

Tax Apportionment in Estate Planning: Drafting Clauses to Preserve Dispositive Provisions

Navigating Techniques for Estate, Gift, Income, Generation Skipping Taxes and Retirement Assets

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Tax Apportionment in Estate Planning

Drafting Clauses to Preserve Dispositive Provisions

OVERVIEW OF TAX APPORTIONMENT

Overview of Tax Apportionment

Why is Tax Apportionment important?

- Tax Apportionment is exactly what it sounds like: it is the process of apportioning the tax liability.
- Therefore, the requirement is that there is an estate with tax payable.

Overview of Tax Apportionment

Why is Tax Apportionment important?

If tax is payable, the typical next question is:

- who is responsible for paying the tax?

Thus, the objective of “tax apportionment” is determining who ultimately pays the tax.

Overview of Tax Apportionment

Why is Tax Apportionment important? Who pays the tax?

Example: Grandma leaves a bequest in her will of a ruby ring to grandchild. Grandma has a taxable estate, meaning tax is payable. Assume a 40% estate tax and a \$10K ring (generating \$4K of tax).

Grandchild either:

- Receives the ring free and clear, or
- Receives the ring, and a \$4K bill for the tax calculated on the bequest.

Overview of Tax Apportionment

Who pays the tax?

The alternatives for determining who will pay the tax begin with how is the property being distributed:

- Is the tax due because of a distribution to a beneficiary?
 - Is the distribution a bequest or devise?
 - Is the distribution a share of the residue?
 - Is there a transfer on death?

Overview of Tax Apportionment

Who pays the tax?

Once a distribution or transfer has been established, look for direction:

- Does the governing instrument (the estate plan, or will or trust agreement) direct who pays the tax?
- Do all estate plans have to direct the apportionment of taxes?
 - No, but that is highly advisable!

Overview of Tax Apportionment

Who pays the tax?

If the estate plan does not specifically direct tax apportionment, is there a state statute or case law that directs who pays the tax?

- In the absence of direction in the estate plan, state law (equitable apportionment) may apply.
 - Equitable Apportionment means everybody pays their fair share.

Overview of Tax Apportionment

Who pays the tax?

Under certain circumstances with some assets, Federal law will apply and direct who is responsible for the tax (ie: the beneficiary of insurance policy pays their fair share).

- This can be “overridden” or waived in the estate planning document.

CASES HIGHLIGHTING THE IMPORTANCE OF TAX APPORTIONMENT

Notable Tax Apportionment Cases

Significance of Tax Apportionment

Estate of Charles Kuralt:

The TV personality left his estate to his wife and daughters, but unbeknownst to his family, he left his Montana ranch to his “long-time and intimate companion.”

- The estate plan directed taxes be paid out of residue, and therefore the wife and daughters were liable for the taxes on the girlfriend's devise.

Notable Tax Apportionment Cases

Significance of Tax Apportionment

Estate of Green:

The taxpayer in Green split her estate between grandchildren and charity.

- The grandchildren's half was subject not only estate tax, but also GST tax.
- The estate plan indirectly allocated the payment of the GST tax from the charitable share, reducing the charitable deduction, and increasing the tax.

Notable Tax Apportionment Cases

Significance of Tax Apportionment

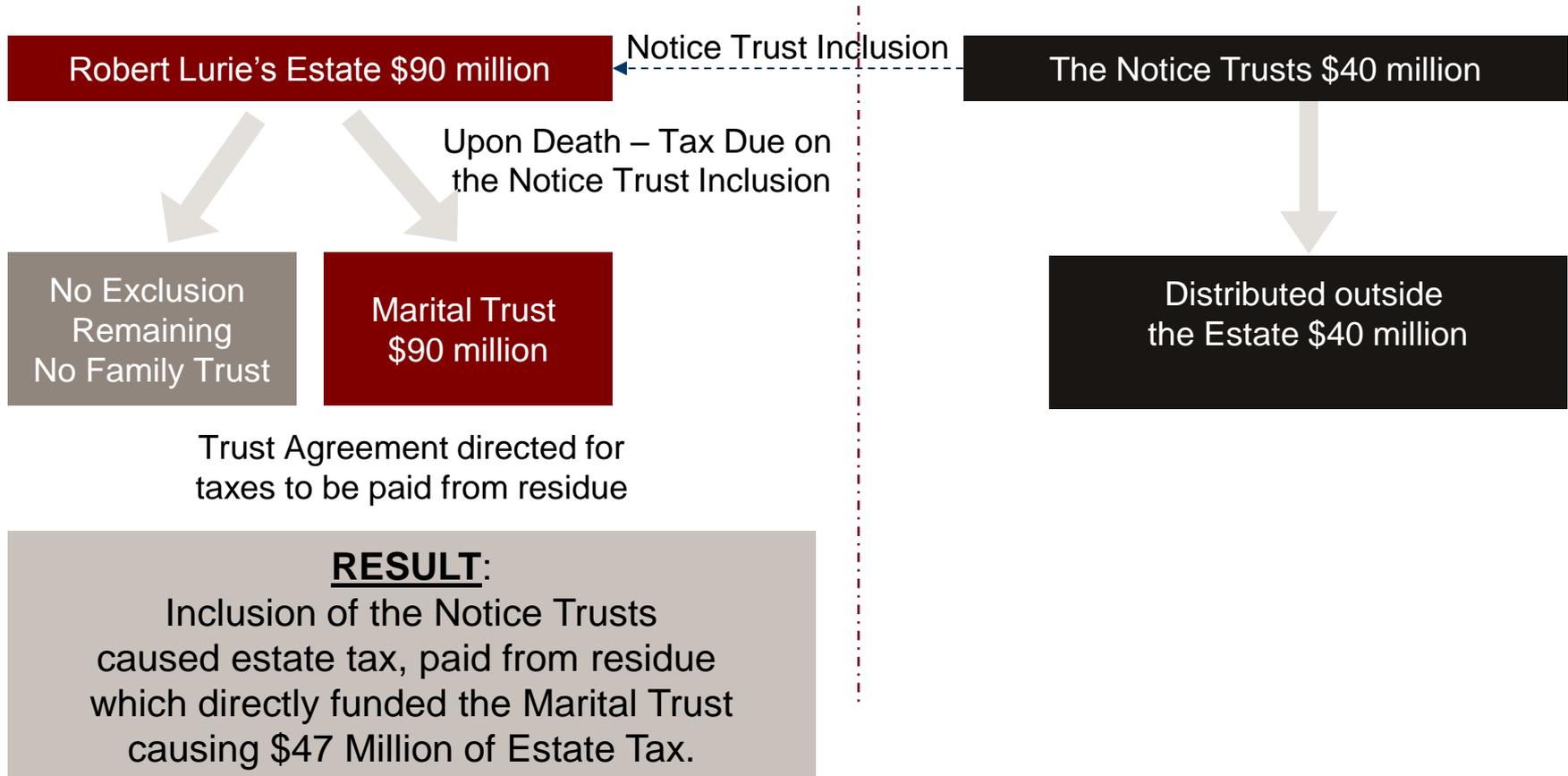
Estate of Lurie:

Similar to Green, in Lurie the estate plan caused a tax on the tax (interrelated calculation). The decedent exercised powers of appointment over some trusts that caused estate tax to his estate.

- The trusts were outside the decedent's estate, and were not under the control of the trustee.

Notable Tax Apportionment Cases

Significance of Tax Apportionment



Notable Tax Apportionment Cases

Significance of Tax Apportionment

Estate of Lurie (continued):

The estate plan directed that all taxes were to be paid out of residue, thereby indirectly allocating the tax caused by the outside trusts to be charged against the marital trust, which otherwise qualified for a deduction.

- The payment of tax from the marital share, reduced the marital deduction, and increased the estate tax.

Notable Tax Apportionment Cases

Significance of Tax Apportionment

The unfortunate irony of the Lurie case is that if the estate plan *had not addressed* tax apportionment, Illinois common law would have “equitably apportioned” the tax.

- The outside trusts would have paid their fair share.
 - Assuming of course that would have been the intent of Mr. Lurie.

COMPONENTS OF A TAX APPORTIONMENT CLAUSE

What Should a Tax Apportionment Do?

Components of Tax Apportionment

A Tax Apportionment clause is a general direction to pay taxes.

- It can direct all taxes are paid out of residue (“anti-apportionment”), or
- It can direct that certain assets, entities or gifts bear a pro-rata share of taxes.
 - This would be an “*apportionment*” tax clause.

General Tax Apportionment Clause

Significance of Tax Apportionment

The general payment of taxes without apportionment is sometimes referred to as a pay out of residue clause.

- For most estates this works just fine.
- In the above example where Grandma leaves a ring to granddaughter, Grandma likely doesn't want granddaughter to cover the taxes on the ring.

Sophisticated Tax Apportionment Clause

Significance of Tax Apportionment

For more complex estates, additional drafting is warranted:

- Don't pay any tax out of a charitable bequest, because that would reduce the charitable deduction and cause additional tax (Green).

Sophisticated Tax Apportionment Clause

Significance of Tax Apportionment

Additional drafting is warranted:

- Don't pay any tax out of a marital bequest, because that would reduce the marital deduction and cause additional tax (Lurie).

Sophisticated Tax Apportionment Clause

Significance of Tax Apportionment

Additional drafting is warranted:

- Don't pay any tax out of an IRD (or retirement) assets, because that would cause immediate recognition of income tax.

Sophisticated Tax Apportionment Clause

Significance of Tax Apportionment

Additional drafting is warranted:

- Apportion the tax to any property that causes estate tax and is included in the taxable estate, but is not under the control of the estate. (again, see Lurie)
- Essentially, seek reimbursement.

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SOURCE OF LAW

What if the Estate Plan is Silent?

Statutory Tax Apportionment

What if the Estate Plan is Silent?

- As alluded to above under the Lurie analysis, in Illinois, if the estate plan was silent as to tax apportionment, the common law rule would have equitably apportioned the tax to those assets causing the tax.
- Equitable Apportionment is common among states as a “back-up” plan.

What if the Estate Plan is Silent?

Statutory Tax Apportionment

Some Federal statutes automatically apply in the absence of specific language or direction in the estate planning documents:

- Section 2206 Life Insurance
- Section 2207 Powers of Appointment
- Section 2207A QTIP Marital Deduction

Section 2206 Life Insurance

Significance of Tax Apportionment

Section 2206 apportions tax to the recipient of a life insurance policy that the estate may not have access to because of the beneficiary designation.

- Section 2206 begins with “Unless the decedent directs otherwise in his will. . . .”

Section 2206 Life Insurance - Example

Statutory Tax Apportionment

Example: Decedent with no tax apportionment direction in the estate plan and no remaining exclusion amount (potentially taxable estate) left the balance of her estate to her husband and children.

- Because of the unlimited marital deduction under Section 2056, this would be an otherwise non-taxable estate.

Section 2206 Life Insurance - Example

Statutory Tax Apportionment

If the decedent owned an insurance policy listing her sister as the beneficiary, the transfer on death would be a taxable event, and the estate would not have control over the flow of the life insurance proceeds.

Section 2206 Life Insurance - Example

Statutory Tax Apportionment

The face value of the policy would be paid to the sister, and the marital trust would bear the tax, creating a tax on a tax scenario.

- Section 2206 solves this problem for life insurance.

Section 2207 Powers of Appointment

Statutory Tax Apportionment

Section 2207 addresses the similar issue with Powers of Appointment.

- If Mr. Lurie did not address tax apportionment in his estate plan, Section 2207 would have applied and allocated pro-rata tax apportionment to the outside trusts (reimbursement).

Section 2207A QTIP Marital Property

Statutory Tax Apportionment

Section 2207A addresses the inclusion of a QTIP Marital Trust.

- The client, however, may not want to recapture if the Marital Trust is GST Exempt as a result of a reverse QTIP election.

Waiver of Sections 2206, 2207 and 2207A

Statutory Tax Apportionment

A taxpayer may waive the application of reimbursement under Sections 2206, 2207 and 2207A.

- Section 2206 and Section 2207 can be accomplished by a general waiver.
- Waiver under 2207A must be specifically identify the intent to waive any right of recovery under Section 2207A.



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Mr. Berek is currently the editor of the two-volume treatise “Illinois Estate Planning, Will Drafting and Estate Administration Forms with Practical Commentary” published by LexisNexis as well as the author of “Federal Income Taxation of Decedents, Estates and Trusts” published by CCH. He is an adjunct professor at DePaul University, and is licensed to practice law in Illinois and Florida (awarded an AV® peer review rating by Martindale-Hubbell). Education: BS Accountancy, DePaul University; JD, The John Marshall Law School, LLM (Employee Benefits), The John Marshall Law School.

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The Big Picture

- First determine the client's dispositive plan
- Second, if the estate does not exceed the Federal exclusion amount and/or any state estate tax exemption amount, then there is no need to be worried about the tax clause
- Third, if the estate plan eliminates any estate tax (by giving any taxable amount to spouse or to charity), then there is no need to be worried about the tax clause

The Big Picture

- Fourth, if all property, whether probate or nonprobate, is distributed to the same persons in the same shares, then there is no need to worry about the tax clause
- Fifth, if there is going to be estate or inheritance tax, then who pays the estate tax could make a big difference in economic outcomes
- Sixth, must be sure to coordinate the apportionment of estate and inheritance taxes under each document

The Big Picture

- In essence, the tax clause may be the most important dispositive clause.
- Must review and modify anytime there could be an estate, inheritance or GST tax
- Must discuss implications with client or else may have result contrary to the client's wishes.

Example One

- Grandfather dies with a taxable estate.
- Specific bequest to grandchild of \$10,000.
- Does grandfather intend a bequest of \$10,000 or \$6,000 after taxes?
- You won't know if you don't ask.

Example Two

- Single person dies with a taxable estate.
- Leaves one half of estate to charity and one half to child.
- If child pays estate tax, then child gets less than charity
- If charity pays estate tax, then there is more estate tax
- What is the client's intent?

Drafting Considerations - Estate Tax

- Who should pay the estate tax?
- Should beneficiary of joint property or non probate property pay share of estate tax
 - If so, should documents state that the beneficiary's share of estate/trust should be delayed until the beneficiary pays the tax

Drafting Considerations - Estate Tax

- Should a specific bequest pay its share of the estate tax?
 - Small specific bequests
 - Bequest of real property or a business interest
 - Should some specific bequests pay their share of the estate tax and some not?
 - What if you plan to have the estate tax paid from the residuary but the residuary is not large enough, then what happens?

Estate Tax - Continued

- Generally, should plan that no estate tax will be paid from marital or charitable share
 - This will minimize the total estate tax due
 - However, if want the shares going to spouse or charity equalized with other beneficiaries, then it may be more desirable to have tax paid first, before the shares are determined
 - For example, if have taxable estate of 10,430,000, then estate tax is 2,000,000.
 - Spouse receives balance of assets (10 million) and the taxable estate is reduced by the 2 million of estate tax.

Estate Tax - Continued

- However, if estate tax is paid from the marital or charitable share then estate tax is then paid on the estate tax paid
 - For example, if have taxable estate of 10,430,000, then estate tax is 2,000,000.
 - So spouse really only receives 8 million and an additional 2 million is subject to estate tax.
 - That additional estate tax is \$800,000
 - Which means that the spouse did not receive it, and therefore there is an additional estate tax of \$320,000
 - Which means the spouse did not receive it, and so on. This is a circular calculation that ends up with an additional estate tax of about 1,333,333.

Estate Tax - Continued

- But, what if the spousal share had to pay the estate tax and the deaths occur in near succession
 - A dies in 2015 with a 25,430,000 estate, leaving 15,430,000 in a Bypass type trust (all income to spouse, discretionary principal with a HEMS standard), balance of assets outright to spouse
 - B dies also in 2015, before estate tax return is filed. B's estate is worth 25,430,000 million, plus \$10,000,000 from A.
 - A's estate tax is \$4,000,000. B's estate will get a prior tax credit for most or all of the estate tax paid.
 - B's estate will pay almost \$12,000,000 in estate taxes.
 - Due to the prior tax credit, total estate tax in both estates is 12 million (without the credit it would have been 16 million).

Estate Tax - Continued

- What if the spousal share does pay the estate tax
 - The \$4,000,000 estate tax reduces the spousal shares, as does the additional \$2,666,666 of additional estate tax that will be due.
 - Now, your prior tax credit is closer to \$6,666,666.
 - When B dies, his estate is worth 25,430,000 million, plus the 3,333,333 that is inherited for A.
 - B's estate will pay about \$9,300,000 of estate taxes.
 - After the prior tax credit, the estate tax in B's estate is \$2,633,334.
 - Total in both estate is about \$9,300,000
 - If the marital share did not pay the estate tax, total estate tax would have been about \$12,000,000
 - Can you plan for both spouses dying within a short time period?

Estate Tax - Continued

- What happens when surviving spouse dies with a QTIP Trust
 - Without any provision, default is that the estate tax is recoverable on an incremental basis
 - Therefore, the QTIP trust will pay estate tax, even if beneficiaries of surviving spouse's estate do not
 - This is most important in a second marriage
 - If the surviving spouse's will or revocable trust does not waive the right of recovery from the QTIP trust, then the failure to recover the estate tax is a gift from the beneficiaries of the surviving spouse's estate to the remaindermen of the QTIP trust

Estate Tax - Continued

- Property subject to IRC sections 2036 et. seq.
- Prior taxable gifts, especially when gift tax has been paid
 - What happens if the gift property has been consumed
- Life insurance proceeds subject to estate tax

Estate Tax - Continued

- When estate tax is deferred under 6166 or 2032A, should almost always require any deferred estate tax to be paid from the 6166 or 2032A property
 - What about deferral under 6161
- Property included in estate due to a general power of appointment
- QPRTs/GRATs

Drafting Considerations – Inheritance Taxes

- Some states impose an inheritance tax, i.e., a tax that is based upon who receives the property
- Therefore, must decide if each person is going to pay their own inheritance tax or if the residue is going to pay the inheritance tax?
- If residue pays the inheritance tax, this will increase the total inheritance tax due

Inheritance Taxes - Continued

- How do you apportion the inheritance tax when the inheritance tax reduces or eliminates the state estate tax
- Must be careful about how to apportion the inheritance tax and make sure the proper person pays it
- If there is real property in a state that imposes an inheritance tax, then must be wary of the consequences, even if no estate tax

Drafting Considerations – Gift Tax

- How do you apportion against prior taxable gifts?
 - What if P gave Child A 5,430,000 and P's Will give 5,430,000 to Child B. Should Child A pay her share of the estate tax in P's estate
 - If so, how do you collect it?

Gift Tax - Continued

- QPRTS and GRATs
 - If die within term of QPRT or GRAT, then should remainder beneficiary of QPRT or GRAT pay share of estate tax?
 - If die after term, then should remainder beneficiary pay share of estate tax that is generated by prior use of applicable exclusion amount?

Drafting Considerations – Income Tax

- Income in respect to decedent (IRD):
items: retirement plans, annuities,
installment sales, savings bonds,
deferred compensation
 - Should estate tax be apportioned against IRD
items
 - What if beneficiary of IRD item is different than
beneficiary of estate?
 - What if IRD items going to grandchildren?

Income Tax - Continued

- If require qualified plan benefits to pay their share of estate tax, then will trigger income tax to withdraw the estate tax to be paid
 - This is important when it is desired or plan for the qualified plan benefits to be ‘stretched” over the beneficiary’s life expectancy
 - If planning for a lump sum withdrawal of the qualified plan benefits, then not necessarily important

Income Tax - Continued

- And will have to withdraw additional sums to pay the income tax
- However, there will be a 691(c) deduction to offset some of the income tax that will be due
- Also consider the marginal income tax rate of the beneficiaries

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Drafting Considerations – GST Tax

- If there is GST tax, should the person who benefits from the gift pay the GST tax?
- Should estate tax be apportioned against any bequest that is exempt from GST tax.
 - P gives 5,340,000 outright to child and \$5,000,000 outright to GC.
 - Who should pay the estate tax

Drafting Considerations – GST Tax

- If boilerplate provision says no estate from bequest exempt from GST tax or from a direct skip, then what if:
 - Child A dies first, should A's kids pay share of estate tax
 - What if creating lifetime, generation-skipping trust for A, but outright to B
 - What if creating lifetime, generation-skipping trusts for all, how do you apportion the estate tax

Drafting Considerations – GST Tax

- If want to override the statutory directions re GST tax, then must specifically refer to the GST tax
- What if direct skip is a result of a disclaimer, rather than direct planning
- Should not direct that GST tax on taxable terminations or taxable distributions be paid from residuary estate
 - If do so, how can you distribute residuary until the payment of the GST tax on taxable terminations or taxable distributions

Drafting Considerations – GST Tax

- GST exempt and non exempt QTIP trusts, any estate tax due at surviving spouses death should be apportioned first against non exempt QTIP Trust
 - But what if there are different beneficiaries of the GST exempt and non exempt QTIP trusts

Tax Apportionment Clauses and Retirement Assets

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Tax Apportionment Clauses and Retirement Assets

Estates that require tax apportionment analysis:

1. Estates that are likely to generate a state or federal estate tax;
2. Different instruments direct different assets to different beneficiaries in different shares;
3. Substantial credits or deductions are available to reduce a portion of the tax due;
4. A substantial portion of the estate of composed of nonprobate assets.

Tax Apportionment Clauses and Retirement Assets

Not always obvious if an estate will meet any of these criteria.

Post-mortem planning such as the use of qualified disclaimers and QTIP elections may cause an estate that was not expected to have tax apportionment issues to have tax apportionment issues.

Tax Apportionment Clauses and Retirement Assets

With increasing frequency, qualified plan assets constitute a substantial portion of a client's estate.

Significant estate tax and tax due on income in respect of a decedent may be generated by these assets.

With the tax character of qualified plan assets, apportionment of the pro rata share of tax attributable to the value of these assets may not be possible or desirable.

Tax Apportionment Clauses and Retirement Assets

Three Types of Apportionment

1. The Common Law Rule.
2. Inside Apportionment.
3. Outside Apportionment.

Tax Apportionment Clauses and Retirement Assets

The Common Law Rule:

All taxes are borne by the residue. Easy and simple from a drafting and administration standpoint.

Does it always make sense?

With this form of apportionment all taxes are paid out of the residuary estate before its division into shares. If the residuary estate is insufficient, taxes would then be borne by general and specific bequests under the will on a pro rata basis up to the amount necessary to make up the shortfall.

Tax Apportionment Clauses and Retirement Assets

Langendorf Estate, 19 Fiduc. Rep. 2d 483 (1999)

Will stated:

“I hereby direct that all estate, inheritance and succession taxes, and interest and penalties thereon, as well as funeral expenses, debts and any other deductible administration expenses, with respect to the property forming my gross estate for tax purposes, whether or not it passes under this Will, shall be paid out of the principal of my general testamentary estate”

Tax Apportionment Clauses and Retirement Assets

The decedent had created IRA accounts that were included in the decedent's gross estate for federal estate tax purposes. The amount of federal estate tax and state (PA) inheritance tax allocable to the non-probate assets was \$67,000.

Tax Apportionment Clauses and Retirement Assets

Based on prior case law the Court held that the word “testamentary” was equivalent to “probate” and, therefore, the testator’s clear intention was for the decedent’s probate estate (general testamentary estate in the words of the will) was to pay the federal and state estate tax.

The Court held that the tax clause was applicable and all death taxes with respect to property forming the gross estate, whether or not passing under the Will, shall be paid by the decedent's probate estate.

Tax Apportionment Clauses and Retirement Assets

Inside Apportionment

With inside apportionment, each beneficiary *under the will* bears a pro rata share of the taxes which are due from the estate.

Outside Apportionment

Outside apportionment determines the tax burden that will be allocated to property passing under the will and property passing outside of the will which is includible in the decedent's estate for estate tax purposes.

Tax Apportionment Clauses and Retirement Assets

State apportionment statutes typically direct outside apportionment. Further, the limited federal rules addressing apportionment apply to outside apportionment.

Outside apportionment may add substantial complexity to the administration of the estate.

The greatest problem is that the executor may have no control over the non-probate assets, and, therefore, may not be able to collect the necessary tax.

Tax Apportionment Clauses and Retirement Assets

Where outside apportionment is used, the instrument should direct a secondary source of payment of the tax in case the executor cannot recover the property that generated the tax.

Whether and how to apportion taxes involves the balancing of simplicity and ease of administration with equitable results.

Tax Apportionment Clauses and Retirement Assets

IRAs and Qualified Plans

In most cases the decedent does not want to allocate taxes to IRAs and qualified plans to preserve the income tax benefits otherwise available to the funds in them.

Further, funds withdrawn from such a plan will have an immediate income tax liability and will need to be grossed up to cover the distribution and associated distribution on the tax associated with the distribution.

Tax Apportionment Clauses and Retirement Assets

Other problems with apportionment to IRAs?

Will the beneficiary have the funds to pay the tax, i.e. the plan will not be distributed in a lump sum at the decedent's death?

Does the plan allow apportionment of tax against the plan itself or must the beneficiary withdraw the funds from the plan to pay the tax?

Tax Apportionment Clauses and Retirement Assets

With outside apportionment of tax, the executor be given as many tools as possible to assist with the collection of tax from assets outside her control.

At the very least, the fiduciary should have the right to offset the amount of tax due on nonprobate assets from any bequest passing to the same beneficiary under the will or trust.

Tax Apportionment Clauses and Retirement Assets

Consider if the executor/trustee should have the right to sell an illiquid asset passing to a beneficiary who does not contribute the required share of tax on a nonprobate asset.

Could also permit the fiduciary to delay distribution of a bequest to a beneficiary from whom a share of tax on a nonprobate asset is due until payment of the tax due or some other method for paying the tax is secure, including the use of a bond.

Tax Apportionment Clauses and Retirement Assets

What happens if when the fiduciary must collect the tax on a nonprobate asset from a beneficiary who does not have an interest passing to her under the will?

What power does an executor have to recover taxes from a beneficiary outside the will?

Tax Apportionment Clauses and Retirement Assets

So, what do we do?

1. Consider authorizing the executor/trustee to pursue enforcement in a foreign jurisdiction.
2. Should suggest client consider a secondary source of payment if unable to recover taxes.
3. Apportioned among other beneficiaries?
4. Paid from residue? – Ultimately the client's call.

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Tax Apportionment Clauses and Retirement Assets

Some states, i.e. North Carolina, supply these powers by statute:

N.C.G.S. § 28A-27-7, Fiduciary's Rights and Duties

- personal representative may withhold property in an amount equal to the tax on the property;
- may sue to recover the amount of the tax from **any** person interested in the estate;
- may require bond or other security in form approved by clerk of superior court (who has original jurisdiction over probate estates).

Tax Apportionment Clauses and Retirement Assets

5. Avoid general waiver of outside apportionment because the value of the nonprobate assets may be substantially higher than the decedent anticipated. Depending on the value, the tax on the nonprobate assets could completely eliminate the decedent's probate estate.
6. If the client wants any specific nonprobate asset to pass without any tax burden, that asset should be addressed in the tax apportionment clause.

Tax Apportionment Clauses and Retirement Assets

Estate Plans With Multiple Documents

Must synchronize apportionment language of each document in relation to the whole estate plan.

How taxes are apportioned in the total estate will be affected not only by the provision in each document, but also by the interrelation of the tax apportionment directions within each document.

Tax Apportionment Clauses and Retirement Assets

Leavenworth v. Nat'l Bank & Trust Co, Inc. v. United States, 1996 WL 225193 (D.C. Kan. 1996).

In 1984 decedent executed a pour-over will that provided:

I direct that all state inheritance taxes, federal estate taxes and other taxes and charges chargeable against my estate or any part thereof, or any beneficiary hereunder, be paid from my estate, without the necessity of charging them against the interest of any beneficiary.

Tax Apportionment Clauses and Retirement Assets

The decedent's 1981 trust agreement authorized the trustee, regardless whether any part of Anthony's estate underwent probate administration, to pay "any part or all of any estate, inheritance, legacy, succession and transfer taxes."

It also directed the trustee to "use any securities redeemable at par in payment of the Federal Estate Tax" on the estate.

Tax Apportionment Clauses and Retirement Assets

The value of decedent's total gross estate, as reported on the federal estate tax return was \$5,401,733.65.

The value of his probate estate totaled \$1,138,521.87.

The total value of the assets held in the trust, as reported on the federal estate tax return, was \$4,034,797.72.

Tax Apportionment Clauses and Retirement Assets

Kansas has a long tradition of construing ambiguities to favor the marital deduction.

The executor argued, that the Court should defer to the policy behind the marital deduction and the presumption in favor of its tax advantages for a surviving spouse

Noting testator could override this policy, the Court held that probate assets were subject to tax prior to pourover to trust, thus diminishing marital share and increasing tax due.

Tax Apportionment Clauses and Retirement Assets

While *Leavenworth* involved a revocable trust and a pour-over will, it could have just as easily been a conduit trust, revocable trust, and pour-over will.

Take the time to make sure the tax apportionment clauses in each of the client's estate planning documents are consistent with the client's overall estate plan.

Tax Apportionment Clauses and Retirement Assets

What if the decedent has traditional IRAs and names her children as primary beneficiaries, all of whom disclaim in favor of their children (decedent's grandchildren), all of whom are skip persons?

IRC § 2603(b) provides that, unless the governing instrument directs otherwise “by specific reference to the tax imposed by this chapter,” the tax will be charged to the property constituting the generation-skipping transfer.

Tax Apportionment Clauses and Retirement Assets

Waiver of the right to have the tax paid from the property constituting the generation-skipping transfer should be done with great care since generation-skipping transfers can be inadvertent and unanticipated.

Tax Apportionment Clauses and Retirement Assets

How many beneficiary designation forms contain a tax apportionment provision?

Is this a reason to consider a conduit trust, which could include a tax apportionment provision?

Tax Apportionment Clauses and Retirement Assets

To what extent can the different documents authorize the payment of taxes out of any property other than the property passing under that document?

Riggs v. Commissioner, 945 F.2d 733 (4th Cir. 1991) – held decedent could not shift burden for tax due on probate property from probate to nonprobate property by use of provision in his will where nonprobate property otherwise qualified for the marital deduction.

Tax Apportionment Clauses and Retirement Assets

Remember:

1. Coordinate tax apportionment clauses among different estate planning documents;
2. Know your state's default rules;
3. Explain, explain, explain. Whether and to what extent various beneficiaries' shares bear the tax burden is up to the grantor/testator.