DRAFT

FOR DISCUSSION ONLY

UNIFORM ESTATE TAX APPORTIONMENT ACT

WITH REPORTER'S NOTES

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

March 2002 Draft

UNIFORM ESTATE TAX APPORTIONMENT ACT

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UNIFORM ESTATE TAX APPORTIONMENT ACT

SECTION 1. SHORT TITLE. This [Act] may be cited as the Uniform Estate Tax Apportionment Act.

SECTION 2. DEFINITIONS. In this [Act]:

(1) "Apportionable estate," with respect to an estate tax, means the value of the gross estate for that estate tax reduced by:

(A) the decedent's funeral expenses and estate administrative expenses;

(B) enforceable claims against the decedent's estate other than claims for:

(i) estate taxes,

(ii) a statutory elective or forced share of the decedent's estate that does not qualify for an estate tax deduction or exemption, and

(iii) a debt to a person other than a charitable organization that is founded on a promise or agreement, but only to the extent that consideration in money or money's worth was not given in exchange for the promise;

(C) any amount added to the decedent's gross estate for a tax paid on gifts made before death; and

(D) the amount or value of any property that is excluded from apportionment of an estate tax.

Comment

The starting point for calculating the apportionable estate is the value of the gross estate. Since the gross estate for different taxes may be different, the apportionable estate figure may be different for different taxes.

If a devise or transfer of property qualifies for a marital or charitable estate tax deduction, unless the decedent directs otherwise, no estate tax is apportioned to the beneficiary of that property under Section 5(b), and so the value of that property is deducted in determining the apportionable estate.

A gift tax paid by the decedent on a gift that was made by the decedent or the decedent's spouse within three years of the decedent's death is added back to the decedent's gross estate for federal estate tax purposes by Internal Revenue Code § 2035(b). A State or foreign estate tax may have a similar provision or effect. By the Act's excluding the amount of any such gift tax from the apportionable estate, that amount is thereby removed from the figure that is used as the base for allocating estate taxes among the persons receiving property interests in the estate. One reason that the amount of gift tax that is added back is taken out of the apportionable estate figure for purposes of apportioning the estate tax under this Act is that the only person who can be said to have an interest in that additional amount is the donee of the gift, and there are both policy and practical objections to allocating the estate tax from the additional amount to the donee. The donor typically will have intended that a gift pass to the donee free of any transfer tax. While that may not be the case if the size of the gift and the size of the gift tax is large, the formula for calculating the apportioned amount would be complex; and, in many cases, it would be difficult to enforce the apportionment. It seems preferable not to treat large and small gifts differently (by resorting to an arbitrarily chosen amount). Instead, it is preferable to treat all such gifts alike, either apportioning to all donees or to none. In this Act, no apportionment is made to donees, which accords with the current treatment by all States. Note that if the additional estate tax were to be apportioned to a gift donee, that would not be treated as a reduction of the amount given to the donee and so would not reduce the amount of gift tax payable on the gift. *Estate of Frank Armstrong, Jr. v. United States*, ____ F.3d ___ (4th Cir. 2002).

If the amount that is added to the gross estate were also included in the apportionable estate and were not apportioned to the donees, the fractions of the estate tax that are apportioned by Section 4(b) of the Act would have a denominator that is greater than the sum of the numerators of all of the fractions, and so less than 100% of the estate tax would be apportioned. Excluding the gift tax payment from the apportionable estate avoids that discrepancy.

An alternative approach to the treatment of gift taxes that are added to the donor's gross estate has been advocated by a committee of the Association of the Bar of the City of New York. The New York Bar committee proposes to allocate a portion of the estate tax to the donee of the gift that caused that gift tax. The allocation would be made by first determining the amount of estate tax, calculated at the average estate tax rate, that was caused by the addition of the gift tax to the gross estate; and then by allocating to the donee a fraction of the estate tax that is deemed attributable to the addition of that gift tax. The fraction of the estate tax that is attributable to the gift tax addition to the gross estate is of such size that the denominator thereof is equal to the sum of the aggregate values of the properties received by persons having an interest in the gross estate plus the gift tax value of the gift that the donee received, and the numerator is the gift tax value of the gift that the donee received. Thus, the allocation of that portion of the estate tax is determined by the size of the gift made to the donee rather than by the amount of gift tax that was added to the gross estate. For reasons noted above, that approach was not adopted in this Act.

The value of the apportionable estate is reduced by expenditures of the estate (other than the payment of estate taxes), including the payment of claims, since the amounts so expended will not be included in the aggregate value of properties received by persons interested in the apportionable estate. The apportionable estate is reduced by expenditures regardless of whether they are deductible in determining the estate tax. If expenditures were not deducted from the apportionable estate, less than 100% of the estate taxes would be apportioned by Section 4(b). However, a claim for an elective or forced share of the decedent's estate (other than a share that qualifies for a deduction such as a marital deduction) will bear its proportionate share of the estate tax, and so the claims for such shares are not deducted from the apportionable estate. Similarly, to the extent that a claim is based on an enforceable promise which was not grounded on money or money's worth consideration, that amount of the claim constitutes a donative disposition of estate assets and so must bear its proportionate share of the estate tax.

A spouse's elective share of a decedent's estate is excluded from the apportionable estate to the extent that the spouse's share qualifies for an estate tax deduction. In virtually all cases, a spouse's elective share will qualify for a marital deduction and so will be excluded from the apportionable estate by Sections 2(1)(D) and 5(b). A forced share of decedent's estate for someone whose interest does not qualify for an estate tax deduction (for example, a pretermitted heir) is included in the apportionable estate.

(2) "Estate tax" means a domestic or foreign tax imposed because of the death of an individual, and interest and penalties associated with the tax, but does not include an inheritance tax, an income tax, or a generation-skipping transfer tax other than a generation-skipping transfer tax incurred on a direct skip.

Comment

The term "estate tax" is defined in the Act to include all estate taxes and certain generation-skipping taxes arising because of an individual's death. The term estate tax does not include any inheritance taxes, income taxes, gift taxes, or generation-skipping taxes incurred because of a taxable termination, a taxable distribution, or an inter vivos direct skip. A generation-skipping tax that is incurred because of a direct skip that takes place because of the decedent's death is included in the term "estate tax."

Currently, there is no United States income tax imposed at death on the amount by which a decedent's assets were appreciated at the time of his death. While Canada and some other foreign countries impose an income tax at death, those income taxes are not apportioned by the Act.

Some states impose an inheritance tax on the recipient of property from a decedent; but the Act does not apportion those taxes. Under state law, inheritance taxes are borne by the recipients of the property giving rise to the tax. There is no need to provide for a different apportionment of those taxes.

Except for Income in Respect of a Decedent, the basis of an asset that is included in a decedent's gross estate in a year other than the year 2010 will become the fair market value of that asset.

The Economic Growth and Tax Relief Reconciliation Act of 2001 repeals the federal estate tax and generation-skipping-tax for estates of persons dying after 2009 and for generation-skipping transfers made after that date, but the sunset provision in that Act will reinstate both the federal estate tax for estates of persons dying after 2010 and the generation-skipping-tax for generation-skipping transfers made after 2010. So, as currently written, the repeal applies only to the estates of persons who die within a 1-year period and to generation-skipping transfers made within that 1-year period. Also, for decedents who die in the calendar year 2010, there will be a carryover of the decedent's basis for property included in the decedent's gross estate (i.e., the basis will be the lesser of the decedent's basis at death or the fair market value of the property at the decedent's death). The decedent's personal representative is authorized to increase the basis of selected properties that were owned by the decedent at death up to the fair market value at death of each selected item; but the aggregate amount of the increase in basis cannot exceed a dollar limitation. A sunset provision terminates these basis rules for persons dying after 2010, and the current basis rules are scheduled to become effective again for the years 2011 and thereafter. It seems likely that Congress will address the estate tax and basis rules before 2010, and it is not possible to know at this date what rules will ultimately be adopted for the years 2010 and thereafter. If Congress decides to make permanent the repeal of the federal estate tax, it is likely to adopt either (1) carryover basis rules such as the one adopted in the 2001 Act for the year 2010, or (2) an income tax on capital appreciation at death. In the event that an income tax on capital appreciation at death is adopted, that tax will not be apportioned under this Act. Similarly, if some form of carryover basis is adopted, any income tax resulting from the subsequent disposition of such assets will not be apportioned by this Act. The determination of whether to apportion income taxes in such cases and how to apportion them can best be made when the exact nature of the tax is established, and so the apportionment of any such tax is left to the future, when the nature of the tax will be known.

This Act does not provide for the apportionment of the income tax payable on the receipt of Income in Respect of a Decedent (IRD). The current tax treatment of IRD causes problems and inequities, but these can only be cured by federal legislation. IRD is subjected to both federal estate taxes and income taxes. If no relief were provided, that treatment would contrast with the tax consequence attending the circumstance where the decedent received during life the item which became IRD, in which case only the net amount of that item remaining after payment of the income tax would have been included in decedent's gross estate and subjected to estate taxation. The federal tax law seeks to mitigate that disparity of tax conseuence by providing a deduction for income tax purposes for the amount of estate tax that is attributable to the IRD. The deduction is allowed against the income recognized when the IRD is collected. However, the deduction for the estate tax on IRD is an itemized deduction, and is subject to the overall limitation on itemized deductions imposed by § 68 of the Internal Revenue Code. Under § 68, when an individual's adjusted gross income exceeds a threshold amount, the individual's itemized deductions are reduced by an amount equal to 3% of the difference between the individual's adjusted gross income and the threshold amount. The maximum amount of reduction cannot exceed 80% of the total amount of the individual's itemized deductions. If IRD constitutes a major portion of a decedent's estate, (for example, if the decedent had a large amount accumulated in a qualified deferred compensation plan), the personal representative will need to draw upon the IRD to pay the estate taxes. If the beneficiary of the IRD collects enough of it to pay the estate tax and turns that amount over to the personal representative, the beneficiary will incur a large amount of taxable income and thus a large amount of adjusted gross income. As much as 80% of the deduction for the IRD's share of the decedent's estate tax could be lost as a deduction because of the § 68 overall limitation. It is not feasible to solve this problem through this Act, but efforts should be made to encourage Congress to address this problem. While the Economic Growth and Tax Relief Reconciliation Act of 2001 phases out the overall limitation of § 68 over a 5-year period beginning in 2006, a sunset provision would reinstate that limitation for years after 2010. If the repeal of § 68 is made permanent by Congress, much of the problem surrounding IRD will be eliminated.

If a decedent held an installment obligation the payment on which was accelerated by the decedent's death, an income tax would then be incurred because of the decedent's death. The income tax incurred in that manner is not apportioned by the Act.

If a donor pays a gift tax during the donor's life, the amount paid will not be part of the donor's assets when the donor dies; and so the gift tax will not be subject to apportionment among the persons interested in the donor's gross estate. Typically, the inter vivos payment of the gift tax will result in a smaller probate estate and therefore a smaller residuary devise than otherwise would have been the case. This consequence is consistent with the typical donor's wish that the gifts made during life pass to the donee free of any transfer tax. If all or part of a gift tax was not paid at the time of the donor's death and is subsequently paid by the donor's personal representative, the incidence of the gift tax should lie with the same persons who would have borne it if the donor had paid it during life. Therefore, the gift tax is not apportioned by this Act, but is treated the same as any other debt of the estate. Typically, the debts of the estate will be paid from the residuary devise. Similarly, if a gift tax deficiency becomes due after the decedent's death, the additional gift tax obligation will not be apportioned by the Act, but will be treated as a debt of the decedent's estate. The gift tax was not repealed by the Economic Growth and Tax Relief Reconciliation Act of 2001.

(3) "Gross estate" means, as to any estate tax, all interests in property which are subject to that estate tax.

Comment

The identity of the property interests included in a gross estate depends upon the particular estate tax to be apportioned and may not be the same for each tax. For example, some State death taxes will have an exemption for a homestead; some will exclude life insurance proceeds and pensions. In determining the gross estate for such taxes, the property excluded from the tax will also be excluded from the gross estate for that tax.

(4) "Time-Limited Interest" means an interest in property which terminates on a lapse of time or on the occurrence or nonoccurrence of an event. The term does not include an interest in property that is a joint tenancy or other cotenancy unless the interest itself is a time-limited interest.

Comment

A "time-limited interest" refers to a term for years, a life interest, a life income interest, an annuity interest, a unitrust interest, and similar interests, whether a present or future interest and whether held alone or in co-tenancy. The fact that an interest that otherwise is not a time-limited interest is held in cotenancy does not make it a time-limited interest.

(5) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government; governmental subdivision, agency, or instrumentality; public corporation, or any other legal or commercial

entity.

(6) "Person interested in the apportionable estate" means a person who is entitled to receive, or has received, whether before or after the decedent's death, an interest in property the value of which is included in the decedent's apportionable estate, except a creditor of the decedent or the decedent's estate or a transferee for full and adequate consideration.

Comment

For purposes of this Act, property, the value of which is deducted from the apportionable estate, is not included in the apportionable estate. See the Comment to Section 2(1).

If a person has a right at the time of decedent's death, whether the right is created by contract or by the decedent's will or other dispositive instrument, to purchase gross estate property at a price that is lower than the estate tax value of that property, the difference between the purchase price and the estate tax value of the property can be viewed as a property interest which the decedent passed to that person. If the right to purchase is exercised, the purchaser may be treated as a "person interested in the apportionable estate," and the bargain element in the purchase price may be treated as property received by that person.

(7) "Property received by a person" means an interest in property of the apportionable estate which the person has received or is entitled to receive.

(8) "Value" means fair market value as finally determined for purposes of the estate tax that is to be apportioned, without reduction for taxes paid or required to be paid, and without reduction for any special valuation adjustment; but any outstanding debt that is secured by the interest is subtracted from the fair market value.

Comment

If a debt is secured by more than one interest in property, the value of each such interest is the fair market value of that interest less a portion of the debt that it secures. The portion of a debt to be so allocated to an interest to determine the interest's value is a fraction of the debt equal to the fraction in which the numerator is the value of the interest (determined without reduction for any debts secured by that interest other than debts senior to the debt to be allocated) and the denominator is the value of all interests in property that secure the debt (reduced only by debts senior to the debt to be so allocated).

If the beneficiary of an interest in property is required by the terms of the transfer to make a payment to a third party or to pay a liability of the transferor, that obligation constitutes an encumbrance on the property for purposes of this provision, but does not necessarily reduce the value of the apportionable estate. If the obligation is to make a transfer or payment to a third party, other than an obligation to satisfy a debt that is based on money or money worth's consideration, the third party will be a "person interested in the apportionable estate" and the property payable to the third party will be subject to apportionment by this Act.

If a decedent's will or other dispositive instrument directs that property controlled by that instrument is to be used to pay a debt secured by an interest in property, that provision constitutes an additional bequest to the person who is to receive the interest securing the debt.

Any taxes imposed on the transfer or receipt of property, regardless of whether those taxes constitute a lien on the property or are payable by the recipient of the property, do not reduce the value of the property for purposes of apportioning estate taxes by this Act.

The date on which gross estate property is to be valued for federal estate tax purposes (and for some other estate tax purposes) is either the date of the decedent's death or an alternate valuation date elected by the decedent's personal representative. An estate tax value that is determined on the alternate valuation date is not, as such, a "special valuation adjustment." If an alternate valuation date is elected, the fair market value of property on the alternate valuation date is the value of the property for purposes of this Act. If a special valuation adjustment is employed when an item of property is valued on the alternate valuation date, that special valuation adjustment is not taken into account when valuing the property for purposes of this Act, just as a special valuation adjustment is not taken into account when the property is valued as of the date of death.

A "special valuation adjustment" refers to a reduction of the valuation of an item included in the gross estate pursuant to a provision of the estate tax law. The special valuation will be less than the fair market value of the property. An example of a special valuation provision in the federal estate tax law is the provision in Section 2032A of the Internal Revenue Code for an election to have certain real property valued at a lower figure than its actual market value.

SECTION 3. APPORTIONMENT BY WILL OR OTHER DISPOSITIVE INSTRUMENT.

(a) To the extent that a decedent's will expressly directs or precludes the apportionment of an estate tax, the tax must be apportioned according to that provision.

Comment

A decedent's direction will not control the apportionment of taxes unless it explicitly refers to the payment of an estate tax and is specific and unambiguous as to the direction it makes for that payment. For example, a direction that "all debts and expenses of and claims against me or my estate are to be paid out of the residuary of my probate estate" is not an express direction for the payment of estate taxes and will not control apportionment. While an estate tax is a claim against the estate, the direction for payment of claims does not explicitly mention estate taxes. A testator who wrote that direction may not have had estate taxes in mind. To protect against an inadvertant inclusion of estate tax payment in a general provison of that nature, the Act requires that the direction explicitly mention estate taxes by name.

On the other hand, a direction that "all estate taxes arising as a result of my death, whether pasing under this will or otherwise, be paid out of the residue of my probate estate" satisfies the

Act’s requirement for an explicit mention of estate taxes and is specific and unambiguous as to what properties are to bear the payment of those taxes. While the residuary of a decedent’s probate estate may be divided among several beneficiaries, one of whom is a surviving spouse whose interest qualifies for a marital deduction, the direction to pay the taxes from the residuary of the probate estate is unambiguous and requires that the payment will reduce the value of the interest of every beneficiary of the residuary estate including the surviving spouse. The Act does not require that the direction acknowledge that the payment will affect all of the residuary beneficiaries.

Whether other directions of a decedent that explicitly mention estate taxes comply with the Act’s requirement that they be specific and unambiguous is a matter for judical construction. For example, there is a split among judical decisions as to whether a direction such as “all estate taxes be paid out of the residue of my estate” is ambiguous becuause it is unlcear whether it is intended to apply to taxes attributable to nonprobate assets. The Act fills the gap for the apportionment of estate taxes to the extent that a decedent fails to do so, but the Act is not designed to provide rules of construction for wills and other documents. To the estent that it is detemrined that a decedent failed to apportion an estate tax, then the Act will apply to apportion that amount of the tax.

(b) To the extent that a decedent’s will does not provide for the apportionment of an estate tax, the tax must be apportioned in accordance with an express provision, if any, in a revocable trust of which the decedent was the settlor. If conflicting express provisions are given in two or more revocable trust instruments, the provision in the most recently dated revocable trust instrument prevails. For the purposes of this subsection, the date of an amendment to a revocable trust instrument is the date of the amended instrument only if the amendment contains an express provision for apportionment.

Comment

If an amendment is made to a revocable trust instrument, and if the amendment itself contains an express provision apportioning an estate tax, the date of the amendment is the date of the revocable trust instrument. However, if an amendment to a revocable trust instrument does not contain an express provision apportioning an estate tax, the date of the revocable trust instrument is the date on which it was executed or the date of the most recent amendment containing an express provision apportioning an estate tax. An express provision apportioning an estate tax includes a provision directing that payment of an estate tax be made from specified property. For the meaning of the requirement that the direction for estate tax apportionment be “express,” see the Comment to subsection (a).

(c) For the purposes of this subsection, “unapportioned estate tax” means all or part of an estate tax that is not expressly apportioned by a provision in the decedent's will or revocable trust. Except as limited by subsection (d), an express provision in a dispositive instrument that the property disposed of in that instrument is to be applied to the payment of an unapportioned estate tax controls the apportionment of estate tax to that property. Except as limited by subsection (d), an express provision in a dispositive instrument that an unapportioned estate tax must not be apportioned to the property disposed of in that instrument prevents apportionment of tax to that property.

Comment

The statutory apportionment rules of the Act are default rules applicable to the extent that the decedent does not make a valid provision as to how estate taxes are to be apportioned. The decedent has the power to determine which recipients of decedent's property will bear the estate taxes and in what proportion. If provisions conflict, it is necessary to determine which prevails. One possible choice was to permit the directions in each instrument that the decedent executed to determine the extent to which property controlled by that instrument will bear a share of estate taxes, but it was deemed undesirable to have the provisions for an allocation scheme scattered among a number of documents. It is preferable to have the decedent's directions set forth in one instrument so that a decedent's personal representative does not have to search multiple instruments to ascertain the decedent's directions. Accordingly, the Act provides an order of priority for a decedent's provisions for estate tax allocations. To the extent that a decedent makes an express provision in the decedent's will, that provision will trump any competing provision in another instrument. To the extent that the will does not expressly provide for the allocation of some estate taxes, an express provision in an instrument that the decedent executed to create a revocable trust will control the allocation of those estate taxes. If the decedent executed more than one revocable trust instrument, the express provisions in the instrument that was executed most recently will control to the extent of any conflict. In determining which revocable trust instrument was executed most recently, the date of any amendment that contains an express apportionment provision will be taken into account. In the event that the allocation of estate taxes is not fully provided for by the decedent's will or revocable trust instrument, then an express provision in other instruments executed by the decedent that disposes of property controls to the extent that the provision applies to the property disposed of in that instrument. An example of a provision in an instrument disposing of property, other than a will or revocable trust instrument, is a provision in a designation of a beneficiary of life insurance proceeds either that the proceeds will or will not be used to pay a portion of estate taxes. A designation of that form will be honored if there is no conflicting provision in a will or revocable trust instrument.

A provision in decedent's will, revocable trust, or other instrument will not be honored to the extent that it would contravene Section 3(d).

The federal estate tax laws provide to a decedent's personal representative a right to collect a portion of the decedent's federal estate tax from the recipients of certain property that is included in the decedent's gross estate. See e.g., §§ 2206 to 2207B of the Internal Revenue Code. Those provisions are not apportionment statutes; rather, they empower the personal representative to collect a portion of the estate tax that is attributable to the property that was included in the decedent's gross estate. Those provisions can be overridden by the decedent's directions either in a will or, in the case of several of the provisions, in a revocable trust instrument. This Act does not track those provisions in that this Act allows the revocable trust instrument to control only if the will does not make a conflicting direction and permits other instruments to control in limited circumstances. These provisions of the Act do not conflict with federal law because federal law only empowers the personal representative to collect the mandated amounts; it does not direct how the collected amounts are to be used by the personal representative. The rights granted by federal law for the collection of assets from others does not conflict with the apportionment of estate assets established by state law or with additional rights of collection granted by state law. For that reason, this Act does not include a direction as to whether federal or state law takes priority when they are in conflict.

The Act does not permit a direction for allocation of estate taxes, or for the insulation from allocation, by anyone other than the decedent to override the allocation provisions of the Act. As explained in the next paragraph, this restriction has no application to a provision of an instrument transferring property that the transferred assets be used to pay a tax because that is not an allocation provision. For example, if X created a QTIP trust for Y, the value of the trust assets will be included in Y's gross estate for federal estate tax purposes on Y's death. If the instrument that X executed to create the QTIP trust were to provide that the trust is not to bear any of the estate taxes imposed at Y's death, the Act overrides that direction; under the Act, only Y can direct that the QTIP trust will not bear any portion of Y's estate taxes. In this regard, it is noteworthy that the right granted to a decedent's estate by § 2207A of the Internal Revenue Code to collect a share of the federal estate tax from a QTIP that is included in the decedent's gross estate can be waived only by direction of the decedent in a will or revocable trust instrument. Y is in the best position to determine the optimum allocation of Y's estate taxes among the various assets that comprise Y's gross estate. If Y fails to make an allocation, the default provisions of the Act are more likely to reflect Y's intentions than would a direction of a third person.

If an instrument transferring property that may be included in the taxable estate of someone other than the transferor provides that any part of the estate taxes of the other person are to be paid from the transferred property, that is a dispositive rather than an apportionment provision. For example, X creates two trusts, Trust 1 and Trust 2, of which Y is the income beneficiary. Under Section 2044 of the Internal Revenue Code, both trusts will be included in Y's gross estate for federal estate tax purposes when Y dies. The trust instrument that created Trust 2 provides that on Y's death, the assets of Trust 2 will be used to pay Y's estate taxes that are attributable both to Trust 1 and Trust 2. That provision does not place the burden of taxes on Trust 2 to some other property. Instead, it constitutes a direction of how the assets of Trust 2 are to be distributed or utilized. The provision for the application of Trust 2's assets to pay taxes attributable to Trust 1 does not contravene this Act. If the provision is valid under trust law, the taxes attributable to Trust 1 and Trust 2 should be paid from the assets of Trust 2 as the trust instrument directs. The holders of interests in Trust 1 are beneficiaries of Trust 2 to the extent that the taxes that the beneficiaries of Trust 1 would otherwise have borne are paid out of assets of Trust 2.

(d) A provision for apportionment does not increase the amount of estate tax apportioned to an interest in property which the decedent had no power to transfer immediately before the decedent's death. For purposes of this provision, a testamentary power of appointment is deemed to have been held immediately before the decedent's death.

Comment

If a decedent had made an irrevocable transfer during his life, and if that transfer is included in the decedent's gross estate for estate tax purposes, a portion of the estate tax will be apportioned to the transferee unless the decedent provides otherwise in a will, revocable trust or other instrument. While, by an express provision in the appropriate instrument, a decedent can reduce the amount of tax apportioned to such inter vivos transfers, the decedent is not permitted to increase the amount of tax apportioned to such transfers. If a decedent attempts to do so, whether directly by apportioning more estate tax to the inter vivos transfer or indirectly by insulating some person interested in the gross estate from all or part of that person's share of the estate tax, the amount of estate tax that is apportioned to the transferee of an irrevocable inter vivos transfer will not be greater than the amount that would have been apportioned to that transferee if the decedent had made no provision for apportionment in another instrument.

This subsection(d)does not apply to a decedent's provision that no estate tax be apportioned to the recipient of an interest who would be excluded from apportionment by this Act in the absence of a contrary direction by the decedent. For example, a decedent's provision that no estate tax be apportioned to the recipient of property that qualifies for a marital or charitable deduction is not subject to this Subsection.

If, immediately before the decedent's death, the decedent had the power, whether inter vivos or testamentary, to change the beneficiary of a property interest, the decedent had the power to transfer the property interest within the meaning of this provision.

(e) If an estate tax is to be paid from property in which a charity has an interest that otherwise qualifies for an estate tax charitable deduction, the payment must first be made, to the extent feasible, from property that has not been distributed to the person entitled to receive that property.

Comment

If a decedent created a trust during life the value of which is included in the decedent's gross estate at death; if immediately after decedent's death, there were one or more time-limited interests in the trust that did not qualify for an estate tax deduction; and if one or more charities held a remainder interest in the trust that otherwise qualified for an estate tax charitable deduction, the charitable deduction for the remainder interests may be lost if the estate taxes generated by the nondeductible time-limited interests are to be paid from assets in the trust. See Rev. Rul. 82-128, Rev. Proc. 90-30 (Secs 4 and 5), and Rev. Proc. 90-31 (Secs 5 and 6). The Service has indicated informally that if the payment of an estate tax is made from funds that, while directed to be added to the trust's assets, were not distributed to the trust before applying them to the payment of the estate tax, the payment will not disqualify the charitable deduction. There are numerous instances in which estate taxes are required to be paid from a charitable remainder trust that was created inter vivos. Subsection (e) is an attempt to protect the deduction in such cases by requiring that funds directed to be added to the trust be used to pay any required estate tax before assets already in the trust itself are used. It seems unlikely that a decedent would wish to negate this provision, but the decedent has the power to do so by including an express statement to that effect in a will or revocable trust instrument.

SECTION 4. STATUTORY APPORTIONMENT OF ESTATE TAXES.

(a) In this section,

(1) "Probate and revocable trust assets" means the aggregate of probate assets and assets held at the time of decedent's death in a revocable trust of which the decedent was a settlor, except any asset that is not part of the decedent's gross estate. For purposes of this paragraph, assets held at the time of decedent's death in a revocable trust include assets, other than probate assets, that are added to the revocable trust as a consequence of the decedent's death.

(2) "Residuary gifts" means the probate and revocable trust assets transferred by residuary provisions, other than those whose transfer qualifies for an estate tax deduction or exemption.

(3) "Pre-residuary gifts" means the probate and revocable trust assets, other than those included in the residuary gifts, and other than those whose transfer qualifies for an estate tax deduction or exemption.

(4) "Residuary provision" means the provision in a will or revocable trust instrument which disposes of all of the probate or revocable trust assets remaining after payment of or provision for debts, taxes, expenses and the disposition of monetary amounts or particular properties or portions thereof.

(5) "QTIP property" means property that is included in a decedent's gross estate for federal estate tax purposes because of § 2044 of the Internal Revenue Code of 1986 or of a comparable future federal estate tax provision.

Comment

Under Subparagraph (c), the taxes that are attributable to interests in probate assets and in the assets of revocable trusts are to be borne by the beneficiaries of the residuary provisions of the decedent's will and of the revocable trusts, other than beneficiaries whose interests qualify for an estate tax deduction or exemption, except that the nonresiduary beneficiaries of the probate estate and of the revocable trusts will bear a share of those taxes if the aggregate value of their interest constitutes a major portion of the gross estate. See Section 4(c). The definitions set forth in this subsection are used in making that allocation of the tax burden. The beneficiaries of the probate and the revocable trust assets are combined so that the taxes attributable to the aggregate amount of probate and revocable trust assets is allocated among them on a composite basis. To the extent that the aggregate value of nonresiduary gifts exceeds 20% of the difference between the federal estate tax value of the gross estate and enforceable claims against the estate, a portion of those gifts is included in the residuary gifts and thus bears a portion of the estate tax.

To the extent that the interest of a beneficiary of a residuary provision qualifies for an estate tax deduction or exemption, no tax will be apportioned to the beneficiary of that interest. See subsection (c) and Section 5(b).

(b) Except as otherwise provided in this [Act,] an estate tax is apportioned to each person who receives a property interest in the apportionable estate in the proportion that the value of that property interest bears to the total value of the apportionable estate.

Comment

The value of a property interest is determined in accordance with Section 2(8) of the Act.

Properties whose values are subtracted from the decedent's gross estate in determining the apportionable estate under Section 2(1) thereby are excluded from the apportionable estate, and so the beneficiaries of those properties do not have any estate tax apportioned to them because of their interest in those properties. This treatment is consistent with the position taken in Restatement (Third) of Property: Wills and Other Donative Transfers §1.1, comment g (1998).

The decedent's gross estate can be subdivided into three categories: the probate estate, assets held in a revocable trust of which the decedent was the settlor, and all other nonprobate assets. The initial apportionment pursuant to subsection (b) is made among persons holding interests in all three of those categories. Then, pursuant to subsection (c), and subject to a limitation of amount, the estate tax apportioned to beneficiaries of pre-residuary gifts is then reapportioned to the benefiicaries of residuary gifts in the manner described in subsection (c).

The estate tax attributable to pre-residuary gifts is not reapportioned to other nonprobate assets, such as life insurance proceeds and jointly held properties, because the transfer of those properties is similar to the transfer of pre-residuary gifts (i.e., they are transfers of specific properties or monetary amounts) and so should not be required to bear the tax attributable to the pre-residuary gifts unless other assets of the estate are insufficient. The holders of other nonprobate assets are required to bear the estate tax attributable to those properties since it is unlikely that that the decedent would wish those taxes to be borne by residuary beneficiaries.

(c) The estate tax attributable to probate and revocable trust assets and the estate tax reapportioned by Section 6(c) to the beneficiaries of those assets must be apportioned to the beneficiaries of residuary gifts in proportion to the respective values of their interests in those gifts. If the aggregate value of pre-residuary gifts exceeds 20 percent of the difference between the gross estate, as valued for federal estate tax purposes, and the enforceable claims against the decedent's estate described in Section 2(1)(B), a prorata portion of each pre-residuary gift is included in the apportionment as if it were a residuary gift. The amount of estate tax apportioned or reapportioned to a beneficiary of a residuary gift must not exceed the value of the beneficiary's interest in residuary gifts. Any excess of the amount of tax otherwise apportioned or reapportioned to the beneficiary of a residuary gift over the value of the beneficiary's interest is apportioned among the beneficiaries of the pre-residuary gifts in proportion to the value of their interests in the probate and revocable trust assets, but the amount of tax apportioned or reapportioned to a beneficiary of pre-residuary gift must not exceed the value of that beneficiary's interest. If, pursuant to this paragraph, the amount of tax apportioned to the beneficiary of a pre-residuary gift is greater than the value of that beneficiary's interest, the deficiency is apportioned proportionately among all of the persons interested in the apportionable estate exclusive of interests in the probate and revocable trust assets.

Comment

In most circumstances, a testator would prefer that testamentary transfers that are not part of the residuary provision of the will be made exclusive of estate taxes. For example, a decedent usually will have intended that the beneficiary of a pecuniary devise or a devise of a specific item of property receive that amount or property free and clear of taxes. Similarly, the same view is likely to occur as to property transferred pursuant to nonresiduary provisions of a revocable trust, a vehicle often used as a will substitute. While that intention is not present in every case, it usually is held. This assumption is supported by the fact that most wills, which have a clause apportioning taxes, apportion them to the residuary provision of the will. The Act therefore apportions taxes attributable to probate and revocable trust assets (and the taxes reapportioned to the beneficiaries of those assets) to the beneficiaries of the residuary provisions of the will and the revocable trusts, other than a beneficiary whose interest qualifies for an estate tax deduction or ecxemption. Since the will and the revocable trusts together often reflect the principal dispositive scheme of the decedent, the Act combines the probate and revocable trust assets and apportions estate taxes attributable to them to the combined beneficiaries of the residuary provisions of both the will and the revocable trusts. However, in most circumstances, the primary object of a decedent's donative motives will be the beneficiaries of the residuary provisions. If the aggregate of the nonresiduary devises and transfers constitute a sizeable portion of the decedent's gross estate, it would frustrate the decedent's major dispositive objective if the estate taxes generated by the nonresiduary devises and transfers were permitted to reduce the size of the residuary transfers to a relatively small value. To prevent that from occurring, the Act has a ceiling on the aggregate value of nonresiduary devises and transfers that are insulated from apportionment of the estate tax. Only an amount that does not exceed 20 percent of the difference between the value of the decedent's gross estate (as determined for federal estate tax purposes) and the claims against the estate described in Section 2(1)(B) are insulated from estate tax apportionment.

The Act's apportionment of taxes to the beneficiaries of the residuary provision of the decedent's will and revocable trusts will not impose that burden on a surviving spouse or a charity to the extent that their interest qualifies for an estate tax deduction or exemption.

If the value of the interest of a beneficiary in the residuary gifts is less than the tax apportioned or reapportioned to that beneficiary, the shortfall is apportioned to the beneficiaries of pre-residuary gifts, but only to the extent of the value of their interest. A shortfall will ot be apportioned to a beneficiary whose interest qualifies for an estate tax deductionor exemption. The burden of those taxes is placed upon the pre-residuary beneficiaries rather than on other beneficiaries of non-probate assets (such as life insurance beneficiaries). If there is a shortfall in the taxes that can be apportioned to the pre-residuary beneficiaries, then that shortfall is apportioned to persons interested in the apportionable estate other than the beneficiaries of the probate and revocable trust assets since, by definition, the value of their interests will have been exhausted before this provision is triggered.

(d) A generation-skipping transfer tax incurred on a direct skip is charged to the property transferred. To the extent that legal restrictions or practical obstacles make collection from that property impractical, the deficiency is apportioned among the transferees of that property in proportion to the value of their respective interests in that property.

Comment

Section 2603(b) of the Internal Revenue Code states that, unless directed otherwise in the governing instrument, the tax on a generation-skipping transfer is charged to the property constituting the transfer. Section 2603(a)(3) of the Internal Revenue Code imposes the duty of paying the tax on a direct skip on the transferor of the property. Under Subsection (c), the decedent's personal representative will pay the generation-skipping tax on a direct skip out of the transferred property (or the proceeds from a sale of all or some of that property). To the extent that it is not feasible or practical to pay the tax from the transferred property, the transferees are to pay their proportionate share of the shortfall. Subsection (d) is consistent with the treatment provided by federal law.

(e) The amount of federal estate tax that is apportioned to the holders of QTIP property is the difference between the decedent's estate's total federal estate tax liability and the amount of federal estate tax for which the decedent’s estate would have been liable if the QTIP property had not been included in decedent’s gross estate. Subject to Section 6, that amount of the federal estate tax is apportioned among the holders of interests in the QTIP property in proportion to the values of their interests.

Comment

QTIP property is property in which the decedent held a life interest and over which the decedent typically had no power of appointment. The general rule of apportionment in the Act is to apportion estate taxes on the basis of the average rate of tax rather than on the marginal rate. In view of the decedent’s incpacity to direct the disposition of the QTIP property, it would be inequitable to require the beneficiaries of the decedent’s other assets to pay a greater tax than they would have borne if the QTIP property had not been included in decedent’s gross estate. This problem is particualry acute when the decedent is survived by children from a marriage subsequent to the death of the spouse who created the QTIP. It is true that the availablity of the marital deduction to the estate of the decedent’s spouse provided the decedent with more income than would otherwise have been obtainable, but that is not adequate compensation for increasing the tax burden on decedent’s beneficiaries. It is noteworthy that the federal estate tax law grants the decedent’s fiduciary the power to collect from the holders of the QTIP property the estate tax generated by that property at the marginal estate tax rate of the decedent’s estate. The Act tracks the federal law in this respect.

SECTION 5. ALLOWANCE FOR EXEMPTIONS, DEDUCTIONS, SPECIAL VALUATIONS, CREDITS, AND DEFERRALS.

(a) In apportioning an estate tax, allowances must be made as provided in subsections (b) through (e) and Sections 6 and 7.

(b) A deduction or exemption inures to the benefit of the person receiving the transfer that gave rise to the deduction or exemption.

Comment

This provision is aimed primarily at transfers that qualify for a marital or charitable estate tax deduction. Since property transferred to a surviving spouse or charity causes no federal estate tax to the extent that it is deductible, no part of a surviving spouse’s or charity’s interest that qualifies for an estate tax deduction should bear any of the estate tax burden; and, to that end, this provision insulates the property and the recipient from bearing any part of the payment of the tax. Similarly, if a deduction or exemption is allowed for the transferred interest under any other estate tax, the transferred property will not bear any part of that tax burden. In addition to the equity of this provision, the insulation of the spouse’s and the charity’s interest from bearing any part of the tax will prevent a reduction of the marital or charitable deduction that otherwise would occur.

Since property for which a marital or charitable deduction is allowed is excluded from apportionment for purposes of the estate tax that allows the deduction, the value of the property that gives rise to the deduction is excluded from the decedent's apportionable estate. See Section 2(1).

(c) A credit for gift taxes and for property previously taxed inures to the proportionate benefit of all persons to whom the estate tax is apportioned.

Comment

Section 2013 of the Internal Revenue Code of 1986 allows a credit for federal estate taxes paid on certain properties that were included in the taxable estate of a person who died within a relatively short time of the decedent's death. This credit is referred to as a credit for property previously taxed

(d) A credit for state or foreign taxes inures to the proportionate benefit of all persons to whom the estate tax is apportioned, except that to the extent that the state or foreign tax was paid by the beneficiary of, or charged against, the property on which the state or foreign tax was imposed, that portion of the credit inures to the benefit of that beneficiary.

Comment

A beneficiary of property which incurred a foreign or State death tax may have paid that tax directly or may have paid it indirectly by virtue of the tax's being paid out of the property passing to that person. If that occurs, while the beneficiary's direct or indirect payment of the foreign or State tax reduces the amount that the beneficiary will receive, it will not reduce the value of the beneficiary's interest in the apportionable estate according to the definition of "value" in this Act. See Section 2(8). The Act therefore gives the beneficiary of the property the benefit of any estate tax credit that is allowed for the foreign or State tax that the beneficiary effectively paid.

(e) Except as otherwise provided in Section 6(b), if payment of any part of an estate tax is deferred or extended because of the inclusion in the gross estate of a certain interest in property, the benefit of the deferral or extension inures proportionately to the persons to whom the estate tax attributable to that interest is apportioned. Except as otherwise provided in Section 6(b), any interest incurred on a deferral or extension of taxes and any tax deduction associated with that interest must be equitably apportioned among the persons receiving the property.

SECTION 6. APPORTIONMENT BETWEEN TIME-LIMITED AND OTHER INTERESTS.

(a) In this section:

(1) "Insulated property" means assets, subject to a time-limited interest, which are unavailable for payment of an estate tax because of legal restrictions or obstacles making collection impractical.

(2) "Uninsulated property" means an interest in property included in the apportionable estate other than an interest in insulated property.

(3) "Uninsulated holder" means a person interested in the apportionable estate who has an interest in uninsulated property.

(4) "Reapportioned tax" means the estate tax on insulated property that is reapportioned to uninsulated holders by Section 6(c) of the [Act]. The estate tax on insulated property is the aggregate amount of estate tax that is otherwise apportioned by this [Act] to the persons holding interests in insulated property because of their interest in that property.

(5) "Reapportioned fraction" is a fraction whose numerator is the amount of the reapportioned tax and whose denominator is the value of the insulated property to which that tax is attributable.

(b) Except as otherwise provided in Sections 3(e) and 7, an estate tax apportioned or reapportioned to persons holding interests in uninsulated property subject to a time-limited interest must be paid, without further apportionment, from the principal of that uninsulated property.

Comment

Subsection (b) applies to property in which at least one person has a time-limited interest and which property can be reached by the personal representative of the decedent. In such cases, an apportioned estate tax, or an estate tax that is reapportioned under Subsection (c), is charged against the principal of the property, and is not apportioned among the several interests in that property. While there is no express apportionment to the time-limited interests in the property, the holders of the time-limited interests will bear a share of the tax burden in that the resulting reduction of the value of the principal will reduce the value of the time-limited interests, except that it will not reduce the value of a dollar annuity interest. So, the holder of a dollar annuity interest will be exonerated from sharing in the burden of estate taxes. The reason for this treatment is discussed in the Comment to Subsection (c).

If the estate tax payable because of uninsulated property were not to be paid from the principal of the property, it would be harsh to collect the tax from persons, such as discretionary distributees or persons with contingent interests, who, while having an interest in the property, may not obtain possession of the assets for many years, if at all. This Act could have apportioned the applicable estate tax to other persons interested in the apportionable estate and provide for a reimbursement of those other persons from the distributees of the property in the manner established by Section 6(c) for insulated property. But, that is a complicated arrangement to administer, and was utilized in Section 6(c) because no simple and equitable alternative was available when the principal of the property cannot be reached by the personal representative. In this Subsection, ease of administration was chosen even though that choice may reduce a deduction. Because of considerations applicable to property for which a special elective benefit (described in Section 7(a)(1)) was made, subsection (b) does not apply to those properties. Instead, the estate tax attributable to those properties is apportioned to the holders of interests in those properties.

If an estate tax is apportioned or reapportioned to a person having an interest in property that cannot be reached but which is not subject to a time-limited interest, the tax is to be collected from that person to the extent that it is feasible to do so. In that circumstance, because there is no time-limited interest, the tax will not be apportioned to a person who may not receive property for many years or who, in the case of a conditional interest, may never receive any property.

If a charitable bequest is made in the form of a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund, an interest that precedes the charitable remainder will not qualify for a deduction unless it is a QTIP interest or another charitable interest. Similarly, a succeeding interest of a charitable lead trust (§ 2055(e)(2)(B) of the Internal Revenue Code) may not qualify for a deduction and frequently will not. As to split interest inter vivos trusts that are included in a decedent's gross estate, requiring the payment of the tax attributable to a nondeductible preceding or succeeding interest in that trust to be made from the principal of the trust might endanger the qualification of the charity's interest for a deduction. See Rev. Procs. 90-30, 90-31, and 90-32. Even if the charitable deduction were not lost, the tax payment would cause a reduction of the amount of the charitable deduction. See Section 3(e) and the Comment thereto. A remainder interest in a personal residence or a farm and a qualified conservation contribution also can qualify for a charitable deduction, and the same considerations would apply to those interests.

Similarly, the devise of a remainder interest to a surviving spouse will qualify for a marital deduction. If the tax apportioned to the interests preceding the marital bequest can be paid from principal, it will reduce the amount of the marital deduction.

Althought the likely intent of a decedent would be to maximize the marital and charitable deductions available for the estate, the Act provides that the estate tax is to be paid from the principal of the property if it can be reached by the decedent's personal representative. That choice was avoids administrative complexity.

While, in certain cases of a split-interest trust in which a charity has an interest, collecting the tax from the principal could forfeit the charitable deduction entirely, that problem will arise infrequently and can best be left to the drafters of the instruments. In many cases, an inter vivos split-interest trust in which a charity is given an interest will not be completely funded at the time of the decedent's death, and so the personal representative can pay the tax from funds that are earmarked for the trust, but not yet distributed to it. While, the use of such funds will reduce the size of the charitable deduction, it will not cause a complete disallowance of the deduction. See Section 3(e).

Even when a split-interest charitable trust is fully funded before the decedent's death, a well-drafted apportionment clause in decedent's will or other instrument can prevent the loss of a charitable deduction. Similarly, an apportionment clause in the decedent's will or other instrument can prevent the reduction of a charitable or marital deduction if that is what the decedent desired. Where there is a significant charitable or marital transfer, the drafters of the instruments that create a split-interest trust for a charity or spouse typically will make an appropriate provision for apportionment of estate taxes in that instrument. The Act leaves it to the parties to tailor the apportionment to accomplish the specific wishes of the decedent when a charitable or marital split-interest trust or property interest is employed rather than to create a complex stationary apportionment scheme to protect against circumstances that will not frequently arise.

(c) An estate tax attributable to interests in insulated property is reapportioned among uninsulated holders in proportion to the value of their uninsulated property interests. When a distribution of insulated property is made, each uninsulated holder may recover from the distributee a ratable portion of the reapportioned fraction of the distribution. To the extent that undistributed insulated property ceases to be insulated, each uninsulated holder may recover from that property a ratable portion of the reapportioned fraction of the total undistributed property.

Comment

Since the estate tax apportioned to the owners of insulated property cannot be collected from the property, the tax must be paid by persons having interests in other assets of the estate (uninsulated holders). It would be harsh to make persons holding future interests pay tax on properties that they will not receive until years later and may never receive. If they were required to pay the tax at the time of decedent's death, that could give rise to widespread disclaimers of interests. Also, it would be difficult to value the interests of discretionary beneficiaries.

The tax attributable to the insulated property that is required to be paid by the uninsulated holders is referred to as a "reapportioned tax." To permit the uninsulated holders who bear the reapportioned tax to be reimbursed, the Act effectively provides the uninsulated holders with a percentage interest in the property whose transfer is the source of the reapportioned tax. While the percentage interest of the uninsulated holder remains constant, its value will increase or decrease as the value of the property waxes or wanes. The percentage interest is determined by dividing the reapportioned tax by the value of the insulated property as determined for purposes of the estate tax. When a distribution of the insulated property is made, a percentage of that distribution must be paid over to the uninsulated holders, and this is a personal obligation of the distributee. The amount collected is divided among the uninsulated holders according to the percentage of the reapportioned tax that they paid. It is important to note that the uninsulated holders do not have an actual interest in the insulated property and have no lien or security interest in that property. The uninsulated holders have no more than a claim against the persons who receive distributions from the trust or fund which holds the insulated property. The only exception is where previously insulated property loses its insulation so that it can be reached by the uninsulated holders without violating any prohibitions against alienation of interests.

Take the following example. X dies having a gross estate and an apportionable estate of $10M and devises his probate property (with a value of $8M) to A, B and C, with A and B each receiving 40% of the probate estate, and C receiving 20%. In addition to the probate property, X had an interest in a nonqualified pension plan at his death which interest had a value of $2M. X's contract with the plan provides that an annuity of $120,000 per year is to be paid to G for life, and upon G's death the remainder of the corpus is to be paid to L. The only estate tax to which X's estate is subject is the federal estate tax. The federal estate tax on X's $10M gross estate is $4M. So, the average rate of the estate tax is 40%. Under Section 4(a) of the Act, the estate tax that is attributable to the $2M pension fund is $800,000 -- the value of the property interests that G and L hold in the fund ($2M) is 20% of the $10M value of the entire apportionable estate, and so 20% of the $2M estate tax is attributable to the pension fund. Assume that under local law, the assets of the pension fund cannot be reached by creditors or by the personal representative of X's estate in order to use those funds to pay estate taxes. Under Section 6(c), the personal representative will collect 40% of the $800,000 (i.e., $320,000) from A and a like amount from B; and the personal representative will collect $160,000 from C.

The reapportioned fraction for the pension fund is $800,000 (the amount of the estate tax that was reapportioned to A, B, and C) divided by the $2M value of the fund (the insulated property), which division results in a percentage of 40%. Putting it differently, the $800,000 estate tax attributable to the fund but not paid by those interested in the fund constitutes 40% of the $2M value of the fund. To compensate A, B and C for paying the reapportioned tax, they obtain what amounts to a 40% interest in the fund. Their interest arises only when distributions are made from the fund or, in the event that the fund loses its insulation from creditors, when that occurs.

In Year One, the fund pays $120,000 to G pursuant to the terms of the contract. Forty percent of that distribution ($48,000) must be paid by G to A, B and C -- 40% or $19,200 payable to A and another $19,200 payable to B, and 20% or $9,600 payable to C, since that is the proportion in which they bore the reapportioned tax. The next year, the fund distributes another $120,000 to G, and the same payments must be made to A, B and C. In the third year, G dies, and the fund distributes the remaining principal of $2,400,000 to L; the value of the principal had increased because of an increase in the value of the investments the fund held. A, B, and C are entitled to 40% of that $2,400,000, and so L must pay them $960,000, to be divided among them. A and B will each receive $384,000 (40% of the $960,000), and C will receive $192,000 (20% of $960,000).

In Section 6(b), in which the apportioned estate tax is collected from the principal of the property or funds, the holders of time-limited interests, other than a fixed dollar annuity interest, will bear a share of that tax. The reduction of the principal will result in a smaller amount of income payable to income beneficiaries, and a smaller amount of payment to a holder of a unitrust interest (a person entitled to periodic payments of a stated percentage of the value of the trust's assets). However, a person entitled to receive a specified dollar amount periodically (a fixed dollar annuity) will receive the same amount when the principal is reduced as he would have received if the principal had not been used to pay the tax. So, in the circumstances of Section 6(b), the annuitant of a fixed dollar annuity interest will not bear any of the burden of paying the apportioned estate tax (unless the reduction of principal results in an exhaustion of the principal before the annuitant's interest expires). The annuitant in Section 6(b) is permitted to receive the annuity free of estate taxes partly because, in many cases, the decedent will have intended that the annuity payable to the annuitant be a net figure, but primarily because that choice conforms to the goal of administrative simplicity.

However, in the context of Section 6(c), the annuitant is charged with his share of the applicable estate tax; and so there is a discontinuity in the Act's treatment of annuitants when the principal of the property or funds can be reached and when they cannot. Since the mechanism for allocating the applicable estate tax to distributees is part of the scheme of Section 6(c), it does not create any additional complexity to apply that formula to annuitants. To the contrary, it would have substantially increased the complexity of the scheme if annuitants were excluded since the formula to be applied to the other distributees would then be difficult to determine. Once again, easing the burden of administering the provision took precedence over other considerations.

If undistributed property which was subject to this Subsection (c) subsequently loses its insulation from claims, the uninsulated holders can collect the balance of their interest from the property at that time.

SECTION 7. APPORTIONMENT OF SPECIAL ELECTIVE BENEFITS AND ADDITIONAL ESTATE TAX FROM RECAPTURE OF THOSE BENEFITS.

(a) In this section :

(1) "Special elective benefit" means a reduction in an estate tax obtained by an election for:

(A) a lower valuation of specified property that is included in the gross estate;

(B) a deduction from the gross estate, other than a marital or charitable deduction, allowed for specified property; or

(C) an exclusion from the gross estate of specified property.

(2) "Specified property" means property for which an election has been made for a special elective benefit.

Comment

The type of special elective benefits at which this provision is aimed are currently set forth in §§ 2031(c), 2032A, and 2057 of the Internal Revenue Code. Section 2032A provides an election whereby "qualified real property" (real property that is used for a specified purpose and is held by certain parties related to the decedent) will be given a lower valuation for federal estate tax purposes than otherwise would have been true. Under § 2032A(c), if within 10 years after the decedent's death the qualified heir disposes of an interest in the qualified realty or ceases to use it for its required purpose, an additional estate tax will be imposed to recapture some of the estate tax reduction that was obtained through the election. Even if the federal estate tax is repealed in 2010, the 2001 Act retains the additional estate tax provision to recapture some of the estate tax reduction; and, unless the repeal is made permanent, the sunset provision in the 2001 Act will reinstate the entire estate tax in 2011. The purpose of Section 7 is to define how the benefit of an estate tax reduction of this or a similar type will be allocated and how any additional estate tax imposed to recapture some of that tax benefit will be allocated.

Another federal estate tax provision to which Section 7 applies is § 2057. That provision grants an election to receive a special estate tax deduction for a "qualified family-owned business interest." Under § 2057(f), if, within 10 years after the decedent's death, one of four listed events occurs, an additional federal estate tax will be imposed in order to recapture some of the tax reduction obtained by electing to take the deduction. Section 7 defines how the benefits of the election and the burden of an additional tax will be apportioned. The Economic Growth and Tax Relief Reconciliation Act of 2001 repealed § 2057 for the estates of decedent's dying after the year 2003. However, the 2001 Act retains the 10-year recapture provision, and the sunset provision will reinstate § 2057 in the year 2011 unless the repeal is made permanent.

Section 2031(c) of the Internal Revenue Code provides an election whereby a portion of the value of land that is subject to a qualified conservation easement, as defined in § 2031(c)(8), is excluded from the gross estate. The exclusion does not apply to the value of a retained development right; but if, prior to the date for filing the estate tax return, all the persons who have an interest in the land execute an agreement to extinguish some or all of the development rights, an additional estate tax deduction will be allowed by § 2031(c)(5). A failure to implement that agreement within a specified time will cause the imposition of an additional estate tax to recapture that deduction. The allocation of the benefits of the exclusion and of the deduction for making the agreement, and the allocation of any additional estate tax, is determined by Section 7. Section 2031(c) was modified but retained in the Code by the 2001 legislation.

(b) If an election is made for one or more special elective benefits for specified property, the apportionment of the estate tax is determined by first apportioning among holders of interests in specified properties the amount of estate tax that would have been apportioned to them if no election for special elective benefits had been made. The aggregate reduction in estate tax resulting from all elections for special elective benefits reduces the estate tax that initially was apportioned with respect to the specified properties, and the aggregate reduction of estate tax is allocated among holders of interests in the specified properties in the proportion that the amount of deduction, reduced valuation, or exemption attributable to each holder's interest bears to the aggregate amount of deductions, reduced valuations, and exemptions obtained by the decedent's estate from the special elections. If the estate tax initially apportioned to the holder of an interest in specified property is reduced to zero, any excess amount of reduction reduces the estate tax apportioned to other persons interested in the apportionable estate in proportion to the values of their interests. The attribution of estate tax to holders of interests in specified properties that are included in the decedent's probate estate or in a revocable trust of which the decedent was the settlor is subject to Section 4(c).

Comment

The allocation of the aggregate tax reduction obtained from all special elective benefits is made among the holders of interests in specified properties in accordance with the reduction of the decedent's taxable estate that is attributable to each holder's interest. Since the determination of the amount of estate tax benefit is made by applying the marginal rate of estate tax to the reduced value of the gross estate, it is necessary to aggregate the tax reduction obtained from all of the special election benefits so that the greater tax reduction obtained from using a marginal rate is not duplicated by applying that rate to several distinct reductions.

Once the amount of estate tax that is apportioned to the holder of an interest in specified property is determined, it will have to be paid. The holders of interests in a specified property may have difficulty paying that tax. To pay the tax, the holders will have to sell the property, borrow against it, use other funds to pay the tax, or defer the payment of the tax under tax deferral provisions and pay the tax in installments with income produced by the property. If they were to sell the property, the special elective benefit would be lost; so a sale is not a viable option. Accordingly, the requirement of Section 6(b) that the estate tax be paid from the principal of property subject to a time-limited interest does not apply to specified properties. The solution chosen in Section 6(c) of having other persons interested in the apportionable estate pay the tax and then collect reimbursement from distributees of the property is not practical here because there would be difficulty in determining what income was derived from the property itself, and there would be no trustee or other fiduciary to see that the amounts were turned over to the persons who paid the tax. So, that approach was not adopted. Instead, Sections 4(b) and 7 apportion the estate tax to the holders of the interests in the properties who, facing the obligation to pay, can determine the best method for obtaining the funds to make that payment. The attribution of estate tax to holders of interests in specified properties is subject to the provision of Section 4(c) requiring the estate tax otherwise apportioned to beneficiaries of nonresidual gifts of probate and Revocable Trust assets to be borne by the beneficiaries of the residuary provisions.

(c) An additional estate tax imposed to recapture all or part of a special elective benefit with respect to specified property is charged to the persons who are liable under estate tax law for that additional tax.

Comment

For additional estate taxes, the Act follows the allocation of liability imposed by the estate tax law that generated the additional tax. The burden of the additional estate tax will be borne by the persons who hold interests in the specified property at the time that the additional tax payment is made, and those persons may not be the same ones who held the specified property when the special elective benefit was allowed and so derived the benefit of that election.

SECTION 8. RECOVERY FROM PROPERTY IN POSSESSION OF FIDUCIARY.

(a) A fiduciary may defer any distribution of property until the fiduciary is satisfied that adequate provision for payment of the estate tax has been made.

(b) A fiduciary may withhold from any property under the fiduciary’s control an amount sufficient to pay an estate tax attributable to the distributees of that property.

(c) As a condition to a distribution, a fiduciary may require the distributee to provide a bond or other security for the distributee's share of the tax.

SECTION 9. RIGHT OF FIDUCIARY TO RECOVER TAX.

(a) A fiduciary may recover the proportionate amount of estate tax from the persons to whom the tax is apportioned.

(b) Except as provided otherwise in this Act, to the extent that a fiduciary cannot recover under subsection (a) the amount of a tax apportioned to any person, the amount not recovered must be apportioned among the other persons interested in the apportionable estate, but the total tax apportioned to a person may not exceed the value of that person’s interest.

(c) To the extent a fiduciary cannot recover under subsection (a) or (b), the fiduciary may recover from other persons interested in the gross estate.

(d) If an ancillary personal representative controls property subject to contribution for the payment of an estate tax, the domiciliary fiduciary may recover from the ancillary personal representative the tax apportioned to that property.

SECTION 10. RIGHT OF REIMBURSEMENT.

(a) A person required to pay a tax greater than the amount apportioned to that person has a right of reimbursement against other persons to the extent that each has failed to pay the tax apportioned to that other person.

(b) The fiduciary may enforce the right of reimbursement under subsection (a) on behalf of the person who is entitled to that reimbursement.

SECTION 11. JUDICIAL ACTION TO DETERMINE OR ENFORCE APPORTIONMENT.

(a) A fiduciary, transferee, or person interested in the gross estate may maintain an action to have a court determine and enforce an apportionment made pursuant to this [Act].

(b) If an apportionment of estate taxes has been ordered by a court of competent jurisdiction, a fiduciary or a person who is not a resident of this State may maintain an action in this State to recover from a person interested in the gross estate who is resident in this State or owns property in this State the amount of estate tax apportioned to the defendant and recoverable by the plaintiff. For purposes of that action, the apportionment is presumed to be correct.

Comment

The presumption that the apportionment ordered by the court is correct is rebuttable.

SECTION 12. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this Uniform Act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among States that enact it.

SECTION 13. SEVERABILITY CLAUSE. If any provision of this [Act] or the application thereof to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this Act are severable.

SECTION 14. SURVIVAL OF FORMER LAW. Sections 1 through 13 and 15 and 16 of this [Act] do not apply to estate taxes payable because the decedent died before [the effective date of this [Act]]. Those taxes must be apportioned pursuant to the law in effect on the date of death.

SECTION 15. EFFECTIVE DATE. This [Act] takes effect on [the date on which it is enacted].

SECTION 16. REPEALS. The following acts and parts of acts are repealed as of the effective date of this [Act]:

(1) ....

(2) ....

(3) ....