POST-MEETING DRAFT of

October 2001

UNIFORM ESTATE TAX APPORTIONMENT ACT

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

WITH COMMENTS

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and has not been accepted into the Draft by the Drafting Committees.

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" means the value of the gross estate reduced by:

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

(B) the amount of claims against the estate other than claims for estate taxes;

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

(D) the amount or value of any property that is part of a devise or transfer of an amount or value that does not exceed $10,000; and

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

Comment

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

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

A devise or transfer of property of a small dollar value is excluded from apportionment by Section 4(b), and so the value of that property is deducted in determining the apportionable estate. Even if there is a shortfall in the payment of the estate tax so that the shortfall is apportioned by Section 4(b) to the recipients of such small devises or transfers, the value of the property nevertheless is deducted in determining the apportionable estate.

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 decedent's 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 apportionable estate, that amount is thereby removed from the figure that is used as the base for allocating estate taxes among the persons holding property interests in the estate. One reason that the amount of gift tax that is added back is taken out of the apportionable estate figure for purposes of apportioning the estate tax under this Act is that 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 apportionable estate under the Act, unless some adjustments were made, 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. The exclusion from the apportionable estate of the gift tax payment prevents that discrepancy from occurring. Moreover, the donor typically will have intended that a gift pass to the donee free of any transfer tax. While that may not be the case if the size of the gift and the size of the gift tax is very 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.

The value of the apportionable estate is reduced by expenditures of the estate (other than the payment of estate taxes), including the payment of claims, since the amounts so expended will not be included in the aggregate value of properties received by persons. If expenditures were not deducted from the value of the apportionable estate, less than 100% of the estate taxes would be apportioned by Section 4(a).

(2) "Estate tax" means a domestic or foreign tax, other than an inheritance tax or an income tax, imposed because of the death of an individual, including any estate tax, any generation-skipping transfer tax incurred on a direct skip, and interest and penalties associated

with those taxes.

[Comment

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

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

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

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

The Economic Growth and Tax Relief Reconciliation Act of 2001 repeals the federal estate tax and generation-skipping-tax for estates of persons dying after 2009 and for generation-skipping transfers made after that date, but the sunset provision in that Act will reinstate the federal estate tax for estates of persons dying after 2010 and will reinstate the generation-skipping-tax for generation-skipping transfers made after 2010. So, as currently written, the repeal applies only to the estates of persons who die within a 1-year period and to generation-skipping transfers made within that 1-year period. Also, for decedents who die in the calendar year 2010, there will be a carryover of the decedent's basis for property included in the decedent's gross estate (i.e., the basis in such property 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 his death up to the fair market value at decedent's 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 ultimately decides to allow the repeal of the federal estate tax to take effect, 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 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 death, and only the net amount remaining would have been subjected to estate taxation on the decedent's death. 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. While the Economic Growth and Tax Relief Reconciliation Act of 2001 phases out the overall limitation of § 68 over a 5-year period beginning in 2006, a sunset provision would reinstate that limitation for years after 2010. If the repeal of § 68 is made permanent by Congress, much of the problem surrounding IRD will be eliminated.

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

If a donor pays a gift tax during the donor's life, the amount paid will not be part of the donor's assets when the donor dies; and so the gift tax will not be subject to apportionment among the persons interested in the donor's gross estate. Typically, the inter vivos payment of the gift tax will result in a smaller probate estate and therefore a smaller residuary devise than otherwise would have been the case. This consequence is consistent with the 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. The gift tax was not repealed by the Economic Growth and Tax Relief Reconciliation Act of 2001.]

(3) "Gross estate" means all property interests which are subject to an estate tax.

[Comment

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

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

[Comment

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

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

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

[Comment

For purposes of this Act, property, the value of which is deducted from the apportionable estate, is not included in the apportionable estate.

If a person has a right at the time of decedent’s death, whether the right is created by contract

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

(7) "Property received by a person" means a property interest received by a person interested in the apportionable estate without reduction for any taxes charged to the property or paid by that recipient. 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).]

(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.

[Comment:

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. APPORTIONMENT BY WILL OR OTHER DISPOSITIVE INSTRUMENT.

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

(b) To the extent that a decedent's will does not expressly direct the apportionment of an estate tax, the tax must be apportioned in accordance with an express direction, if any, in a revocable trust of which the decedent was the settlor. If conflicting express 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 an amendment to a revocable trust instrument is the date of the amending 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 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.]

(c) For the purposes of this subsection, "unapportioned estate tax" means all or part of an estate tax that is not expressly apportioned by a direction in the decedent's will or revocable

trust. Except as limited by Section 3(d), an express provision in an instrument disposing of property subject to the instrument that the property be applied to the payment of an unapportioned estate tax or that an unapportioned estate tax must not be apportioned to the property, controls the extent of the application of the property to the satisfaction of the unapportioned estate tax or the insulation of the property from payment of the unapportioned 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 an 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 expressly provide for the allocation of some estate taxes, an express direction in an instrument that the decedent executed to create a revocable trust will control the allocation of those estate taxes. If the decedent executed more than one revocable trust instrument, the express 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 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 direction 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.

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

The federal estate tax laws provide 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 overridden 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 federal estate tax purposes on Y's death. If the instrument that X executed to create the QTIP trust were to provide that the trust is not to bear any of the estate taxes imposed at Y's estate, the Act does not honor that direction; Under the Act, only Y can direct that the QTIP trust will not bear any portion of Y's estate taxes. In this regard, it is noteworthy that the right granted to a decedent's estate by § 2207A of the Internal Revenue Code to collect a share of the federal estate tax from a QTIP that is included in the decedent's gross estate can be waived only by direction of the decedent in a will or revocable trust instrument. 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 holder 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 cannot increase the amount of estate tax apportioned to a property interest that the decedent had no power to alter 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 is not permitted to increase the amount of tax apportioned to such transfers. If a decedent attempts to do so, whether directly by apportioning more estate tax to the inter vivos transfer or indirectly by insulating some person interested in the gross estate from all or part of that person's share of the estate tax, the amount of estate tax that is apportioned to the transferee of an irrevocable inter vivos transfer will not be greater than the amount that would have been apportioned to that transferee if no directions for apportionment had been made by the decedent in another instrument.

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 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 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 limited interests are to be paid from assets in the trust. See Rev. Rul. 82-128, Rev. Proc. 90-30 (Secs 4 and 5), and Rev. Proc. 90-31 (Secs 5 and 6). The Service has indicated informally that if the payment of an estate tax is made from funds that, while directed to be added to the trust's assets after decedent's death, have not been distributed to the trust before applying them to the payment of the estate tax, the payment will not disqualify the charitable deduction. There are numerous instances in which estate taxes are required to be paid from a charitable remainder trust that was created inter vivos. Subsection (e) is an attempt to protect the deduction in such cases by requiring that funds directed to be added to the trust be used to pay any required estate tax before assets already in the trust itself are used. It seems unlikely that a decedent would wish to negate this provision, but the decedent has the power to do so by including an express statement to that effect in a will or revocable trust instrument.]

SECTION 4. STATUTORY APPORTIONMENT OF ESTATE TAXES.

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

(b) None of the tax is apportioned to the recipient of any property having a value of $10,000 or less except to the extent that the apportionable estate is insufficient to satisfy the tax.

[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 assets of the apportionable estate are insufficient to pay all of the estate tax. To the extent that assets of the apportionable estate are not available to the decedent's personal representative because of legal restrictions or obstacles making collection impractical, that amount will not be included in determining whether the assets of the apportionable estate are sufficient.

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. As noted in the Comment to Section 2(1) of this Act, property to which this Subsection (b) applies is not included in the decedent's apportionable estate even if the recipients of that property are required to pay some of the estate tax because the assets of the apportionable estate are insufficient.]

(c) A generation-skipping transfer tax that is incurred on a direct skip is charged to the property that constitutes the transfer. To the extent that there are legal restrictions or obstacles making collection from that property impractical, the shortfall is apportioned among the transferees of that 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 (c), the decedent's personal representative will pay the generation-skipping tax on a direct skip out of the transferred property (or the proceeds from a sale of all or some of that property). To the extent that it is not feasible or practical to pay the tax from the transferred property, the transferees are to pay their proportionate share of the shortfall.]

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

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

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

[Comment

This provision is aimed primarily at transfers that qualify for a marital or charitable estate tax deduction. Since 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.

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

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

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

[Comment

A recipient of property which incurred a foreign or State estate 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 recipient's direct or indirect payment of the foreign or State tax will reduce the amount that the recipient will receive, it will not reduce the value of the recipient's interest in the apportionable estate according to the definition of "value" in the Act. See Section 2(8) of the Act. The Act therefore gives the recipient of the property the benefit of any estate tax credit that is allowed for the foreign or State tax that the recipient effectively paid.]

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

SECTION 6. APPORTIONMENT BETWEEN LIMITED AND OTHER INTERESTS.

(a) In this Section:

(1) "Insulated property" means property which is unavailable for payment of an estate tax because of legal restrictions or obstacles making collection impractical.

(2) "Uninsulated property" means property interests in the apportionable estate other than an interest in insulated property that is subject to a limited interest.

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

(4) "Reapportioned tax" means the estate tax on property subject to a limited interest that is reapportioned to uninsulated holders by Section 6(c) of the [Act].

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

(b) Except as provided otherwise in Section 4(e), an estate tax apportioned or reapportioned to persons holding interests in uninsulated property subject to a limited interest will be paid, without further apportionment, from the principal of that uninsulated property and not by the holders of interests in that property.

[Comment

Subsection (b) applies to property in which at least one person has a limited interest and which property can be reached by the personal representative of the decedent. In such cases, an apportioned estate tax, or an estate tax that is reapportioned under Subsection (c), is charged against the principal of the property, and is not apportioned among the several interests in that property. While there is no express apportionment to the limited interests in the property, 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 the tax were not to be paid from the principal of the property, it would have to be collected from other persons interested in the apportionable estate. It would be harsh to collect the tax from persons having interests in the property who will not obtain the use of the assets for many years, if at all. The Act could have apportioned the applicable estate tax to other persons interested in the apportionable estate and to provide for a reimbursement of those other persons from the distributees of the property in the manner established by Section 6(c) when the property cannot be reached by the decedent's personal representative. But, that is a complicated arrangement to administer, and was utilized in Section 6(c) because no simple alternative was available when the principal of the property 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.

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

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

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

The likely intent of a decedent would be to maximize the marital and charitable deductions available for the estate. 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 if it can be reached by

the decedent's personal representative. That choice was made largely to avoid administrative complexity.

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

(c) The estate tax attributable to an insulated property subject to a limited interest is reapportioned among uninsulated holders in proportion to the value of their uninsulated property interests. Each uninsulated holder may recover from the distributees of that insulated property a ratable portion of the reapportioned fraction of the distribution. To the extent that undistributed insulated property ceases to be insulated, each uninsulated holder can recover from that property a ratable portion of the reapportioned fraction of the total undistributed property.

[Comment

Since the estate tax apportioned to the owners of insulated property having limited interests cannot be collected from the property, the tax will have to be paid by persons having interests in other assets of the estate (uninsulated holders). It would be too harsh to make persons holding future interests pay tax on properties that they will not receive for many years later and may never receive. If they were required to pay the tax at the time of decedent's death, that would give rise to 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 uninsulated holders who bear the reapportioned tax to be reimbursed from the beneficiaries of the insulated property for the estate tax that the uninsulated holders paid,

the Act effectively provides the uninsulated holders with a percentage interest in the property whose transfer is the source of the reapportioned tax; and the value of an uninsulated holder's percentage interest will increase or decrease as the value of the property waxes or wanes. The percentage interest is determined by dividing the reapportioned tax by the value of the insulated property. So, when a distribution of the insulated property is made, a percentage of that distribution can be collected by the uninsulated holders.

In Section 6(b), in which the apportioned 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 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. So, 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 becomes available for collection, the uninsulated holders can collect the balance of their interest from the property at that time.]

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

(a) In this Section :

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

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

(B) a deduction from the gross estate allowed for specified property; or

(C) 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.

[Comment

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

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

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

(b) If an election is made for one or more special elective benefits for specified property, the apportionment of the estate tax is determined by first apportioning the amount of estate tax

that would have been payable if no election for special elective benefits had been made for any properties. The reduction in estate tax resulting from the elections for special elective benefits reduces the estate tax that initially was apportioned with respect to the specified properties. If the estate tax initially apportioned to specified property is reduced to zero, any excess amount of reduction reduces the estate tax apportioned to other persons interested in the apportionable estate in proportion to the values of their interests.

[Comment

The allocation of the tax reduction obtained from a special elective benefits is made among all of the specified properties in the aggregate in accordance with the values of each property. 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.

Once the amount of estate tax that is apportioned to a specified property is determined, it will have to be paid. There is a difficulty in how the owners will obtain the funds for paying that tax. To pay the tax, the owners of specified property will either 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. The solution chosen in Section 6(c) of having other persons interested in the apportionable estate pay the tax incurred by the specified property and then collect reimbursement from distributees of the property is not practical in this case 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 persons who paid the tax. Accordingly, that approach was not adopted. Instead, Section 7 provides that the tax is to be charged to the property, and the owners of the interests in the property can determine the best method for obtaining the funds to make that payment.]

(c) If an additional estate tax is imposed in order to recapture all or part of a special elective benefit with respect to specified property, the additional tax is charged to that property.

SECTION 8. RECOVERY FROM PROPERTY IN POSSESSION OF FIDUCIARY.

(a) A fiduciary may defer any distribution of property until the fiduciary is satisfied that

adequate provision for payment of the estate tax has been made.

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

(c) Before property held by a fiduciary is distributed, 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 9. RIGHT OF FIDUCIARY TO RECOVER TAX.

(a) If the fiduciary does not control property subject to apportionment, the fiduciary may recover the proportionate amount of estate tax from the persons who hold that property.

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

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

(d) 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 10. RIGHT OF REIMBURSEMENT.

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

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

SECTION 11. JUDICIAL ACTION TO DETERMINE OR ENFORCE APPORTIONMENT.

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

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

[Comment

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

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

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

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

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

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

(1) .....

(2) .....

(3) .....