. The apportionment issue relating to annuities is extraordinarily important because of the high incidence of retirement benefit annuities. The issue can be avoided if the benefit qualifies for the estate tax marital deduction and state law recognizes equitable apportionment. Similarly, with respect to retirement benefit payments made in a lump sum, no serious issue is raised because the recipient has the funds to make immediate payment. Otherwise, because federal law does not grant a right of reimbursement with respect to §2039 includible benefits, this likely will be a significant issue because of the amount of wealth tied up in these plans. At a minimum, clients must be mindful of tax payment when selecting death benefit payout options, to ensure that liquidity will exist if needed to pay any taxes due.

Conflict of Laws and Enforcement Jurisdiction

Perhaps the most perplexing and least definite issues under the entire apportionment umbrella are whose law should govern apportionment questions in multiple state estates. Questions may arise as to how an apportionment rule in one state is to be enforced against property or beneficiaries in another state, especially if the law of that other state is at variance with the law of the state calling for apportionment.

Conflict of laws issues often are the most difficult and least predictable aspect of any controversy, and this certainly is true of apportionment. Based on how it sees the equities of the controversy, a court will want to decide an apportionment question a certain way on the merits. If so, the court may undertake to resolve the conflict of laws issue in a manner that allows the court to select the substantive law needed to render the decision it prefers. In the conflict of laws arena, looking for a state whose law supports the result a court may prefer frequently involves forum shopping that is not entirely copacetic under accepted conflict of laws principles. But it probably is fair to note that courts are prone to adopt their own state's law if possible, meaning that forum shopping to bring a case in a state whose law is favorable is a wily litigation tactic.

As a policy matter, probably the law should favor four essential conflict of laws objectives in this arena: (1) uniformity; (2) predictability;

(3) equal treatment of all parts of an estate, regardless of their physical or legal location for conflict of law purposes, with application of the same rules with respect to testate and intestate assets; and (4) equal treatment of various legal issues, applying the same conflict of laws rules for apportionment as, for example, for testing the validity of a will.

As an example of how confused this area may become, consider the following rules, all of which potentially apply in a particular situation. As to intestate property, the law of the actual situs of the asset with respect to immoveables (land) and the law of the state of the asset's situs (meaning the law of the decedent's domicile) with respect to moveables, may be applicable. Regarding testate property, classification of the apportionment issue for conflict of laws purposes will affect the choice of law rules applied. For example, in all likelihood the law of the decedent's domicile will govern the choice of law if the apportionment question is regarded as either a succession or a validity question. The law of the situs of the primary estate administration may be applicable, however, if apportionment is regarded merely as an administrative question. If inter vivos nonprobate transfers are involved, either the law of the donor's domicile at the time of the transfer or the law of the situs of the transferred property at the time the conflicts issue is resolved may apply for choice of law purposes (and these could differ).

Regarding apportionment and the use of trusts, the law of the situs of the trust for administration may govern for choice of law purposes. And, if appointive property is involved, the traditional conflict of laws rule applies the law of the state of the domicile of the person who created the power (its donor), on the fiction that appointment relates back to the donor's estate plan, with the powerholder merely acting as the donor's "agent" in exercising the power or otherwise with respect to the appointive assets. This conflict of laws rule (that the law of the donor's domicile shall govern, rather than that of the powerholder's domicile) is one of the most troublesome and least expected conflict rules applicable in the estate planning arena. Scoles, *Apportionment of Federal Estate Taxes and Conflict of Laws*, 55 COLUM. L. REV. 261, 285 (1955), suggests that §2207 was enacted in large part to minimize the difficult and unexpected effect of this conflict of laws rule.

Professor Scoles also argues that the proper resolution of a conflict of laws issue in the apportionment setting should follow a two step analysis. First, the law of the situs of property should apply to determine whose law will govern the choice of law question. Thus, if a trust is involved, the choice of law rules of the state of trust administration should govern the choice of law issue. With respect to transfers at death, situs law also should govern the choice of law, whether the assets are probate or nonprobate and regardless of whether administration is domiciliary or ancillary. Second, regardless of the state of situs, every state's choice of law rule should then dictate selection of the substantive apportionment rules of the decedent's domicile, on the simple theory that the decedent's intent should govern the apportionment issue and that the decedent most likely relied on domiciliary law.

This suggestion is not, however, necessarily what the courts of a given jurisdiction will adopt. As a consequence, probably the only way to ensure consistent apportionment results is either to designate the applicable law with respect to all assets (which cannot be done in some cases because there is no way to designate the governing law with respect to some assets) or to provide for tax payment and apportionment that does not rely in any manner on state law.

Planning Aspects of the Apportionment Rules

If state law shifts the tax payment liability to nonprobate takers under applicable apportionment rules, the interests of those takers must be considered during administration of the estate to avoid unintentionally affecting their rights without their knowledge or consent. Any failure to notify or join these beneficiaries may invalidate certain orders obtained or actions taken during administration of an estate if a state court might decide that they are entitled to representation regarding administrative decisions that affect them. One easy mechanism to avoid this concern (and the general lack of state law to dictate the requisite form of joinder or notice) is simply to direct that all taxes be paid out of the probate estate. If negation of apportionment under state law is not appropriate or desirable, however, state law might permit the decedent to indemnify the fiduciary from liability to nonprobate takers and direct that all decisions of the fiduciary in the ordinary course of probate administration shall be final, without notice or joinder. That is one of dozens of issues that inform the drafting of tax payment provisions.

Under §§2206, 2207, 2207A, and 2207B the estate initially pays its tax liability and then is entitled to reimbursement. As a consequence, liquidity may not be where it needs to be and collection problems may arise or may be exacerbated by the existence of multiple beneficiaries, all subject to these rights of reimbursement. In this respect, directing apportionment in the first instance rather than preserving these reimbursement rights may be more expeditious. In most cases, therefore, the better approach is to waive federal reimbursement rights but to preserve all state law apportionment rights, except with respect to specifically designated assets or beneficiaries (or classes of either). But this resolution only works properly to the extent state law calls for apportionment, and it exacerbates the potential of liability to nonprobate takers.

Retirement Benefits

Taxes attributable to retirement benefits includible in the estate under §2039 must be considered carefully in conjunction with beneficiary designations and the terms of the plan. The question is whether the beneficiary can afford to pay taxes imposed by apportionment if settlement of the plan is not in a lump sum. You may need to consider some other beneficiary designation or some other source for payment of the tax if the beneficiary does not have liquidity and if the plan does not permit apportionment against the plan itself. All other things being equal, it probably is wiser to impose tax on the beneficiary (because it is not likely permissible to impose it on the plan), and then attempt to provide the beneficiary with the funds to pay that tax, thereby avoiding the need to even study plan restrictions. You also must pay careful attention to whether the spousal annuity rules will prevent the type of payout otherwise desired. Finally, the income tax consequences of the payout option selected, and of the tax apportionment selected, also should be considered.

As a practical matter, the estate plan must consider whether the breadth of nonprobate assets is such that apportionment would be difficult (if not impossible) to administer and, if so, whether the tax clause should waive apportionment or reimbursement (at least with respect to certain assets or beneficiaries or classes of either). With all the various forms of nonprobate property and taxes that may be involved, however, it seems unlikely that blanket waiver of all apportionment or rights of reimbursement will be appropriate or even feasible.

Administrative Uncertainties

Finally, in some states it is uncertain how various computations and allocations are to be made and in what order, in which case the estate plan should establish the mechanism and dictate apportionment consistent with it. In addition, during (and in anticipation of) estate administration, a number of uncertainties or problems may affect the personal representative and ought to be considered at the time the estate plan is prepared.

One such uncertainty is the effect that an audit will have on the determination of estate and inheritance taxes and their apportionment and collection. Any previously determined allocation of taxes under an apportionment routine will be affected if values change, resulting in either a change in taxes payable or simply a readjustment in the relative size of various shares. This will be particularly problematic in a state that imposes different wealth transfer tax rates, based on degrees of consanguinity, if property subject to any audit changes passed to beneficiaries in different degrees and the rate differential is apportioned under state law. The issue is whether it is prudent to distribute the bulk of an estate prior to final determination and collection of taxes. You should consider whether needs of the beneficiaries are such that a mechanism must be established for early distributions with allocation of taxes secured by a lien, bond, repayment agreement, or other method, or whether apportionment should be waived entirely, or waived only with respect to certain beneficiaries or as to changes resulting from audit.

In addition, problems of collection and asserting jurisdiction over nonprobate takers should be considered before the death of a client, with measures taken premortem to alleviate potential problems either by waiving apportionment or by assuring an ancillary administration in the beneficiary's domiciliary state to obtain jurisdiction. Indeed, if multiple jurisdictions might be involved, conflict of laws issues should be anticipated, especially if a change of the client's domicile is likely or if a conflict of laws battle is anticipated because of the nature and location of nonprobate assets.

Conflict of laws issues probably are the easiest potential problems to address, with the estate plan adopting either or both of two defensive procedures. First, the estate plan may dictate the method of apportionment (if any) desired, thereby alleviating the vagaries of state law and uncertain application of any state's rules. Second, the estate plan may dictate the law that should apply. For the second procedure to succeed, there must be a substantial relation of the client's estate or estate plan to the jurisdiction whose law is selected and the policies of the governing law state must not violate any strong conflicting policy of any state that might be deemed to have the most significant relationship to the client's estate.

Spousal Planning Choices

A number of affirmative planning options or decisions are important with respect to apportionment and planning for a surviving spouse. For example, if only a partial QTIP marital deduction election is made, taxes generated by that decision usually should be paid out of the nonelected portion of the marital deduction trust. By proper accounting, assuring payment of taxes from the nonelected portion of the QTIP trust has the advantage of preventing an alteration of the decedent's estate planning equities if the QTIP and the nonmarital trusts benefit different remainder beneficiaries. Otherwise, payment from the nonmarital property of taxes incurred by virtue of a partial election would shift taxes from the death of S (under §2044) imposed on the QTIP trust (under §2207A) to the death of D, imposed on the nonmarital property (assuming that is how D's tax clause otherwise apportions all taxes).

A similar concern should apply if S disclaims part of the marital bequest, causing taxes to be incurred. These taxes should be payable from the disclaimed property.

In addition, some thought ought to be given to the proper sequence for payment of taxes in relation to division of an estate into shares under a fractional marital deduction entitlement or in conjunction with a partial QTIP election, again as illustrated at page 16 and in Chapter 7 at pages 123-124. As shown by the difference in the various beneficiaries' entitlements, a gross estate fraction is best if D's intent is to freeze S's estate to the extent possible, to minimize tax in S's estate. Most drafters probably call for a net estate division, however, either by inadvertence, for liquidity purposes, or because that result best protects S.

The issue is not determination of the size of the deduction, nor is it whether equitable apportionment should apply. The simple issue is whether taxes are paid first, followed by division, or whether division occurs first, followed by payment out of the nonmarital fund. And the same issue can be relevant in other planning contexts as well.

Simply put, the estate plan (and, for that matter, any premarital agreement that dictates such a bequest) ought to be clear whenever defining terms such as the "residue" available for division or distribution and whether it is being referred to as that amount before or after payment of taxes. See, for example, Barley v. Albertini, 694 So. 2d 843 (Fla. Ct. App. 1997), in which the tax payment provision preceded all other provisions in the document and directed payment from the "*residuary* estate," along with the proviso that "[I]n no event shall any portion of such taxes be apportioned or allocated to my spouse or any property passing to my spouse . . . which qualifies for the marital deduction." Two paragraphs below this the marital trust was described as "90% of the *remainder* of my estate . . . after the payment of . . . taxes . . . referred to above." The trial court held that taxes should be paid first and the marital trust created out of the remaining balance, meaning that 90% of the taxes effectively would be paid from the marital bequest. On appeal the court reversed and remanded because an ambiguity existed. This conclusion appears to be an understatement given the inconsistent statements in the two provisions (relating to nonapportionment to the spouse and division after payment) along with the different terms used in the two provisions. Do you think the drafter might have liability for the costs of resolving this mess?

A similar problem involving the charitable deduction is illustrated by two conflicting cases: Greene v. United States, 447 F. Supp. 885 (N.D. Ill. 1978), and *In re* Estate of Bell, 764 P.2d 689 (Wyo. 1988). In *Greene*, the decedent's placement of the tax burden on the residue of the estate created problems of interpretation of earlier provisions in the will giving 10% of the residuary estate to charity, half of "the rest, residue, and remainder" to the testator's surviving spouse, and "the entire remainder of my estate (hereinafter referred to as the 'Residuary Estate')" to a trust. In this context, payment of taxes from the residue was deemed to be after division into the charitable and marital shares, causing the tax payment to come from the "residue of the residue" and, not coincidentally, preserving a larger marital and charitable deduction.

In *Bell,* on the other hand, the court held that the Uniform Estate Tax Apportionment Act was superseded by a tax payment provision directing payment of all taxes from the residue of the decedent's estate. The residuary provision included two charitable bequests of a fraction of the residue. The charities argued that equitable apportionment should apply so that a gross residue division would be made and all taxes would be paid from the noncharitable portion of the residue. The court concluded that the tax payment direction overrode all portions of the Uniform Act, including equitable apportionment. Then it held that a net estate division was mandated by the chronological organization of the will, directing payment of taxes and then division of the balance of the residue. The court did not even mention the effect of this conclusion on the §2055 charitable deduction, nor did it discuss equitable apportionment as a matter of policy that might guide its decision.

Consistent about both cases is the courts' application of a chronological interpretation, by which division and payment of taxes were deemed to occur in the order in which the respective provisions were found in the documents. That approach is not always best, nor do courts always follow it, making proper anticipation of these issues essential in the initial drafting of the document and the order of each of its provisions.

A more subtle application of the same type of problem is illustrated by Technical Advice Memorandum 9126005, which involved a will that directed payment of all state and federal taxes from the residue of the decedent's estate. State law was the Uniform Estate Tax Apportionment Act, which would apportion taxes among all beneficiaries, subject to equitable apportionment, but only to the extent the decedent did not provide otherwise. The will made several preresiduary bequests and left the residue 25% to an individual and 75% to a charity. Faced with the question of how much the charitable bequest should be reduced under §2055(c) for taxes payable from the residue, the government concluded that equitable apportionment within the residue was not altered by the tax payment provision directing all taxes to be paid from the residue. But the effect was not to impose all taxes on the noncharitable portion of the residue. Instead, the tax on the preresiduary bequests was payable from the residue prior to its division, which effectively reduced the charitable bequest by 75% of the tax on the preresiduary bequests. Only taxes generated by the residue, all attributable to the noncharitable portion of the residue, were apportioned under state law entirely against that noncharitable portion.

The government stated that the question whether the tax payment provision was a direction against statutory apportionment of every dimension was very close, indicating the significance of careful consideration and drafting of tax payment provisions in general. The result reveals the need for careful thought in conjunction with charitable planning in particular. The tax payment provision did not waive all rights to apportionment or reimbursement, which distinguished it from many poorly considered tax payment provisions. It also seems unlikely that the decedent intended that the charitable beneficiary receive a portion of the residue before reduction for taxes attributable to the preresiduary bequests (that is, that the individual residuary beneficiary should pay all taxes), so the government probably reached the right result. But the decedent's intent was not as clear as it might have been and the Memorandum might have dictated an even greater diminution of the charitable deduction.

Benefit of Rates

The focus in so much of this Chapter on federal wealth transfer tax may seem incongruous given the focus in this course on planning for estates that are smaller than the applicable exclusion amount, but the federal tax cases are much more prevalent and often better highlight concerns that are applicable under state law as well. This will become more true in the future as more states restore their state taxes to replace revenue lost due to repeal of the revenue sharing aspects of the state death tax credit under federal tax law. In addition, a client also should consider whether the effect of any differentials in the rate of state wealth transfer tax imposed on the estate (based on degrees of consanguinity of the various takers) should be preserved to the benefit of the respective takers. A spouse typically enjoys this benefit, automatically through equitable apportionment (unless state law does not recognize that doctrine). The benefit of a lower rate for children or descendants as opposed to more distant relatives or strangers also is preserved under some states' laws, including under the Uniform Estate Tax Apportionment Act.

As an easy, common example of a situation in which this might be relevant, consider is the client with children and stepchildren whom the client wants to benefit equally. In some states the stepchildren would bear a larger share of any state wealth transfer tax burden if state law imposes a higher tax rate on stepchildren than it does on natural born or adopted children. The client may wish to alter the normal apportionment rule if the computation necessary to allocate rate differentials is not easy, or if the client does not wish to discriminate against the stepchildren. Indeed, even if preservation of this apportionment rule is the intent, it might be possible to do so in an easier and roughly comparable manner by adjusting the size of various shares or bequests (taking into consideration the effect of state taxes and the beneficiary's relation to the client) and override the state apportionment rule.

Generation-Skipping Transfer Taxes

Generation-skipping taxes are a major tax allocation concern but only in very large estates or those that will benefit multiple generations in trust. For that reason they are not a further subject here than already mentioned, except to the extent this caution reminds you to consider them if your practice takes you in that direction. For more assistance on the topic see Chapter 18 at page 33, or 1 Casner & Pennell, ESTATE PLANNING §3.3.11 (6th ed. 1995).

Principal and Income Rules

Finally, in considering apportionment of the tax or expense payment burden, an income and principal rule should be kept in mind. Typically estate income earned on assets that are expended for payment purposes remains income in the estate.[25] A will may, however, direct that this

25. See, e.g., Uniform Principal and Income Act (1997 Act) §201(2)(A), 7B U.L.A. 150 (2000), and Revised Uniform Principal and Income Act (1962 Act) §5(b), 7B U.L.A. 213 (2000). An extreme example that illustrates this rule is Union Planters Nat'l Bank v. Dedman, 1998 Tenn. App. LEXIS 9, in which the tax payment provision placed the burden on the residue of the probate estate without apportionment and taxes attributable to nonprobate property exceeded the value of the estate as determined at the date of death.

income be added to principal to help compensate for the diminution caused by the payment expenditures. Alternatively, or in addition, the will could provide that the income also be used to pay debts, expenses, and taxes, in either event shifting a part of the burden to the income beneficiaries.

Drafting Considerations

Equity favors equality. Thus, if the provisions of an estate plan are ambiguous the presumption favors apportionment of taxes to achieve equality, putting a heavy burden on drafting to alter that result. But the drafter also must make clear any intent to deviate from state law if, for example, the old burden on the residue rule is applicable.

The federal rights of reimbursement and whether to preserve or waive them is so important an issue that it ought to come first in thinking about drafting. Each of §§2206, 2207, 2207A, 2207B (and, in its special way, §2603(b)) create a right of reimbursement for taxes caused by an individual's death (or a generation-skipping taxable transfer). Inadvertent waiver of these rights could be calamitous, given all the other property that might generate taxes and the possibility that there will be insufficient assets otherwise available to pay taxes under a burden on the residue apportionment rule. In reflection of this fact, §§2207A, 2207B, and 2603(b) require a specific indication of intent to waive their rights of reimbursement for waiver to be effective.

Nevertheless, full apportionment is better than reimbursement for liquidity purposes, because apportionment forces the recipient of property to make the initial payment while reimbursement requires the estate to pay initially and then seek a recovery of the expended assets. Because of this format, there may be no right to receive interest even if the beneficiary who must contribute under a reimbursement provision delays in making payment.

Liquidity, and the apportionment versus reimbursement issue, is particularly important in a tax environment that includes state death taxes that could exceed the amount of a nonmarital trust, even in an otherwise nontaxable optimum marital deduction situation. Marital deduction property may be needed to pay taxes if this occurs, and use of that property will generate a loss of the marital deduction and a corresponding imposition of federal estate tax, with the need to further invade the marital property to pay those taxes, resulting in corresponding loss of more deduction and, ultimately, a whirlpool computation. Even equitable

There was sufficient postmortem income and capital appreciation, however, to satisfy the tax payment obligation, but the court held that postmortem income was payable to the residuary beneficiary under what it called the "Massachusetts" rule that the income beneficiaries enjoy the income from the entire residue and not just the income from whatever corpus remains after satisfaction of all payments from the residue. The result is counterintuitive in that it assumes there to be residuary income even though there is no residue. It does correctly reflect that, prior to payment of these estate charges, there is the possibility for investment returns to the estate that must be considered in drafting those provisions that dispose of the estate.

apportionment cannot protect against this result to the extent the marital bequest does not fully work to eliminate state taxes.

In addition, waiver of the §2207A reimbursement right should be considered carefully because Treas. Reg. §20.2207A-1(a)(2) provides that the simple failure to enforce the right of reimbursement is a gift (neither §2206, §2207, nor §2207B so provides). Often this liability will be unexpected and about which the beneficiaries deemed to have made the gift likely will be without knowledge. But liability can be avoided if the surviving spouse as beneficiary of qualified terminable interest property waives the §2207A right of reimbursement. It is particularly important that the surviving spouse have flexibility to decide whether to preserve or waive this right of reimbursement. Normally the QTIP trust should specify that taxes attributable to trust property will be paid from the trust before it is distributed, unless the surviving spouse's will overrides that direction by a provision making specific reference to the QTIP trust.

With respect to the indication of intent required under §2207A itself, consider *In re* Estate of Gordon, 510 N.Y.S.2d 815, 817 (Surr. Ct. 1986), in which the decedent's tax clause read, "I direct that all . . . taxes . . . imposed . . . by reason of my death with respect to any property includable in my estate . . . whether such property passes under or outside my will be paid out of my Residuary Estate . . . without apportionment." A charitable residuary bequest would have abated completely if the court had found that the §2207A reimbursement right had been waived by this provision. The court instead found that this provision was not adequate to work such a result, and a subsequent amendment to §2207A now will generate the same result nationwide.

For comparison purposes, the following language was adequate to waive §§2206 and 2207 rights of reimbursement in a case involving no "special" remainder beneficiary: "All estate taxes payable by reason of my death shall be chargeable against and payable out of my residuary estate without contribution by anyone." *In re* Estate of Bruce, 516 N.Y.S.2d 748 (App. Div. 1987). The court reached this result notwithstanding the drafter's testimony that the decedent and the drafter were unaware of nonprobate assets and that the purpose of the provision was to avoid inside apportionment only. The point is that you can't be too careful in specifying intent in the document.

Items to Consider

More specifically yet, a good tax clause will address the following topics clearly, even if state law is crystal on many of these concepts, because of the migratory nature of clients and the potential conflict of laws problems that could arise.

- Language should make clear which taxes are being apportioned (estate, generation-skipping, Chapter 14, state, income, alternative minimum income, and appreciation estate taxes).

- Both inside and outside apportionment, or the waiver thereof, clearly should be covered; often only outside apportionment is contemplated and statutory inside apportionment across the entire estate is forgotten.
- Equitable apportionment should be considered; it usually will be the client's intent to embrace it, even if no other form of apportionment is desired.
- Any intent to preserve the effect of state wealth transfer tax computation differentials (if any) should be stated clearly.
- Any desire to allocate credits to recipients of assets to which the credits relate should be covered.
- Alteration of the apportionment rule relative to temporal interests always should be considered, particularly in estates with annuity or installment payouts of retirement benefits.
- The provision should apportion or call for payment of interest and penalties in the same manner as the taxes to which they relate.
- If it is known that there will be deductible claims against the estate (such as pursuant to a premarital or separation agreement) and they are similar to or in lieu of bequests from the estate, the determination of the size of those dispositions and apportionment of taxes to them should be considered and specified in the tax clause, frequently applying the same considerations applicable to other bequests. Especially sensitive, however, is whether the agreement permits apportionment and whether various issues noted here were considered in the preparation of that agreement.
- It should be specified whether it is appropriate to look to particular assets first for tax payment. The desire to preserve certain assets should be noted rather than relying on the personal representative to ferret out the decedent's intent. However, stating a preference to protect certain assets probably should not be allowed to override other presumably more important apportionment principles. For example, the preference for preservation of farm property was alleged to cause marital deduction property to be tapped for tax payment in Estate of Reno v. Commissioner, 945 F.2d 733 (4th Cir. 1991), rev'g (en banc) 916 F.2d 955 (4th Cir. 1990), which aff'd 51 T.C.M. (CCH) 909 (1986). The tax payment provision would have negated the concept of equitable apportionment and generated a tax if this had been found to be correct, because the marital deduction would have been reduced.

As a checklist of other commonly overlooked apportionment issues that are discussed herein but don't always arise, remember to consider:

- fees and expenses;
- state taxes that don't conform to federal estate tax rules and that can produce disparities;

- special use valuation and recapture under §2032A;
- future interests that invoke tax that may be deferred under §6163;
- deferral of tax under §6166 and the question of who shall pay the deferred tax and interest on it;
- with respect to any apportionment that is preserved, how enforcement will be effected and whether to include a power of setoff in the client's will for any dispositions of probate property to takers of nonprobate property that will bear a share of the tax burden.

In any event, if apportionment is preserved, the order for computation of any bequest or share of the estate and for payment of taxes should be specified, even if it is clear under state law. It is surprising how seldom this is done, given the number of cases revealing that the proper method frequently is *un*clear. Thus, for example, the document should specify clearly whether a gross or a net estate division is desired in computing a marital deduction fractional share.

Often several tax clauses will (or should) be involved if a client has a funded living trust and perhaps an irrevocable insurance trust in addition to a will directing disposition of the probate estate. Most decisions indicate that the provision in the will controls to the extent those clauses differ or are contradictory. But some cases hold that the latter in time controls, which may be a trust. As among other documents, no clear order of priority exists.

Much more importantly, the Uniform Acts and §§2206 and 2207 all ostensibly require that waiver of apportionment or reimbursement be by a will provision. Only §§2207A and 2207B allow waiver by the decedent's revocable trust as well. Thus, although waiver of reimbursement by a provision in a trust or other document may not succeed if the will does not also waive the right, it probably can't hurt (unless there is an inconsistency) for each document to state the client's intent. But be consistent when doing so!

The significance of this is well illustrated by Estate of Roe, 426 N.W.2d 797, 798, 799 (Mich. Ct. App. 1988), in which the decedent's will provided that "I make no direction for the payment of . . . taxes assessed by reason of my death, as I have provided for their payment under a certain Agreement hereinafter mentioned." The trust called for tax payment and specified that "the Trustee shall not seek contribution from anyone for any portion of the taxes so paid." The court held that apportionment under state law would apply, notwithstanding this clear intent that the trust pay for all, because the will failed to waive application of the state apportionment statute.

The most notable aspect of *Roe* is that the tax clauses involved were verbatim from a major Chicago fiduciary's forms book. This problem exists in literally thousands of estate plans nationwide. With respect to the other end of the spectrum, if there is a tax payment obligation in more than one document, and taxes may be paid by more than one entity, the estate plan must coordinate these documents to specify how the burden is computed for each and how aggregated apportionment will work.

It also makes sense to include a safety valve tax clause in trusts (such as an irrevocable insurance trust or a grantor retained interest trust) that are intended to escape inclusion if everything goes as planned. Such a provision would specify that the fiduciary may purchase assets from the grantor's estate or loan money to it (to provide liquidity) and that taxes caused by inclusion of any part of the trust that is includible in the grantor's estate are payable from that portion. To succeed probably requires that the grantor's estate plan not waive apportionment with respect to the trust. Also, the trust document must clearly provide that this provision operates only if, quite independently, the trust is found to be includible, so as not to generate inclusion in the first instance.

Clearly Specify Intent

The case reporters are full of decisions involving the meaning of provisions relating to apportionment. It almost goes without stating that any intent to override any state apportionment rule must be stated clearly. The task requires more than just directing "payment of all debts and taxes from the residue of my estate" or "pay all taxes imposed on my estate by reason of my death" or "pay all taxes out of my residuary estate without apportionment." Among the questions raised by provisions like these would be whether these provisions actually waive apportionment or only direct payment of taxes that thereafter may be apportioned?[26] Could the

26. For example, in Estate of Fine v. Commissioner, 90 T.C. 1068 (1988), the decedent's will directed payment of taxes "without apportionment," which in all likelihood was meant to impose the tax burden on the residue without apportionment to or contribution from takers of includible nonprobate property. Unfortunately, the court determined that the effect was to override a state statute calling for equitable apportionment of all taxes to the nonmarital portion of the estate. As a result, the court held that the decedent's estate available for division between the surviving spouse and others was the residue left after payment of taxes rather than dividing the estate before such payment and charging the taxes to the nonmarital share. The net effect was to reduce the allowable marital deduction. Accord, Estate of Miller v. Commissioner, 76 T.C.M. (CCH) 892 (1998), aff'd per curium, 2000-1 U.S. Tax Cas. ¶60,370 (5th Cir. 2000) (a tax payment provision directing the residuary estate to bear the entire burden was adequate to override state law equitable and outside apportionment, notwithstanding reduction of the marital deduction as a result); Estate of McKay v. Commissioner, 68 T.C.M. (CCH) 279 (1994) (notwithstanding that 75% of the residue passed to charities, the decedent's will directing payment of all taxes imposed on the probate estate from the residue without apportionment among the residuary beneficiaries was sufficient to require reduction of a charitable bequest and the corresponding charitable deduction). But in McKeon v. United States, 151 F.3d 1201 (9th Cir. 1998), and Estate of Brunetti v. Commissioner, 56 T.C.M. (CCH) 580 (1988), involving marital and charitable deductions, respectively, and similar tax payment provisions, the courts refused to accept the government's reduction of the deduction because the courts read the state law apportionment rules as applying unless clearly overruled, and found that sufficient ambiguity existed in each document to preclude a finding of a clear intent to abandon that otherwise favored result. The government itself reached the same result in Private Letter Ruling 200206024, finding that state law equitable apportionment applied to a pay from the residue direction such that residuary charitable and marital bequests were not obliged to contribute to the tax payment obligation.

To the same effect, after two different rounds of litigation with appeals, one through the federal courts and another through the state courts, is Estate of Swallen v. Commissioner, 98 F.3d 919 (6th Cir. 1996), rev'g 65 T.C.M. (CCH) 2332 (1993), and provision be interpreted to include any additional estate tax imposed under §2032A upon a recapture event with respect to any special use property? Does the reference to "my estate" mean the gross estate, the taxable estate, the probate estate, or something else? Consider the sleight of hand performed in the following decision; do you agree that the court reached an appropriate result?

In re Estate of Ogburn

406 P.2d 655 (Wyo. 1965)

GRAY, J.

The will of Alice R. Ogburn, deceased, disposed of real and personal property . . . Out of that property a special devise was made to her foster son, . . . and a special bequest of certain stocks . . . was made to his children. A brother and five sisters of decedent were made the residuary devisees and legatees. In addition to the above-described property passing under the will, the foster son . . . acquired ownership of jointly held property . . . and proceeds of insurance policies . . . . [A]s executor, the foster son undertook to charge the residuary estate with the full amount paid for Federal estate tax and the full amount paid for Wyoming inheritance tax. Exceptions to the accounting treatment accorded such items were duly taken by the residuary legatees. . . .

The clause of the will that brought about this controversy states: "FIRST: I direct the payment of all my just debts, taxes, funeral expenses and expense of administration of my estate." Following this are articles "THIRD" and "FOURTH" making the specific devises and bequests to the foster son and his children, and article "FIFTH" granting the residuary estate to the brother and sisters of the testatrix. For our purposes that is the sum and substance of the will.

The Federal Taxes

As an initial approach to the matter of apportionment of Federal estate taxes we point out . . . that the public policy of this State, as declared by the legislature, is to apportion such taxes to the persons benefited. Section 2 of the Act succinctly lays down that proposition. It provides:

Matthews v. Swallen, 1995 Ohio App. LEXIS 4669 (Ct. App. 1995), in which the decedent's irrevocable inter vivos trust was includible in the gross estate and, although it provided for the decedent's surviving spouse, did not qualify for the marital deduction; the residue of the decedent's estate qualified for the marital deduction but only after payment of all taxes and subject to a direction "that no tax . . . shall be charged . . . against . . . any . . . trust beneficiary, so long as the funds or property in the hands of my Executor . . . are sufficient . . . ." Holding that this provision in the will was not adequate to override state law apportionment to the trust, and relying on an income tax provision in the will as stating the decedent's overall intent to minimize taxes, the court on appeal stretched to find the tax payment direction inadequate to impose on the residue the tax liability attributable to the trust and thereby salvaged the marital deduction for the residue.

> Unless the will otherwise provides, the tax shall be apportioned among all persons interested in the estate. The apportionment shall be made in proportion that the value of the interest of each person interested in the estate bears to the total value of the interests of all persons interested in the estate. The values used in determining the tax shall be used for that purpose.

. . .

Practically all of the cases agree that a directive against apportionment should be expressed in clear and unambiguous language. Depending, of course, upon the complexity of the testamentary plan a few simple words may suffice to effectuate that purpose. It is essential, however, that the words, or combination of words, used in the will sufficiently indicate an intention against apportionment. In case of doubt the burden of the taxes must be left where the law places it. . . .

Turning now to article "FIRST" of the will, stripped of irrelevant language in order to reach the tax clause, it is provided "I direct payment of all my . . . taxes . . . of my estate. " We by no means commend this clause as a model directive against apportionment. It is a superficial, artless, and inept expression relating to this important and crucial element of a testamentary plan prepared by a nonresident attorney confessedly unfamiliar with the applicable laws of Wyoming.

As appellants point out, the tax clause fails by direct language clearly to specify the nature of the taxes embraced within the clause, the source from which the taxes affected were to be paid, and the persons interested in the estate who were to receive benefits freed of the burden of taxes. Such deficiencies, of course, prompted the present litigation. Furthermore, as we indicated above, there is some basis under the authorities for appellants' contention that such lack of clarity condemns the clause as an enforceable directive against apportionment or, at least, when related to the matter of the purpose intended, demonstrates that neither the testatrix nor the scrivener of the will had in mind the importance of fitting death taxes into the testamentary plan. . . .

Reminding that we are presently considering the relationship of the language used to the apportionment of the Federal estate taxes, an important consideration is the nature of the tax. Unlike our inheritance tax, the tax is not imposed upon the privilege of the devisees, legatees, and heirs to take and receive an interest in property from a decedent. Rather it is a tax imposed upon the interest of a decedent which ceased by reason of death thus causing the transfer of such interest to the recipients thereof. In other words, the tax might be described as a tax on the privilege of transferring an interest in the property upon death, which generally is understood as an obligation imposed upon the transferor.

When the nature of the tax is taken into consideration, together with the fact that testatrix, over the years, was a successful and experienced businesswoman, we think it must be assumed that she had some familiarity with the impact of death taxes and that by the language "all my taxes of my estate" she did intend to embrace at least a portion of such taxes. Further, by inclusion of the tax clause in the usual ritualistic and introductory portion of the will directing payment of debts, expenses, et cetera, which when possible are ordinarily satisfied from the residuary estate, it seems clear that testatrix also intended that the death taxes embraced within the language were to be paid from the same source.

That leaves for consideration the portion of the taxes affected. As stated above, we think that question cannot be precisely answered without relating the tax clause to each segment of the testatrix's property transferred as a result of death and upon which the tax was levied, i.e., testamentary gifts, nontestamentary gifts, and proceeds of insurance policies.

In fact the necessity for so doing seems inherent in the distinction made under the laws of Wyoming between what we shall term the "taxable" estate defined as being "the gross estate of a decedent as determined for the purpose of federal estate tax" and the "probate" estate, which as commonly understood consists of the property owned by a decedent at the time of death which is transferred in accordance with the provisions of the will or statute relating to intestacy through the processes of the probate court. While both estates have some interrelation, there is a substantial difference. The "probate" estate, as indicated, is concerned with the devolution of a decedent's interest in property at the time of death which does not occur otherwise than by the will or the intestacy statute. A property interest such as an unsevered interest in a joint tenancy forms no part of the "probate" estate. On the other hand, Federal law for purposes of determining the "taxable" estate, while including all of the assets of the "probate" estate, is not concerned with the manner in which property interests of a decedent are otherwise transferred, and interests such as the joint tenancy mentioned are treated as integral parts of a decedent's estate for purposes of the Federal estate tax. That such a distinction has special significance in considering the question before us can readily be seen. A somewhat ambiguous tax clause may contain language sufficient to disclose an intent on the part of the testator or testatrix to shift the burden of the Federal estate tax levied upon decedent's property passing under the will and yet be insufficient to shift the tax levied upon the transfer of a decedent's interest in property which is not controlled by the will. Such a possibility is much too important to be overlooked and we find nothing in the apportionment statute that would cause us to reject such an approach.

Relating the tax clause to the testamentary gifts, we are inclined to the view — based on the foregoing general discussion — that testatrix must be understood as having this portion of the taxes in mind when she referred to "my taxes of my estate" and that such language, although not entirely clear, sufficiently expressed the intention of testatrix to direct against statutory apportionment of the taxes imposed on such gifts. It is only by such an interpretation that force and effect can be given to such language, and as stated above we have concluded that this must be done. We are not disposed, however, to go further than that.

Just as testatrix must be assumed to have been familiar with the tax imposed upon the transfer of the property in her estate in accordance with the will, it must likewise be assumed she was familiar with the fact that a tax would be imposed upon the nontestamentary gift of the joint property to her foster son. As stated, such property formed no part of her probate estate, and that testatrix so understood can also be assumed. Yet no mention is made of an interest in property passing other than by the will, as a result of the death. Nor do we find language in the will from which a purpose to shift the burden of such tax to appellants can be inferred, a purpose which is required clearly to appear. The dominant words are "my estate. " That such phrase fails to establish a basis for nonapportionment of the tax here being discussed seems well established by the authorities. In Union Trust Co. v. Watson, 68 A.2d 916, 919 (R.I. 1949), the court had this to say:

> We think that the testator's expression "my estate" in his later will has a very definite and explicit meaning. Such expression, it has been said, "has a fixed and a limited meaning; it is positive, clear-cut and free from doubt. It conveys an inference of existing title or ownership in the maker of the phrase and leads to the single conclusion that he had in mind the payment only of such taxes which might be levied upon his testamentary gifts or devises. "

. . .

In view of the foregoing we think the only reasonable interpretation of the will which can be reached is that by the language testatrix could have intended nothing more than a shifting of taxes imposed upon the property passing under the will.

. . .

State Inheritance Taxes

> Of this, we think little need be said. The statutes imposing such taxes clearly and specifically place the burden thereof upon the recipients of the testatrix's bounty. That such was to continue as the public policy of this State was clearly demonstrated when the legislature in adopting the Uniform Estate Tax Apportionment Act in 1959 deleted from the prescribed form any reference to inheritance taxes payable to the State. True, the inheritance tax statute does not take from a testator or testatrix the right to shift the statutory burden to a particular fund, but to accomplish such purpose the directive must clearly appear from the will. That the language here could not possibly constitute such a directive is self-evident. The testatrix refers only to "my taxes of my estate. " These were not her taxes, nor were the taxes levied upon her estate. To hold such language to constitute a sufficient directive would be to reach a most inequitable result in clear contravention of the statute that is designed to prevent such a happening. The State taxes paid were attributable entirely to the gifts made to appellees. The amounts received by the appellants were entirely exempt. The executor was clearly wrong in attempting to charge appellants' accounts with such taxes. . . .

See also Landmark Trust Co. v. Aitken, 587 N.E.2d 1076 (Ill. App. Ct. 1992), in which litigation was needed to ascertain the decedent's intent because the will simply directed payment of all taxes from the residue, which was insufficient, and it was not clear whether state common law equitable apportionment should apply with respect to the balance. The court determined that state law apportionment was negated entirely by the tax clause and that common law abatement principles were applicable to determine how the excess taxes were to be paid. The result was that general bequests abated while specific bequests were protected from paying their proportionate share of the excess taxes.

About a shockingly similar provision in the will of one Elmer Cohen, deceased, ("I direct my Personal Representatives to pay, without reimbursement or contribution, all estate [sic], inheritance taxes, and succession duties assessed by reason of my death by the United States or any State thereof"), the Probate Division of the Circuit Court of St. Louis County, Missouri, No. 113549 (April 22, 1996), ruled that the will was "not ambiguous. Ambiguous means reasonably susceptible of more than one meaning. [This provision] is not susceptible of any meaning and cannot be construed." This portion of the holding was overruled on appeal, Estate of Cohen v. Crown, 954 S.W.2d 409 (Mo. Ct. App. 1997), the court refusing to conclude that there was no meaning in the provision but still concluding that it did not effectively waive the §2206 right of reimbursement with respect to includible insurance proceeds and thereby protecting a charitable bequest that otherwise would have been reduced.

You do *not* want to be the drafting attorney about whose work such a controversy swirls!

As a practical matter, most estate plans probably still waive all apportionment, the effect being that taxes are a burden on the residue as provided under common law. Apportionment rules create a more equitable method for payment of taxes and may represent the average decedent's intent when thought is given to the issue. But they are not a panacea either, because they may create problems of their own, particularly of an administrative and enforcement nature. And even in states with well drafted apportionment statutes (such as either Uniform Act, in most respects), the estate plan always must address issues relating to the payment of taxes.

Sample Tax Clause

Because of the complexity of this matter, the following sample tax clause is offered for discussion purposes only. It is designed for use in a will and reflects far more complexity than the typical user would want to incorporate, on the theory that it is both easier to delete provisions that are not needed and better to be comprehensive if the user may not want to tailor the provision for every situation. It also may apportion taxes to recipients the client would want to spare. The presumption is in favor of apportionment except to the extent a recipient is absolved. By way of example, many users are likely to delete paragraph 1.2.1.2, requiring apportionment with respect to donees who received gifts during life, because the amounts involved are too small to be concerned with and the hassle of apportionment is too great.

1. *Debts, Expenses, and Taxes:* My personal representative shall pay from the residue of my estate all proper obligations of my estate, including expenses of my last illness and funeral, costs of administration (including ancillary), other proper charges and enforceable claims[a/] against my estate, and (subject to apportionment as provided below) death taxes as defined next below. Payments may be charged to estate income or principal[b/] in the discretion of my personal representative to the extent no deduction otherwise allowable is reduced thereby.

1.1. *Death Taxes Defined:* Death taxes means all estate, inheritance, succession, or transfer taxes and any income or similar

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a/ The term "proper" charges and "enforceable" claims is meant to preclude acceleration of charges that are not yet due and owing. Exoneration or premature payment of debts is *not* the intent of this provision.

b/ Reference to using income is meant to authorize the flexibility authorized by the so-called *Hubert* regulations in Treas. Reg. §20.2056(b)-4(d)(5), and the restriction relating to reduction of any deduction refers to the government's position in Treas. Reg. §20.2056(b)-4(d).

taxes on appreciation (including interest, penalties, and any excise or supplemental taxes) imposed by the laws of any domestic or foreign taxing authority at the time of or by reason of my death, but shall not include:[c/]

1.1.1. Any additional estate tax incurred under §2032A(c) of the Internal Revenue Code or any similar or corresponding state tax law or any successor provision to any such law, all as amended prior to my death (hereafter collectively referred to as the Code) because of the disposition of or failure to use qualified real property or family-owned business interests; and

1.1.2. Generation-skipping transfer taxes imposed by Chapter 13 of the Code [, except to the extent attributable to a direct skip of which I am the transferor and that is not caused by a qualified disclaimer by a nonskip person (as those terms are defined in the Code), which shall be paid from the residue of my estate without apportionment or reimbursement, notwithstanding the provisions of §§2603(a)(3) and (b) of the Code or any other provision of this will].[d/]

1.2. ***Apportionment:*** **Except as otherwise provided herein, it is my intent that each recipient of property that is includible in my estate for death tax purposes (whether passing under this will or otherwise) pay the death taxes attributable to the property (s)he receives,**[e/] **determined as follows:**

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c/ The exceptions here are designed to avoid imposition on the decedent's estate of certain taxes that ought to be left on particular beneficiaries, as further identified in the payment provision itself. By way of example, the first exclusion from payment is any recapture tax that might ought to burden the recipient of qualifying property because it would be their failure to comply with material participation rules that would cause this tax to be incurred. To make this fair, however, the benefit of the tax reduction attributable to that property ought to be allocated in their direction. Some clients will prefer to give the tax saving to all beneficiaries equally notwithstanding that the recapture liability is imposed on the recipient of the particular property, feeling that the property itself is their "crown jewel" asset and receipt of it alone is benefit enough. However, imposition of the recapture tax on beneficiaries other than the recipient of the qualifying property could create untenable administrative, enforcement, and equity concerns.

d/ The sense of this provision is that generation-skipping transfer taxes caused by a child's disclaimer of property should not be a burden on other children, because the tax on one child's share of an estate normally would reduce that one share, typically when the child dies. Acceleration of the tax by virtue of the disclaimer should not alter the source for its payment. This concern does not have the same merit if a generation-skipping tax was going to be incurred anyway (for example, because the bequest is to a grandchild who is disclaiming in favor of a great grandchild), in which case the optional provision appropriately might be included.

e/ The overarching principle of this provision is stated here: the default is full apportionment (everyone pays their own way) except to the extent the recipient or a particular asset is identified and exempted from carrying a portion of the total tax load. This approach avoids surprises because a

1.2.1. The death tax attributable to:

1.2.1.1. Appreciation is the full amount of income or similar taxes incurred by reason of my death.

1.2.1.2. Adjusted taxable gifts as defined by §2001(b)(1)(B) of the Code, any gift taxes includible in my gross estate by §2035(b) of the Code, any recaptured inter vivos transfer subject to §529(c)(4)(C) of the Code, or any comparable inclusion (hereafter collectively referred to as completed lifetime gifts) is the difference between (a) the total death taxes incurred by my estate, less those death taxes described in paragraph 1.2.1.1 and (b) the death taxes that would have been incurred if there were no completed lifetime gifts.[f/] For apportionment purposes, the recipient of property that produced gift tax includible by §2035(b) of the Code shall be treated as having received the amount of that gift tax, and the recipients of completed lifetime gifts will pay the tax attributable thereto.

1.2.1.3. The death tax attributable to all other property is the difference between (a) the total death taxes paid by my estate and (b) those death taxes described in paragraphs 1.2.1.1 and 1.2.1.2 that actually are collected by my personal representative.

1.2.2. *Multiple Recipients:* If there is more than one recipient of property separately described in paragraphs 1.2.1.1 through 1.2.1.3, each recipient shall pay a proportionate share of the death tax attributable to all of the property described in that separate paragraph based on the value of the property received by the recipient as finally determined in the death tax computation as compared to the same value of all property described in that separate paragraph that is not excluded from apportionment under paragraph 1.2.6.

1.2.3. *Tax Benefits:* Credits, deductions, exclusions, exemptions, and similar benefits shall be reflected as follows:

1.2.3.1. In computing the death tax paid by my estate for purposes of paragraph 1.2.1.2 and determining the proportionate share of such tax to be paid by any individual recipient, any gift tax allowed as a credit by §2001(b)(2) that was paid by the recipient shall inure to the benefit of that recipient.

1.2.3.2. In computing the death tax paid by my estate for purposes of paragraph 1.2.1.3 and determining the proportionate share of such tax to be paid by any individual recipient, the credit granted by §2001(b)(2) for gift taxes that were not paid by any individual recipient, the unified credit granted by §2010 of the Code, the credit for gift taxes granted by §2012 of the Code, the credit for

particular tax or asset that was unknown to the planner would not be identified and the default full apportionment rule would apply.

f/ The logic behind this assignment of tax to lifetime gifts is that the beneficiary already received the benefit of early receipt of the gifted property and incremental tax versus pro rata liability is a form of rough justice.

property previously taxed granted by §2013 of the Code (but only to the extent attributable to property that cannot be identified specifically as includible in my estate at death), and any other tax benefit that is not allocated by paragraph 1.2.3.3 because it is not possible to identify the property passing to a recipient that produced the tax benefit shall inure to all recipients of property described in paragraph 1.2.1.3.

1.2.3.3. The benefit of any other tax benefit shall inure to the recipient of property that produced the tax benefit (e.g., the recipient of property that generates a state death tax shall enjoy the benefit of the deduction granted by §2058 with respect to payment of that tax, the recipient of property subject to foreign death tax shall enjoy the benefit of the credit granted by §2014 with respect to the taxation of that property, and the recipient of specifically identifiable property that is includible in my estate and that previously was taxed shall enjoy the benefit of any credit granted by §2013 with respect to that property).

1.2.3.4. The benefit of any reduction in tax attributable to an election under §2032A of the Code shall inure to the qualified heir who receives the property that is the subject of the election.

1.2.3.5. The benefit of any reduction in tax attributable to property qualifying for the marital or charitable deduction shall inure to the recipient of that property. Any increase in death taxes attributable to a disclaimer of such property or a failure to elect to qualify any part of a bequest that otherwise could constitute qualified terminable interest property under §2056(b)(7) of the Code shall be charged to the disclaimed or nonelected property without the benefit of any marital deduction otherwise available to my estate.

1.2.3.6. The benefit of any tax rate differential in computing state death taxes attributable to the relation of the recipient to me shall inure to that beneficiary.

1.2.3.7. The benefit of any other entitlement directly attributable to identifiable property shall inure to the beneficiary who receives that property.

1.2.4. *Temporal Interests:* Death tax attributable to property held in temporal interests (e.g., a life estate, annuity, or term of years, followed by a remainder or a reversion) shall be paid from corpus to the extent the effect thereof is to amortize the cost over the respective interests but otherwise shall be apportioned between the respective interests based on their respective values. Apportionment to a lead interest may entail a loan from principal or recomputation of an annuity or other guaranteed payment, but neither this paragraph nor any provision of state law shall apply to the extent the effect is to reduce a deduction otherwise allowable for any part of the property.

1.2.5. *Qualified Terminable Interest Property:* Notwithstanding paragraph 1.2.3.5, with respect to property includible in my estate under §2044 of the Code, all taxes attributable to all §2044 property shall be apportioned to the §2044 property with the highest inclusion ratio to the extent doing so will not constitute a constructive addition with respect to any §2044 property with a lower inclusion ratio.[g/]

1.2.6. *Exoneration:* Notwithstanding any other provision of this will, the recipient of property described in this paragraph shall not be subject to apportionment and the taxes attributable to this property shall be paid by the remaining recipients of property includible in my estate according to the computation of attributable tax described in paragraphs 1.2.1 and 1.2.2:

1.2.6.1. To the extent apportionment of the attributable tax would violate federal law relating to retirement benefits and deferred compensation.

1.2.6.2. To the extent apportionment of the attributable tax would cause an acceleration of income taxation or to the extent the property otherwise would be eligible for exclusion from my estate by §§2039(c) or (e) of the Code pursuant to the transition rules in §§525(b)(2) through (b)(4) of the Tax Reform Act of 1984 as amended.

1.2.6.3. Proceeds of life insurance that are exempt from inheritance or similar state death taxes to the extent not subject to apportionment because paid to a beneficiary other than my personal representative.

1.2.6.4. Property not passing under this will to the extent the total tax attributable thereto is less than *% of the total death taxes described in paragraph 1.1.[h/]

1.2.6.5. Personal effects passing under this will to the extent the total tax attributable thereto is less than *% of the total death taxes described in paragraph 1.1.[i/]

1.3. *Reimbursement:* Because I intend to apportion death taxes as described above, it is unnecessary to assert the rights to reimbursement provided by §§2206, 2207, 2207A, 2207B, and 2603 of the Code (and any similar provisions hereafter adopted) and, except to the extent inconsistent with the foregoing, I hereby waive those entitlements.

1.4. *Interest and Setoffs:* In the discretion of my personal representative, death taxes attributable to property not passing under

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g/ This mumbo jumbo is designed to avoid using GST exempt assets in payment of tax in the estate of the surviving spouse.

h/ This provision merely absolves the need to track down the recipients of nonprobate property if the tax attributable to that property is insignificant.

i/ This provision serves the same nonapportionment function as the prior provision, if the personalty disposed of in the identified provision of the will also is insignificant, avoiding the need for any recipient of this typically nonmarketable or illiquid property to generate cash with which to pay tax attributable to it.

this will may be paid out of the residue of my estate before recovering the attributable tax from the recipient of that property.

1.4.1. Attributable tax that has not been paid by the recipient before my personal representative pays death taxes or that is not yet due because my personal representative made a valid deferral election under §6161, §6163, or §6166 or any similar provision of the Code shall bear interest equal to that imposed by the Code on my personal representative.

1.4.2. In the discretion of either my personal representative or a beneficiary under this will, as a form of payment by that beneficiary to my personal representative, any entitlement of that beneficiary under this will may be applied in payment of that beneficiary's share of the taxes and interest attributable to other property received by that beneficiary.

1.4.3. In its discretion my personal representative may distribute my estate in whole or in part before final audit and settlement of the tax liability of my estate, notwithstanding that attributable taxes may be altered thereafter.

1.4.4. My personal representative shall not be personally liable for withholding an insufficient amount as a setoff against the liability of a recipient or for failing to recover attributable taxes or interest following reasonable efforts, and shall not be required to litigate to enforce apportionment unless indemnified against the costs thereof.

1.5. *Adjustments:* My personal representative's selection of assets to be sold to pay death taxes, and the tax effects thereof, shall not be subject to question by any beneficiary. My personal representative is hereby indemnified against any liability it may incur to any recipient of property not passing under this will for the effect of any action taken in the computation or payment of death taxes that directly or indirectly affects any recipient's liability under this provision. Elections or allocations authorized under the Code may be made by my personal representative in its discretion without regard to or liability for the effect thereof on any beneficiary. No adjustment shall be made between income and principal, in the relative interests of the recipients, or in the amount or selection of assets allocated to any beneficiary under this will, to compensate for the effect of any such action or for the effect on the amount of any tax attributable to any recipient of property includible in my estate for death tax purposes.[j/]

j/ This provision largely is about compensatory or equitable adjustments that otherwise might be required, notwithstanding that the proper adjustment might be quite uncertain both in terms of the legal need for it and the proper action. Often these adjustments are asserted as the fiduciary's duty to treat all beneficiaries fairly, following an income or wealth transfer tax election that saved taxes but produced an inequity. See, e.g., Chapter 7 at pages 38-39 and 66-67.