

1951

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Recommended Citation

Robert B. Preston, *Apportionment of Federal Estate Tax*, 3 W. Rsrv. L. Rev. 164 (1951)

Available at: <https://scholarlycommons.law.case.edu/caselrev/vol3/iss2/8>

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Apportionment of Federal Estate Tax

THE FEDERAL ESTATE TAX is an excise on the *transfer* of property at death.¹ The tax is levied not on the persons who receive property from a decedent according to the amounts which they receive, but on the entire estate of the decedent before it is distributed. In this respect an estate tax differs from an inheritance tax, which is a tax on the right to *receive* property from a decedent.²

Decedents estates for federal tax purposes are comprised of assets subject to probate administration and certain assets not subject to probate administration. Non-probate assets that are included in a decedent's taxable estate are: transfers of property in contemplation of, or taking effect at, death;³ transfers of property with power in the transferor to alter, amend or revoke;⁴ joint or community property and tenancies by the entirety;⁵ property controlled by power of appointment;⁶ and proceeds of life insurance policies.⁷

The Internal Revenue Code provides that the executor shall pay the federal estate tax⁸ and, because he has only probate assets in his possession, he has to pay the tax with the probate assets. The word "executor" as used in the statute includes "administrator."⁹

The problem then arises whether the executor or administrator may obtain a proportionate contribution for the payment of the tax from all the assets of the estate, probate and non-probate. This problem is twofold; there is a question of apportionment among the probate assets, and a question of apportionment between probate and non-probate assets. The entire problem of apportionment has been settled in fifteen states by the enactment of apportionment statutes.¹⁰ This discussion will be confined, unless otherwise specified, to cases decided without the benefit of such statutes. It should also be borne in mind that when the intention of the

¹ PAUL, FEDERAL ESTATE AND GIFT TAXATION § 1.05 (1942)

² *Ibid.*

³ INT. REV. CODE § 811 (c)

⁴ INT. REV. CODE § 811 (d)

⁵ INT. REV. CODE § 811 (e)

⁶ INT. REV. CODE § 811 (f)

⁷ INT. REV. CODE § 811 (g)

⁸ INT. REV. CODE § 822 (b)

⁹ INT. REV. CODE § 930 (a)

¹⁰ ARK. STAT. ANN. tit. 63, § 150 (1948); CAL. PROB. CODE ANN. § 970-77 (1944); CONN. REV. GEN. STAT. § 2075-81 (1949); DEL. REV. CODE c. 119 (1947); FLA. STAT. ANN. § 734.041 (Supp. 1951); MD. ANN. CODE GEN. LAWS art. 81, § 126 (Cum. Supp. 1947); MASS. ANN. LAWS c. 65A, § 5-5B (Supp. 1950); NEB. REV. STAT. § 77-2108 (1950); N.H. REV. LAWS c. 175 (1943) as amended

deceased regarding tax incidence is clearly expressed by a testamentary provision, this intention governs.¹¹

APPORTIONMENT AMONG PROBATE ASSETS

In the case where a person dies intestate leaving an estate composed of real and personal probate assets, can the administrator, who will pay the tax out of the personalty,¹² recover from the realty its proportionate amount of the federal estate tax? The cases are few on this point, for a person with a large estate usually dies testate. Kentucky has decided that the realty should bear its proportionate burden of the tax,¹³ but New Jersey, before the enactment of its apportionment statute,¹⁴ held that the personalty should bear the entire burden.¹⁵

If a person dies testate, the majority of courts, including Ohio,¹⁶ have held that the residuary estate is liable for the entire tax.¹⁷ Most of these courts reason that, in the absence of any direction in the will providing for the payment of the tax, it is the testator's intention that the residuary estate pay the tax. This reasoning is persuasive for in the abatement of wills the residuary estate is usually first liable for the payment of debts.¹⁸ A New Hampshire decision which overruled prior decisions allowing apportionment among probate assets,¹⁹ required the residuary estate to pay the entire

by LAWS c. 102 (1947); N.J. STAT. ANN. § 3:26-45 (Supp. 1950); N.Y. DECEDENT EST. LAW § 124 (Supp. 1951); PA. STAT. ANN. tit. 20, § 844 (1950); TENN. CODE ANN. § 8350.7 (Williams Supp. 1951); TEX. REV. CIV. STAT. ANN. art. 3683a (Vernon's Supp. 1950); VA. CODE ANN. § 64-150 (1949). For a general discussion of the statutes see Reidy, *Apportionment of Estate Taxes Application of State Statutes*, 88 TRUSTS AND ESTATES 623 (1949)

¹¹ See Note, 15 A.L.R. 2d 1216 (1951).

¹² Generally the realty passes at once to the heirs. ATKINSON, WILLS § 262 (1937).

¹³ *Martin v. Martin's Adm'r*, 283 Ky. 513, 142 S.W. 2d 164 (1940); *Hampton's Adm'r v. Hampton*, 188 Ky. 199, 221 S.W. 496 (1920).

¹⁴ N.J. STAT. ANN. § 3:26-45 (Supp. 1950). For a discussion of this statute see Saiber and Widmark, *Estate Taxes and the New Jersey Apportionment Act*, 73 N.J.L.J. 319 (1950).

¹⁵ *Turner v. Cole*, 118 N.J.Eq. 497, 179 Atl. 113 (1935).

¹⁶ *Y.M.C.A. v. Davis*, 106 Ohio St. 366, 140 N.E. 114 (1922), *aff'd*, 264 U.S. 47, 44 Sup. Ct. 291 (1924). The Ohio court said that the state law as to the preference of devises and bequests is controlling and that the testator showed his intention that the residue should bear the burden of the tax by remaining silent as to the payment of taxes.

¹⁷ *Hepburn v. Winthrop*, 83 F.2d 566 (D.C. Cir. 1936); *Plunkett v. Old Colony Trust Co.*, 233 Mass. 471, 124 N.E. 265 (1919); *Bryant v. Green*, 328 Mo. 1226, 44 S.W.2d 7 (1931); *Y.M.C.A. v. Davis*, 106 Ohio St. 366, 140 N.E. 114 (1922), *aff'd*, 264 U.S. 47, 44 Sup. Ct. 291 (1924); *Amoskeag Trust Co. v. Trustees of Dartmouth College*, 89 N.H. 471, 200 Atl. 786 (1938); *Re Hamlin*, 226 N. Y. 407, 124 N.E. 4, *cert. denied*, 250 U.S. 672, 40 Sup. Ct. 14 (1919)

¹⁸ ATKINSON, WILLS § 250 (1937).

¹⁹ *Amoskeag Trust Co. v. Trustees of Dartmouth College*, 89 N.H. 471, 200 Atl. 786 (1938), *overruling*, *Fuller v. Gale*, 78 N.H. 544, 103 Atl. 308 (1918) and *Williams v. State*, 81 N.H. 341, 125 Atl. 661 (1924)

tax, and based its decision not on the ground that the testator intended it to pay all the tax,²⁰ but on the ground that the federal estate tax, being a transfer tax and not a succession or receipts tax, is not to be prorated among those who succeed to the decedent's estate.

If the residuary estate consists of realty and personalty, it has been held that the personalty is first liable.²¹

In a case of partial intestacy or in a case where there is no residuary estate, the question of where the burden of the tax should fall will naturally arise. Since the courts have treated the tax as a debt of the estate,²² as a charge against the estate²³ and as an expense of administration;²⁴ it would seem to follow that the tax will be paid from that fund which would, as in the case of other debts, charges and expenses of administration, abate first in each particular jurisdiction.

Kentucky, relying on their prior decisions in cases of intestacy, has allowed apportionment among probate assets.²⁵ Although a minority decision, the equities are in favor of this conclusion. The presumption of the testator's intention is a mere fiction in most cases and the fact that the federal estate tax is an estate tax and not an inheritance tax should not of itself preclude apportionment.

APPORTIONMENT BETWEEN PROBATE AND NON-PROBATE ASSETS

A decision disallowing apportionment among probate assets is not authority for a case involving probate and non-probate assets, and a court not allowing apportionment among purely probate assets would not overrule itself by allowing apportionment between probate and non-probate assets.

The Internal Revenue Code specifically provides that the executor may recover proportionate contributions from such non-probate assets as life insurance proceeds and property controlled by powers of appointment.²⁶ As to other non-probate assets the code is silent regarding apportionment.

²⁰ The court said that the testator's silence was ambiguous and gave no clear indication of his intention in respect to the incidence of the burden of the tax.

²¹ *Hepburn v. Winthrop*, 83 F.2d 566 (D.C. Cir. 1936).

²² *Hepburn v. Winthrop*, 83 F.2d 566 (D.C. Cir. 1936); *Plunkett v. Old Colony Trust Co.*, 233 Mass. 471, 124 N.E. 265 (1919).

²³ *Hepburn v. Winthrop*, 83 F.2d 566 (D.C. Cir. 1936); *Brown's Estate v. Hoge*, 198 Iowa 373, 199 N.W. 320 (1924); *Y.M.C.A. v. Davis*, 106 Ohio St. 366, 140 N.E. 114 (1922), *aff'd*, 264 U.S. 47, 44 Sup. Ct. 291 (1924); *Plunkett v. Old Colony Trust Co.*, 233 Mass. 471, 124 N.E. 265 (1919).

²⁴ *Hepburn v. Winthrop*, 83 F.2d 566 (D.C. Cir. 1936); *Brown's Estate v. Hoge*, 198 Iowa 373, 199 N.W. 320 (1924); *Plunkett v. Old Colony Trust Co.*, 233 Mass. 471, 124 N.E. 265 (1919).

²⁵ *Louisville Trust Co. v. Walter*, 306 Ky. 756, 207 S.W.2d 328 (1948).

²⁶ INT. REV. CODE § 826 (c) & (d).

The case of *Riggs v. Del Drago*,²⁷ decided by the United States Supreme Court in 1942, held that while the executor must pay the federal estate tax in the first instance, it is a matter of state law as to where the ultimate burden of the tax will fall.²⁸ Prior to the *Del Drago* case the decided weight of authority was against apportionment between probate and non-probate assets.²⁹ Some courts took the position that when Congress specified that the estate tax should be paid by the executor, it intended to impose the entire tax on the executor, whether the taxable estate was composed of probate or probate and non-probate assets.³⁰ These same courts also reasoned that, because Congress expressly allowed apportionment with respect to some non-probate assets and was silent as to others, Congress did not intend to allow apportionment except where it was specifically provided for in the code.

Randolph Paul makes the following comment on the *Del Drago* decision:

Riggs v. Del Drago is not merely significant for the constitutional freedom it affords to local apportionment legislation. State courts in jurisdictions lacking such statutes might well reexamine their earlier decisions which sanctioned tax distortion on the basis of supposed Congressional intention, whether express or implicit. The Supreme Court has now announced that estate tax incidence is a state matter and the local courts are accordingly free to fashion equitable solutions in the absence of state legislation.³¹

Where a person dies intestate possessed of an estate composed of probate and non-probate assets, the decedent has manifested no intention, express or implied, concerning who should bear the burden of the tax. The *Del Drago* decision frees the state courts from any Congressional prohibition against apportionment in such a situation and permits each state to decide the issue for itself. Since the *Del Drago* case, the two courts considering this situation have permitted apportionment on the ground that

²⁷ 317 U.S. 95, 63 Sup. Ct. 109 (1942).

²⁸ See Note, 142 A.L.R. 1131 (1943).

²⁹ *Erickson v. Childs*, 124 Conn. 66, 198 Atl. 176 (1938); *Central Trust Co. v. Burrow*, 144 Kan. 79, 58 P.2d 469 (1936); *Pratt v. Dean*, 246 Mass. 300, 140 N.E. 924 (1923); *Bemis v. Converse*, 246 Mass. 131, 140 N.E. 686 (1923); *Dexter v. Jackson*, 245 Mass. 333, 140 N.E. 267 (1923); *Farmers' Loan & Trust Co. v. Winthrop*, 238 N.Y. 488, 144 N.E. 769 (1924), *cert. denied*, 266 U.S. 633, 45 Sup. Ct. 225 (1925); *Ely's Estate*, 28 Pa. D. & C. 663 (1936). *Contra*: *Regents of University System of Georgia v. Trust Co. of Georgia*, 194 Ga. 255, 21 S.E.2d 691 (1942); *Gaede v. Carroll*, 114 N.J.Eq. 524, 169 Atl. 172 (1933).

³⁰ *Bemis v. Converse*, 246 Mass. 131, 140 N.E. 686 (1923); *Farmers' Loan & Trust Co. v. Winthrop*, 238 N.Y. 488, 144 N.E. 769 (1924), *cert. denied*, 266 U.S. 633, 45 Sup. Ct. 225 (1925).

³¹ PAUL, FEDERAL ESTATE AND GIFT TAXATION, 1946 SUPPLEMENT § 13.54 at page 465 (1946).

it would be inequitable to permit non-probate assets to profit at the expense of probate assets.³²

If a person dies testate leaving an estate consisting of probate and non-probate assets, even assuming for the moment that the residuary estate should be held liable for the burden of taxes on his probate estate, it does not follow that he intended his probate assets to pay the tax on his non-probate estate. Among decisions since the *Del Drago* case, the weight of authority is in favor of apportionment.³³ In a case where the decedent had made inter-vivos gifts in contemplation of death, the Kentucky court holding for apportionment, said, "The obligation of the personal representative to pay the tax is a mere rule of administration to insure its payment, and does not in any way affect the rights of the heirs and distributees as among themselves."³⁴

SOLUTIONS AND CONCLUSION

The enactment of a federal statute allowing apportionment is unlikely for two reasons. First, if Congress made apportionment of the tax mandatory, it would in effect be changing the estate tax to an inheritance tax. This does not result when a state directs apportionment because the state is not the taxing authority.³⁵ Secondly and more realistically, the federal government is not concerned with the question of who pays the tax, but

³² *Pearcy v. Citizens Bank & Trust Co. of Bloomington*, 96 N.E. 2d 918, *rehearing denied*, 98 N.E.2d 230 (Ind. App. 1951) (administrator could not enhance value of the non-probate assets by paying entire tax from probate assets); *In re Gato's Estate*, 276 App. Div. 651, 97 N.Y.S.2d 171 (1st Dept. 1950) A Florida resident died intestate leaving two inter-vivos trusts in New York. The trustee in New York applied to the New York Court for instructions as to whether he should pay a pro-rata share of the Federal Estate Tax. The court directed the trustee to pay.

At the time this article was sent to the printers the case of *McDougall, Adm'r v. Central Nat. Bank* was pending before the Ohio Supreme Court. The Appellate Court (not reported) held against apportionment.

³³ *Pearcy v. Citizens Bank & Trust Co. of Bloomington*, 96 N.E.2d 918, *rehearing denied*, 98 N.E.2d 230 (Ind. App. 1951); *Trimble v. Hatcher's Ex'rs.*, 295 Ky. 178, 173 S.W.2d 985 (1943), *cert. denied*, *Trimble v. Justice*, 321 U.S. 747, 64 Sup. Ct. 611 (1944); *Succession of Ratcliffe*, 212 La. 563, 33 So.2d 114 (1947); *In re Comer's Trust*, 101 N.Y.S.2d 916 (N.Y. Sup. Ct. 1950); *In re Gato's Estate*, 276 App. Div. 651, 97 N.Y.S.2d 171 (1st Dept. 1950); *Industrial Trust Co. v. Budlong*, 76 A.2d 600 (R.I. 1951) *Contra: Seattle First Nat. Bank v. Macomber*, 32 Wash. 2d 696, 203 P.2d 1078 (1949) The court held that the probate estate is liable for the entire tax, and followed the reasoning of *Bemis v. Converse*, 246 Mass. 131, 140 N.E. 686 (1923)

³⁴ *Trimble v. Hatcher's Ex'rs.*, 295 Ky.178,184, 173 S.W. 2d 985,988 (1943), *cert. denied*, *Trimble v. Justice*, 321 U.S. 747, 64 Sup. Ct. 611 (1944)

³⁵ Cahn, *Local Law in Federal Taxation*, 52 YALE L.J. 799,813 (1943) Randolph Paul, in criticizing this reasoning as being unrealistic, states: "The criteria of incidence for tax purposes should not necessarily determine ultimate burden among recipients."

only whether the tax be paid, and initial payment by the executor is assured with or without an apportionment statute.

A more probable solution to the apportionment problem is by way of state legislation. It is obvious that state legislation can be a desirable and effective method of solving the problem as evidenced by the fact that fifteen states have enacted apportionment statutes.³⁶ In the absence of statute the attorney can solve the problem of apportionment by drafting an instrument which clearly shows his client's intention as to the burden of the tax.

The remaining solution to the problem lies with the state courts who, after the *Del Drago* decision, can allow apportionment without benefit of statute. It is to be hoped that these decision allowing apportionment will continue to be forthcoming so that, even in the absence of any legislation, apportionment of the federal estate tax may become a firmly established rule.

ROBERT B. PRESTON, JR.

³⁶ See note 10 *supra*.