DRAFT

FOR DISCUSSION ONLY

UNIFORM ESTATE TAX APPORTIONMENT ACT

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

For Drafting Committee Meeting February 21-23, 2003

WITH PREFATORY NOTE AND REPORTER'S NOTES

February 4, 2003

The ideas and conclusions set forth in this draft, including the proposed statutory language and any comments or reporter's notes, have not been passed upon by the National Conference of Commissioners on Uniform State Laws or the Drafting Committee. They do not necessarily reflect the views of the Conference and its Commissioners and the Drafting Committee and its Members and Reporters. Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal.

DRAFTING COMMITTEE TO REVISE UNIFORM ESTATE TAX APPORTIONMENT ACT

The Committee appointed by and representing the National Conference of Commissioners on Uniform State Laws in preparing this Uniform Estate Tax Apportionment Act consists of the following individuals:

RICHARD V. WELLMAN, University of Georgia, School of Law, Athens, GA 30602, *Chair*
THOMAS L. JONES, University of Alabama School of Law, University Station, P.O. Box 865557, Tuscaloosa, AL 35486-0050
EDWARD F. LOWRY, JR., 4200 N. 82nd St., Suite 2001, Scottsdale, AZ 85251
MATTHE S. RAE, JR., 520 S. Grand Ave., 7th Floor, Los Angeles, CA 90071-2645
CHARLES A. TROST, Nashville City Center, 511 Union St., Suite 2100, Nashville, TN 37219
FRANK W. DAYKIN, 2180 Thomas Jefferson Dr., Reno, NV 89509, *Enactment Plan Coordinator*
DOUGLAS A. KAHN, University of Michigan, Law School, 625 South State St., Ann Arbor, MI 48109-1215, *Reporter*

EX OFFICIO

K. KING BURNETT, P.O. Box 910, Salisbury, MD 21803-0910, *President*
JACK DAVIES, 687 Woodridge Dr., Mendota Heights, MN 55118, *Division Chair*

AMERICAN BAR ASSOCIATION ADVISORS

JOSEPH KARTIGANER, 812 Fifth Ave., New York, NY 10021

EXECUTIVE DIRECTOR

WILLIAM H. HENNING, University of Missouri-Columbia, School of Law, 313 Hulston Hall, Columbia, MO 65211, *Executive Director*
FRED H. MILLER, University of Oklahoma, College of Law, 300 Timberdell Road, Norman, OK 73019, *Executive Director Emeritus*
WILLIAM J. PIERCE, 1505 Roxbury Road, Ann Arbor, MI 48104, *Executive Director Emeritus*

Copies of this Act may be obtained from:
NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS
211 E. Ontario Street, Suite 1300
Chicago, Illinois 60611
312/915-0195
www.nccusl.org

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) any claims or expenses ~~that are~~ allowable as deductions for purposes of ~~that~~ the tax;

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

(C) the value of any property that, for purposes of that tax, qualifies for a marital or charitable deduction or otherwise is deductible or exempt.

Comment

The starting point for calculating the apportionable estate is the value of the gross estate. Since the properties included and deductions allowed for determining different taxes can differ, the apportionable estate figure may not be the same for different taxes. Values deducted in determining the apportionable estate, reflect property that is not included in the apportionable estate regardless of whether the recipients of that property bear any of the tax.

Property not included in the apportionable estate for an estate tax typically will not bear any of that tax. However, the recipients of such property will bear part of an estate tax to the extent that the assets of the apportionable estate are insufficient to pay the tax. See Sections 6(c) and 9(d). Since deductible transfers will not generate any estate tax, it is appropriate to insulate ~~the~~ those transfers ~~property~~ from the allocation of that tax to the extent that properties of the apportionable estate are sufficient. In addition to considerations of equity, the insulation from tax of the recipient of a deductible transfer will prevent the deduction from being reduced.

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. Section 2(1)(B) excludes any such gift tax from the apportionable estate, and that exclusion accords with the current treatment by all States.

If the amount that is added to the gross estate were, contrary to the Act, included in the apportionable estate and were not apportioned to the donees, the fractions of the estate tax that are apportioned by Section 4(a) 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. Instead of excluding those amounts from the apportionable estate, an alternative approach is to allocate a portion of the estate tax to the donee of the gift that caused the gift tax that was added to the gross estate. If that approach were adopted, it would be necessary to approximate the amount of estate tax caused by the addition to the gross estate, and the proposals for making that calculation are complex. Rather than impose the administrative burden of making those calculations, the choice was made in the Act simply to exclude the additional amounts from the apportionable estate. Among the reasons for making that choice, two are most prominent. One is that in most cases, with the exception of some large gifts, the donor intends the donee to take the property free of tax. It was deemed undesirable to treat large and small gifts differently by drawing an arbitrarily chosen line of demarcation. Second, in many cases, if estate taxes were allocated to donees, it would be extremely difficult to enforce the donee's liability.

The value of the apportionable estate is reduced by expenditures of the estate, including the payment of claims, that are allowable estate tax deductions ~~regardless of~~ whether or not allowed. For example, administrative expenses that could have been claimed as estate tax deductions, but instead are taken as income tax deductions, will reduce the apportionable estate. When a decedent's estate includes property in more than one State, the apportionable estate for each State's estate tax will be reduced by the expenses and claims that are deductible for purposes of that tax. Where an expenditure cannot be identified as pertaining to property in the gross estate of only one State tax, the expenditure is to be apportioned ratably among the taxes of the States in which the relevant properties are located, in accordance with the values of those properties.

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 for federal estate tax purposes. A statutory claim against a 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. The term 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, no United States income tax is imposed on the unrealized appreciation of a decedent's assets at the time of 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 recipients of property from a decedent. This Act does not apportion those taxes because State law causes inheritance taxes to be 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.

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~~ occurring in 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 inequities, but those can be cured only by federal legislation.

If a decedent held an installment obligation the payment on which is accelerated by the decedent's death, the income tax incurred thereby 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. 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 burden of the gift tax should lie with the same persons who would have borne it if the donor had paid it during life, typically, the residuary beneficiaries. A gift tax liability is not apportioned by this Act, but is treated the same as any other debt of the estate. A gift tax deficiency that becomes due after the decedent's death also is treated as a debt of the decedent's estate.

The Act's treatment of the estate tax incurred because of the addition of a gift tax to a decedent's gross estate when the decedent died with three years of making the gift is described in the Comment to subsection (1).

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

Comment

The kinds of death benefits 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. Property that is deductible under an estate tax, such as property that qualifies for a marital or charitable deduction, is nevertheless "subject to" that tax and included in the gross estate. Once the value of the gross estate for an estate tax is determined, the reductions described in Subsection (1) are applied to ascertain the apportionable estate.

(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 or that is subject to the exercise of discretion that could transfer a beneficial interest to another person. The term does not include a cotenancy unless that cotenancy itself is a time-limited interest.

Comment

A "time-limited interest" includes a term of years, a life interest, a life income interest, an annuity interest, an interest that is subject to a power of transfer, a unitrust interest, and similar interests, whether present or future, and whether held alone or in cotenancy. 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) "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 or for any special valuation adjustment, but reduced by any outstanding debt that is secured by the interest.

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 ratable portion of the debt that it secures.

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 subsection, 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 based on money or money worth's consideration, the right of the third person to that payment

constitutes an interest in the apportionable estate and ~~the third party will be~~ so is subject to apportionment. ~~because of the right to receive that property.~~

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

Taxes imposed on the transfer or receipt of property, regardless of whether 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 pursuant to the estate tax law. 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. See the Comment to Section 7(a). 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.

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~~ below its estate tax value, ~~of that property,~~ the estate tax value of the property is the amount included in the value of the decedent's gross estate. The difference or discount between the purchase price and the estate tax value of the property ~~(hereinafter referred to as "the discount")~~ can be viewed as an ~~property~~ interest which the decedent passed to that person. If the right to purchase is exercised, the amount of the discount is the value of that person's interest in the apportionable estate.

The value of a person's interest ~~that a person has~~ in the apportionable estate depends upon the value of the apportionable estate. So, the value of a residuary interest in a decedent's estate will reflect the amount of allowable deductions which, under this Act, reduce the apportionable estate, but will not be reduced by expenditures that are not allowable deductions for that estate tax. The formula for allocating estate taxes in Section 4(a) utilizes a fraction of which the numerator is the value of a person's interest in the apportionable estate rather than the value of the person's interest in the net estate or in the taxable estate. Since the denominator of the fraction is the value of the apportionable estate, the sum of the numerators of all persons having an interest in the apportionable

estate will equal the denominator, and so 100% of the estate taxes will be apportioned. Consider the following examples.

Ex. (1) D dies leaving a gross estate with a value of $10,150,000 and makes no provision for apportionment of taxes. D's will makes pecuniary devises totaling $1,000,000, and gives ~~devises~~ the residue to A and B equally. There are no claims against the estate and no marital or charitable deductions are allowable. The funeral expenses are $10,000, and the estate incurs administrative expenses of $140,000, all of which are allowable as federal estate tax deductions. The personal representative elects to claim the administrative expenses as federal income tax deductions rather than as estate tax deductions. Nevertheless, those expenses are allowable as estate tax deductions and so reduce the gross estate in determining the apportionable estate. For purposes of the federal estate tax, the apportionable estate is $10,000,000 of which the residuary beneficiaries together have interests valued at $9,000,000 or 90%. The value of the two residuary beneficiaries' interests in the apportionable estate is equal to the difference between the entire apportionable estate of $10,000,000 and the $1,000,000 that was devised to the pecuniary beneficiaries. ~~While the actual amount that will be distributed to the residuary beneficiaries will not be $9,000,000 (since that figure does not reflect the taxes and expenses that are paid and the net income earned by the estate on that share), the allocation of taxes is made on the basis of the beneficiaries' interests in the apportionable estate rather than on the actual amount received by them.~~ So, for purposes of apportioning the federal estate taxes, each residuary beneficiary has an interest in the apportionable estate valued at $4,500,000, which constitutes 45% of the apportionable estate of $10,000,000. Forty-five percent of the federal estate taxes are apportioned each to A and B, and 10% of the federal estate taxes are apportioned to the pecuniary beneficiaries.

Ex. (2) The same facts as those stated in Ex. (1) except that the administrative expenses total $240,000 of which, while all were allowed as administrative expenses by the State probate court, $100,000 was disallowed by the Service for a federal estate tax deduction on the ground that $100,000 of the expenses was not necessary for the administration of the estate. See Rev. Rul. 77-461 and TAM 7912006. The personal representative elected to deduct the remaining $140,000 of administrative expenses as a federal estate tax deduction. For federal estate tax purposes, the apportionable estate is equal to the difference between the gross estate ($10,150,000) and the allowable deductions of $150,000 ($140,000 deductible administrative expenses and $10,000 deductible funeral expenses); and so the apportionable estate is $10,000,000. As noted in Ex. (1), the value of the two residuary beneficiaries interests in the apportionable estate is equal to the difference between the entire apportionable estate of $10,000,000 and the $1,000,000 that was devised to the pecuniary beneficiaries. While the residuary beneficiaries will not receive any part of the $100,000 of administrative expenses for which no federal estate tax deduction is allowable, that expense does not reduce the gross estate in determining the apportionable estate, and so does not affect the value of their residuary interests for the purpose of apportioning the federal estate tax. So, just as was true in Ex. (1), for purposes of apportioning the federal estate taxes, each residuary beneficiary has an interest in the apportionable estate valued at $4,500,000, which constitutes 45% of the apportionable estate of $10,000,000. Forty-five percent of the federal estate taxes are apportioned each to A and B, and 10% of the federal estate taxes are apportioned to the pecuniary beneficiaries.

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 testamentary 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, a will's direction for payment of claims that does not explicitly mention estate taxes is likely to be a boiler plate that was written with no intention of controlling tax apportionment. To protect against an inadvertent inclusion of estate tax payment in a general provision of that nature, the Act requires that the direction explicitly mention estate taxes by name.

On the other hand, a direction that "all taxes arising as a result of my death, whether attributable to assets passing 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. Even if one of the residuary beneficiaries is the 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 judicial construction. For example, there is a split among judicial decisions as to whether a direction such as "all estate taxes be paid out of the residue of my estate" is ambiguous because it is unclear 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 extent that it is determined that a decedent failed to apportion an estate tax, then the Act will apply to apportion that amount of the tax.

The term "will" is defined in Section 1-201(55) of the Uniform Probate Code.

(b) Any portion of an estate tax not apportioned pursuant to subsection (a) 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 appear 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) If any portion of an estate tax is not apportioned pursuant to subsections (a) and (b):

(1) an express provision in a dispositive instrument that the property disposed of in that instrument is to be applied to the payment of the estate tax attributable to the property disposed of in that instrument controls the apportionment of that portion of the estate tax to that property; and

(2) an express provision in a dispositive instrument that a designated portion of the estate tax is not to be apportioned to the property disposed of in that instrument prevents apportionment of that portion of the 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. A ~~One~~ possible choice would ~~was to~~ permit the directions in each of the decedent's instruments determine the extent to which property controlled by that instrument bears a share of estate taxes, but having the provisions for an allocation scheme scattered among a number of documents would make decedent's personal representative search multiple instruments to ascertain the decedent's directions. Instead, 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 by 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 a revocable trust instrument will control. ~~the allocation of those 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~~ containing 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 enable a decedent's personal representative to collect a portion of the decedent's federal estate tax from the recipients of certain nonprobate property that is included in the decedent's gross estate. See e.g., §§ 2206 to 2207B of the Internal Revenue Code. There is a conflict among the courts as to whether those federal provisions preempt a State law apportionment provision. Choosing the position that there is no federal preemption, the Act apportions taxes without regard to the federal provisions. The federal provisions are not apportionment statutes; rather, they simply 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 and do not direct use of ~~how~~ the collected amounts ~~are to be used~~ by the personal representative. The rights granted to the personal representative by federal law for the collection of assets from nonprobate beneficiaries do not conflict either with the apportionment of taxes by State law or with other 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 anyone other than the decedent to override the allocation provisions of the Act. 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. See § 2044 of the Internal Revenue Code of 1986. If X's QTIP trust provided that the trust is not to bear any of the estate taxes imposed at Y's death, the direction would be ineffective under the Act because only Y can direct apportionment of taxes on Y's estate. 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 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 directs payment from the transferred property of any part of the estate taxes of the other person, the direction affects the size of the gift, and so 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 § 2044 of the Internal Revenue Code of 1986, 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 attributable to Trust 2 on 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) Subsections (a), (b), or (c) does not authorize a direct or indirect increase in the amount of estate tax apportioned to a person having an interest in property which the decedent had no power to transfer immediately before the decedent's death. For purposes of this subsection, a testamentary general power of appointment is a power to transfer 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 effectively 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 a transferee. 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 a general power of appointment, whether inter vivos or testamentary, 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 (§§ 4 and 5), and Rev. Proc. 90-31 (§§ 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, had not been distributed to the trust before 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) Except as otherwise provided in Sections 6 and 7, an estate tax is apportioned to each person who receiving an interest in the apportionable estate in the proportion that the value of that interest bears to the total value of the apportionable estate.

Comment

The value of an interest in the apportionable estate is determined in accordance with Section 2(6) of the Act and is discussed in the Comment to that subsection. The Comment to Section 2(6) contains two examples illustrating how this subsection operates.

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. See the Comment to Section 2(1). This treatment is consistent with the position taken in Restatement (Third) of Property: Wills and Other Donative Transfers §1.1, comment g (1998). While the Act does adopt a method of equitable apportionment of estate taxes, the Act does not adopt the method utilized by the Restatement, which allocates taxes apportioned to the probate estate first to the residuary beneficiaries.

(b) A generation-skipping transfer tax incurred on a direct skip is charged to the interest in property transferred. To the extent that legal restrictions or other obstacles make collection from that property impractical, the deficiency is apportioned among the transferees of that interest in property in proportion to the values 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 (b), 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 (b) is consistent with the treatment provided by federal law.

(c) Subject to Section 6, the difference between the total estate tax for which a decedent's estate is liable and the amount of estate tax for which the estate would have been liable if the property that is included in the decedent's gross estate for estate tax purposes because of Section 2044 of the Internal Revenue Code of 1986 or of any comparable estate tax provision had not been included in decedent's gross estate is apportioned among the holders of interests in that property in proportion to the values of their interests.

Comment

The property to which this subsection applies is sometimes referred to as "QTIP property" since § 2044 of the Internal Revenue Code of 1986 deals with "qualified terminable interest property," commonly referred to as "QTIP property." See §§ 2044(b)(1), 2056(b)(7), and 2523(f) of the Internal Revenue Code of 1986. While the general rule of apportionment in the Act is to apportion estate taxes on the basis of the average rate of tax, the tax apportioned to the holders of interests in QTIP property by the Act is based on the marginal rate of tax. ~~Unless the decedent had the power to direct the disposition of the QTIP property, some think that it would be inequitable to require the beneficiaries of decedent's assets (as contrasted to the QTIP property, which is not an asset of the decedent) to pay a greater tax than they would have borne if the QTIP property had not been included in decedent's gross estate; and so the tax borne by the QTIP property should be determined at the marginal rather than at the average rate of tax. The availability of the marital deduction to the estate of the decedent's spouse resulted in a larger QTIP trust than otherwise would have existed, and so the income generated by that trust, all of which had to be paid to the decedent during decedent's surviving life span, swelled the decedent's assets and probably resulted in an increase in the decedent's estate, which passes to decedent's beneficiaries. Nevertheless, many conclude that the resulting increase in the amount passing to decedent's beneficiaries is not adequate compensation for increasing the marginal rate of tax they bear.~~ Note that 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 SPECIAL VALUATIONS, CREDITS, AND

DEFERRALS.

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

(b) A credit for gift taxes and for property previously taxed inures ratably to the 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.

(c) A credit for state or foreign taxes inures ratably to the benefit of all persons to whom the estate tax is apportioned, except that ~~to the extent that~~ the amount of state or foreign tax ~~was~~ paid by the beneficiary of the property on which the state or foreign tax was imposed, directly or by a charge against the property, ~~that portion of the credit~~ inures to the benefit of that beneficiary.

Comment

A beneficiary of property ~~which incurred~~ attracting 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(6). The Act ~~therefore gives~~ mitigates the beneficary's burden by giving the beneficiary ~~of the property~~ the benefit of any estate tax credit ~~that is~~ allowed for the foreign or State tax and paid by ~~that~~ the beneficiary.] ~~effectively paid.~~

(d) 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 ratably to the persons to whom

the estate tax attributable to that interest is apportioned; ~~Except as otherwise provided in Section 6(b),~~ and the burden of any interest incurred on a deferral or extension of taxes and the benefit of any tax deduction associated with the accrual or payment of that interest is allocated ratably among the persons receiving the property.

Comment

The benefits and burdens described in this subsection are to be allocated ratably among persons in accordance with the amount of deferral or extension attributable to their interests in the apportionable estate.

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

(a) In this section:

(1) "Advanced fraction" is a fraction that has as its numerator the amount of the advanced tax and as its denominator the value of the insulated properties to which that tax is attributable.

(2) "Advanced tax" means the aggregate amount of estate tax attributable to interests in insulated property which is required to be advanced by uninsulated holders under subsection (c).

(3) "Insulated property" means assets subject to a time-limited interest which are included in the apportionable estate but are unavailable for payment of an estate tax because of obstacles making collection impossible or impracticable.

Comment

The term "time-limited interest" is defined in Section 2(4).

(4) "Uninsulated holder" means a person who has an interest in uninsulated property.

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

(b) Except as otherwise provided in Sections 3(e) and 7, an estate tax apportioned to, or advanced by, persons holding interests in uninsulated property subject to a time-limited interest must be paid or advanced, 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 payable as an advanced tax 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). The term "time-limited interest" is defined in Section 2(4).

It would be harsh to collect the estate tax payable because of uninsulated property 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. Hence, the tax is to be paid or advanced from principal. This Act might 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 would be a complicated arrangement to administer, and is used in Section 6(c) because no simple and equitable alternative is 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 when a special elective benefit (described in Section 7(a)(1)) is involved, subsection (b) does not apply to properties for which those benefits were elected. Instead, the estate tax attributable to such properties is apportioned to the holders of interests in those properties.

If an estate tax is apportioned to or payable as an advanced tax by a person having an interest in property that cannot be reached but is not subject to a time-limited interest, the tax is to be collected from that person to the extent feasible. 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 (and frequently will not) qualify for a deduction. As to split interest inter vivos trusts in a decedent's gross estate, requiring the payment of the tax attributable to a nondeductible preceding or succeeding interest to be made from principal 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 its Comment. 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.

Although 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, a choice that 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 an instrument creating a split-interest trust for a charity or spouse typically will include an appropriate provision for apportionment of estate taxes in the instrument. The Act invites the parties to tailor tax apportionment to accomplish the specific wishes of the decedent when a charitable or marital split-interest trust or property interest is employed. This approach is preferable to creating a complex statutory apportionment scheme to protect against infrequently ocurring circumstances.

(c) Subject to the limitation provided in Section 9(b) and in the absence of a contrary determination pursuant to subsection (d), an estate tax attributable to interests in insulated property must be advanced by uninsulated holders in proportion to the value of their uninsulated property interests. If the value of an interest in uninsulated property is less than the amount of estate taxes apportioned to, and required to be advanced by, the holder of that interest, the excess must be advanced ratably by the persons holding interests in properties that are excluded from the apportionable estate under Section 2(1)(C), and those properties are treated as uninsulated properties for purposes of this [Act]. When a distribution of insulated property is made, each uninsulated holder may recover from the distributee a ratable portion of the advanced 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 advanced 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 is to be paid (as an advancement) by persons having interests in other assets of the estate (uninsulated holders), provided however that the total tax attributed to and advanced by an uninsulated holder cannot exceed the value of that person's interest in the uninsulated property. See Section 9(b). If the amount of the aggregate tax apportioned to and by an uninsulated holder exceeds the value of that holder's interest in the uninsulated property, then the excess shall be apportioned to the holders of interests in properties that otherwise are excluded from apportionment such as properties that qualify for marital and charitable deductions. In such cases, those properties are reclassified as uninsulated properties, and so the beneficiaries of those properties will be uninsulated holders who will have a right of recovery from the distributees of insulated properties for which they paid a portion of the estate tax.

It would be harsh to make persons holding future interests in insulated property 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. For that reason, with one exception noted below, the tax attributable to insulated properties is reallocated to uninsulated holders who are required to advance the funds to pay the tax.

However, in certain circumstances, it would be more equitable to require the beneficiary of an interest in insulated property to bear the tax on that interest than to reapportion it to others. For example, if the beneficiary's interest is one that will become possessory in a short period of time, so that the beneficiary will soon have possession of assets from the fund or trust, it would be more equitable to place personal liability on that beneficiary; and the court has discretion to do so. In determining whether a beneficiary is likely to obtain possession of all or a significant part of the beneficiary's interest in the insulated property, the court can consider not only distributions that are required to be made to the beneficiary, but also distributions that, based on an examination of the history of the administration of the fund or trust, are likely to be made in the near future. Subsection (d) provides the court with the discretion to make that determination. While a beneficiary's receipt of a distribution from the trust or fund would make that beneficiary liable to uninsulated holders who paid the advanced tax, that places a burden of collection on the uninsulated holders; and so, when the distribution is likely to be made to a beneficiary within a short period of time, it would be more equitable to have that beneficiary bear the tax.

The tax attributable to the insulated property that is required to be paid by the uninsulated holders is referred to as an "advanced tax." To permit the uninsulated holders who bear the advanced tax to be reimbursed, the Act effectively provides the uninsulated holders with a phantom percentage interest in the property whose transfer is the source of the advanced tax. While the phantom percentage interest of the uninsulated holder remains constant, its value will increase or decrease as the value of the property changes. The phantom percentage interest is determined by dividing the advanced tax by the aggregate value of insulated properties as determined for purposes of the estate tax. When a distribution of 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 uninsulated holders have a right of reimbursement from the distributees under Section 10, but this subsection gives them a right to an amount determined by a fraction of the distributed amount rather than as a fixed dollar amount plus interest. The amount collected from a distributee is divided among the uninsulated holders according to the percentage of the advanced 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 while it is in the possession of the trust or fund. The uninsulated holders only have 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 prohibition against alienation of interests. Once insulated property is in the hands of a distributee, subsection (e) provides the uninsulated holders with a lien on that property for the amount owed to them under this subsection; but there is no lien or other encumbrance on the insulated property while it is in the possession of the trust or fund.

The operation of this subsection and subsection (e) does not interfere with the administration of the trust or fund that possesses the insulated property. If the insulated property is an ERISA fund, this provision does not contravene the antialienation rule of § 206(d)(1) of ERISA, a view that is in accord with the holding of the Tenth Circuit in *Guidry v. Sheet Metal Workers Int'l Association, Local No. 9*, 10 F.3d 700 (10th Cir. 1993) (2-1 decision) (on remand from the Supreme Court), aff'd en banc *sub nom. Guidry v. Sheet Metal Workers Nat'l Pension Fund*, 39 F.3d 1078 (10th Cir. 1994). The Tenth Circuit view was followed by the Third Circuit in *North Jersey Welfare Fund, Inc. v. Colville*, 16 F.3d 52 (3d Cir. 1994).

The operation of this subsection is illustrated in the following examples.

Ex. (1) 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~~ $4M 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 advanced fraction for the pension fund is $800,000 (the amount of the estate tax that was advanced by 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 advanced tax, they obtain what amounts to a 40% phantom interest in the fund. Their actual 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 advanced 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).

Ex. (2) X dies leaving a taxable estate of $10,000,000 on which a federal estate tax of $5,000,000 is payable (for convenience of computation, we treat all of X's estate as subject to a tax at a 50% marginal rate). X's estate has no marital or charitable deductions. X left $4,000,000 of assets in an offshore trust that cannot be reached by X's personal representative and so constitutes insulated property. The federal estate tax attributable to that property is $2,000,000. X had nonprobate assets having an aggregate value of $2,000,000 and a residuary estate of $4,000,000. The holders of the nonprobate assets will have $1,000,000 in federal estate taxes apportioned to them, and the holders of the residuary interests will have $2,000,000 of federal estate taxes attributed to them. But, the personal representative must also pay the $2,000,000 of federal estate taxes attributable to the offshore assets. If the holders of interests in those assets cannot be reached, and if the Act did not apply, the personal representative would have to pay the $2,000,000 from the residuary of the estate, thereby wiping it out completely. Under the Act, 1/3 of the $2,000,000 of federal estate tax attributable to the offshore assets ($666,667) will be paid by the holders of the nonprobate assets, and the remaining $1,333,333 of that tax will be paid by the beneficiaries of the residuary estate. Under the Act, the holders of the nonprobate assets will have to bear their proportionate share of the tax on the offshore assets. When distributions are made of the offshore assets, the distributees will be personally liable to pay a portion of their distribution to the persons who paid the estate tax on the offshore fund.

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.

(d) A court having jurisdiction to determine the apportionment of an estate tax may require a beneficiary of an interest in insulated property to pay all or part of the estate tax attributable to that interest if the court finds that it would be substantially more equitable for that beneficiary to bear that tax liability personally than for that part of the tax to be advanced by insulated holders.

Comment

See the Comment to subsection (c).

~~(e) Upon a distribution of insulated property for which, pursuant to subsection (c), the distributee incurs an obligation to make a payment to uninsulated holders, each uninsulated holder acquires a lien on the amount distributed to that distributee for the amount owed to each uninsulated holder. This lien applies to the distributed property only after it has been distributed to the distributee.~~

~~[Comment: The lien provided by this subsection does not affect insulated property in the possession of the trust or fund. It applies only to property in the hands of a distributee. Therefore, the lien does not interfere with the administration of the trust or fund. For reasons set forth in the Comment to subsection (c), the lien does not contravene the anti-alienation provisions of ERISA.]~~

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 types 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 of 1986. 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 the year 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 the year 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 of the Internal Revenue Code of 1986. 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 of 1986 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, an initial apportionment of the estate tax is made as if no election for any of those benefits had been made. The aggregate reduction in estate tax resulting from all elections made is then 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 ratably the estate tax apportioned to other persons who receive interests in the apportionable estate.

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(a) 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.

(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 the 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. SECURING PAYMENT OF TAX FROM PROPERTY IN POSSESSION OF FIDUCIARY.

(a) A fiduciary may defer a 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 distributee any property under the fiduciary's control an amount of any estate tax attributable to an interest of the distributee in the

apportionable estate.

(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. COLLECTION OF TAX BY FIDUCIARY.

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

(b) Except as otherwise provided in Section 6, to the extent that a fiduciary cannot recover under subsection (a) the amount of a tax apportioned to any person, the amount not recovered may be collected from the other persons receiving interests in the apportionable estate, but the total tax collected from a person may not exceed the value of that person's interest.

(c) A domiciliary fiduciary may recover from an ancillary personal representative the tax apportioned to the property controlled by the ancillary personal representative.

(d) Except as otherwise provided in Section 6, to the extent a fiduciary cannot recover under subsection (a), (b), or (c), the fiduciary may recover ratably from other beneficiaries of the gross estate.

Comment

The "other beneficiaries of the gross estate" will include beneficiaries of properties that qualify for a marital or charitable deduction since those properties are part of the decedent's gross estate.

SECTION 10. RIGHT OF REIMBURSEMENT.

(a) A person required under Section 9 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 other person has failed to pay the tax apportioned to the other person.

(b) A fiduciary may enforce the right of reimbursement under subsection (a) on behalf of the person who is entitled to the reimbursement and shall take reasonable steps to do so if requested by the person.

SECTION 11. JUDICIAL ACTION TO DETERMINE OR ENFORCE APPORTIONMENT.

(a) A fiduciary, transferee, or beneficiary of the gross estate may maintain an action to have a court determine and enforce any provision of this [Act].

(b) If a court of competent jurisdiction has entered an order relating to the apportionment of an estate tax, a fiduciary or other person may maintain an action in this State to enforce the order. For purposes of the 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.

(a) Sections 1 through 13 and 15 and 16 of this [Act] do not apply to estates of decedents:

[(i) dying before the date on which this [Act] was enacted, or

(ii) dying on or within one year after the date on which this [Act] was enacted if the decedent left an instrument controlling apportionment which was executed by the decedent before the date on which this [Act] was enacted.]

(b) For estates of decedents dying on or after the date on which this [Act] was enacted to which Sections 1 through 13 and 15 and 16 do not apply, estate taxes must be apportioned pursuant to the law in effect on the day immediately before the date on which this [Act] was enacted.

SECTION 15. EFFECTIVE DATE. Except as otherwise provided in Section 14, this [Act] applies to estates of decedents who die on or after the date on which this [Act] was enacted.

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

(1) .....

(2) .....

(3) .....