DRAFT

FOR DISCUSSION ONLY

REVISION OF UNIFORM ESTATE TAX APPORTIONMENT ACT AND SECTION 3-916 OF THE UNIFORM PROBATE CODE

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

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REVISION OF UNIFORM ESTATE TAX APPORTIONMENT ACT AND SECTION 3-916 OF THE UNIFORM PROBATE CODE

With Reporter's Notes

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 AND SECTION 3-916 OF THE UNIFORM PROBATE CODE

RICHARD V. WELLMAN, University of Georgia, School of Law, Athens, GA 30062, *Chair*
FRANK W. DAYKIN, 4745 Giles Way, Carson City, NV 89704, *Enactment Plan Coordinator*
THOMAS L. JONES, University of Alabama School of Law, University Station, P.O. Box 865557, Tuscaloosa, AL 35486-0050
EDWARD F. LOWRY, JR., Suite 1120, 2901 N. Central Avenue, Phoenix, AZ 85012
MATTHEW S. RAE, JR., 520 S. Grand Avenue, 7th Floor, Los Angeles, CA 90071-2645
CHARLES A. TROST, Nashville City Center, 511 Union Street, Suite 2100, Nashville, TN 37219
DOUGLAS A. KAHN, University of Michigan Law School, 625 S. State Street, Ann Arbor, MI 48109-1215, *Reporter*

EX OFFICIO

JOHN L. McCLAUGHERTY, P.O. Box 553, Charleston, WV 25322, *President*
TERESA ANN BECK, House Legislative Services Office, P.O. Box 1018, Jackson, MS 39215, *Division Chair*

AMERICAN BAR ASSOCIATION ADVISOR

JOSEPH KARTIGANER, 955 Fifth Avenue, New York, NY 10021

EXECUTIVE DIRECTOR

FRED H. MILLER,University of Oklahoma, College of Law, 300 Timberdell Road, Norman, OK 73019, *Executive Director*
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

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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) "Estate tax" means a domestic or foreign tax imposed because of the death of an individual, including the federal estate tax, the federal generation-skipping transfer tax incurred on a direct skip, state estate and inheritance taxes, state generation-skipping transfer taxes incurred on a direct skip, and interest and penalties associated with those taxes. The term does not include an income tax, gift tax, or generation-skipping tax incurred because of a taxable termination, taxable distribution, or direct skip that takes place during the decedent's life.

[COMMENT: The term "estate tax" is specially defined in the Act to include all succession and other taxes arising because of an individual's death, except that the term does not include any 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 income tax imposed at death on the amount by which a decedent's assets were appreciated at the time of his death. Except for Income in Respect of a Decedent, the basis of an asset that was included in a decedent's gross estate will become the fair market value of that asset. There currently are proposals to eliminate federal estate taxes. If the federal estate taxes are repealed, it is virtually certain that the repeal will be accompanied by either: (1) an income tax on capital appreciation at death, or (2) a carry-over basis under which the transferees of the decedent's properties will take the same basis in those properties that the decedent had; but certain properties or dollar amounts may be exempted from income taxation at death or a carryover basis. 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 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 serious 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 would be unfair in that the IRD would have been reduced by the income tax payable thereon if it had been collected before the decedent's estate, and only the net amount remaining would have been subjected to estate taxation on the decedent's estate. The federal tax law seeks to prevent an inequity from taking place 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. For the estate of an individual who had a large amount of IRD that constitutes a major portion of the 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 the Act, but efforts should be made to encourage Congress to address this problem.

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 the 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 donor's typical 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 the 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 the donor did pay a gift tax during life, but an additional gift tax becomes due because of a determination of a deficiency, the additional gift tax payment will not be apportioned by the Act, but will be treated as a debt of the decedent's estate if paid by the estate.

If a gift tax is paid on a gift that is made within three years of the donor's death, that gift tax will be added to the donor's gross estate for federal (and some state)estate tax purposes. The treatment of gift taxes that are added to the donor's gross estate is set forth in Subsection 2(2) of the Act and is discussed in the Comment to that Subsection.]

(2) "Gross estate" means all interests in property which are subject to an estate tax and which are not excluded from apportionment by this [Act] except: (A) an amount added to a decedent's gross estate for federal estate tax purposes for a tax on gifts made before death; and (B) an amount added to a decedent's gross estate for state or foreign estate tax purposes for a tax on gifts.

[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 states will have an exemption for a homestead; some will exclude life insurance proceeds and pensions from an inheritance or other estate tax. 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.

A gift tax 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 gross estate for federal estate tax purposes by Internal Revenue Code § 2035(b). A State or foreign estate tax can have a similar provision or effect. By the Act's excluding the amount of any such gift tax from the gross estate, that amount is thereby removed from the gross estate figure that is used as the base of allocating estate taxes. One reason that the amount of gift tax that is added back is taken out of the gross estate figure for purposes of apportioning the estate tax under this Act is that there is no person who has an interest in that additional amount, and so there is no recipient of that amount to whom an estate tax could be apportioned. If the additional amount were included in the gross estate under the Act, unless some adjustment were made as to the identity of the persons interested in the gross estate, the fractions of the estate tax that are apportioned among the persons interested in the gross estate 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. The exclusion from the gross estate of the gift tax payment prevents that discrepancy from occurring. Moreover, if the amount of the gift giving rise to such a gift tax is not large, the donor typically will have intended that the 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, there would be administrative complexities engendered by apportioning any of the estate tax to such donees. The formula for calculating the apportioned amount would be complex. In some cases, it would be difficult to locate the donee of the gift and to enforce the apportionment. It seems preferable not to divide gifts between those of small and large size (by resorting to an arbitrarily chosen amount). Instead, it seems administratively preferable to treat all such gifts alike, either apportioning to all such donees or to none. In the Act, no apportionment is made to the donees; and that accords with the current treatment by all states.

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.

A devise or transfer of property of a value of $10,000 or less is excluded from apportionment by Subsection 5(b), and so such property is excluded from the gross estate for purposes of this Act. Even if there is a shortfall in payments of the estate tax so that the shortfall is apportioned by Subsection 5(b) to the recipients of such small devises or transfers, such property nevertheless is excluded from the gross estate.]

(3) "Internal Revenue Code" means Title 26 of the United States Code as it exists on [the effective date of this [Act]] [or as subsequently amended].

[COMMENT: From time to time, the lettering or numbering of subsections of a Code section may be changed or even moved to another Code section. Any references in the Act to Code sections or subsections are intended to refer to the substance of those provisions regardless of whether they are subsequently relettered or renumbered. A reference to a Code provision includes amendments that Congress subsequently makes to that provision. However, the constitution of some States prohibit a delegation of the legislative function from the State legislature to Congress, and so those States cannot incorporate subsequent changes of federal law into their apportionment acts. Instead, those States will need to make legislative adjustments to their acts from time to time in order to adopt Congressional amendments to Internal Revenue Code provisions that are incorporated in their acts.]

(4) "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.

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

[COMMENT: 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 gross estate," and the bargain element in the purchase price may be treated as property received by that person.]

(6) "Property received by a person" includes an interest in property and a right to receive any interest in property, without reduction for any taxes charged to the property or paid by the recipient.

[COMMENT: The meaning of "property" in the Act is as broad as the definition of "gross estate" in § 2031(a) of the Internal Revenue Code. For the treatment of the bargain element in a right to purchase gross estate property as "property received by a person," see the Comment to Section 2(5).

(7) "State" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

[COMMENT: While the definition of "State" does not include a political subdivision of a governmental entity listed in that definition, an estate tax imposed by a city or other political subdivision of such a governmental entity will be included in the definition of an "estate tax" in the Act and so will be apportioned by the Act.]

(8) "Value" means fair market value as finally determined for purposes of the estate tax that is to be apportioned under this [Act], without reduction for the portion of the interest in property that is used, or required to be used, for the payment of estate taxes, without reduction for the payment of estate taxes, made or required to be made, by the recipient of the interest, and without reduction for any special valuation adjustment. If an interest in property is encumbered, the term

means the fair market value of the interest, as determined under this paragraph, less the 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 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 a decedent's will or other dispositive instrument directs that property controlled by that instrument is to be used to pay a debt that is secured by an interest or interests in property, that provision will constitute an additional bequest to the person or persons who are to receive the interests securing the debt.

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 if 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 the alternate valuation date is elected, the fair market value of property on the alternate valuation date will be the value of the property for purposes of the 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 the Act, just as a special valuation adjustment is not taken into account when the property is valued at the date of death.]

SECTION 3. SURVIVAL OF FORMER LAW. Sections 1 through 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 4. APPORTIONMENT BY WILL OR OTHER DISPOSITIVE INSTRUMENT.

(a) If a decedent's will expressly directs the apportionment of any or all estate taxes, those estate taxes must be apportioned according to that direction.

(b) To the extent that a decedent's will does not direct the apportionment of an estate tax, the tax must be apportioned in accordance with an express direction in a revocable trust of which the decedent was the settlor. If conflicting directions are given in two or more revocable trust instruments, the apportionment directions in the most recently dated revocable trust instrument prevails. For the purposes of this subsection, the date of amendment to a revocable trust instrument is the date of the instrument only if the amendment contains an express direction 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 will be treated as 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 will be the date on which it was executed or the date of the most recent amendment containing a provision apportioning an estate tax.]

(c) For the purposes of this subsection, an "unapportioned estate tax" means an estate tax that is not apportioned by a direction in the decedent's will or revocable trust. To the extent that a decedent's will or a revocable trust of which the decedent was the settlor does not direct the apportionment of an estate tax, a provision in an instrument, inter vivos or testamentary, disposing of property subject to the instrument that the property be applied to the payment of an otherwise unapportioned estate tax or that an otherwise unapportioned estate tax must or must not be apportioned to the property, controls the extent of the application of the property to the satisfaction of the estate tax or the insulation of the property from payment of the estate tax.

[COMMENT: The statutory allocation rules of the Act essentially are default rules in the event that the decedent does not make a valid provision as to how estate taxes are to be allocated. The decedent has the power to determine which recipients of decedent's property will bear the estate taxes and in what proportion. It is necessary to determine in which of the instrument or instruments that the decedent executed must the decedent's direction be included to be valid. 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 was determined that it would be preferable to have the decedent's directions set forth in one instrument so that the decedent's personal representative would not have to search multiple instruments to ascertain the decedent's directions. Accordingly, the Act provides an order of priority for a decedent's directions of estate tax allocations. To the extent that a decedent makes a valid express direction in the decedent's will, that direction will trump any competing direction in another instrument. To the extent that the will does not validly provide for the allocation of estate taxes, an express direction in an instrument that the decedent executed to create a revocable trust will control the allocation of estate taxes. If the decedent executed more than one revocable trust instrument, the directions in the instrument that was executed most recently will control. In determining which revocable trust instrument was executed most recently, the date of any amendment that contains an 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 express directions contained in other instruments executed by the decedent that disposes of property will control to the extent that the direction applies to the property disposed of in that instrument. An example of a direction in an instrument disposing of property, other than a will or revocable trust instrument, is a direction in a designation of a beneficiary of life insurance proceeds either that the proceeds will be used to pay a portion of estate taxes or that the proceeds are not to be used to pay estate taxes. A designation of that form will be honored if there is no conflicting designation in a will or a revocable trust instrument.

The federal estate tax laws provide a right of the decedent's personal representative 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 overriden by the decedent's directions either in a will, or in the case of several of the provisions, in a revocable trust instrument. The Act does not track those provisions in that the Act allows the revocable trust instrument to control only if the will does not make a conflicting direction, and the Act permits other instruments to control in limited circumstances. These provisions in the Act do not conflict with federal law since the 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 Act does not permit a direction for allocation of estate taxes, or for the insulation from an allocation, that is made by 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 estate tax purposes on Y's estate. The instrument that X executed to create the QTIP trust might provide that the trust is not to bear any of the estate taxes imposed at Y's estate. The Act does not honor that direction, and provides that 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. The view of the Committee is that 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. There is a stronger case for allowing the donee of a power of attorney from the decedent to make a valid direction as to the application of the property subject to that power to the payment of estate taxes; but, even there, the view was taken that the default provisions of the statute were more likely to represent the decedent's wishes than would a third person's direction.]

(d) A direction for apportionment, whether in a decedent's will, revocable trust, or other instrument, does not apply to increase the amount of tax apportioned to an interest in property over which the decedent had no power to amend or revoke 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 direction in the appropriate instrument, a decedent can reduce the amount of tax apportioned to such inter vivos transfers, the decedent will not be permitted to increase the amount of tax apportioned to such transfers. So, 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 that the amount that would have been apportioned to that transferee if no directions for apportionment had been made by the decedent.

This Subsection(d)does not apply to a decedent's direction 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 direction 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.]

(e) If a decedent directs by will, revocable trust, or other instrument that estate taxes be paid from a fund or trust in which a charity has a remainder, income or annuity interest and does not expressly state otherwise, the payment must be made, to the extent feasible, from property that would have been added to the fund or trust.

[COMMENT: The reference in this subsection to a charity's having an "annuity interest" includes a charity's having a unitrust interest. If taxes are to be paid from a fund or trust for which a charity has a remainder interest or an annuity or unitrust interest, that could cause a loss of the entire charitable deduction. The Service has been reluctant to treat a payment from such a trust or fund as merely reducing the size of the charitable deduction, and has disallowed the charitable deduction entirely. The Service has indicated informally in at least one case that if the payment of the tax is made before that cash is made a part of the fund or trust, then the payment will not disqualify the charitable deduction. There are numerous instances in which instruments have been drafted requiring a portion of estate taxes to be paid from a charitable remainder trust or a charitable lead trust. Subsection (e) is an attempt to protect the deduction in such cases.]

SECTION 5. STATUTORY APPORTIONMENT OF ESTATE TAXES.

(a) Except as otherwise provided in this [Act,] an estate tax is apportioned among the persons interested in the gross estate in the proportion that the value of the interest in property received by each person interested in the gross estate bears to the total value of the gross estate.

(b) Unless other assets of the gross estate to which taxes are apportioned by this [Act] are insufficient to satisfy the decedent's liability for estate tax, none of that tax is apportioned to the recipient of any disposition of property having a value of $10,000 or less. If the other assets of the gross estate are insufficient, the shortfall is apportioned to the recipients of dispositions of property having a value of $10,000 or less in proportion to their respective values. In this subsection, a "disposition" of property means any passage of property that is included in the decedent's gross estate, whether the passage took place before or after the decedent's death and whether or not the property is subject to probate.

[COMMENT: No estate tax shall be apportioned to the recipient of a disposition of property having a value of $10,000 or less unless the other assets of the gross estate, to which taxes are apportioned by this Act, are insufficient to pay all of the estate tax. This provision applies to both non-probate and probate dispositions. So, if a joint bank account of less than $10,000 passes to the surviving joint owner, no tax will be apportioned to that joint owner. Similarly, if the proceeds of a life insurance policy that are payable to a beneficiary do not exceed $10,000, no estate tax will be apportioned to that beneficiary; and no estate tax will be apportioned to the beneficiary of a testamentary pecuniary devise of $10,000 or less.]

(c) A state inheritance tax that is imposed on the receipt of an interest in property is charged to the person receiving that interest.

[COMMENT: While only a few states currently have an inheritance tax, as contrasted to an estate tax, this provision has been included in the Act to deal with the possibility that a number of states may reintroduce an inheritance tax if the federal estate tax is eliminated or substantially reduced. State estate taxes typically are based on the federal estate tax, and so the elimination or

reduction of the latter would have a significant impact on the revenue collections of the State.]

(d) A federal or state generation-skipping transfer tax that is incurred on a direct skip is charged to the transfer to which that tax is applied. If there is more than one transferee, the tax is apportioned among them in proportion to the values of their respective interests.

SECTION 6. ALLOWANCE FOR EXEMPTIONS, DEDUCTIONS, SPECIAL VALUATIONS, CREDITS, AND DEFERRALS.

(a) In making an apportionment, allowances must be made as provided in subsections (b) through (e) and Sections 7 and 8.

(b) Except as otherwise provided for special elective benefits in Section 8, 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 deduction. Since the property transferred to the surviving spouse or charity effectively causes no federal estate tax to the extent that it is deductible, no part of the surviving spouse's or charity's interest that so qualifies should bear any of the estate tax burden; and, to that end, the 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.]

(c) A credit for gift taxes and for property previously taxed inures to the proportionate benefit of those persons to whom the federal estate tax is apportioned. A credit for estate taxes inures to the benefit of the persons interested in the gross estate, except that to the extent that the estate tax was paid by the recipient of the property on which the estate tax was imposed, that portion of the credit inures to the benefit of that recipient.

[COMMENT: The reference to credits for estate taxes is to a credit for foreign and state estate taxes. A recipient of property which incurred a foreign or state estate tax may have paid that tax by virtue of the amount's being paid out of the property passing to that person. The only state estate tax that is payable out of the interest in property the transfer of which caused the imposition of that tax is an inheritance tax. An inheritance tax will reduce the amount that the recipient of that property will receive, but it will not reduce the value of the recipient's interest in the gross estate according to the definition of "value" in the Act. The payment of the state estate tax is essentially a payment of a portion of the federal estate tax to the extent that a federal estate tax credit is allowed for the payment. Accordingly, the Act gives the recipient of the property the benefit of the federal estate tax credit for the inheritance tax that the recipient effectively paid.]

(d) If payment of any part of an estate tax is deferred because of the inclusion of a certain interest in property in the gross estate, the benefit of the deferral inures proportionately to the persons to whom the estate tax attributable to that interest is apportioned. Any interest payable on an extension or deferral of taxes and any tax deduction associated with the interest paid must be equitably apportioned to reflect the benefit of the extension or deferral and the burden of the interest paid.

(e) To the extent that an interest in property passing to or for the benefit of a surviving spouse, or for any charitable, religious, public, or similar purpose, would not give rise to an allowable federal estate tax deduction solely because the value passing to the recipient would be reduced by the imposition of a tax upon the interest, the estate tax may not be apportioned to the recipient of that interest.

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SECTION 7. APPORTIONMENT BETWEEN LIMITED AND REMAINDER INTERESTS.

(a) In this section:

(1) "Insulated from being used to pay all or part of the estate tax." with

reference to property or a fund subject to limited interests, means unreachable by the decedent's personal representative because of legal restrictions preventing creditors from reaching the property or fund or practical obstacles to collection.

(2) "Nonholder" means a person interested in the gross estate who holds an interest in the gross estate other than an interest in property or a fund subject to limited interests.

(3) "Property or a fund subject to limited interests" means property or a fund in which in which one or more persons have a limited interest.

(b) Except as otherwise provided in Section 8, to the extent that property or a fund subject to limited interests whose existence gives rise to a portion of the estate tax is not insulated from being used to pay all or part of the estate tax, the tax is apportioned to the holder of that property or fund without apportionment among the several interests therein, to be paid from the principal of the property or fund.

[COMMENT: Subsection (b) applies to property or a fund in which at least one person has a limited interest and which property or fund can be reached by the personal representative of the decedent. In such cases, the apportioned estate tax is charged against the principal of the property or fund, and is not apportioned among the several interests in that property or fund. While there is no express apportionment to the limited interests in such property or fund a, the holders of the 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 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 the estate taxes. The reason for this treatment is discussed in the Comment to Subsection (c). If property or a fund with a limited interest cannot be reached by the decedent's personal representative, the attribution of estate taxes for such property is set forth in Subsection (c).

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. If the tax apportioned to a nondeductible preceding or succeeding interest were to be paid from the principal of the trust, that might endanger the

qualification of the charity's interest for a deduction. See Treas. Reg. § 20.2055-2(e)(2)(vi)(f), and Rev. Procs. 90-30, 90-31, and 90-32. Even if the charitable deduction were not lost, as would be the case where the estate tax is paid from funds that were designated to pass to the trust but had not yet been transferred to the trust, the tax payment would cause a reduction of the amount of the charitable deduction. See Subsection 4(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.

The likely intent of a decedent would be to maximize the marital and charitable deductions available for the devises. Despite the fact that that is the likely intent of the decedent, the Act provides that the estate tax is to be paid from the principal of the property or funds if those properties can be reached by the decedent's personal representative. That choice was made largely to prevent administrative complexity.

If the tax were not to be paid from the principal of the property or fund, it would have to be collected either from the non-charitable interests in that property or from other persons interested in the gross estate. It would be harsh to collect the tax from persons having interests in the property or fund who will not obtain the use of the assets for many years, if at all. The Act could have chosen to apportion the applicable estate tax to other persons interested in the gross estate and provided for a reimbursement of those other persons from the distributees of the property or funds as is provided by Subsection 7(c) when the assets of the property or fund cannot be reached by the decedent's personal representative. But, that is a complicated arrangement to administer, and was utilized in Subsection 7(c) because no simple alternative was available since the principal of the property or fund cannot be reached. In this Subsection, ease of administration was chosen over utilizing a complex mechanism even though that choice may cause a reduction of a deduction.

While there is the problem that, in the case of a split-interest trust in which a charity has an interest, collecting the tax from the principal could lose the charitable deduction entirely, it appears that that problem will not arise frequently and can best be left to resolution by the drafters of the instruments. In many cases, the 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 use funds that are earmarked for the trust, but not yet distributed to it, to pay the applicable estate tax. While, in some cases, the use of such funds will reduce the size of the charitable deduction, it will not cause a complete disallowance of the deduction. See Subsection 4(e).

Even when a split-interest charitable trust is completely funded before the decedent's death, a well-drafted attribution 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 attribution 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 apportionment scheme to protect against circumstances that will not frequently arise.]

(c) Except as otherwise provided in Section 8, to the extent that property or a fund subject to a limited interest whose existence gives rise to a portion of the estate tax is insulated from being used to pay all or part of the estate tax, initially no tax is apportioned to the owners of that property or fund. The estate tax that would have been apportioned to those owners is apportioned proportionately to the nonholders. If a distribution is made from the property or fund, each nonholder may recover from each distributee that proportion of the estate tax apportioned to the distributee which the amount of tax paid by the nonholder bears to the amount of tax paid by nonholders. Upon a distribution, the amount of the estate tax apportioned to each distributee is that fraction of the amount distributed whose numerator is the amount of the estate tax, and whose denominator is the value of the gross estate.

[COMMENT: If the estate tax cannot be collected from property or a fund because it is insulated from creditors by law or because of practical difficulties, the tax will have to be paid by persons having interests in other assets of the estate. It would be too harsh to make beneficiaries of the properties or funds pay tax on properties that they will not receive until many years later and may never receive. If the beneficiaries were required to pay the tax at the time of decedent's death, that would sponsor widespread disclaimers of interests. Also, there would be a difficulty in valuing the interests of discretionary beneficiaries of such funds.

In order to permit the nonholders to be reimbursed from the beneficiaries of the property or funds for the estate tax that the nonholders paid, the Act effectively provides the nonholders with a percentage interest in the property or funds; and the value of their percentage interest will increase or decrease as the value of the property or fund waxes or wanes. The percentage interest is determined by applying the average estate tax rate times the value of the property or fund as of the estate tax valuation date. So, when a distribution is made, a percentage of that distribution can be collected by the nonholders.

In Subsection 7(b), in which the applicable estate tax is collected from the principal of the property or funds, the holders of limited interests, other than a fixed dollar annuity interest, will bear a share of that payment of the taxes. 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 Subsection 7(b), the annuitant of a fixed dollar annuity interest will not bear any of the burden of paying the applicable estate tax (unless the reduction of principal results in an exhaustion of the principal before the annuitant's interest expires). The annuitant in Subsection 7(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 Subsection 7(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 Subsection 7(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. So, once again, easing the burden of administering the provision took precedence over other considerations. The balancing of administrative ease against the possible wishes of a decedent to provide a net amount of annuity to the annuitant is influenced by the fact that many decedents would not want the annuitant to escape a share of the tax liability at the expense of other persons interested in the gross estate. The identification of a decedent's likely wishes is not so clear in this case as to receive a great amount of weight.

(d) If, after the death of the decedent, the undistributed property or fund subject to limited interests cease to be insulated from being used to pay all or part of the estate tax, an amount of estate tax equal to the same fraction of the value of the remaining property or fund as is provided in subsection (c) for aportionment of a distribution is apportioned to the holder of the property or fund and no estate tax is apportioned to the distributees of later distributions. Each nonholder is entitled to recover the same proportion of the estate tax apportioned to the holder of the property or fund as is provided in subsection (c) for recovery from a distributee.

[COMMENT: If undistributed property or a fund subsequently becomes available for collection, the nonholders can collect the balance of their interest from the property or fund at that time, and subsequent distributees will have no liability for taxes.

SECTION 8. 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 the federal estate tax obtained by an election for a lower valuation of specified property that is included in the gross estate, a deduction from the gross estate allowed for specified property, or an exclusion from the gross estate of specified property; and (2) "specified property" means property for which an election has

been made for a special elective benefit.

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[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. The purpose of Section 8 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 8 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 8 defines how the benefits of the election and the burden of an additional tax will be apportioned.

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 8.]

(b) If an election is made for one or more special elective benefits for specified property, the apportionment of the federal estate tax is determined by first apportioning to the owners of all of the interests in all of the specified properties, including the owners of limited interests, the amount of federal estate tax that would have been payable if no election for special elective benefits had been made for any properties. This initial apportionment is made to the owner of each interest in the specified properties in the proportion that the value of that interest bears to the aggregate value of all of the interests in the gross estate. The reduction in federal estate tax resulting from the elections for special elective benefits reduces the federal estate tax that initially was apportioned to the owners

of interests in the specified properties by the amount of the reduction. If there are two or more owners, the reduction is apportioned among them according to the proportionate values of their interests in the specified properties. If the federal estate tax initially apportioned to the owner of an interest in specified property is reduced to zero, any excess amount of reduction reduces the federal estate tax apportioned to other persons interested in the gross estate. This amount of reduction is apportioned among those persons in proportion to the values of their interests in the gross estate.

[COMMENT: The allocation of the tax reduction obtained from a special elective benefit is made among the holders of interests in all of the specified properties in the aggregate in accordance with the values of each person's respective interest. Since the determination of the amount of estate tax benefit is made by applying the marginal rate of estate tax on 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.

The apportionment of the federal estate tax between limited and remainder interests in Section 8 is contrary to the general rule in Subsection 7(b) that charges estate taxes to the principal of the property in which a limited interest exists if the property can be reached by a personal representative. There are several reasons why that approach was not adopted in Section 8. To pay their share of the tax, the owners of the specified properties will have either to sell the properties, borrow against them, 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. If they obtain the money by borrowing or from other funds, there would be no reduction in the amount of income produced by the realty, and so the holders of the limited interests would not bear any of the tax unless it were apportioned to them (as Section 8 does). The alternative chosen in Subsection 7(c) of having other persons interested in the estate pay the tax incurred by the specified properties and then collect reimbursement from distributees of the property is not practical since there would be difficulty in determining what income was derived from the realty itself, and there would be no trustee or other fiduciary to see that the amounts were turned over to the other persons who paid the tax. Accordingly, Section 8 provides that the tax is to be paid by the owners of the interests in the property and the parties can determine the best method for them to do so.]

(c) If an additional federal estate tax is imposed in order to recapture all or part of a special elective benefit, the additional tax is apportioned among the persons holding interests in the specified property, including limited interests, for which the election for the recaptured special elective benefit was made. The additional federal estate tax is apportioned among the persons holding interests in the specified property in proportion to the respective values of their interests as of the date on which

the additional federal estate tax was imposed.

[COMMENT: The apportionment of the additional federal estate tax between limited and remainder interests is contrary to the general rule in Subsection 7(b) that charges estate taxes to the principal of the property in which a limited interest exists if the property can be reached by a personal representative. The reasons for treating the additional federal estate tax differently in Subsection 8(c) are similar to the reasons described in the Comment to Subsection 8(b) in which taxes are attributed to limited interests. Since the property involved is realty,, there will be no principal from which to pay the additional tax unless the property is sold. If the parties do not wish to sell the property and so either borrow the funds or use other funds to pay the tax, the amounts received by the owners of the limited interests would not be reduced thereby unless the tax is apportioned to them. So, because of the apportionment method adopted in this Subsection, while the owners have the option of paying the tax from other funds, borrowing the funds, or selling the property, whichever method they choose, the owners of the limited interest will bear their share of the tax.

The allocation between the limited and remainder interests is made according to the actuarial values determined under the federal estate and gift tax regulations. Those actuarial values are set according to standards established in § 7520 of the Internal Revenue Code, which mandates the utilization of current market conditions to establish actuarial values. See e.g., Treas. Reg. § 20.2031-7(d).

The Act allocates the additional federal estate tax among the owners according to the values of their interests as determined at the time that the additional tax is incurred rather than as of the date of the decedent's estate. Persons who had an interest in the specified property at the time of the decedent's estate may not have an interest when the additional tax is imposed and therefore will not share in the payment of the additional tax.]

(d) If a [state or] foreign estate or succession tax has a provision for a special tax benefit of the kind described in subsection (a), the apportionment of the reduction of the state or foreign tax which is obtained thereby, and the apportionment of any additional tax incurred by reason of a recapture of all or part of that tax reduction, must be made in the same manner as is provided in this [Act] for the federal estate tax.

SECTION 9. RECOVERY FROM PROPERTY IN POSSESSION OF FIDUCIARY.

(a) A fiduciary may withhold the estate tax apportioned to the interest of a person interested in the gross estate from any property that is under the control of the fiduciary and is distributable to that person. If that property is insufficient to satisfy the tax apportioned to that person, the fiduciary may recover the deficiency from that person.

(b) If property held by a fiduciary is to be distributed before final apportionment of the estate tax, the fiduciary may require the distributee to provide a bond or other security for the distributee's share of the tax in the form and amount prescribed by the fiduciary.

SECTION 10. RIGHT OF FIDUCIARY TO RECOVER TAX.

(a) If all property subject to apportionment does not come into the control of the fiduciary that has the duty to pay the estate tax, the fiduciary may recover the propotionate amount of estate tax from the persons who hold the uncontrolled property.

(b) To the extent that the fiduciary does not 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 gross estate who are subject to apportionment, but the total tax apportioned to a person may not exceed the value of that person's interest.

(c) If an ancillary personal representative controls property that is 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 11. RIGHT OF REIMBURSEMENT.

(a) If a person is charged with or required to pay a tax greater than the amount apportioned to the person because another person does not pay the tax apportioned to the other person, the person charged with or required to pay the greater amount has a right of reimbursement

against the other person.

(b) In the discretion of the fiduciary, the right of reimbursement under subsection (a) may be enforced by the person entitled to reimbursement or by the fiduciary for the benefit of that person.

SECTION 12. 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 the apportionment pursuant to this [Act].

(b) A fiduciary or other 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, an apportionment by a court having jurisdiction to make that apportionment shall be presumed to be correct; but the presumption may be rebutted by a contesting party.

[(c) An action under this [Act] must be brought in the court in which the estate of the decedent is or was administered or, if an administration has not been commenced, in the court of any county in which the estate of the decedent may be administered.]

SECTION 13. 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 14. 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 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]:

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(2) .....

(3) .....

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