MEMORANDUM

Date: Wednesday, 22 Jan 2003
To: Drafting Committee on Estate Tax Apportionment
From: Doug Kahn
Subject: Amendments to the Comments for the Uniform Act

I have made a few changes to the Comments to the Uniform Act. I have set forth below those changes, using strikeout and underline, and I will raise a few questions for discussion in Dallas.

In the Comment to Section 2(6), defining value, there are two Examples. I have struck a sentence from Ex. (1) as shown below. I think that sentence was incorrect,

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

I have a question about Ex. (2) that we can discuss at the Dallas meeting. The question is whether the $100,000 of administrative expenses that was disallowed as a tax deduction, but was allowed by the probate court, should be treated as a gift to which estate taxes should be apportioned. Currently, the Comment does not treat the $100,000 as a gift, and I think that that is correct. However, others might wish to question that treatment.

I have added a sentence to the second paragraph of the Comment to Section 4(a) as follows:

Properties whose values are subtracted from the decedent''s gross estate in determining the apportionable estate under Section 2(1) thereby are excluded from the apportionable estate, and so the beneficiaries of those properties do not have any estate tax apportioned to them because of their interest in those properties. See the Comment to Section 2(1). This treatment is consistent with the position taken in Restatement (Third) of Property: Wills and Other Donative Transfers §§1.1, comment g (1998). <u>While the Act does adopt a method of equitable apportionment of estate taxes, the Act does not adopt the method utilized by the Restatement, which allocates taxes apportioned to the probate estate first to the residuary beneficiaries.</u>]

Finally, the Comment to Section 4(c) includes a lengthy defense of the position adopted in the Act to compute the estate taxes engendered by the inclusion of QTIP property in a surviving spouse's estate at the marginal rate of tax rather than at the average rate. Dick feels that the explanation generates more confusion than light. I propose that the material discussing the considerations that were weighed in making that choice be deleted from the Comment in the interest of simplification and brevity.