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Federal Estate Tax Apportionment

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FEDERAL ESTATE TAX APPORTIONMENT

The federal estate tax has created myriad problems for the judicial system. One major problem has been apportionment of the ultimate burden of the tax among those "persons interested in the estate." Congress has directed that the executor of the estate is primarily responsible for paying the federal estate tax, and that he is entitled to recover the tax generated by proceeds of certain insurance policies and funds over which the decedent had a general power of appointment, from the distributees of those assets. However, state laws determine from whom the executor should recover for taxes attributable to other property included in the gross estate of the decedent.

There are two basic theories concerning where the ultimate impact of an estate tax should fall in the absence of contrary directions by a decedent. The burden must either: (1) fall entirely on the residuary estate; or (2) be divided among some of the interested persons in proportion to the value of their share of the estate. The first theory is commonly referred to as the "burden on the residue" rule; and the latter is identified as the "equitable apportionment" or "equitable contribution" rule.

This note will examine the application of these two theories and the variations which have been developed to overcome the inequities

2. Apportionment of state-imposed estate and inheritance taxes will not be considered in this note. Therefore, "the tax" and "estate tax" hereinafter refer to federal estate tax.
3. "Persons interested in the estate" means any person entitled to receive or who has received from a decedent or by reason of the death of a decedent any property or interest therein included in the estate. It includes a personal representative, guardian and trustee. Uniform Laws Annotated (Master Edition) § 1(c) (1958) (Revised in 1964).
4. I.R.C. § 2002. (However, the Commissioner of Internal Revenue can proceed personally against the transferees of the estate assets.) I.R.C. §§ 6901, 6324; (or through liens against the assets) I.R.C. §§ 6321-25.
5. I.R.C. §§ 2206, 2207.
8. "Residuary estate" means that which remains in the probate estate after debts and expenses of administration and legacies and devises have been satisfied. See Foerster v. Foerster, 54 Ohio Op. 441, 447, 122 N.E.2d 314, 322 (1954).
9. See In re Estate of Joas, 16 Wis. 2d 489, 114 N.W.2d 831 (1962).
10. See In re Estate of Van Duser, 19 Ill. App. 3d 1022, 313 N.E.2d 228 (1974).
resulting from strict adherence to them. Although the majority of states have enacted legislation concerning the ultimate payment of the federal estate tax, some states still leave the question to the discretion of the state judiciary. Judicial discretion in this area has resulted in diverse problems. This note will provide examples of these problems and suggestions for avoiding similar problems by adopting the "better approach" for apportionment of the federal estate tax.

COMPLEXITIES OF APPORTIONMENT

The complexities involved in apportionment of taxes become apparent upon examination of various methods of distributing the ultimate tax burden. For purposes of analysis, the estate of a decedent can be divided into three distinct parts: (1) assets not subject to probate, (2) assets transferred by specific or general bequests, and (3) other assets (the residue). Strict application of the equitable apportionment rule requires distribution of the taxes proportionately among all three parts.


14. See text accompanying notes 110-36 infra.

15. See text accompanying notes 137-50 infra.

16. The term "estate" throughout this note refers to the gross estate of a decedent as determined for the purpose of federal estate tax, unless preceded by a limiting term or phrase which would require a different definition such as "probate estate."

17. In the case of an intestate decedent the estate consists of only two parts: (1) assets not subject to probate and (2) assets passing by the laws of intestacy. The latter "part" of the estate is the residue.
"parts" of the estate, while the burden on the residue rule requires all of the taxes be paid out of the residuary (the third "part") alone. An alternative to the strict equitable apportionment rule is that the taxes generated by specific and general bequests are apportioned among the respective beneficiaries and the residuary is charged with the remaining taxes. Another "limited" method of equitable apportionment charges the recipients of nonprobate assets with the portion of taxes generated by their part of the estate and charges the residuary with the rest of the taxes.

Further complications can arise because of the type of beneficiary. For instance, when the estate contains either an inter vivos or testamentary trust, the method which is selected must provide for apportionment among the life tenants, income beneficiaries, and the remaindermen or among only some of these recipients. Moreover, a provision must be made for the method for apportioning the taxes when the beneficiary is the surviving spouse, a minor child of the decedent, or a charitable institution.

The estate is allowed a limited deduction for a transfer to the surviving spouse, and to certain minor children, and also for the value of property transferred to certain public, charitable and religious institutions. Strict application of the equitable contribution rule would require each of these beneficiaries to contribute that proportion of the tax which the value of their transfer bears to the taxable estate. This method distributes the benefit for each deduction over the entire estate rather than entirely to the spouse, child or charitable institution. The burden on the residue rule places the entire burden of the taxes on the residue whether the residuary beneficiary is the surviving spouse or child, or a charitable institution.

19. Apportionment between specific legatees and residuary beneficiaries is merely a possibility. No state has actually adopted this method of apportionment.
21. See National Newark & Essex Bank v. Hart, 309 A.2d 512 (Me. 1973). Income beneficiaries have never been charged with a portion of the estate tax. However, the argument has frequently been made that they should share in the taxes. See generally, Annot., 67 A.L.R.3d 273 (1975).
22. I.R.C. § 2056.
23. I.R.C. § 2057 (This section was added by the Tax Reform Act of 1976).
could be required to contribute toward the taxes only to the extent that their share of the estate exceeds the allowable deduction.\textsuperscript{28}

Each of the states has had to struggle with these complexities. The majority of states have enacted comprehensive legislation pertaining to distribution of the tax burden.\textsuperscript{29} The recent trend among the states, both legislatively and judicially, seems to be in the direction of apportionment among those "persons interested in the estate."\textsuperscript{30} Once again the United States takes one giant leap forward only to wind up right where it started.\textsuperscript{31}

**HISTORY OF APPORTIONMENT IN THE UNITED STATES**

The earliest decision directing which funds should be charged with the estate tax was rendered by the New Hampshire Supreme Court in 1918 in *Fuller v. Gale*.\textsuperscript{32} The testatrix, Isabel J. Gale, neglected to include in her will directions for the payment of the federal estate tax. The court asserted that "the estate tax is not a property tax but one upon the transfer of the net estate."\textsuperscript{33} Without any further explanation the court determined that the taxes should be paid out of the estate but ultimately should be charged pro rata to each beneficiary.

The following year the New York Court of Appeals adopted the

\textsuperscript{28} Cf. Hammond v. Wheeler, 347 S.W.2d 884 (Mo. 1961) (equitable apportionment only to the extent their share exceeds the marital deduction); Spurrier v. First Nat'l Bank, 207 Kan. 406, 485 P.2d 209 (1971) (burden on residue only if share exceeds allowable deduction under Internal Revenue Code § 2056).

\textsuperscript{29} See, e.g., ALASKA STAT. § 13.16.610 (1972); CAL. PROB. CODE § 970 (West 1956); CONN. GEN. STAT. § 12-400 (1958); DEL. CODE tit. 12, § 2901 (1974); FLA. STAT. § 733.817 (Supp. 1978); HAW. REV. STAT. § 236 A-1 (1976); IDAHO CODE § 15-3-916 (Supp. 1978); IND. CODE § 29-2-12-1 (1976); MD. EST. & TRUSTS CODE ANN. § 11-109 (1974); MASS. GEN. LAWS ANN. ch. 65A, § 5 (West Supp. 1978); MICH. COMP. LAWS § 720.11 (1968); MINN. STAT. § 524.3-916 (1975); MONT. REV. PROB. CODE ANN. § 91A-3-916 (1977); NEB. REV. STAT. § 77-2108 (1971); NEV. REV. STAT. § 150.290 (1973); N.H. REV. STAT. ANN. § 88-A (1970); N.M. PROB. STAT. ANN. § 32A-3-916 (1975); N.Y. EST., POWERS & TRUSTS LAW § 2-1.8 (McKinney 1967); N.D. CENT. CODE § 30.1-20-16 (1976); OR. REV. STAT. § 116.303 (1977); PA. CONS. STAT. § 3701 (1975); R.I. GEN. LAWS § 44-23.1-1 (Supp. 1977); TENN. CODE ANN. § 30-1117 (1955); UTAH UNIFORM PROB. CODE ANN. § 75-3-916 (1977); VT. STAT. ANN. tit. 32, § 7301 (Supp. 1977); VA. CODE § 64.1-160 (1973); W. VA. CODE § 44-2-16a (1966); WYO. STAT. § 2-7-102 (1977). Many states with legislation concerning apportionment have been omitted because some of the considerations discussed above are not answered in those statutes. E.g., ARK. STAT. ANN. § 63-150 (1971) (no provision for apportionment when bequest is to a charitable institution); S.D. COMPILED LAWS ANN. § 29-7 (1976) (no provision for apportionment between income beneficiary and remaindermen).


\textsuperscript{31} The first case to consider the issue of estate tax apportionment was *Fuller v. Gale*, 78 N.H. 554, 103 A. 308 (1918). (The estate tax was apportioned among all the beneficiaries.) Then the burden on the residue rule was applied consistently until 1942 in almost all jurisdictions. (See text accompanying notes 34-59 infra.) Now the majority of jurisdictions apply equitable apportionment.

\textsuperscript{32} 78 N.H. 544, 103 A. 308 (1918).

\textsuperscript{33} Id. at 546, 103 A. at 309.
opposite view in *In re Hamlin.*34 There, the court determined that in the absence of instruction from a decedent, the federal estate tax must be paid out of the residue of the estate. The testatrix in that case specifically bequeathed property to one of her daughters and to nine other individuals. The remainder of her estate was to be held in trust for the benefit of her other daughter and grandson. The executor deducted from each specific legacy the amount of taxes generated by inclusion of such property in the estate. The court determined that the action taken by the executor was incorrect and that the estate taxes should be borne by the residuary alone. The reason given by the court for this result was that Congress had implied that the residuary be charged with all of the estate taxes.35

In reaching this decision, the court traced the statutory history of death taxes. In doing so, the court contrasted the federal estate tax with its predecessor "inheritance tax" which was adopted by Congress in the 1898 War Revenue Laws.36 Among the various revenue raising taxes was one on "legacies and distributive shares of personal property."37 This inheritance tax was imposed on any transfer of personal property intended to take effect in possession or enjoyment after the transferor's death.38 The amount of tax was determined by the legal relationship of the transferor to the transferee and the value or amount of property transferred to each beneficiary.39 In 1901, this section of the Act was amended to provide that the executors and administrators should reduce each particular legacy or distributive share by the amount attributed to each transfer.40 The tax on legacies and distributive shares was repealed in 190241 and in 1916 Congress adopted the federal estate tax.42 The amount of federal estate tax is not determined by the legal relationship between the decedent and the transferee nor by the amount of each separate distribution. The estate tax is based on the net value of the estate. In 1919, the estate tax law was amended to provide that beneficiaries of life insurance policies should be charged with the taxes attributable to the insurance proceeds.43 However, this was the only provision relating to apportionment of the estate tax burden.44

35. Id. at 418, 124 N.E. at 7.
37. Id.
38. Id.
39. Id.
44. In 1942 the Internal Revenue Code of 1939 was amended to provide that recipients of
After reviewing these statutory developments, the court in *Hamlin* reasoned that since Congress had not adopted an "inheritance tax" statute similar to the one contained in the War Revenue Laws, it had intended the burden of the taxes fall on the residuary rather than on each recipient. The court also inferred that since Congress did not direct apportionment, it had intended the opposite result. Many other jurisdictions followed *Hamlin* by placing the burden on the residuary of the estate. The primary justification for adopting the "burden on the residue" rule for the next two decades was that Congress had intended such a result.

The burden on the residue rule was applied in its strictest form during this period. Therefore, even if the property received by the residuary beneficiary did not generate any tax, because of a deduction applying to such property, the burden still fell on the residuary. In *Young Men's Christian Association v. Davis,* the Ohio Supreme Court contrasted the federal "inheritance tax" with the federal estate tax and, as the New York court had in *Hamlin,* inferred that Congress contemplated that the residuary would be charged unless the decedent directed otherwise. In this case the decedent made various specific bequests in her will and then provided for the remainder of the estate to be paid to various charitable institutions. The court primarily relied on those sections of the Internal Revenue Code which provide that the taxes should be paid by the executor and that "as far as is practicable the tax [should] be paid out of the estate before its distribution" in concluding that the charitable remainder should be charged with all of the estate tax.

On appeal, the result was affirmed by the United States Supreme Court, but based upon different reasoning. The only question presented to the Court was whether the charity was being deprived of a federal right of exemption from such taxes on charitable gifts when property subject to a power of appointment should also be charged with their proportionate share of the tax. *Int. Rev. Code of 1939, ch. 3, § 826(d), 56 Stat. 943 (now I.R.C. § 2207)*.


49. *See text accompanying notes 52-54 infra.*

50. 106 Ohio St. 366, 140 N.E. 114 (1922), *aff'd,* 264 U.S. 47 (1924).

51. Revenue Act of 1918, ch. 18, § 407, 40 Stat. 1096 (now I.R.C. § 2002). "The tax imposed by this chapter shall be paid by the executor."


54. I.R.C. § 2055.
the Ohio Supreme Court directed that the estate tax be paid out of the charitable residuum. The Court emphasized that nothing in the Code precluded a charitable residuary beneficiary from paying all of the tax even though that part of the estate transferred to the charity did not generate any of the tax. The Court ruled only on the issue presented and did not, at this time, explain whether federal or state law controlled which "persons interested in the estate" should be burdened with the taxes.

The New York Court of Appeals reaffirmed the Hamlin interpretation of the Code in In re Del Drago's Estate. That court was confronted with a question concerning the constitutionality of a New York statute which apportioned the federal estate taxes among the beneficiaries. The court concluded that:

[Insofar as the [statute] requires or directs distribution and apportionment of the Federal estate taxes levied and to be levied upon the estate of the deceased among the legatees, they are repugnant to the provisions of the Federal Estate Tax Act of 1926 and amendments thereto, the Congress being competent to legislate on the subject of estate excises, and to the uniformity and supremacy clauses of the Federal Constitution and are, therefore, unconstitutional.]

The Del Drago court agreed with the reasoning in Hamlin, but added that Congress had more than implied that the taxes should be charged to the residuary of the estate. The court stated that "Section 826(b) of the Code leaves no doubt that it was the purpose and intent of Congress to exclude specific legatees, as such, from bearing any of the burden of the tax." Nonetheless, Del Drago was reversed by the United States Supreme Court in Riggs v. Del Drago. The Court denied that section

56. N.Y. DECEDENTS EST. LAW. ch. 709, § 124 (1930) (re-enacted as N.Y. EST., POWERS & TRUSTS LAW § 2-1.8 (McKinney 1967)).
57. 287 N.Y. at 79, 38 N.E.2d at 140.
58. Section 826(b) provides:
   If the tax or any part thereof is paid by, or collected out of that part of the estate passing to or in the possession of, any person other than the executor in his capacity as such, such person shall be entitled to reimbursement out of any part of the estate still undistributed or by a just and equitable contribution by the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts, or other charges against the estate, it being the purpose and intent of this subchapter that so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution.

59. 287 N.Y. at 64, 38 N.E.2d at 135 (footnote added).
60. 317 U.S. 95 (1942).
826(b) of the Code should be interpreted as placing the burden on the residue of the estate. The Court explained that Congress only intended that "if the tax must be collected after distribution, the final impact of the tax should be the same as though it had been taken out of the estate before distribution."

The Court also rejected the theory that section 826(c) and 826(d) providing for contribution from recipients of life insurance proceeds and distributees of property subject to a power of appointment, should be interpreted as forbidding further apportionment among other distributees. The Court concluded that state law should determine what part of the estate would ultimately be charged with the burden because "Congress did not contemplate that the Government would be interested in the distribution of the estate after the tax was paid . . . ."

Since the Supreme Court's decision in the Riggs case, thirty-six states have adopted statutes directing the method for distributing federal estate taxes. Three of these states, Alabama, Iowa and Oklahoma follow the "burden on the residue" rule. The other thirty-three states require that the taxes be apportioned among some or all of the distributees. Fourteen states have left the method of distributing the tax burden to the discretion of the judiciary.


62. 317 U.S. at 100-01.

63. Id. at 101.


66. 317 U.S. at 95.

67. Id. at 98.

68. Ala. Code tit. 40 § 40-15-18 (1975); Iowa Code § 633.436 (1964); Okla. Stat. tit. 84, § 3 (1970). (Whether this statute should actually be applied in determining who actually bears the tax burden is questionable. See text accompanying notes 87-91 infra.)


NOTES AND COMMENTS

BURDEN ON THE RESIDUE VERSUS EQUITABLE
APPORTIONMENT: ANALYSIS

Of the fourteen states where the distribution issue has been left up
to the state judiciary, the highest court in six of those states has de-
clared that the rule of burden on the residue should be applied.\(^7\) In
the remaining eight states, the equitable apportionment rule has been
chosen by the judiciary.\(^7\)

*The Burden on the Residue Approach*

Use of the “burden on the residue” rule is justified most often by
three lines of reasoning: (1) the difference between the estate tax and an
“inheritance tax;” (2) the similarity between the estate tax and adminis-
tration expenses; and (3) the intent of the decedent would best be ac-
complished by this rule.

The first line of reasoning involving the difference between estate
and inheritance tax, is based on the fact that the federal estate tax is
levied on the transfer of a person’s property at his death. It is not a tax
on the property itself nor on the privilege of an heir or beneficiary to
receive the property.\(^7\) Consequently, the tax should not be paid by the
individual recipients of the estate. Generally, this line of reasoning is
supported by contrasting an inheritance tax with an estate tax.\(^7\) The
former is a tax on the right to receive property, the latter on the right to
transfer property. However, proponents of this line of reasoning ignore
the fact that both are taxes involving the same property. The basic dif-
ference between these two taxes is that an inheritance tax rate is gener-

Kan. 79, 58 P.2d 469 (1936); Louisville Trust Co. v. Walter, 306 Ky. 756, 207 S.W.2d 328 (1948); Bragdon v. Worthley, 153 A.2d 627 (Me. 1959) (Maine repealed their total apportionment statute in 1949); Banks v. Junk, 264 So. 2d 387 (Miss. 1972); Carpenter v. Carpenter, 364 Mo. 782, 267 S.W.2d 632 (1954); Cornwell v. Huffman, 258 N.C. 363, 128 S.E.2d 798 (1963); McDougall v. Central Nat'l Bank of Cleveland, 157 Ohio St. 45, 104 N.E.2d 441 (1952); Sinnott v. Gidney, 159 Tex. 366, 322 S.W.2d 507 (1959); Seattle First Nat'l Bank v. Macomber, 32 Wash. 2d 696, 203 P.2d 1078 (1949); *In re* Estate of Joas, 16 Wis. 2d 489, 114 N.W.2d 831 (1962).


74. *Id.,* 315 N.E.2d at 660.
ally based on the relationship of the recipient to the decedent,\textsuperscript{75} whereas an estate tax is based on the size of the whole estate.\textsuperscript{76} This difference is merely a matter of the form in which the tax tables are set up and does not inherently determine what part of the estate should ultimately be burdened with the estate tax.

The courts which apply this line of reasoning as a justification for placing the burden on the residuary fail to appreciate that a tax computed by reference to the whole estate is more "readily administered with less conflict than a tax based upon shares."\textsuperscript{77} An estate tax also "prevents the federal government from going into the courts contesting and construing wills and statutes of distribution."\textsuperscript{78} In other words, the estate tax was chosen over an inheritance tax because the former is so much easier to calculate and collect.

Second, many of those jurisdictions which propound the difference between the federal estate tax and an inheritance tax suggest that the federal estate tax liability is comparable to funeral expenses and administration expenses.\textsuperscript{79} In Illinois,\textsuperscript{80} for example, many decisions have stated that the "nature" of the federal estate tax is different from the "nature" of the state inheritance tax but that the "priority and status" of the federal estate tax liability is the same as that of funeral expenses and administrative expenses.\textsuperscript{81} These propositions are logically inconsistent.

The Illinois Probate Act\textsuperscript{82} establishes that funeral expenses are a first priority claim against the estate and that federal estate taxes are a third class claim.\textsuperscript{83} If these two liabilities can be called "equal" then surely the state inheritance tax, a sixth priority claim,\textsuperscript{84} is also "equal" to the federal estate tax. In one sense the Illinois courts seem to be saying that the state legislature intended inheritance taxes and federal estate taxes to be treated differently and intended administrative expenses and federal estate taxes to be treated similarly. However, nowhere in the Probate Act are administrative expenses and estate taxes

\textsuperscript{75} See, e.g., ILL. REV. STAT. ch. 120, § 375 (1975).
\textsuperscript{76} I.R.C. § 2001(c).
\textsuperscript{77} In re Hamlin, 226 N.Y. 407, 415, 124 N.E. 4, 6 (1919) (Quoting a passage from the report of the Committee on Ways and Means.)
\textsuperscript{78} Id.
\textsuperscript{80} Illinois was generally considered a "burden on the residue" state prior to 1974 when In re Estate of Van Duser, 19 Ill. App. 3d 1022, 313 N.E.2d 228 (1974) was decided.
\textsuperscript{82} ILL. REV. STAT. ch. 3, §§ 1-1 to 30-3 (1975) (amended 1976).
\textsuperscript{83} Id. at § 18-10.
\textsuperscript{84} Id.
referred to without an additional reference to inheritance taxes.\textsuperscript{85} Moreover, there is a long established rule of statutory construction that when two phrases are used in the same statute each phrase is to be given an independent meaning, because the legislature does not intend to be merely repetitious.\textsuperscript{86}

The Oklahoma Supreme Court, in \textit{Tapp v. Mitchell},\textsuperscript{87} used a similar line of reasoning in deciding that only the residuary should be charged with the taxes. They stated that the statute directing “payment of debts”\textsuperscript{88} controlled because the estate tax was a debt of the estate. However, the statute does not explicitly refer to estate taxes and in most states “debts” are not treated as including federal estate taxes.\textsuperscript{89} In those states where the legislature has directed how the estate taxes should be apportioned,\textsuperscript{90} the legislature has also enacted a statute similar to the one used in \textit{Tapp}, directing the order for abatement of property for the payment of debts.\textsuperscript{91}

Finally, the supporters of the “burden on the residuary” rule reason that when the residuary is sufficient to defray the cost of the taxes, there is a presumption that by specifically providing for certain individuals in a testamentary instrument, or by transferring property inter vivos, the transferor has manifested an intent that such gifts not be reduced by apportioning estate taxes to the recipients.\textsuperscript{92} This argument is inherently lacking in the case of an intestate decedent if there is non-probate property included in the gross estate. All state legislatures have enacted statutes of descent and distribution which apply to the probate estates of intestate decedents.\textsuperscript{93} These statutes are designed to represent the presumed intent of the decedent. The property generally passes to those relatives in the order of the proximity of their relationship to the decedent.\textsuperscript{94} The legislators have expressed the belief that the decedent wants his property to pass to his closest relatives. If this were not true the decedent would have prepared a will evidencing such an intent. It seems inconsistent that the same legislature would charge the residuary with all of the federal estate taxes since in many cases the “remainder”

\textsuperscript{85} See, e.g., ILL. REV. STAT. ch. 3 at §§ 18-14, 19-1.
\textsuperscript{86} United States v. Menasche, 348 U.S. 528 (1955).
\textsuperscript{87} 352 P.2d 900 (Okla. 1960).
\textsuperscript{88} OKLA. STAT. tit. 84, § 3 (1951).
\textsuperscript{89} See, e.g., \textit{In re Estate of Wahlin}, 505 S.W.2d 99, 105 (Mo. App. 1973).
\textsuperscript{90} See note 69 supra.
\textsuperscript{91} E.g., N.Y. EST., POWERS & TRUSTS LAW § 13-1.3(c)-(d) (1966) (amended 1973 to include § 13-1.3(d)).
\textsuperscript{92} See \textit{In re Estate of Penny}, 504 F.2d 37, 40 (6th Cir. 1974).
\textsuperscript{93} E.g., ILL. REV. STAT. ch. 3, § 2-1 (1977).
\textsuperscript{94} Id.
of the estate is left to a close relative.95

The Equitable Apportionment Approach

The majority of jurisdictions have adopted the “equitable apportionment” rule.96 The “equitable apportionment” rule is based on one principle line of reasoning, the maxim of “equality is equity.”97 That is, equity dictates that those who receive property which has been included in the computation of federal estate taxes should share proportionately in the payment of those taxes.98 This proposition follows from the assumption that when a decedent does not direct to the contrary, he intends for all beneficiaries to share in the tax burden.99 The testator could easily direct which recipients should bear the burden of the taxes; or conversely, which shares should not be diminished by the taxes levied against the estate.100

In addition, where the value of the nonresiduary estate101 is great, the federal estate tax may equal or surpass the value of the residuary estate. In the case of an intestate decedent, nonapportionment could mean that the heirs at law would receive virtually nothing.102 Moreover, nonapportionment could result in additional inequities to the

101. The “nonresiduary” estate includes both nonprobate assets and specific devises and bequests.
heirs at law. For instance, consider a case wherein an intestate decedent, prior to death, held an interest in joint tenancy property with someone other than a relative. The value of the decedent's interest in the joint tenancy property is included in the estate for estate tax purposes. The tax generated by the inclusion of this property is then paid by the executor out of the probate assets. Thus, the amount the heirs at law could have received is reduced. If the surviving joint tenant were to die within the next two years, then the tax on his estate would be credited with the amount of tax paid on the "prior transfer." Consequently this results in the anomaly of the first decedent's family paying the tax for a stranger's estate. This example should not be interpreted as a suggestion that the Congress intended for the estate tax to be distributed among the various distributees. Rather, this is another illustration where placing the burden on the residue could result in a gross inequity.

A decedent does have the right to specify what part of the estate shall bear the burden and therefore can avoid these inequities if he so desires. The problem arises, in states without explicit statutes, when the decedent has failed to draw up a will or when testamentary language directing payment is found to be insufficient. An executor or representative cannot know where to apportion the taxes if the courts in one case "equitably apportion" the taxes and then later place the "burden on the residuary." 

PROBLEMS ENCOUNTERED IN STATES WITHOUT EXPLICIT LEGISLATIVE DIRECTION

Although the supreme court of a state could set forth a rule regarding apportionment in terms that would cover every possible factual situation, this is essentially the function of the legislature. The problem

N.E.2d 924 (1950). (Probate estate consisted of $180,571 in assets, nonprobate estate consisted of $528,973, and the federal estate tax was $190,532.)

103. I.R.C. § 2040.

104. I.R.C. § 2013. (The credit is allowed for up to 10 years after the transfer; after two years the amount of the credit is reduced by 10% each year until the eleventh year when the credit is zero.)

105. "Stranger" is defined as a person who was not related (by law or blood) to the decedent at death.


that many courts have faced is that the state supreme court decisions have not covered all of the various factual situations which may arise.

**Missouri**

Missouri is an example of a state that has encountered this problem. In *Carpenter v. Carpenter*, the Missouri Supreme Court was faced with the choice of apportioning taxes between the nonprobate property and the residuary estate or burdening only the residuary with the taxes. The testator directed in his will that all bequests and devises should be free and clear from any charges, including federal estate taxes. The majority of the nonprobate property (an annuity and jointly owned bonds) passed to the decedent's wife. The residue of the estate was left in equal proportions to the spouse and the decedent's sons.

The issue presented in *Carpenter* was whether the recipients of the nonprobate property should contribute proportionately in the payment of the estate tax or whether the residue alone should bear the burden. The court rejected the burden on the residue rule and held that absent a clearly expressed intent on the part of the testator to the contrary, Missouri would apply the doctrine of equitable apportionment.

The Missouri Supreme Court was again confronted with the problem of fixing the tax in *Hammond v. Wheeler*. In *Hammond*, the surviving widow renounced the will of her deceased husband and elected to take her statutory share. The issue before the court was whether the statutory share, to the extent of the "marital deduction," should be undiminished by and bear no part of the tax burden. The court found in favor of the widow's estate (she had subsequently died) and announced that a spouse's share should not be burdened with the estate tax to the extent that such share does not exceed the marital deduction. In *Carpenter*, the surviving spouse was the recipient of nonprobate property and one-third of the residuary estate. However, the court did not even consider whether the spouse's share should remain undiminished to the extent of the allowable marital deduction.

This same issue came before the Missouri Supreme Court in *Jones v. Jones*. The facts were virtually identical to those in *Hammond*, but the appellants urged the court to reverse their prior decision. The

110. 364 Mo. 782, 267 S.W.2d 632 (1954).
111. 347 S.W.2d 884 (Mo. 1961).
112. I.R.C. § 2056.
113. Contra, Banks v. Junk, 264 So. 2d 387 (Miss. 1972). (Taxes were deducted prior to distributing renouncing spouse's share. Therefore, the spouse's share was reduced by the taxes.)
114. 376 S.W.2d 210 (Mo. 1964).
115. See text accompanying notes 111-13, supra.
appellants argued that the surviving spouse, in renouncing the will, was electing to take by "descent;" and that property taken by "descent" was subject to payment of the claims of the estate. This argument was rejected by the court and they reaffirmed their decision in *Hammond*, which exempted recipients of property not generating the taxes.116

*In re Estate of Wahlin*,117 required the Missouri Court of Appeals to decide whether the "percentage" bequests to several charitable residuary legatees should be determined before or after payment of the taxes. The decedent, in his will, made only one specific bequest. The remainder of his estate was left to his sister, a friend, and numerous charitable institutions in certain specified percentages of the residuary. The decedent also owned a substantial amount of property in joint tenancy with his sister and a friend. The issue presented was whether these percentage residuary bequests should be determined before or after deducting the federal estate tax attributable to property included in the residuary.

The court declared that the rule in Missouri, as expressed in *Carpenter*, is that taxes should be apportioned among all "persons interested in the estate" but only to the extent that the property distributed generates a part of the tax. Since the charitable bequests did not generate any estate tax, the court determined that the specified percentages should be applied to the net estate before calculating the federal estate tax.

Even though the Missouri Supreme Court had established that the law in that state would require equitable apportionment in 1954,118 questions based on differing factual situations have been raised for almost two decades and the later decisions limited the rule of apportionment.119 Such varying circumstances impede the executor from making an informed decision as to where the law requires the tax burden be placed.

**Ohio**

Other state courts have encountered problems similar to those in Missouri. In 1922, the Ohio Supreme Court supported the burden on the residuary rule in *Young Men's Christian Association v. Davis*.120 However, this court was relying on the then prevailing "misinterpreta-

116. 347 S.W.2d 884 (Mo. 1961).
117. 505 S.W.2d 99 (Mo. App. 1973).
119. See text accompanying notes 111-17, supra.
120. 106 Ohio St. 366, 140 N.E. 114 (1922), aff'd, 264 U.S. 47 (1924).
tion" of the Code. That is, the idea that Congress intended the estate taxes be charged to the residuary beneficiaries.

The Ohio Supreme Court was again presented with a federal estate tax apportionment problem in *McDougall v. Central National Bank of Cleveland*. The decedent died without making a will but during her life the decedent had set up a trust (nonprobate property). In *McDougall* the court departed from the "burden on the residue" rule and required contribution from the beneficiary of the trust. Since the estate did not consist of any specific or general bequests the court did not define the apportionment scheme in terms of contribution from all recipients of any property included in the estate, but rather as apportionment between the nonprobate estate and the residue. The reasoning in this case was that the tax was a common obligation of the beneficiaries and, therefore, "one who pays more than his share of the taxes is entitled to contribution from those who have not paid their share." The trustee argued that the trust agreement represented a specific disposition of property and, thus, disclosed an intention by the decedent to transfer the property undiminished by any of the federal estate tax. The court rejected this argument, stating that, unless there is a clear expression of intention by a decedent, the courts could not speculate where the decedent intended the burden of the taxes to rest.

Up to this point, the Ohio rule had moved from burden on the residuary, whether charitable or otherwise, to apportionment between the nonprobate estate and the residuary. In 1974, the United States Court of Appeals for the Sixth Circuit was faced with apportioning taxes by applying Ohio law in *In re Estate of Penny*. The estate consisted of specific bequests to the surviving spouse and various charities, a trust (for the benefit of the surviving spouse and the testator's son) which was not subject to probate, and a residuary estate which the decedent directed be added to the trust. The court determined that to the extent that transfers of nonprobate assets do not generate taxes they should not be diminished by the taxes. Therefore, the wife's share of the nonprobate assets were not charged with the tax liability. Again, the Ohio rule was modified. The present result is that the burden is divided

121. See text accompanying notes 26-42, supra.
122. 157 Ohio St. 45, 104 N.E.2d 441 (1952).
123. By definition an intestate estate cannot contain any specific or general bequests.
124. 157 Ohio St. at 49, 104 N.E.2d at 442.
125. Id. at 48, 104 N.E.2d at 446. (It is ironic that this argument was similar to the justification used by the court to distinguish the specific bequest exempted from contribution in *Y.M.C.A. v. Davis*, 106 Ohio St. 366, 140 N.E. 114 (1922).) See 157 Ohio St. 45, 49, 104 N.E.2d 441, 447 (1952).
126. 504 F.2d 37 (6th Cir. 1974).
among the nonprobate and residuary recipients, but if the nonprobate transferee is the surviving spouse or a charitable institution, that part of the transfer which does not generate any taxes will not be diminished.

**Illinois**

Another major problem with judicial determination of tax apportionment is that at a future date the court may reverse a prior decision. Illinois is an unparalleled example of a state where the method of distributing the tax has frequently shifted. Until 1974, Illinois was generally considered one of the states which judicially sanctioned the burden on the residuary rule. Then, in 1974, the Appellate Court for the First District decided the case of *In re Estate of Van Duser*. The court ordered the surviving joint tenants of certain real property to contribute proportionately with the heirs of the intestate's probate estate.

Later in 1974, the Appellate Court for the Fourth District of Illinois "limited" the application of the rule of equitable contribution in the case of *In re Estate of Fairchild*. The decedent, Fairchild, specifically devised certain property to her granddaughter and then designated others as residuary legatees. However, unlike *Van Duser*, there were no nonprobate assets included in the estate. The residuary legatees brought an action against the specific devisee to recover that portion of the estate tax generated by the inclusion of the specific bequest in the taxable estate. Distinguishing *Van Duser* on its facts, the court determined that the specific devisees should be exempted from contributing toward the federal estate tax.

Apparently, the law in Illinois was shifting from the "burden on the residuary" rule to a version of the "equitable apportionment" rule. Then, in 1976, the Appellate Court for the Third District, in the case of *Roe v. Estate of Farrell*, was faced with facts substantially similar to those of *Van Duser*. In both *Van Duser* and *Roe*, the decedents died intestate and the gross estate of each decedent included nonprobate property. However, the ruling in *Roe* was contrary to the decision in

127. *In Amoskeag Trust Co. v. Trustees of Dartmouth College*, 89 N.H. 471, 200 A. 786 (1938), the New Hampshire Supreme Court stated that "the doctrine of stare decisis is not one to be either rigidly applied or blindly followed." Ironically, this case overruled the prior decision in *Fuller v. Gale*, 78 N.H. 544, 103 A. 308 (1918), which equitably apportioned the burden among all of the "persons interested in the estate," by relying upon the interpretation of the Code which was declared erroneous by the United States Supreme Court in *Riggs*, 317 U.S. 95 (1942).


131. *Id*.

Van Duser, and the residuary was directed to bear all of the tax burden, thus exempting the recipients of the nonprobate property from contribution.

In 1978 the Illinois Supreme Court reversed the appellate decision in Roe and stated that the rule in Illinois is equitable apportionment between the nonprobate estate and the intestate estate. The only issue presented by the facts of this case, was whether the tax should be apportioned between the recipients of nonprobate property and the intestate estate or be charged only to the intestate estate. Since the estate of an intestate by definition will not contain any specific or general bequests, charitable or otherwise, and in this case there was no surviving spouse, the issue was very narrow. Because the supreme court ruled on only the issue presented by the facts, the law in Illinois concerning apportionment within the probate estate is still uncertain.

These three states, Missouri, Ohio and Illinois, are not the only states which have been burdened with the task of apportioning taxes. The problems are, however, representative of the problems encountered by those states without apportionment statutes.

**Statutory Equitable Apportionment: The Better Approach**

The Uniform Estate Tax Apportionment Act was approved by the National Conference of Commissioners on Uniform State Laws and the American Bar Association in 1958. This Act has been adopted

134. Id.
135. On February 17, 1978, less than one month after the Illinois Supreme Court filed its decision in Roe, the United States Court of Claims was confronted with the problem of applying Illinois law concerning apportionment in Farley v. United States, No. 423-72 (Ct. Cl. Feb. 17, 1978). This case was primarily concerned with whether the amount paid to the surviving spouse in settlement of a dispute over the proper method of computation of her statutory share qualified for the estate tax marital deduction under the Internal Revenue Code. In order to answer this question it was necessary for the court of claims to first determine whether in Illinois a surviving spouse's statutory share is calculated before or after the federal estate tax. The court of claims concluded that in light of Roe and equitable principles, the Illinois Supreme Court would more likely determine that the statutory share is calculated before subtracting the federal estate tax from the probate estate. This decision will inevitably give rise to future litigation on the topic of calculation of the spouse's forced share in Illinois since a court of claims decision interpreting state law is not binding on the state courts. In view of the fact that the decedent cannot direct the method for determining the spouse's statutory share, this present uncertainty in Illinois law can only be remedied by the state legislature or the state supreme court.


137. 8 Uniform Laws Annotated (Master Edition) 169-79 (1958) [hereinafter referred to as the 1958 Act].
in five states. In 1964 two substantive changes were made to the 1958 Act. The revised Act has been adopted in seven states.

Except to the extent of the revisions in federal estate taxation brought about by the 1976 Tax Reform Act, the Revised Act is a comprehensive solution to the federal estate tax apportionment problem. This Act apportions the taxes among all interested persons but provides that any allowance or deduction or credit under the Internal Revenue Code should inure to the benefit of the respective person or interest. Thus, for example, the surviving spouse is charged with a portion of the tax only to the extent that the value of the transfer exceeds the allowable marital deduction. This is also true, to the extent of the deduction provided, for a charitable institution, and for an orphaned minor child of the decedent. In addition this Act provides that any credit for state death taxes should inure to the benefit of the person charged with such taxes.

The Revised Act also provides for apportionment of penalties and interest incurred because of a delay in payment of the taxes. However, the Act provides that if the probate court determines that such apportionment of the interest or penalty would be inequitable, it may direct apportionment in the manner it finds equitable. This might occur, for instance, if one of the persons interested in the estate unreasonably delayed payment of the taxes and thus caused a penalty to be assessed against the estate.

Each of the problems discussed in the previous section would have been resolved under the Uniform Estate Tax Apportionment Act.


139. 8 Uniform Laws Annotated (Master Edition) 159-67 (1964) [hereinafter referred to as the Revised Act]. The two major changes were 1) the addition of a subsection to section 3 which provides for apportionment of the expenses incurred by the estate in connection with the determination of the tax and its apportionment and 2) the addition of the last sentence to section 8 which eliminates the necessity of federal participation in the validity of the reciprocity provisions. Commissioners' Prefatory Note at 158.


142. Revised Act § 5.

143. Id. at § 5(b) and 5(e).

144. Id.

145. Id.

146. Id. at § 5(d).

147. Id. at § 2.

148. Id. at § 3(b).

149. See text accompanying notes 105-33, supra.
However, the changes in the Internal Revenue Code arising out of the Tax Reform Act of 1976 may result in new issues for the courts and the legislatures to consider.\(^{150}\) Notwithstanding these new problems, it is imperative that the state legislatures at least provide the answers to the recurring problems which have burdened the courts for many decades. This would be accomplished by adoption of a statute similar to the Revised Uniform Federal Estate Tax Apportionment Act.

**CONCLUSION**

In 1916, Congress enacted the first federal estate tax. For the next three decades most jurisdictions placed the burden of these taxes on the residue of the estate through an erroneous interpretation of two statutes dealing with the federal estate tax. This interpretation was rejected by the United States Supreme Court in *Riggs*, which held that state laws determine what part of an estate should be charged with the ultimate burden. Since that decision, thirty-five states have legislatively determined where the burden should be placed, the other fifteen states leave the decision to the state courts. As long as these decisions are left to the courts, conflicts may arise.

Those states which do not have statutes directing the placement of the burden of the federal estate tax should note that the same confusion created in Missouri, Ohio and Illinois, and the continuing need for judicial determination on this matter could be avoided through legislative action. The federal estate tax was instituted over sixty years ago but in many states the law concerning payment of this tax is still unsettled.

The legislature could solve the problem once and for all by enacting a statute for “equitable apportionment.” The testator may direct that payment of taxes be deducted from the residue of the estate; but without this type of instruction, all who share in the estate should also share in the tax burden created by their portion of the estate.

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\(^{150}\) Some of the problems which may require additional state determination are the “generation-skipping tax” (I.R.C. §§ 2601-22) and the unified credit for estate and gift taxes (I.R.C. §§ 2010, 2012, 2505).