Apportionment of Federal and Oregon Estate Taxes—Planning and Pitfalls

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### Chapter 1

**Apportionment of Federal and Oregon Estate Taxes—Planning and Pitfalls**

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I. BACKGROUND

A. The Problem

1. The issue which must be addressed in tax apportionment, stated simply, is "Who bears the burden of tax?"

2. Although the testator generally has the ability to control the allocation of tax among beneficiaries, too often the matter is not even discussed between the testator and the attorney. As a result, a method of apportionment contrary to the goals of the testator (and too often contrary to the family plan, as well) evolves.

B. Allocation Among Estate Beneficiaries.

1. Generally, the practitioner must discuss estate tax apportionment with client during the planning process.

2. Often, the testator wants the burden of taxes to be shared by all beneficiaries. However, the testator may indicate his or her desire to exempt certain favored gifts or favored beneficiaries from the burden of tax. It is essential that this issue is discussed with respect to every gift under the Will or Trust.

3. The problem manifests itself to a greater extent when the bulk of the estate passes to a spouse. In this case, absent careful planning, one of two results will arise:

   a. Certain specific bequests, intended to be paid in full, could be reduced or extinguished entirely because of tax apportionment;

   b. The spouse's share could be reduced by a pro rata share of taxes which serves to limit the marital deduction and further increase taxes.

II. OREGON LAW: THE CONTROLLING STATUTE


1. In 1969, the Oregon Legislature adopted the Uniform Estate Tax Apportionment Act, embodied in ORS §§116.303 -116.383 (the “State Apportionment Statute”). The purpose of the law was to make uniform a reasonable and understandable set of rules to be followed when the issue of apportionment of federal estate tax and Oregon inheritance tax arises.
2. Expenses of administration, which pose a similar problem, are dealt with separately under the abatement rules of ORS §116.133.

3. Oregon law directs full apportionment of taxes, sometimes referred to as "outside apportionment". Outside apportionment, as opposed to "inside apportionment", provides that taxes will be apportioned not only among the takers of the probate assets, but from the takers as well of all non-probate assets of the estate which are includable for federal estate tax purposes. Inside apportionment, in the alternative, provides for full apportionment, but only within the confines of the probate estate, and does not confer authority upon the personal representative to apportion taxes to those who received non-probate property otherwise taxable in the estate.

C. Definitions Under ORS §116.303.

1. Estate - the federal gross estate or the Oregon gross taxable estate.

2. Person – any individual, partnership, association, joint stock company, corporation, government, political subdivision, governmental agency or local governmental agency.

3. Tax - federal and/or Oregon tax, but only estate tax (noticeably missing from the definitions is the generation skipping transfer tax and the IRC § 4974 tax on excess retirement accumulations).

D. The Basic Rule: Tax Apportionment.

1. The terms of the will control and supersede all other rules, if conflicting. ORS §116.313.

2. Apportionment in absence of provision in will:

   a. It should be noted that the Statute does not define whether the term "will" includes trust or other testamentary device.

      (1) Interpretation may come from other sections of the Oregon Probate Code.

      (2) Safeguard - when drafting a trust with a pourover will, include apportionment language in the pourover will, even if the trust is the controlling document. At the very least, the two documents should be coordinated.

      (3) Often, whether the tax clause in the decedent's will overrides a tax apportionment statute is a question of the testator's intent. In a case out of New York, the court determined that the decedent's will did not override the application of IRC §2207A, requiring a QTIP trust to pay its share of taxes.
due to a partial QTIP election. Holding that the decedent intended not to wipe out a residuary gift to charity through the use of a partial QTIP election, the court required apportionment under §2207. Matter of Estate of Gordon, 510 NYS2d 815 (Sur 1986).

b. Apportionment is made "in the proportion that the value of the interest of each person interested in the estate bears to the total value of the interests of all persons interested in the estate." ORS §116.313.

(1) Definition of "person interested in the estate" - generally, this is anyone receiving property as a result of the death of the testator, whether by will, contract or operation of law. ORS §116.303(3).

(2) Apportionment is based upon values used in determining such taxes.

(a) What if value is different between federal and Oregon returns?

(b) It appears that in this situation, each tax is apportioned according to the taxability of each beneficiary's bequest for purposes of the tax being apportioned.

c. A testamentary direction to pay debts, charges, taxes and expenses of administration is not considered to be a direction that the estate tax rules be superseded.

(1) If one directs by will that taxes shall not be apportioned, then the personal representative must determine against whom such tax shall be charged. In the absence of a contrary provision, unless the will directs that tax must be paid from the residue or some other source, apportionment seems the only alternative. The burden for proving a basis for nonapportionment is upon the party challenging the presumption in favor of apportionment. Matter of Bruun's Estate, 52 Or App 635 (1981) rev den, 291 Or 419 (1981). See also 47C C.J.S. Internal Revenue § 742 (2015).

(2) When in doubt, direct the personal representative to apportion tax in accordance with Oregon law. The Apportionment Statute was carefully considered by the drafters of the Uniform Laws to be the most equitable method of allocation of taxes among beneficiaries of an estate. The practitioner should think long and hard about a contrary method of apportionment in each situation, and should strongly consider relying upon the State Apportionment Statute in the absence of compelling considerations to the contrary. Reliance upon the State Apportionment Statute serves to allocate the tax ratably among all beneficiaries of the taxable estate whose bequests serve to bear the burden of the tax. This is
sometimes referred to as "equitable apportionment". Any other method of apportionment would provide for a disproportionate allocation of such tax burden.


d. Allowances for Exemptions, Deductions and Credits:

(1) Generally, allowances which reduce the effect of apportionment upon beneficiaries will be given for:

(a) any exemptions granted;

(b) any specific classifications made of persons interested in the estate;

(c) deductions; and

(d) credits. ORS 116.343(1).

(2) Exemptions or deductions because of the relationship of a certain beneficiary or the purpose of a gift generally inure to the beneficiary. ORS 116.343(2). Examples:

(a) exemption for property held between spouses by the entireties;

(b) marital deduction;

(c) charitable deduction;

(d) Exception: when the interest is subject to a non-deductible prior present interest, the tax on the prior present interest is chargeable to principal. ORS §116.343(2).

(3) The credit for tax on prior transfers, the credit for gift taxes paid and the credit for foreign estate taxes are apportioned prorata among beneficiaries of the property subject to the credit. ORS §116.343(3).

e. The tax is not apportioned among income interests and remainder interests, between life tenants and remaindermen, and the like. Instead, the tax is charged to the corpus of the asset subject to the interests. ORS §116.353. This could create serious problems with respect to the creation of charitable remainder trusts and
other qualifying charitable split interest gifts under IRC §2522. If tax is paid against the charity's share, this may upset the deductibility of the gift. Therefore, a provision in the governing instrument directing taxes away from the charitable bequest is essential.

III. THE INTERNAL REVENUE CODE AND RIGHTS OF RECOVERY

A. Application of the Internal Revenue Code.

A number of provisions exist in the Internal Revenue Code regarding rights of recovery of a personal representative for tax he or she has paid. This right generally is available to recover from the person otherwise receiving property taxable in the estate the proportionate share of tax from such property. It is important to note, however, that these are not apportionment rules. In other words, even though under state law or the governing instrument the tax may be payable from the probate estate or a particular fund of assets, the Internal Revenue Code provisions authorize recovery by the personal representative from the recipient for those taxes so incurred. This is a right to seek reimbursement or collection of previously paid taxes; it is not a right to seek payment of the applicable taxes directly to the Internal Revenue Service. Nor is this a right to seek reimbursement for state taxes paid, inasmuch as the Code only applies to the federal taxes incurred. As a result, the federal reimbursement rules should only be used as a last resort. A much more effective method of apportionment and provision for payment of tax is to deal in the governing instrument itself with the collection and payment of such tax, or to rely upon state law for apportionment procedures. However, in a full apportionment will, if assets outside the probate estate or trust generate taxes, the Code gives the Personal Representative the right to recover those taxes from the recipient.

B. IRC Section 2205 - Reimbursement Out of Estate.

Under this provision, if the tax or any part thereof is paid by or collected out of the portion of the estate passing to or in the possession of any person other than the executor, the person is entitled to reimbursement from the estate for the payment of such tax. If the estate has already been distributed, then the person is entitled to a just and equitable contribution from the recipients.

1. Section 2205 establishes the fact that it is the intent of the Code to require taxes to be paid from the estate prior to its distribution. It appears that this provision was added to the Code because the District Director cannot be required to apportion tax among persons interested in the estate.

2. The Section provides that the estate is primarily responsible for payment of the tax, and if assets have already been distributed and the taxes paid by someone who receives property not subject to the payment of such tax, then that person has the right to seek reimbursement either from the estate or from the recipient of property who should have rightfully paid the tax in the first instance.
C. IRC Section 2206 - Liability of Life Insurance Beneficiaries.

1. With respect to life insurance, the ability of the personal representative to collect taxes from the recipient is well defined under Section 2206 of the Internal Revenue Code.

   a. In 1919, Congress provided that beneficiaries of proceeds of life insurance includible in the insured's gross estate must bear their share of taxes and reimburse the personal representative, absent a contrary direction in the will.

   b. Currently, IRC §2206 provides that absent a direction to the contrary in a will, if any part of a gross estate consists of life insurance proceeds includible in the gross estate and payable to a beneficiary other than the personal representative, the personal representative is entitled to recover from such beneficiary the tax attributable to the inclusion of such life insurance proceeds.

      (1) If there is more than one beneficiary, the personal representative is entitled to recover from the beneficiaries in the same ratio.

      (2) The weight of authority seems to hold that in any event there is no right to reimbursement from the insurance company itself. See, Maurice T. Brunner, Annot., Remedies and Practice Under Estate Tax Apportionment Statute, 71 A.L.R. 3d 371 (1976). In other words, the Personal Representative cannot require the insurance company to withhold.

      (3) Note that the statutes specifically require apportionment in the ratio that the share of the recipient bears to the taxable estate.

      (4) Section 2206 confers upon the personal representative a right to recover tax from the beneficiary of the insurance. This is not a direct apportionment rule; it is only a right of recovery.

      (5) A direction in the Will to pay taxes out of the "estate" will, in all likelihood, prevent outside apportionment. As a result, a direction to pay taxes only out of the estate will prevent proceeds of insurance in most cases from bearing any share of the tax burden, when the proceeds pass outside of the probate estate. See Old Nat. Bank of Washington v. Damon, 3 Wash App 721, 477 P2d 29 (1970); 47C C.J.S. Internal Revenue § 742 (2015).

2. The courts have interpreted §2206 very literally. For example, in a case where the decedent's will directed that estate taxes be paid from the residuary estate, even though a life insurance policy caused the entire value of the estate to be set aside for the payment of estate taxes, the claimants were unable to force a court to direct apportionment of tax to the life insurance recipients under IRC §2206. The court, in Estate of Tovrea v. Nolan, Ariz 845 P2d 494 (Ct App 1992), held that a direction requiring all taxes to be paid from the residuary estate meant taxes on non-probate as well as probate property. See also
3. IRC §2206 goes on to provide that where proceeds of life insurance are receivable by the surviving spouse and a deduction is claimed in connection with such proceeds under the marital deduction provisions of §2056, then §2206 will not apply to such insurance proceeds, except to the extent that such insurance proceeds are in excess of the amount claimed as a marital deduction.

4. A major problem under §2206 deals with the method of collecting taxes when the beneficiary chooses an optional method of settlement under the policy.

   a. One approach involves collection of the proceeds directly from the insurance company. However, the weight of authority is clearly against this approach. Marks v. Equitable Life Assur. Soc. of U.S., 135 NJ Eq 339 (Ch 1944).

   b. It is always possible to levy upon other assets received by the beneficiary under the terms of the will. This creates problems, however, in the case where the beneficiary receives only the life insurance proceeds, or in the case of unborn or contingent beneficiaries.

   c. The third, and most widely used option, permits the personal representative to keep the estate open, and collect tax on each insurance installment as it becomes due. Wentling, Insurance Proceeds and Estate Tax Proration, 9 U. Pitt. L. Rev. 157, 169 (1948).

D. IRC Section 2207 - Recipients of Property Over Which Decedent Had a Power of Appointment.

   If any part of the estate consists of property which, under §2041, is attributable to a general power of appointment possessed by the decedent, then absent a contrary provision in the will, the personal representative has the right to recover from the recipient of such property the applicable federal estate tax.

   1. It does not matter if the recipient of the property received the same as a result of the exercise, non-exercise or release of the power of appointment. What matters is that the decedent had a general power of appointment, and that some person received property as a result of the death of the decedent.

   2. Once again, the amount of tax attributable to inclusion of the property subject to the power is the ratio that the value of the property bears to the total taxable estate of the decedent.
3. To the extent that such property qualifies for the marital deduction, the Code Section specifically relieves the recipient from the obligation to pay any such tax.

E. IRC Section 2207A - Right of Recovery in the Case of Certain Marital Deduction Property

Under this provision, property, which is required to be taxed in a surviving spouse's estate under §2044 because of an earlier QTIP election attributable to that property, must be paid from the property itself. This is true unless the governing instrument of the surviving decedent requires that the tax be paid from a different source. For a further discussion of these issues, see the provisions regarding marital deduction clauses at §V E. of this outline.

F. IRC Section 2207B - Right of Recovery Where Decedent Retained Interests.

Under this Section, if part of the gross estate includes property against which taxes are assessed because the value of the property is includable in the estate under §2036, then the estate is entitled to recover from the recipient of such property the amount that the value of the property taxable in the estate bears to the total taxable estate.

1. Section 2207B contains two important exceptions.

   a. First, the decedent may direct by Will that the recipient of such property shall not bear his or her share of taxes.

   b. Second, and of equal importance, is the fact that this provision does not apply to enable the executor to seek recovery against a trust to which Section 664 applies (a charitable remainder trust).

2. IRC §2207B provides for the right to seek reimbursement for penalties and interest attributable to the tax, just as the right exists under §2207A. Any gift taxes incurred as a result of §2036 would also be reimbursable under the provisions of §2207B. In order to waive the right to reimbursement under §2207B, the will must contain specific reference to the provision. A general direction against apportionment may not work to obviate the provisions of §2207B.

G. Excess Accumulations Tax.

Under IRC Section 4974, there is a special excise tax equal to fifty percent of the amount of the decedent's excess accumulation in a retirement plan as of the date of death. This fifty percent excise tax, although not an estate tax, must still be considered by the practitioner in planning for an estate with large accumulations inside retirement accounts.

1. Since there are no credits, deductions or exclusions which apply against the special fifty percent excise tax, the issues regarding allocation of expenses and deductions to
apportioned shares do not appear with respect to this tax. Under Section 4974, the payee of the retirement plan is liable for the fifty percent excise tax.

2. A provision in the governing instrument requiring distribution of all required minimum distributions should be sufficient. If the excess accumulations tax applies then the payee will be liable for the tax. Because the payee is receiving a distribution, they will usually pay the fifty percent tax out of the account.

4. It is essential that the practitioner carefully evaluate any potential tax on excess retirement accumulations and address the issue by requiring the estate to take the required minimum distributions out of the retirement accounts.

H. IRC Section 2032A(c). Additional Estate Tax on Dispositions by Qualified Heirs.

Under this provision an additional estate tax will be assessed against a "qualified heir" when he or she ceases to use or sells certain qualified use property within ten years after the death of the decedent in whose estate a §2032A election was made. For further analysis, see paragraph V.H. of this chapter.

I. Generation Skipping Transfer Taxes.

Under the provisions of IRC §§2601 et seq., certain rules regarding the payment of generation skipping transfer taxes by transferors, recipients and trusts are included. For a further discussion, see paragraph V.F. of this outline.

J. Determinations of Tax Apportionment Under Oregon Law.

1. Under ORS 116.323(1), the court in which the probate administration is proceeding may, upon petition, determine apportionment of the tax.

2. Penalties and interest are normally apportioned in the same proportion as the actual tax.

   a. However, if the court finds that the incidence of penalties and interest result from delay or negligence of the personal representative, the court may apportion the penalties and interest directly to the personal representative. See ORS 116.323(3).

   b. If the court finds inequity in the normal method of apportioning interest and penalties because of special circumstances, it may direct apportionment in any manner the court deems equitable. ORS 116.323(2).

3. In the event the court determines apportionment, such determination is prima facie correct in a later suit to recover from any interested person his or her share of the tax.
K. Collection of Apportioned Taxes.

1. Generally, the personal representative is charged with the duty of paying estate and inheritance taxes.

2. ORS 116.333(1) gives the personal representative, or other person in possession of the property, the right to withhold from property otherwise distributable to a person, his or her share of the tax.

   a. It appears the personal representative can encumber or sell all or a portion of such property to pay the tax.

   b. If the value of the property is insufficient to pay the tax due from the distributee of such property, the personal representative may recover the deficiency from the distributee.

   c. If the property passes outside probate, ORS 116.333(1) provides the personal representative with a legal right to collect the tax from the recipient of the property.

   d. The personal representative may secure a bond in the amount of the apportioned tax from the distributee if the personal representative distributes the property prior to final apportionment. ORS 116.333(2).

(1) Query: Is the personal representative liable for breach of fiduciary duty if he or she does not take a bond? Could this be asserted as an affirmative defense by the distributee?

(2) Rule of thumb: Never distribute before full apportionment of taxes. In touchy situations, it is best not to distribute until the Estate Tax Closing Letter and the Oregon Estate Tax Closing Letter are received.

L. Obligations of the Personal Representative.

1. The personal representative is liable to pay the tax, unless he or she has been discharged of further obligation by the court or relieved of liability pursuant to statute.

2. Under ORS 116.363, the personal representative (or other person required to pay the tax) is under no duty to bring any action against a distributee to recover his or her share of unpaid tax until three months following final determination of the tax.

3. If, within a reasonable time following the three-month period, the personal representative files suit to recover tax, the personal representative will not be liable to pay the tax, even if the tax later becomes uncollectible from the distributee.
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a. The fact that the personal representative could have recovered the tax from the distributee at an earlier time does not alter this result.

b. The amount not recoverable will be equitably apportioned among the other persons interested in the estate who are subject to apportionment. ORS 116.363. Note: the statutes refer to "equitable apportionment" in this case, and not necessarily "pro rata" apportionment.

M. Oregon Application for Discharge.

1. Commencing January 1, 2010, an executor, personal representative or trustee of an estate has a right to file a request with the ODR for a determination of tax due under Chapter 118 and request a discharge for personal liability.

   a. If the tax return has been filed prior to or concurrent with the discharge request, then the ODR has 18 months to notify the fiduciary of the amount of tax due.

2. Although the fiduciary has been discharged from personal liability, the regular estate tax statute limitations are not terminated. Thus, if a subsequent audit occurs and there is a commensurate increase in Oregon Estate Tax, then the assets of the estate, even though distributed and even though the personal representative can still be subject to levy.

3. The discharge form can be found online at http://www.oregon.gov/DOR/BUS/docs/103-1005.pdf.

N. Foreign Personal Representatives (ORS 116.373).

1. If a distributee is domiciled or owns property in Oregon, the statutes give a foreign personal representative jurisdiction in Oregon to institute an action for collection of the distributee's share of federal estate tax or state inheritance tax payable from the foreign estate.

2. In this case, the determination of the court in the foreign state having jurisdiction of the estate administration regarding apportionment shall be deemed prima facie correct in Oregon.

IV. THE GENERAL RULES OF TAX APPORTIONMENT

A. Applicability to Federal and State Tax.

It is important to note that most state statutes, including the Oregon statute, apply to both federal and state taxes. The statutes assume that a tax has been or will be paid, and then determines upon whom the ultimate burden lies. In re Estate of McMahon, 2014AP2037, 2015 WL 1824109 (Wis Ct App Apr. 23, 2015); New York Trust Co. v. Doubleday, 144 Conn 134, 128 A2d
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192 (1956). While most questions of tax apportionment deal with federal tax, there is no specific provision of the Internal Revenue Code dealing with apportionment of federal tax. Instead, the question has been left to each state to determine. Riggs v. Del Drago, 317 US 95, 63 S Ct 109, 87 L Ed 106 (1942); Estate of Ginn v. Almond, 427 SW3d 291, 294 (Mo Ct App 2014).

1. Most states apportion tax among the beneficiaries receiving taxable property in the proportion such beneficiaries take the property.

2. However, some states, such as Florida, require that all taxes be charged to the residue, absent an overriding provision in the will. Prior to the 1930's, the Florida rule was the rule of the land. At that time, most cases passing upon the question as to the burden of estate taxes held that estate taxes were not unlike any other debts of administration, and should be paid from the residue. The landmark change in this precedent was provided by the New York statute in 1930. At that time, the New York legislature determined that taxes should be divided prorata, i.e., apportioned between the various persons receiving benefits from the estate, in whatever form. "The principal objection to an estate tax has been that where the decedent dies leaving a will, and makes no provision therein to the contrary, the entire burden of the tax must be borne by the residuary legatee or legatees. Experience has demonstrated that in most estates the residuary legatees are the widow, children, or nearer or more dependent relatives. This has been one of the objections to the Federal Estate Tax Law in New York. The burden of the tax has been imposed upon the residuary legatees not only as to property passing under the will, but also upon transfers whether by gift or by inter vivos trust." Reprinted from the 4th Report of the Temporary State Commission on the ... Simplification of the Law of Estates (of New York), Legislative Document (1965) No. 19, p. 337 (1645), BNA Tax Management Portfolios, No. 219-3d, A-24. The New York statute was questioned constitutionally in the Riggs v. Del Drago case, supra, and was upheld. In the Riggs case, the Supreme Court emphasized that a method of providing for federal estate tax payment and apportionment was a determination to be made by each state. The court did not disagree with the analysis undertaken by the New York State Commission to Investigate Defects in the Law of Estates, which was the body passing the New York statute. See also Estate of Ginn v. Almond, 427 SW3d 291, 294 (Mo Ct App 2014).

3. There is strong public policy in favor of statutory apportionment of estate taxes. In re Constr. of Last Will & Testament of Sued, 33 Misc 3d 1206(A), 941 NYS2d 537 (Sur 2011); In re Shubert’s Will (State Report Title: Matter of Shubert), 10 NY2d 461, 180 NE2d 410 (1962).

a. As a result, courts generally have no equitable power to amend the apportionment formula provided by statute.

b. The only exception is a clear mandate to the contrary by the testator. McCoy v. C.I.R., 97 TCM (CCH) 1312 (TC 2009); New York Trust Co. v. Doubleday, 144 Conn 134, 128 A2d 192 (1956).
c. Any testamentary direction to the contrary must be clear and unambiguous. In re Estate of McMahon, 2014AP2037, 2015 WL 1824109 (Wis Ct App Apr. 23, 2015).

d. The effect of whether taxes are charged to the residue or are apportioned among beneficiaries can be dramatic. Take the following example: at A's death, he left five beneficiaries. Presume an unused exemption of $5 million. B and C each receive a $1.5 million specific bequest. D receives a $3 million bequest. E and F share the residue equally. A's net taxable estate is $7,550,000, less expenses of administration of $50,000. Federal estate taxes are $800,000. The beneficiaries are all individuals.

**Effect of Prorata Sharing of Tax**

<table>
<thead>
<tr>
<th>Gross Amount</th>
<th>% of Whole</th>
<th>Net Share of Taxes</th>
<th>Net % of Estate</th>
</tr>
</thead>
<tbody>
<tr>
<td>B: $1,500,000</td>
<td>21.4%</td>
<td>$171,200</td>
<td>$1,328,800</td>
</tr>
<tr>
<td>C: 1,500,000</td>
<td>21.4%</td>
<td>171,200</td>
<td>1,328,800</td>
</tr>
<tr>
<td>D: 3,000,000</td>
<td>42.9%</td>
<td>343,200</td>
<td>2,656,800</td>
</tr>
<tr>
<td>E: 500,000</td>
<td>7.15%</td>
<td>57,200</td>
<td>442,800</td>
</tr>
<tr>
<td>F: 500,000</td>
<td>7.15%</td>
<td>57,200</td>
<td>442,800</td>
</tr>
<tr>
<td>$7,000,000</td>
<td>100%</td>
<td>$800,000</td>
<td>$6,200,000</td>
</tr>
</tbody>
</table>

**Effect of Paying Tax from Residue**

<table>
<thead>
<tr>
<th>Gross Amount</th>
<th>% of Whole</th>
<th>Net Share of Taxes</th>
<th>Net % of After Tax Estate</th>
</tr>
</thead>
<tbody>
<tr>
<td>B: $1,500,000</td>
<td>21.45%</td>
<td>-0-</td>
<td>$1,500,000</td>
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<tr>
<td>C: 1,500,000</td>
<td>21.4%</td>
<td>-0-</td>
<td>1,500,000</td>
</tr>
<tr>
<td>D: 3,000,000</td>
<td>42.9%</td>
<td>-0-</td>
<td>3,000,000</td>
</tr>
<tr>
<td>E: 500,000</td>
<td>7.15%</td>
<td>400,000</td>
<td>100,000</td>
</tr>
<tr>
<td>F: 500,000</td>
<td>7.15%</td>
<td>400,000</td>
<td>100,000</td>
</tr>
<tr>
<td>$7,000,000</td>
<td>100%</td>
<td>$800,000</td>
<td>$6,200,000</td>
</tr>
</tbody>
</table>
As the above example shows, the decision as to whether or not to apportion tax can have a significant impact upon all beneficiaries. This is especially true with respect to residuary beneficiaries. This effect must be even more pronounced when one beneficiary is a charity to which no apportionment is attributable.

B. Effective Date of Apportionment Statute.

Generally, an apportionment statute will prevail in the case of all persons dying after its enactment, even if the will or governing instrument was executed prior to the date of enactment of the statute. 42 Am. Jur. 2d Inheritance, Estate, and Gift Taxes § 284. This rule has been upheld in the face of due process arguments to the contrary.

C. Interest and Penalties.

Some apportionment statutes require that interest and penalties on unpaid tax should also be apportioned. This is clearly the case in Oregon. ORS §116.303(5) defines "tax" to include interest and penalties.

D. Exemptions, Deductions, and Credits.

Most states' statutes provide that allowances for exemptions, deductions and credits shall inure to the benefit of the beneficiary who received the gifts upon which such exemptions or credits are subject.

1. This is the case in Oregon. See §II D.2.d., infra. For three non-Oregon cases in which charities were forced to bear their proportionate share of tax, see Shriners Hosp. for Children v. Schaper, 215 SW3d 185, 193 (Mo Ct App 2006); Estate of Boder, 850 SW2d 76 (Mo 1993); and Matter of Estate of DeVoss, 474 NW2d 542, (Iowa 1991).

2. Oregon law goes further to provide that when the decedent's will or trust provides that taxes shall be paid from the residue, such benefit is not deemed to be an added taxable benefit to a specific devisee or legatee. Nor is this deemed to be considered a reduction of the value of the residuary devise. OAR §150-118.010(6). Rather than treating this as a benefit or detriment to any particular beneficiary, it is merely deemed to be an appropriate method of dealing with the tax burden.

E. Ratable Apportionment Among Beneficial Interests.

Under Oregon law, taxes are to be apportioned among the persons interested in the estate in accordance with the ratio which the property each interested person receives bears to the total taxable amount of property.

1. Generally, these terms apply to beneficiaries only, and not to creditors of the estate. Accounting of Vernon, 107 Misc 2d 1021, 1022, 437 NYS2d 562, 563 (Sur 1981); In re Oppenheimer's Estate, 166 Misc 522, 2 NYS2d 786 (Sur 1938).
2. Nor is apportionment charged to a person who receives an amount in compromise of a will contest. See In re Richheimer's Estate, 200 Misc 345, 102 NYS2d 750 (Sur 1951); But see Matter of Estate of Barnard, 867 P2d 47, 49 (Colo App 1993).

3. Taxes may also be apportioned against the donee of a gift later includible in the donor's estate, even if the donee has since died. See 42 Am. Jur. 2d Inheritance, Estate, and Gift Taxes § 288.

4. When a surviving spouse elects to take against the will, the share subject to the election will generally be computed as against the "net estate", after reduction for expenses of administration, but not taxes. In other words, taxes should still be apportioned against the spouse's elective share, if and to the extent any taxes are chargeable to such share. 42 Am. Jur. 2d Inheritance, Estate, and Gift Taxes § 290.

5. When the decedent creates an inter vivos trust which is includible in the gross estate under §§2036, 2037 or 2038, the trust must bear its share of the tax, absent a contrary provision in the will. 42 Am. Jur. 2d Inheritance, Estate, and Gift Taxes § 284; In re Abry's Trust, 30 Misc 2d 265, 214 NYS2d 555 (Sup Ct 1961). This is strong incentive for a method of coordinating taxes between the will and an inter vivos trust. See V., infra.

6. It is clear that in the absence of a contrary direction in a will, a life insurance beneficiary must pay his or her share of tax. In one case, it was held that the insurance company, when holding proceeds on deposit as an escrow agent or pursuant to an interpleader, may be charged with a proportionate share of the tax.

   a. However, the rules do not go so far as to make an insurance company a "withholding agent" in cases where proceeds are payable in the form of an annuity. In re Zahn's Estate, 300 NY 1, 87 NE2d 558 (1949); In re Moreland's Estate, 351 Pa 623, 42 A2d 63 (1945).

   b. If the decedent's will specifically provides that all taxes should be paid from the residue, then the beneficiary of a life insurance policy on the decedent's life will likely be exonerated from tax. See S. Alan Medlin, Howard M. Zaritsky, F. Ladson Boyle, Construing Wills and Trusts During the Estate Tax Hiatus in 2010, 36 ACTEC L.J. 273, 297 (2010); Estate of Tovrea v. Nolan, 173 Ariz 568, 845 P2d 494 (Ct App 1992).

7. Generally, as between a life estate and remainder interest, estate taxes are apportioned to corpus. The rationale behind this rule rests upon the fact that to the extent corpus is reduced, there is a corresponding reduction of the interest of the life tenant. The same holds true with respect to apportionment against a trust created by the decedent. 71 A.L.R.3d 247. Under the general rule, this holds true even when a charity is the remainder beneficiary and the life tenant's share is taxable.
a. In *Estate of Malpas*, 7 Cal App 4th 1901, 9 Cal Rptr 2d 806 (1992), the Court held that even though there was no bequest of liquid assets to assist a life tenant in the decedent's residence in paying the tax, the California Full Apportionment Statute should still prevail. See also *Simpson v. White*, 57 Cal App 4th 814, 820, 67 Cal Rptr 2d 361, 365 (1997).

b. What is even more important is the Court's statement that the will was prepared by an attorney who presumably knew the California apportionment rules and therefore intended this result. Query, whether this dicta establishes potential attorney malpractice liability?

F. Method of Securing Apportionment.

1. When apportionment is necessary, the best practice is to secure an order of the probate court directing apportionment. This is normally done in connection with filing of the Final Account. However, an Order for Apportionment may be taken in connection with a Petition for Construction of the Will. The executor's computations should be submitted to the court and served upon all interested persons.

   a. It is best to withhold from each bequest an amount sufficient to pay its share of the apportioned tax, subject to court order.

   b. This is especially true since the ruling of the Probate Court has the force and effect of a final judgment.

2. The Court, in making a determination, must rely on the actual findings of the taxing authorities as to the amount of tax being apportioned. The court cannot rule that the taxing authorities should have come to a different tax result.

G. Intra-residuary Methods of Apportionment.

1. If the Will does not evidence a contrary intent, a direction to pay taxes from the residue means the residue of the probate estate, and not the remainder of the federal taxable estate. *Grimes v. Grimes*, 242 Or 158, 408 P2d 731 (1965).

2. Even though a will may direct that taxes shall be paid out of the residue, the question of apportionment still arises when there is more than one residuary beneficiary. While such a direction exempts pre-residuary gifts, the burden of taxes must still be apportioned among residuary beneficiaries.

   a. Ordinarily, this creates little problem, because taxes are first paid, and the residue after taxes is then apportioned among residuary legatees in the proportions stated in the governing instrument.
b. However, in some cases, this can create significant problems, such as when a partial distribution has previously been paid, and the remainder is insufficient to discharge the remaining tax liability.

3. In most cases, taxes will be apportioned among residuary legatees under the same rules governing apportionment of non-residuary devises. In other words, charities, etc. should still inure to the benefit of their particular exemptions, deductions or credits. 42 Am. Jur. 2d Inheritance, Estate, and Gift Taxes § 273 (2015); In re Smithers' Estate, 15 Misc 2d 701, 702, 181 NYS2d 702 (Sur 1959).

V. PRACTICE TIPS

A. Drafting of Tax Apportionment Clauses.

1. Clearly, it is dangerous, at best, to draft a particular apportionment scheme into a will without full knowledge of all the facts which will be present at the testator's death.

   a. What if assets change?

   b. What if a beneficiary dies and his or her bequest lapses?

   c. What happens in the event of a will contest?

   d. What if the system of taxation changes?

2. A properly drafted tax clause in a will should address, among other things, the following topics:

   a. Which taxes are being apportioned, i.e., the estate tax, the generation skipping transfer tax, state estate tax, and the Section 4974 additional tax.

   b. The clause, if not referring to Oregon statute, should also address whether non-probate property will bear its burden of tax, i.e., whether the apportionment scheme is an inside apportionment or outside apportionment scheme.

   c. The clause should address whether equitable apportionment will be considered. In other words, will those bequests, such as marital bequests, which do not incur any tax, still bear a share of the tax? Under equitable apportionment, these bequests are relieved from an aliquot share of the tax.

   d. If there is a desire to allocate certain credits or other tax benefits to recipients of assets subject to those credits, this desire should be expressed in the instrument.
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e. To the extent that any installment or annuity payouts exist, which generally require charging of the tax to principal, any different apportionment scheme should be specifically identified.

f. The apportionment scheme should indicate whether or not apportionment should also apply to the payment of any interest and penalties on taxes to which they relate.

g. If any deductible claims which are similar to or in lieu of bequests are included, such as payments to a spouse under a Prenuptial Agreement, then the drafter should determine whether or not to apportion taxes to those bequests.

h. If it is appropriate in certain cases to identify certain assets for tax payment, this should be specified in the instrument.

3. The safest alternative is to take one of three alternative approaches:

a. Require all taxes to be paid from the residue;

b. Require all taxes on probate assets to be paid from the probate residue and all taxes on non-probate assets to be apportioned directly to those assets; or

c. Require that taxes be apportioned in accordance with Oregon law.

4. The drafter must seriously consider the results of each decision at the time the document is drafted.

a. The will should contain a provision to the effect that if the residue is insufficient to pay taxes, then the apportionment statute shall apply to the excess.

b. In some cases, a particular testator may want a specific devisee to pay his or her share of the tax. This may be true when one child receives a gift of cash and the other child receives illiquid assets, such as an interest in a closely held business. In this case, a specific direction that a gift shall be charged with its share of tax would be appropriate. Caveat: Make sure an analysis of the potential tax is properly undertaken, so the gift of non-liquid assets might be supplemented with an extra amount to pay the tax.

(1) The opposite may be true where the decedent leaves two children, one interested in the family business and one who is not. In this case, a direction to pay taxes from the residue, coupled with a specific devise of the family business to child A and a residuary devise to child B, could wipe out child B’s interest in the estate.
(2) The adverse effect of the above fact situation could be ameliorated with proper life insurance and liquidity planning.

5. In order to be effective, a testamentary direction against apportionment must be clear and unambiguous. This is so because of the strong public policy favoring statutory apportionment. In the event the testator wants taxes to be paid from the residue, the will should say so in clear and unambiguous language. This direction should also deal with taxes on non-probate assets.

a. A direction merely to pay taxes from the estate has been deemed to be a direction in favor of apportionment. Skaggs v. Yunck, 10 Or App 536, 500 P2d 1230 (1972); Matter of Estate of Shoemaker, 22 Kan App 2d 444, 449, 917 P2d 897, 900 (1996); See also Matter of Bruun's Estate, supra. It might also be appropriate to add the words "without apportionment."

b. In Barlow v. Brubaker, 465 NW2d 276 (Iowa 1991), the decedent's will provided that all taxes relating to property passing under his will be paid from the residue of the probate estate. The Court ruled that this meant all taxes attributable to non-probate property should be fully apportioned. The Law Of Trusts And Trustees § 286.5; but see Matter of Estate of DeVoss, 474 NW2d 542, 546 (Iowa 1991).

6. Just as important is a definition of which taxes will be subject to the testamentary direction. The words "estate, inheritance, succession and estate taxes, including penalties and interest" should suffice, but the instrument should also deal with generation skipping taxes and the IRC § 4974 tax on excess retirement accumulations.

B. Specific Devises of Tangible Property and "String Transfers".

1. Often, a problem will manifest itself when a testator devises illiquid assets to a beneficiary under a "full apportionment" will. Suppose a beneficiary receives only tangible property, such as non-income producing real property or a valuable article of jewelry, without receiving any cash to pay the tax attributable to the bequest. The result can often create a hardship upon the beneficiary, who must either disclaim the gift or find the funds necessary to pay the tax. There are a number of solutions to this problem:

a. Provide that taxes shall be paid from the residue;

b. Provide that the specific bequest shall not share in tax apportionment, i.e., make the gift "free of tax" under the terms of the will;

c. Ensure that the testator includes sufficient cash together with the specific bequest, so that the tax attributable to the total gift can be paid with the cash; or
d. Advise the beneficiary in advance that the gift may be made, and caution the beneficiary that he or she should set aside sufficient cash to accommodate payment of the tax upon the testator's death.

2. A similar problem results in the case where assets not transferred at death are includible in the gross estate and are subject to tax apportionment.

a. Under federal law, proceeds of a life insurance policy transferred within three years of death are includible in the gross estate under §2035. Also included are certain "string transfers", under circumstances in which the decedent made a transfer and retained certain tainted powers over the property under IRC §§2036, 2037 and 2038.

b. In these cases, tax will be apportioned to the donee, transferee or beneficiary, as the case may be.

(1) A provision in the original instrument of transfer, which exonerates the party succeeding to the interest from the payment of tax, should suffice, if not inconsistent with the will.

(2) However, ORS §116.303 does not include previous transfers under the definition of "will". As a result, a determination as to whether the prior gift escapes tax apportionment by its terms may be left to the probate court. And remember, there is a strong public policy in favor of apportionment.

(3) It is safest to specifically exonerate any such gifts by including a separate clause to that effect in the will.

C. Charitable Bequests.

1. As stated above, a bequest to a charity generally will not be charged with a prorata share of federal or Oregon tax, since the bequest usually bears no tax.

2. What about a residuary bequest to charity?

a. If the will directs that taxes shall be apportioned, this bequest shall bear no tax.

b. However, if the will directs that taxes shall be paid from the residue, then the charity, as a residuary beneficiary, ends up bearing the tax burden. This is compounded by the fact that since the taxes are a charge upon the residue, the amount remaining for payment to the charity suffers a corresponding reduction. As a result, the deduction for charitable bequests is reduced. The estate tax is, by virtue of the reduced charitable deduction, correspondingly increased. This
increase reduces further the amount of residue payable to the charity, which reduces the charitable deduction, which increases the tax, and so on. This compound effect results in a complicated simultaneous equation computation. When a charity is a residuary beneficiary, the practitioner should seriously consider the alternative of tax apportionment.

D. Defining Terms.

Once the decision is made as to how taxes shall be apportioned, it is essential that the drafter take the steps necessary to clearly and unambiguously set forth the apportionment language in the will, so that there is no question as to the intention of the testator.

1. The bulk of the litigation involving tax apportionment deals not with interpretations of the statutes, but with interpretations of decedents' wills. In these cases, courts look not only to the language of the will, but the court will consider the apparent intention of the testator. In some cases, courts go so far as to presume that the testator's intent was to benefit the natural objects of his bounty. See 68 A.L.R.3d 714; 71 A.L.R.3d 247.

2. In states where there is a statute providing for apportionment, there is a further problem regarding whether the testator intended the statute to apply, or whether the will should apply.

3. Take, for instance, the clause "I direct that all taxes on my estate shall be paid from the residue." Although this clause appears, at first glance, to be straightforward, the following problems arise:

   a. The sentence does not specifically define the words "taxes", "estate", and "residue". A myriad of courts have attempted to construe these words, and there is little consistency between the decisions.

   b. In In re Hoffmann's Estate, 399 Pa 96, 160 A2d 237 (1960), the court held a direction that "any and all inheritance taxes" be paid from the decedent's estate did not apply to federal estate taxes, even though the words "and all" were included. The court relied upon the meaning of the word "inheritance", and emphasized the fact that the federal estate tax is not "an inheritance tax." An inheritance tax, it was reasoned, is a tax on the right of succession to property, whereas an estate tax is a tax on the transmission of property. But see Spaeder v. United States, 478 F Supp 73, 83 (WD Pa 1978).

   c. Does the word "estate" mean gross estate for federal estate tax purposes (which includes "string transfers", joint property, some life insurance proceeds and some gifts), or does the word apply only to the "probate estate"? A simple definition in the will would remove any doubt.
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E. Marital Deduction Clauses.

1. Under the Tax Reform Act of 1976, the federal estate tax marital deduction was limited to the greater of $250,000 or 50% of the decedent's adjusted gross estate. Following enactment of the 1976 Act, practitioners were careful to provide that taxes would be paid out of the non-marital share of the estate. Otherwise, the amount transferred to the marital share would have been reduced by the amount of tax chargeable thereto, which had the effect of triggering more tax, and so on. This created a situation similar to that discussed in paragraph C above, regarding charitable bequests.

2. Then came the Economic Recovery Tax Act of 1981, which provided for an unlimited marital deduction. Since enactment of the 1981 Act, in most estates, there will be no federal tax payable at the death of the first spouse. Often, though, wills are drafted to provide for a marital share (outright or in trust) and bypass trust, so that the bypass trust takes advantage of the then-existing exemption equivalent of the federal estate tax unified credit. Most of these wills contain "reduce-to-zero" marital deduction bequests, which provide that the marital deduction will equal that amount which, when taking into effect all other deductions and credits available to the estate, reduces the federal estate tax to zero.

   a. In these cases, it is essential that the taxes attributable to the decedent's gross estate, and all expenses of administration (not deducted on the estate tax return) should be charged to the non-marital share of the estate.

   b. The primary focus of the tax payment clause following the 1981 Act should be to place the burden of the federal estate tax and state estate taxes on the share of the estate not passing to the surviving spouse, so that the spouse's share continues to qualify for the federal estate tax marital deduction. In other words, such taxes should normally be paid from the bypass trust.

3. In the event that the will establishes no bypass trust, or if the property qualifying for the bypass trust is insufficient to pay the entire estate tax burden, the practitioner may consider carefully drafting the will so that taxes may be charged against any other properties which contribute to the tax burden.

4. What happens if the surviving spouse disclaims an interest in the estate? In many cases, practitioners now draft disclaimer wills which contemplate the fact that a spouse may disclaim a share of the estate, which later falls into either the hands of alternative beneficiaries or into a trust similar in form to a bypass trust. Whenever the possibility for disclaimer is contemplated (which includes almost every estate), the practitioner should ensure that the tax allocation clause directs that any taxes which may be generated as a result of a disclaimer should be charged against the disclaimed property, and not against other property of the estate.

   a. For instance, suppose a testator establishes a will providing a QTIP trust (income to his wife and remainder to his son), a specific bequest to his son, and the
balance, if any, to a bypass trust which provides the spouse with a limited power of appointment. Suppose further that the will directs that taxes are to be charged to the share passing to the son.

(1) In this situation, if the wife wants to limit the share of the son, she could disclaim from the QTIP trust into the bypass trust, giving her more flexibility to determine the ultimate beneficiary of the disclaimed property. Even though this may create additional tax, the terms of the instrument would require the tax to be paid by the son.

(2) A provision in the instrument directing all taxes attributable to disclaimed property to be paid from the disclaimed property itself would alleviate this unfair result.

5. The Economic Recovery Tax Act of 1981 also established a new type of marital deduction trust under the tax law, that being the Qualified Terminable Interest Property (QTIP) Trust. Under these provisions, found at IRC §2056(b)(7), if a personal representative so elects, he or she can treat all or a portion of the property passing to a trust for the benefit of the decedent's surviving spouse to qualify for the marital deduction, even though the trust is of such a variety that it would otherwise not qualify for the marital deduction because of the terminable interest rule. Generally, in order to qualify as a QTIP Trust, all of the income of the trust must be payable to the surviving spouse for the remainder of his or her lifetime, and no other person or entity has the right to invade principal or income for the benefit of anyone other than the surviving spouse.

a. In drafting wills with QTIP provisions, remember that any taxes must be charged against the share of the trust not subject to an effective QTIP election. In other words, taxes should be apportioned only from the share of the QTIP trust which does not qualify for the federal estate tax marital deduction. This conclusion is based upon the same reasoning applicable to apportioning taxes to the bypass trust as opposed to the marital deduction share, discussed above. It would be best to provide in the governing instrument for an actual split of the QTIP into exempt and non-exempt shares, making it easier to identify each and to justify apportionment. Jeffrey N. Pennell, Apportionment Can Make Tax Payment More Equitable, 22 Est. Plan. 3 (1995).

b. Under IRC §2044, the value of the gross estate includes the value of any property over which a QTIP election was made at an earlier time. Under IRC §2207A, if any part of the gross estate consists of property taxable under §2044, the decedent's estate is entitled to recover the amount of tax attributable to inclusion of the QTIP property in the estate directly from the person receiving the property. In this case, the amount of tax attributable to the QTIP property is computed at the highest bracket taxable in the estate of the second spouse; i.e., the tax is computed as though the QTIP property were the last item added to the taxable estate.
c. The right of the estate of the surviving spouse to collect the federal estate tax attributable to the QTIP property from the recipient of such property may be superseded by a contrary direction in the will of the decedent in whose estate the QTIP property is taxable.

(1) These rules require meticulous planning by the practitioner.

(2) In the absence of family considerations, it is best to provide in the will establishing the QTIP trust that unless otherwise directed, the QTIP trust shall bear its share of taxes in the spouse's estate prior to distribution to beneficiaries of the QTIP trust. Although this is in accordance with §2207A, that section specifically provides that taxes are chargeable from the "recipient" of the QTIP property, and not from the trust.

(3) With respect to a QTIP transfer which is not in trust, it may be appropriate to provide in the will of the decedent which establishes the QTIP bequest that the taxes be paid directly from the recipient, in accordance with §2207A.

(4) On the contrary, it may happen that for some reason, payment of taxes attributable to inclusion of the QTIP property in the surviving spouse's estate directly from the QTIP property is not the desired result. This may occur when the QTIP property consists of illiquid assets, and the beneficiaries of the QTIP trust are the same as the beneficiaries of the spouse's residuary estate. In that case, it would be appropriate, in the spouse's will, to include a provision under §2207A(a)(2) to the effect that the QTIP property should not be charged with any taxes attributable to inclusion of the QTIP property in the spouse's estate under §2044.

6. Be careful, however, when any planning involves the failure to seek reimbursement of taxes under §2207A from the appropriate payor. At death, failure to seek the reimbursement of taxes incurred under §2207A caused by §2044 from the beneficiaries of the §2044 property, and collection instead from other beneficiaries, will result in a gift from the beneficiaries paying the tax to the beneficiaries who should have paid the tax under §2207A. This is true even if collection would have proved impossible. 26 C.F.R. § 20.2207A-1(a). Therefore, if the right of reimbursement is to be waived, it must be done by the surviving spouse in his or her testamentary instrument, by way of a specific provision allocating the §2207A tax to a specific individual or individuals.

a. In these cases, the gift will often occur as a result of a failure by the personal representative to either waive or assert the right of reimbursement under §2207A.

b. This provides another reason for exercising great caution in this area, so that the personal representative is not deemed to suffer liability for breach of fiduciary duty in generating the "phantom gift tax".
7. In drafting a will clause intended to relieve marital deduction property from estate tax liability, the practitioner should consider the entire estate plan of the testator, and design the clause to fit the testator's needs. Normally, the goal is to optimize the marital deduction. In this case, a clause directing that the estate residue should bear estate taxes assessed against property passing both under and outside of the will, may serve to reduce the marital deduction, if the marital bequest consists of part of the residuary estate, as discussed above. This type of clause, however, would be appropriate if the marital deduction is provided pursuant to a pre-residuary bequest.

a. An initial analysis should be made to determine whether or not any taxes will be payable. If taxes will not be payable because of the size of the estate, there should be little problem. In that case, a clause directing payment of the taxes out of the residue, even though the marital bequest is a residuary bequest, should not cause hardship. Extra care should be exercised in these cases to ensure the estate will not grow to the size where taxes may be a consideration.

b. Alternative tax clauses might be designed as follows:

1. One clause might provide that estate taxes payable from property interests includible in the estate but passing outside of probate will be paid by the recipients of such interests, and taxes passing under the will will be paid from the residuary estate. This clause may, however, be difficult to administer.

2. A tax clause might provide that taxes shall be paid from the residue, but only such portions of the residuary estate which do not qualify for the marital deduction. Such provision might read as follows, "I direct that all estate, inheritance, transfer, succession and other estate taxes (including any interest and any penalties with respect to such tax) imposed by reason of my death, in respect of property passing under this will, shall be paid from the residue of my estate. All such taxes imposed in respect of property passing outside of this will shall be apportioned against and payable by the persons to whom such property is paid, or for whose benefit such property is held."

8. A provision in the will requiring that the estate taxes be paid out of the non-marital residuary share should be explicit. In one case, the will provided that estate taxes would be paid out of the nonmarital assets, "... unless in the best business judgment and sole discretion of the executor, such taxes could be more prudently paid from any assets of my estate without respect to what is or is not included in the Marital Trust created by this my Last Will". In that case, the executor actually paid the estate taxes out of non-marital trust assets, and not from the marital share. However, the Tax Court, as affirmed by the Tenth Circuit, reduced the marital deduction by the entire amount of the estate tax. The Court ruled that the value of the marital bequest had to be reduced by the potential liability "for all the death taxes" that might have been assessed. The Court applied the test at the time
of death of the decedent, and indicated that a potential reduction of the marital deduction is not affected by the later events showing the actual payment of the tax was made out of the non-marital share. Wycoff's Estate v. Comm'r of Internal Revenue, 59 TC 617 (1973) aff'd sub nom. Estate of Wycoff v. C.I.R., 506 F2d 1144, 74-2 US Tax Cas P 13037 (10th Cir 1974). But see Patterson v. United States, 181 F3d 927, 930 (8th Cir 1999). Subsequent to the Wycoff decision, the IRS ruled that discretionary authority given to an executor to pay estate taxes from a marital bequest, even if such taxes were paid from other property, causes reduction of the allowable marital deduction by the entire amount of estate taxes payable. IRS TAM 7827008 (IRS TAM Mar. 24, 1978)

9. In Estate of Miller, 230 Ill App 3d 141, 595 NE2d 630 (1992), the will of a surviving spouse, in whose estate a substantial QTIP was included, contained a provision directing the personal representative to pay all debts "without reimbursement or contribution, all estate taxes...". The Court held this language was sufficient to exonerate the QTIP trust from paying its share of taxes, even when this meant abating certain specific devises otherwise payable from the probate estate. But see In re Estate of Klarner, 113 P3d 150, 156 (Colo 2005).

F. Generation Skipping Transfer Tax.

1. The generation skipping transfer tax (the "GST" tax) is a tax assessed on transfers of property from a transferor to beneficiaries who are in a generation more than one generation below that of the transferor. The purpose of this tax is to prohibit the ability of wealthy taxpayers to transfer property to beneficiaries who are in generations more than one generation below that of the transferor, so that an estate tax would otherwise be skipped.

2. GST's generally occur in one of two ways: either an outright gift is made to a person who is more than one generation below that of the transferor ("a skip person"), or a transfer is made in trust or in an equivalent trust fashion so that an income interest may be payable to a person who is one generation below the transferor, but distributions of principal will be made at some time in the future to a skip person.

   a. Direct Skips. A direct skip is a direct transfer from a transferor to a skip person or to a trust of which all beneficiaries are skip persons.

   b. Taxable Distribution. A taxable distribution occurs when a distribution of principal is made from a trust to a skip person.

   c. Taxable Termination. A taxable termination occurs when a trust terminates, and the principal of the trust is payable to one or more skip persons.

3. A complete discussion of GST's is well beyond the scope of this outline. However, a basic understanding of the general rules will assist the practitioner in developing an understanding of the considerations involved when potential GST's are
included in the planning process. In order to develop even a basic understanding of the GST tax problem involved in determining a method of tax apportionment, it is essential to at least understand the following rules:

a. The GST tax is a flat rate equal to the highest marginal estate and gift tax bracket applicable at the time the transfer is made. As of right now, the highest tax rate is 40 percent. Valuation dates differ depending upon when a transfer is made or, in many cases, whether a taxable termination or taxable distribution is made. The key, however, is that the highest existing federal estate tax rate becomes the only tax rate applied for GST tax purposes. In other words, the GST tax is that which would be assessed if the property were included in the estate of the person whose generation was skipped at the highest then existing estate tax bracket (currently 40 percent). IRC §2061.

b. For the 2015 calendar year, each transferor is entitled to a $5,430,000.00 exemption against the GST tax. If planned appropriately, a husband and wife could take advantage of generation skips totalling $10,860,000.00 and escape GST taxes.

c. Gifts which are excluded for gift tax purposes either as gifts of $14,000.00 or less per donee per annum under IRC §2503(b) or related gifts for medical and tuition payments under IRC §2503(c) are exempt from GST taxes.

d. IRC §2603 provides that the liability for tax depends upon whether a direct skip ("DS"), taxable distribution ("TD"), or taxable termination ("TT") is made.

(1) With respect to a TD, the tax imposed under §2601 is paid by the "transferee", i.e., the person who receives the actual distribution from the trust or trust substitute.

(2) In the case of a TT, or in the case of a DS which is made from a trust, the GST tax is paid by the Trustee, not the recipient of the property.

(3) With respect to a DS (other than a DS from a trust), the transferor pays the tax.

(4) No matter who bears the responsibility for tax, IRC §2603(b) provides that unless the governing instrument otherwise directs pursuant to a specific reference to the GST tax, then the GST tax is charged against the property constituting the transfer. This differs from many of the rules discussed earlier in this outline dealing with reimbursement directly from the estate of the decedent. The law specifically provides that the property subject to the GST tax itself is the property from which the tax is exacted. There is no other provision in Oregon law which would supersede this provision, inasmuch as the GST tax is not a "tax" as defined under ORS
Section 116.303(5). This means that in the event a testator provides that taxes shall be paid from the residue, and if the testator does not specifically identify GST taxes, then it is likely that the federal statute will prevail. To date, however, there is no Oregon case directly on point. The practitioner should evaluate the potential GST taxes in each case and, if those taxes may occur, provisions regarding the payment of such tax should be evaluated.

4. The regulations under the GST tax contain a number of rules governing the timing of the allocation of the $5,430,000.00 exemption, rules for automatic allocation of the exemption, and the procedure for making allocation of the exemption. See 57 FR 61356-01 and 57 FR 61353-02; but see Announcement 93-57 Generation-Skipping Transfer Tax; Correction, 1993-15 IRB 12 (IRS ANN 1993).

   a. With respect to lifetime transfers which are DS's, the regulations reflect the rule under IRC §2632(b), that the transferor's unused GST exemption is automatically allocated to the transfer. If he or she chooses, the transferor can elect out of the allocation.

   b. With respect to a lifetime transfer which is not a DS, allocation of the exemption is made on Form 709. 26 C.F.R. § 26.2632-1(b). The Regs. further provide that allocation of the exemption may be made by formula set forth in the governing instrument. With respect to wills and trusts, a formula requiring allocation of the exemption to result in an inclusion ratio of zero will be acceptable.

   c. 26 C.F.R. § 26.2632-1(d) provides that at death, the executor can allocate unused GST exemption on the Federal Estate Tax Return, filed within nine months of date of death. Any unused GST exemption is allocated pro rata first to DS's occurring at death, with the balance being allocated pro rata to trusts with respect to which a TT may occur, or from which a TD may be made. There are certain limited exceptions to this rule.

5. In the planning process, the practitioner must determine how the GST tax, if any, should be allocated. If the transferor wishes to allocate GST tax in a method other than that set forth in the statute, he or she may be able to do so by specifically allocating exemption to some gifts and not others. This must be done, generally, by way of an affirmative act or direction in the instrument. If the transferor wishes to allocate GST tax in a method which is most equitable at the time the tax is incurred, then certain drafting tips should be followed:

   a. If a trust is involved in the estate plan, the Trustee should be authorized to divide a single trust into separate trusts, giving authority to establish one trust with an inclusion ratio up to one and the second trust with an inclusion ratio of zero. This will enable the Trustee or Executor to allocate the GST tax exemption to one trust, and not the other.
b. If a marital trust at the death of the first spouse is exempt from estate and GST tax, then the tax allocation clause in the will or trust should provide for payment of estate tax at the death of the second spouse from a source other than that trust, so long as other funds are available and the result would be consistent with the dispositive scheme.

c. The will or trust should include a provision empowering the Executor to allocate GST exemption on a non-prorata basis.

6. If the first spouse to die did not exhaust his or her GST exemption on lifetime transfers, then to the extent the exemption is not allocated to non-marital gifts, there should be provisions for a reverse QTIP trust to be created. Remember, the portability rules do not apply to GSTs. A reverse QTIP trust is, in all respects, identical to a QTIP trust, except that for GST tax purposes, the first spouse to die is deemed to be the transferor. In this way, the full exemption available to the first spouse is allocated to the reverse QTIP trust, with the balance of the QTIP trust being deemed to be property transferred by the second spouse at his or her subsequent death. The second spouse will then use his or her own GST exemption against the property inside the normal QTIP trust. A reverse QTIP will generally be established one of three ways:

   a. The will or trust may authorize the Executor to create a reverse QTIP trust;

   b. The will or trust may allow the surviving spouse to create, through use of a disclaimer, a reverse QTIP trust upon the first spouse's death; or

   c. The will or trust may direct the Executor to create the reverse QTIP trust.

7. The will or trust instrument should authorize the Executor to fund the reverse QTIP by using a pecuniary formula clause, which should define the amount of the reverse QTIP as the amount of exemption less

   a. Allocations of the exemption made to lifetime transfers;

   b. Allocations made by the Executor to other transfers occurring at death.

8. The practitioner should include a provision protecting the reverse QTIP trust or any other trust which qualifies for the GST tax exemption against allocation of taxes and expenses of administration.

9. For an excellent evaluation and analysis of the establishment of a reverse QTIP trust and sample language for will and trust documents, see ¶16,801, Planning a Married Couple's Estates to Make Maximum Use of Both Spouses' GST (Generation-Skipping Transfer Tax) Exemptions, RIA Estate Planning & Taxation Collection.
G. Revocable Living Trusts.

Quite often, practitioners are engaged in drafting revocable living grantor-type trusts for their clients, which contain testamentary provisions at death. These trusts are drafted for a number of reasons, most often probate avoidance, privacy and avoidance of ancillary probates. A properly planned estate, when using a revocable trust, also includes a pourover will, making sure that all of the decedent's assets are payable to the revocable trust following the decedent's death, to the extent that they were not transferred to the trust at an earlier time. In some cases, a revocable trust may be established to hold only certain specific assets, with the bulk of the decedent's estate being held outright, for distribution pursuant to the terms of the will. A pourover will is often used in these situations as well, to simply transfer the decedent's estate assets to the trust. The dispositive provisions of the estate plan will be contained in the trust.

1. Although ORS §§116.303 to 116.383 deal with allocation absent contrary provisions in wills, there is no corresponding provision in the statute to deal with revocable living trusts.

2. The problem which the practitioner must face in drafting these documents rests upon an analysis of the fund from which the taxes should be paid. There are a number of alternatives:

   a. Should taxes be apportioned among all beneficiaries of the decedent's estate, receiving assets from both the revocable trust and the will?

   b. Should taxes be apportioned only to the estate?

   c. Should taxes be apportioned only to the revocable trust?

   d. If taxes are apportioned only to either the will or the revocable trust, should they be payable from the residue or apportioned among the beneficiaries of that particular document?

   e. It is essential to keep in mind that whatever alternative is chosen, the will and trust must have consistent apportionment language. See Construction, and Application of "Pay-All-Taxes" Provision in Will, as Including Liability of Nontestamentary Property for Inheritance and Estate Taxes, 56 A.L.R.5th 133 (Originally published in 1998).

3. Generally, the determination as to where taxes should be apportioned is based upon the facts and circumstances in each case. For example, if the revocable trust only contains land in another jurisdiction and provides for distribution in equal shares to the decedent's children, and the accompanying probate estate contains the remaining assets which will be more than sufficient to pay taxes, it would be appropriate to charge such taxes to the decedent's estate, and not the revocable trust.
a. On the contrary, if a revocable trust comprises the bulk of the assets of the decedent's estate, and the pourover will has been drafted only as a devise to sweep up any assets which might escape transfer into the trust, a provision in the will requiring taxes and expenses of administration to be apportioned to the decedent's revocable trust would be appropriate.

b. In all of these cases, the trust should contain a provision authorizing the trustee to purchase assets from the decedent's estate at their fair market value, so that in the event taxes must be paid from the decedent's estate, there is a mechanism to move assets from the will to the trust, in exchange for cash of the trust, to provide the liquidity necessary to pay such taxes. Because the basis in the assets is stepped up to fair market value at date of death, a sale from the estate to the trust at fair market value at date of death should incur little or no tax.

4. In the event a method of apportionment different from the scheme set forth under Oregon law is chosen by the client, then any contrary provisions should be included in the client's will, as well as the trust. Since the statute does not specifically recognize the use of trusts as a method of circumventing the apportionment laws, including apportionment language in the trust in contravention of statutory apportionment could jeopardize the estate's apportionment plan. Using words of apportionment in the will of the decedent should take care of this problem.

a. This may create additional problems. Each time a trust is amended to add a new specific bequest or change the method of apportionment, it is likely that a codicil to the will may also be required to reflect any additional changes to the preconceived apportionment plan.

b. There is no guarantee that the trust can supersede Oregon statute. It is likely that a disgruntled beneficiary may challenge the trust if no conforming apportionment schedule appears in the will. To circumvent this problem, one might include a provision in the will to the effect that the taxes will be apportioned in accordance with the terms of the revocable living trust of the decedent. However, inasmuch as the revocable living trust is not executed with testamentary formalities, the trust and any subsequent amendments may not conform to the definition of "will" set forth in the Oregon Revised Statutes. Probably the best method of protecting against this problem is including the provision discussed above in the will and then duplicating in the will the apportionment plan set forth in the trust instrument. It would be important to ensure that the apportionment language appears as well in the trust.

5. In cases where problems are anticipated, it may be wise to force a probate of the will to take advantage of Oregon law. This is based on the fact that the law confers upon personal representatives certain collection rights against beneficiaries to whom taxes may be apportioned, as discussed above. The Internal Revenue Code, as well, confers rights of reimbursement to the personal representative under IRC §§2205-2207B. In addition, the
personal representative is in the best position to secure an order of the probate court approving the tax apportionment scheme. In the event the assets remaining in the estate are insufficient to pay such taxes, then the personal representative would have the right to collect from the trustee of the revocable living trust such sums as are necessary to pay the remaining taxes.

a. A corresponding provision should be included in the living trust, authorizing the trustee to distribute assets from the trust to the personal representative for the payment of such taxes. In the event that the assets of the estate are of the type and quality that the personal representative would wish to have preserved for the benefit of the trust beneficiaries, the provision authorizing sale of assets to the trust, in exchange for the trust's liquidity, would take care of the problem.

b. In the alternative, a provision could be included in the will providing that in the event the assets of the estate are of such a type and variety that it would be imprudent to liquidate them to pay the taxes and expenses of administration levied upon the estate, the personal representative shall have the right, in his discretion, to seek such sums from the trustee as are necessary to pay such taxes. In this case, the trust should contain language authorizing the trustee to pay to the personal representative the trust's appropriate share of the tax.

c. The drafter must be careful in these situations to ensure that taxes payable, whether from the estate or from the trust, shall not be chargeable against the marital or any other exempt share.

6. In all of the situations set forth above, the primary consideration for the fiduciary is whether taxes shall be paid from the residuary share of either the estate or the trust, or whether taxes shall be apportioned among all beneficiaries. Once that determination is made, a simple computation regarding the expected tax payable and the proposed effect upon beneficiaries will assist the practitioner in advising the client as to the effect of each alternative. This alternative can then be incorporated into the language of both the will and trust.

H. Special Use Valuation Recapture.

Under IRC §2032A, certain property used in the trade or business, generally associated with farming and ranching, can be valued for estate tax purposes at its actual current use, rather than its highest and best use. This reduction in value can be as much as $1,100,000.00. IRC §2032A(a)(2).

1. Under §2032A(c), an additional estate tax is assessed if, within ten years after the decedent's death and before death of a qualified heir, the qualified heir disposes of any interest in the property or ceases to use the property for a qualified use.
2. Under §2032A(c)(5), the qualified heir (the person who receives the property) is personally liable for any additional tax due.

3. On its face, this appears to cover the apportionment problem. However, the real problem manifests itself in the fact that the estate tax benefit of electing special use value under §2032A will often inure to someone other than the qualified heir. If, at a subsequent time, the qualified heir ceases to use the property in its qualified use, then the qualified heir is subject to payment of the tax. Therefore, if any qualified use property exists at the time the estate plan is prepared, one of two methods should be taken into consideration:

a. The will or trust instrument should allocate the benefit of the reduction in value directly to the qualified heir, and reduce his or her otherwise allocable tax burden proportionately; or

b. The will or trust instrument should provide that any recapture of tax if the property ceases to be used in a qualified use will be allocable not to the qualified heir but to the beneficiaries who inured to the benefit of the tax reduction in the first place.

(1) There appears to be no law directly on point authorizing a testator to override the application of §2032A(c)(5).

(2) Therefore, it is probably wise to provide in the will or trust instrument that the qualified heir has the right to full indemnification from the beneficiaries who initially received the tax benefit, in the event the qualified heir is charged with the additional tax. See Klug, The Effect of Special Valuation on Estate Tax Apportionment: A Plea for Uniform Legislation, 1 Prob. & Prop. 6 (March/April 1987).

4. An additional problem under §2032A presents itself in the case of partial interests. If the qualified use property is placed into a trust, with the life tenant being the party causing recapture, it appears under the apportionment statutes that the corpus of the trust would bear the tax, causing inequity between the life tenant and the remainderman. This should also be closely evaluated in drafting any estate plan in which qualified use property may be included.

I. Oregon Natural Resource Credit Recapture. Oregon HB3201, enacted on July 31, 2007, introduced the Oregon Natural Resource Credit into the law. HB3618, passed in 2008, and HB2541, passed in 2011, introduced substantial changes to the Oregon Natural Resource Credit law.

1. Basically, the law provides that to the extent an Oregon decedent owns natural resource property, which is designated either as farm use property or one or more farm use homesites related to the real property, or forest land or one or more forest land homesites not to
exceed 5,000 acres, or for fishery operations, then a credit against Oregon Estate Tax may be available.

2. The law provides the formula for calculating a credit against Oregon Estate Tax for a percentage of the adjusted gross estate that is claimed is Natural Resource Property. The maximum amount is capped at $7.5 million. ORS 118.140(1)(b).

3. It is interesting to note that the Natural Resource Credit is available for Oregon purposes even if the property passes to the surviving spouse and a marital deduction is claimed against the property on the federal return.

4. Even though a discussion of the Oregon Natural Resource Credit is well beyond the scope of this outline, a similar issue to that existing with IRC § 2302A also exists with respect to the Oregon Natural Resource Credit.

   a. If, pursuant to the terms of the governing instrument, taxes are to be paid from the residue, then the residual beneficiaries will actually inure to the benefit of the Natural Resource Credit.

   b. However, ORS 118.140(9)(a) provides that if a qualifying heir does not continue to own and operate the natural resource property for five out of the eight years following the decedent’s death, then the credit is recaptured. The tax is not paid by the residual beneficiaries who inured to the credit; instead, it is paid by the qualified heir.

   c. Therefore, it is important when drafting to take advantage of the Oregon Natural Resource Credit, to evaluate whether the beneficiaries who inured to the benefit of the credit or the qualified heirs should pay the recapture tax. If the testator includes a residuary apportionment clause and the beneficiaries of the residue are not the beneficiaries of the natural resource property, and if the testator wants the residual beneficiaries to pay any recapture tax, then a condition of their bequest should be the obligation to pay any recapture tax.

J Problem Areas.

1. In many instances, a properly drafted buy-sell agreement can establish a justifiable federal estate tax value for closely held corporate stock.

   a. In some instances, the owner of stock in a closely held corporation may enter into a buy-sell agreement requiring the executor to sell his or her stock at fair market value. If the IRS accepts this provision, there should be no problem.

   b. However, sometimes taxpayers become "piggish", requiring repurchase at a reduced fair market value. In the event the IRS refuses to accept the buy-sell agreement as binding for estate tax purposes, or if the buy-sell agreement does not contain restrictions which the IRS deems acceptable in establishing valuation, the
IRS could refuse to accept the buy-sell agreement as binding. In this case, both marital and charitable deductions could be adversely affected.

(1) If the disparity between the amount the estate receives for purchase of the stock and the estate tax attributed to the fair market value of the stock is large enough, the residuary estate may be insufficient to pay expenses and estate taxes.

(2) This could have the effect of requiring charitable bequests and/or the marital deduction to bear their share of the additional tax. This has the further effect of reducing the charitable and/or the marital deduction, which further increases tax.

2. Under IRC §401(a)(11), the non-participant spouse in a retirement plan has the right to receive a spousal annuity under the Retirement Equity Act of 1984. If the spouse fails to consent to override this provision, and if the participant dies first leaving a disposition from the retirement plan which does not conform to the §401(a)(11) annuity requirements, the non-participant spouse is deemed to make a gift. This gift will serve to reduce the unified credit otherwise available to the non-participant spouse and may, at some time, trigger additional tax. Care should be taken to ensure that if this occurs, provisions for the allocation of potential federal estate taxes should be taken into account.

3. IRC §2002 requires that the tax imposed under the Internal Revenue Code shall be paid by the executor. If any portion of the estate tax is paid by a recipient of non-probate property included in the gross estate, that person is entitled to reimbursement from the executor. The executor then has the right to secure reimbursement of tax from the recipients of the property under IRC §§2005-2007B. It is important in planning for tax apportionment to provide adequate funds for the executor to pay the tax initially, rather than having the executor needlessly waste time in securing funds to pay the tax prior to the time reimbursement is sought. The only exception to this rule is IRC §2210, which permits voluntarily assumption of the obligation to pay tax by a qualified employee stock ownership plan or a qualified worker owned cooperative, relieving the executor of primary responsibility. This only applies to the extent that the plan administrator agrees to execute an agreement under §2210(e), which appears to result in a gratuitous payment of the taxes otherwise payable from the estate. See Recent Cases Narrow Scope of Executor's Personal Liability for Estate Taxes, 7 Est. Plan. 2 (1980).

a. The executor, once tax is paid, can rely upon the different transferee liability rules discussed above.

b. The executor can also rely upon IRC §6324(a)(2) establishing a lien against property from which the personal representative may secure reimbursement, and IRC §6901(a)(1), dealing with transferee liability.
4. Previous discussions in this outline have presumed that the marital deduction should be preserved at all costs. However, in most cases there has not been a determination as to whether the marital deduction is actually a benefit solely for the surviving spouse or is a benefit instead for the estate in general.

   a. The initial purpose of the marital deduction was to provide equality between common law and community property states, which seems to argue in favor of the fact that the marital deduction is a benefit conferred upon the entire estate.

   b. However, the purpose of the intestate or forced heir marital share is to protect the surviving spouse, which arguably means that the marital deduction should be for the sole benefit of the surviving spouse.

   c. If the marital deduction benefits the entire estate, then the tax attributable to other assets of the estate should in some way be apportioned to the marital share.

   d. If the marital deduction benefits the surviving spouse only, then it is appropriate to preserve the marital deduction and apportion taxes away from the marital deduction at all costs. Jeffrey N. Pennell, Apportionment Can Make Tax Payment More Equitable, 22 Est. Plan. 3 (1995).

5. What happens if Congress finally enacts a tax on capital gains at death or an additional estate tax on appreciated assets? Will this be an estate tax or an income tax? Although these questions are unanswered, it may be wise to contemplate the eventual presence of such an act at the time a particular client dies. Including provisions in the governing instrument to take into account any potential capital gains or appreciation taxes at death may avoid significant problems at a later time.

   a. If all else fails, a provision in the governing instrument authorizing allocation of the tax in accordance with the Oregon Apportionment Laws, as though any such capital tax or appreciation tax were identical to an estate tax, should suffice.

   b. Be careful, however, if in the enactment of such a tax Congress refuses to provide exemption to the extent assets pass to a surviving spouse or charity. In this case, the treatment of the tax as an estate tax may cause the marital deduction or charitable deduction to be reduced, thereby increasing estate taxes.

6. One of the most difficult areas in tax allocation deals with apportionment in multiple state estates, and how the rules of one state may be enforced against property or beneficiaries in another state.
a. Under the Doctrine of Equitable Conversion, personal property is deemed to be located in the state of domicile of the decedent. Real property, however, is deemed to be located in the state of its situs.

b. When dealing with multiple state estates, the will or governing instrument should contain specific apportionment provisions, so that conflicts between state laws will not prevail. In these situations, make sure that the governing instrument supersedes all provisions of state law and provides for a uniform method of tax apportionment.

c. For excellent analysis of these issues see Scoles, Estate Tax Apportionment in the Multi-State Estate, 5 Inst. On Est. Plan. ¶700 (1971).

7. Special consideration should also be given to the provisions of IRC §303. Under this Section, certain favorable income tax treatment is given to the estate if closely held securities are redeemed to pay expenses of administration or estate taxes.

a. However, the dividend avoidance benefit of IRC §303 is only available if the owner of the stock in the closely held corporation also is the person or entity against whom the tax is assessed.

b. If the estate plan contemplates taking advantage of the provisions of IRC §303, then the practitioner should make sure that the tax is allocated to the appropriate party. In many cases, this will be the estate itself, which will transact the §303 redemption prior to distribution of assets to beneficiaries.

8. Special consideration must be given to inter vivos tax planning devices which may "go bad" in the future. For instance, presume an individual creates an irrevocable life insurance trust, ostensibly for the purpose of removing the life insurance from the transferor's estate. The transferor then dies within three years of the transfer, and a significant amount of insurance owned by the trust becomes taxable in the transferor's estate.

a. In these cases, it is important to include a provision in the life insurance trust authorizing the purchase of assets from or the lending of money to the decedent's estate or living trust, so that funds can be allocated to the source upon which the burden of tax rests.

b. Additional provisions authorizing indemnification for any taxes attributable to property in the life insurance trust may also be helpful in this situation.

c. Be sure to remember that in these cases, strong consideration should be given to a provision in the trustor's will specifically authorizing apportionment against the trust, if taxes are incurred by the trust.
K. Tax on Adjustable Taxable Gifts.

Under IRC §2001(b)(1)(B), the federal estate tax is computed based upon property includable in the estate at death and the value of adjusted taxable gifts made prior to death. The term "adjusted taxable gifts" means the total amount of taxable gifts made by the decedent after December 31, 1976, other than those which are already includable in the gross estate. Any plan for potential apportionment of estate taxes should take into account the adjusted taxable gifts of the decedent at the time the estate plan is developed.

1. If an adjusted taxable gift exceeds the amount of the unified credit (i.e., gifts in excess of $5,430,000.00 plus any per donee exclusion), then gift tax is immediately payable upon those gifts at the time of the gift. The apportionment question in that situation really depends upon the intent of the donor. If the donor wants the donee to pay gift tax, the donor will probably make a "net gift", which, essentially, is a gift less the value of the gift taxes attributable thereto.

2. On the other hand, the donor can pay the gift tax himself or herself.

3. What happens, however, with adjusted taxable gifts totaling less than $5,430,000.00 which were made by the testator during lifetime, but which are includable in the testator's estate at death? If the testator's taxable estate exceeds $5,430,000.00, then there will be a tax attributable to the adjusted taxable gifts made prior to death. The practitioner should take these gifts into account in determining whether to apportion taxes to those gifts or, in the alternative, to assign the tax attributable to those gifts to some other property, presumably the residuary estate at death.

   a. If the decision is made to apportion tax to the adjusted taxable gift, then the practitioner or the donor should take the steps necessary at the time of gift to advise the donee that a tax will eventually be attributable to that gift.

   b. This can often be cumbersome and unworkable. Care should be taken in connection with this planning.

4. The same problem will often arise in situations where even though a taxable gift was made prior to death, the size of the estate at the time of death, coupled with the adjusted taxable gift, makes the tax attributable to the prior taxable gift substantially more than the gift tax paid at the time the gift was made. Should additional estate taxes be allocated to the beneficiary of the gift at that time? These are questions which the donor and his or her counsel must evaluate at the time the estate plan is conceived or when the gift is made.

5. Another problem has arisen in recent years regarding adjusted taxable gifts and their treatment by the IRS. Although the IRS may accept a Gift Tax Return as filed at the time a gift is made, the Service reserves its right to revalue the gift as an adjusted taxable gift at the time of the donor's death. For instance, if a donor makes a gift of real property...
valued at $100,000.00 and later dies, the IRS reserves its right to revalue that gift as an adjusted taxable gift for federal estate tax purposes. If the Service determines that the actual value of the property was $200,000.00, then even though the Gift Tax Return statute may have expired, the gift can still be revalued as an adjusted taxable gift for federal estate tax purposes. Who should pay the tax in this instance?

a. Again, it depends upon the intent of the donor, if the donor even considered this situation.

b. It seems logical that any additional tax generated as a result of inclusion of the adjusted taxable gift at a higher value should be apportioned to the gift. ORS 116.313 seems to provide that the additional tax should be apportioned to the donee, and not to the residuary estate. A standard apportionment clause which provides that all taxes and expenses of administration shall be charged to the residue would supersede this provision and allocate the tax to the residuary estate.

c. If, at the time a gift is made, there exists a question regarding whether the gift tax value of property will be sustained as an adjusted taxable gift, consideration should be given by the practitioner and the donor at the time of the gift and any later testamentary instrument regarding this issue.

L. Disclaimers.

As discussed in the preceding chapters in this outline, disclaimers are a valid and effective device for correcting problems or taking advantage of certain tax or other benefits following a testator's or trustor's date of death. However, no disclaimer should be undertaken without first examining the effect of the disclaimer upon the apportionment of taxes and expenses of administration.

1. In drafting alternatives for disclaimers, such as marital deduction disclaimer and disclaimer bypass trusts, care should be taken to ensure that if a disclaimer is made, the effect of the disclaimer should not cause federal estate tax to be apportioned to property other than that originally considered for apportionment.

2. Take, for example, the effect of a tax apportionment clause allocating all taxes to the residuary share, and allowing a portion of the share to be disclaimed into a trust which qualifies for the marital deduction. Any such disclaimer, although creating a transfer which would otherwise qualify for the marital deduction, may be academic, inasmuch as the marital deduction would be subject to limitation by taxes and expenses of administration directly allocable to the property otherwise qualifying. This could upset the plan. A clause in the governing instrument allocating all taxes and administration expenses to be charged against the share of the estate which does not qualify for the marital deduction, even in the event of a disclaimer, should take care of this problem.
3. However, special care should be given when adding a provision such as the one described above to ensure that a heavier burden of taxes and administration expenses do not fall upon a beneficiary who is not receiving enough property to pay such costs.

VI. EQUITABLE ADJUSTMENTS

A. The Basic Dilemma.

In many cases, a decision by a fiduciary to determine whether or not an item is chargeable as a deduction for income tax purposes or, instead, is deducted for estate tax purposes, will have a significant effect upon the beneficiaries involved. This is just one situation in which the doctrine of equitable adjustments has come into play. Although the concept of equitable adjustments is relatively new, with the increasing awareness of practitioners and the alternatives available with respect to tax allocation, the determinations made by fiduciaries, although appropriate for tax purposes, may not be equitable under local law.

B. Basic Analysis.

An in-depth discussion of the doctrine of equitable adjustments is inappropriate for purposes of this outline on tax apportionment. However, it is important to note that in making certain tax allocation decisions in a decedent's estate, the ramifications of such decisions can be far-reaching.

1. For example, when a personal representative elects to take an expense of administration as a deduction against the estate tax return, as opposed to the income tax return, or vice versa, this decision affects the net amount receivable by the appropriate beneficiaries of either the income or the principal of the estate. Probably the most famous case in this area is In re Warms' Estate, 140 NYS2d 169 (Sur 1955). In the case, the executor elected to treat estate administration expenses as income tax deductions, rather than estate tax deductions. The election had two effects:

   a. First, the election reduced the amount of the estate's taxable income. This had the effect of increasing the net amount of distributable income to the income beneficiaries.

   b. Second, the amount of estate taxes, which were chargeable to corpus, was increased by virtue of the fact that the deduction was not taken on the federal estate tax return. This had the effect of reducing the amount distributable to the remaindermen.

   c. The court determined that it was inappropriate for the income account to receive the tax benefit, since the expenses were actually paid from the principal account. The court ruled that the income account should reimburse the principal account for the amount of increase in estate taxes which resulted from using the expenses as an income tax deduction. The Warms decision has been consistently

2. In some situations, where conflicts over tax elections arise, it may be appropriate to provide in the will that the fiduciary is authorized to make the election which results in the lowest tax, and to divide the benefits of such election to make the parties whole. This, unfortunately, has significant tax effects.

   a. If the reimbursement is deemed to be a reimbursement of income tax, then this provides additional taxable income to the person or entity being reimbursed.

   b. The issue is more clouded when one of the beneficiaries is the surviving spouse or marital deduction trust, or is a charity.

   c. Perhaps the best approach would be to draft an instrument which prohibits all equitable adjustments where the overall tax effect would be adverse. This is best done by providing that no equitable adjustments shall be made, to the extent the effect of the equitable adjustment would be to cause the estate tax marital deduction or charitable deduction, which might be allowed if no adjustment were made, to be lost in whole or in part. To the extent that the equitable adjustment causes corpus from either a marital or charitable bequest to be allocated to a taxable entity, the marital deduction or charitable deduction may be reduced. The opposite result occurs if property passing to a beneficiary other than the spouse or a charity ends up passing to the spouse (or marital trust) or charity, incurring additional marital or charitable deductions.

   d. For an excellent discussion of the current law regarding equitable adjustments and the effect which such equitable adjustments have on estate taxes and income taxes, see Blattmachr, supra.

VII. ABATEMENT

In some cases, the assets of an estate are insufficient to pay all claims, expenses, and devises in full. This is generally true when the costs of administration and related claims against the estate consume a substantial share of the estate. Under ORS 111.005(1), the term "abate" means to reduce a devise on account of the insufficiency of the estate to pay all claims, expenses, and devises in full.

A. General Rules.

The general rules of abatement under Oregon law appear at ORS 116.133. Pursuant to that provision, if the will expresses an order of abatement, or if the testamentary plan or the express or implied purpose of a devise would be defeated by statutory abatement, then shares of
distributees will abate as may be found necessary to give effect to the testator's intent. In other words, if the testator's intent is known, shares of the estate will abate consistent with such intent.

B. Special Situations.

ORS 112.405(5) provides that a pretermitted child has the right to take his or her share either from the other children, if any are living, or from the testamentary beneficiaries other than the decedent's children, if the decedent left no children. The statute goes on to provide that interests of those beneficiaries will abate proportionately, so as not to upset the character of the testamentary plan.

C. General Order of Abatement.

Other than these two exceptions, the shares of distributees abate without any preference or priority as between real and personal property in the following order under Oregon law:

1. Property not disposed of by the will;
2. Residuary devises;
3. General devises;
4. Specific devises.

D. Abatement Within Classes.

Abatement within each of the classifications set forth above is in proportion to the amounts of property each of the distributees would have received had full distribution of the property been made.

E. Tangible Personal Property.

Recipients of tangible personal property generally are not subject to abatement, unless the tangible personal property is used in trade, agriculture or other business or unless the particular devise of personal property forms a substantial amount of the total estate, and the court specifically orders contribution because of the devise.

F. Sale of Specifically Devised Property.

If any particular property subject to a devise is sold or used incident to administration, then the statute provides that abatement may be achieved by appropriate adjustments in or contributions from other interests in the remaining assets of the estate. ORS 116.133(6).
G. Planning for Abatement.

Often, the will does not provide for abatement of bequests in order to pay claims and expenses of administration. In the absence of such a provision, these costs will be paid first from intestate property subject to administration and then from the residue of the estate. If these assets are insufficient, then the abatement scheme set forth above will prevail.

1. It is important, then, to consider from which share of the estate these expenses and claims should be paid. Probably the easiest planning device is to ensure that sufficient assets remain in the residue to pay these expenses and claims. If so, then reliance upon the Oregon statute would be appropriate.

2. If, however, certain large specific devises or general devises exist in a will, it may be appropriate to provide that these assets will bear a proportionate share of the tax, based upon a preconceived equation.

H. Determine Intent.

The key, as in the case of apportionment of estate taxes, is first to determine the client's intent. Once intent is determined, and if a reasonable estimate of the amount of expenses and claims can be made, then appropriate planning can be completed and the provisions of the will or trust can be drafted to accommodate the plan.