

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
January 15, 1999

Index (UIL) No.: 2056.11-00
CASE MIS No.: TAM-116975-98
Number: **199918003**
Release Date: 5/7/1999

LEGEND:

Decedent =
Spouse =
Daughter =
Family Trust =

Company =
Step-Son =
State =

ISSUE(S):

(1) Under the terms of Decedent's will and revocable trust, are estate taxes to be equitably apportioned under State law?

(2) Does § 2207B, prior to amendment by the Taxpayer Relief Act of 1997, require that Decedent's revocable Family Trust reimburse the probate estate for any federal estate taxes paid that are attributable to the inclusion of the value of the trust corpus in the gross estate?

TAM-116975-98

CONCLUSIONS:

(1) Decedent's will directs that estate taxes shall be paid from the residue of the estate and further directs that, in no event, shall estate taxes be apportioned to any person holding any interest in the taxable estate. Accordingly, under Decedent's will and revocable Family Trust, the federal estate taxes are payable from the probate estate without apportionment and before distribution from the estate to the revocable trust.

(2) The value of the corpus of the revocable Family Trust is includible in Decedent's gross estate under § 2036 of the Internal Revenue Code and his will does not waive the right of reimbursement by specific reference to § 2207B. Accordingly, the estate is entitled to be reimbursed from the Family Trust property for a proportionate share of the estate tax attributable to the inclusion of the value of the trust corpus in the gross estate.

FACTS:

Decedent died on October 27, 1995, and was survived by Spouse and Daughter. Two days prior to his death, Decedent executed his will and a revocable trust (Family Trust).

Article 2.1 of the will provides that the personal representative of the estate shall pay out of the residue of the estate Decedent's debts, medical expenses, funeral and burial expenses, and the expenses relating to the administration of the estate, both probate and nonprobate.

Article 2.2 is entitled "Payment of death taxes" and states as follows:

I also direct the Personal Representative to pay out of the residue of my estate all inheritance, estate, succession, and transfer taxes . . . imposed by any domestic or foreign law on account of my death or because of the transfer, disposition or distribution of any property deemed a part of my taxable estate at my death, whether or not the property with respect to which a particular tax is due is part of my probate estate.

Article 2.3 is entitled "Direction against apportionment of death taxes" and states as follows:

In no event shall any inheritance, estate, succession, or transfer taxes (except generation-skipping taxes imposed by chapter 13 and any additional estate tax imposed by section 2032A(c) of the Internal Revenue Code) imposed by any domestic or foreign law by reason of my death or

TAM-116975-98

because of the transfer, disposition, or distribution of any property deemed a part of my taxable estate at my death be apportioned to or among any people or persons holding any interest in or entitled to receive any item or items included in my taxable estate; provided, however, that the Personal Representative shall recover the amount of any estate taxes attributable to terminable interest property included in my gross estate in accordance with the provisions of section 2207A of the Internal Revenue Code or its counterpart under any state's estate tax law that permits an estate tax marital deduction for qualified terminable interest property.

In Article 3, Decedent bequeathed items of personal property to Spouse and Daughter and also devised any interest that he had in his principal residence to Spouse.

Article 4.1 provides that the residue of Decedent's estate is to be paid to the trustees of Family Trust and is to be held, managed, administered, and distributed according to the terms, conditions, and provisions of the trust agreement, including any amendments made before Decedent's death, regardless of whether made before or after the execution of the will.

Decedent also executed Family Trust on October 25, 1995. Paragraph 1.2, of Family Trust provided Decedent with the power to amend or revoke the Family Trust.

Paragraph 2.1 of Family Trust directs the trustee to pay the trust net income to Decedent, during his life. Paragraph 2.3 provides that, upon his death, the trust shall be administered under the terms provided in Paragraphs 3, 4, 5, 6, and 7 of the trust agreement.

Paragraph 3.1 provides that the trustees may pay out of the trust estate, or reimburse the personal representative of Decedent's estate for Decedent's debts, the expenses of Decedent's last illness, funeral and burial, the expenses of the administration of Decedent's estate, both probate and nonprobate, and the expenses of any ancillary administration, as the trustees, in their discretion, may deem necessary or advisable, taking into consideration any other assets available for such purposes and the liquidity of such other assets.

Paragraph 3.2 is entitled "Payment of death taxes" and states as follows:

The Trustees may pay out of the Trust Estate, or reimburse the personal representative of the [Decedent's] estate for, such of the inheritance, estate, succession, and transfer taxes (including any interest and penalties concerning any such tax but excluding any generation-skipping taxes imposed by chapter 13 and any additional estate tax imposed by section 2032A(c) of the Internal Revenue Code), imposed by any

TAM-116975-98

domestic or foreign law on account of the [Decedent's] death or because of the transfer, disposition, or distribution of any property deemed a part of the [Decedent's] taxable estate at the [Decedent's] death, as the Trustees, in the Trustees' discretion, may deem necessary or advisable, taking into consideration any other assets available for such purposes and the liquidity of such other assets.

Paragraph 3.3 is entitled "Source of payments" and states as follows:

No payments made pursuant to paragraphs 3.1 or 3.2 shall be borne by or paid out of either the income from or the principal of that portion of the Trust Estate allocated to and distributed pursuant to paragraph 3.4, 3.5, 3.7 or paragraph 4.1(1) of this Trust Agreement, unless there shall be no source available for such payments. Such payments, including taxes, shall not be apportioned to or among any person or persons holding any interest in or entitled to receive any item or items included in the [Decedent's] taxable estate; provided, however, that the Trustees shall recover from the [Decedent's] estate the amount of any estate taxes attributable to terminable interest property includible in the [Decedent's] gross estate in accordance with the provisions of section 2207A of the Internal Revenue Code or its counterpart under any state's estate tax law that permits an estate tax marital deduction for qualified terminable interest property. Notwithstanding any provision herein to the contrary, no assets received by the Trustees which, unless expended in making any payment authorized or directed by paragraph 3.1 or 3.2, would be exempt from federal estate tax shall be expended in making any such payment.

Paragraph 3.4 provides for bequests of specific amounts to various individuals.

Paragraph 3.5 provides for a bequest of stock in Company to Step-Son.

Paragraph 3.7 provides for bequests to various charitable organizations.

Paragraph 4.1 provides that, if Spouse survives Decedent, the balance of the trust estate remaining after compliance with the foregoing provisions of the trust agreement shall be distributed as follows:

(1) Fifty percent of the remaining assets of the trust estate less the value of any assets that may have passed to Spouse otherwise than by the terms of the trust agreement is to be held in the Spouse Right of Withdrawal Marital Trust to be administered pursuant to the provisions of Paragraph 5.1 of the trust agreement.

TAM-116975-98

(2) Regarding the remaining fifty percent of the trust estate, an amount equal to Decedent's remaining generation-skipping transfer tax exemption, if any, will continue to be held in trust for the benefit of Daughter and her issue; and the balance of the trust is to be distributed to Daughter, if she is living.

Under Paragraph 5.1, the Right of Withdrawal Marital Trust created under paragraph 4.1(1) is to be administered as follows. During the lifetime of Spouse, the Trustees are to pay Spouse all of trust net income from the date of Decedent's death in annual or more frequent installments. In addition to payments of income, the trustees are to pay for the benefit of Spouse from principal such amounts as Spouse may direct in writing from time to time. On Spouse's death, the trust corpus is to be distributed as Spouse may appoint pursuant to the exercise of a general power of appointment.

Paragraph 5.1 further provides that it is the Decedent's intent to obtain the federal estate tax marital deduction allowable under the Internal Revenue Code with respect to the Right of Withdrawal Marital Trust and all questions relating thereto are to be resolved accordingly.

LAW AND ANALYSIS:

Issue 1

Section 2001(a) of the Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that for purposes of the tax imposed by § 2001, the value of the taxable estate, except as limited by § 2056(b), is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse.

Section 2056(b)(4)(A) provides that, in determining, for purposes of § 2056(a), the value of any interest in property passing to the surviving spouse for which a deduction is allowed under § 2056, there is to be taken into account the effect which the tax imposed by § 2001, or any estate, succession, legacy or inheritance tax has on the net value of the interest passing to the surviving spouse.

In Riggs v. Del Drago, 317 U.S. 95 (1942), the Supreme Court held that the applicable state law as to the devolution of property at death should govern the ultimate impact of the federal tax on the respective beneficiaries. The applicable rules of the state apply if the will or other governing instrument has no tax payment directions. But directions in the governing instrument may provide for the burden of tax payments to be apportioned otherwise.

TAM-116975-98

In Estate of Lewis v. Commissioner, TCM 1995-168, the decedent's will provided for specific devises of real property to her children and further provided that the residue of her estate was to be paid to a revocable trust created during her lifetime. The will also provided that any inheritance, legacy, succession or estate taxes and duties "shall be paid out of the residue of my estate without apportionment and with no right of reimbursement from any recipient of any such property. . . ."

The revocable trust provided that, at the decedent's death, the trustee was to establish a "Marital Trust" that was to be funded with the minimum amount necessary to reduce the estate tax to zero, taking into account all available credits. The balance passed to a "Family Trust." The revocable trust also provided the trustee with the discretionary authority to pay or advance to the executor of the estate amounts for expenses including death taxes resulting from the decedent's death. However, any amount paid or advanced was to be paid from the income or principal of the Family Trust, even if the tax was attributable to the Marital Trust or to any other property qualifying for the marital deduction.

The issue before the court was whether the estate tax should be paid from the residue of the probate estate or apportioned to the Family Trust as provided in the revocable trust. The estate argued that the decedent's testamentary documents were ambiguous because the provisions in the will directing that all estate taxes are to be paid from the residuary estate conflicted with the revocable trust provisions relating to the Marital Trust and the provisions directing that only the Family Trust could be used to pay estate taxes. The court concluded that the tax payment clause in the will unambiguously directed that the estate taxes are to be paid from the residue of the estate without apportionment. The court noted that the trust provisions that referred to the maximum marital deduction and gave the trustee the discretion to pay estate taxes did not override the clear language of the will. In Estate of Miller v. Commissioner, TCM 1998-416, the court reached a similar conclusion. But see, McKeon v. United States, 151 F.3d 1201 (9th Cir. 1998).

Under applicable State law, unless the will or other governing instrument provides otherwise, the estate tax shall be apportioned among all persons interested in the estate. The apportionment is to be made in the proportion that the value of each person's interest in the estate bears to the total value of the interests of all persons interested in the estate. However, assets passing to the surviving spouse or charity that do not generate any estate tax are relieved from payment of a portion of the tax. If the decedent's will or other written instrument directs a different method for apportioning the estate tax burden, the method described in the will or other written instrument controls. However, under State law, the statutory equitable apportionment rules can only be waived by clear and unambiguous direction in the instrument.

The estate argues that the estate taxes should be equitably apportioned under the terms of the instruments and State law.

TAM-116975-98

In this case, Decedent executed his will and revocable trust shortly before his death. As in Estate of Lewis, Decedent's will explicitly provides, in Article 2.2 and 2.3, that all estate taxes imposed on any property deemed a part of Decedent's taxable estate are to be paid from the estate residue, without apportionment. Paragraph 3.2 of the revocable trust grants the trustee of the revocable trust the discretion to pay estate taxes out of the revocable trust estate. If this discretion is exercised, then under Paragraph 3.3, the taxes cannot be paid from the marital trust. However, as the court found in the Estate of Lewis and Estate of Miller, this discretionary authority granted to the trustee does not override the mandatory provision in the will that estate taxes be paid from the residuary estate without apportionment. Further, if the trustee has the discretion to contribute or not contribute to the payment of taxes, the marital deduction would be reduced, even if the trustee did not contribute. See Rev. Rul. 79-14, 1979-1 C.B. 309.

The estate argues that the directive in Article 2.3 of the will that the estate taxes not be apportioned applies only to estate tax attributable to items of personalty. That is, the estate reads the clause as providing that estate taxes may not be apportioned to persons "holding any interest in or entitled to receive any item or items included in my taxable estate;" (Emphasis added.) Thus, the directive against apportionment applies only to taxes generated by "items," i.e., personalty. The estate argues that, at the least, the provision is ambiguous, and thus, is not an unambiguous direction against apportionment. Therefore, the estate taxes should be equitably apportioned under State law.

However, we believe that the direction against apportionment in Article 2.3 applies to all taxes generated by the taxable estate, and exonerates from apportionment all persons "holding any interest in, or entitled to receive any items, included in the taxable estate." Indeed, the remaining part of the sentence at issue continues on to discuss the payment of estate taxes if § 2044 property is included in the gross estate. Thus, the Article 2.3 clear direction against apportionment of taxes cannot be viewed as referencing only taxes generated by personalty items. Rather, Article 2.2 clearly directs that all estate taxes on any property included in the taxable estate are to be paid out of the estate residue, and the direction against apportionment contained Article 2.3 clearly applies to those taxes referenced in Article 2.2. Article 2.3 is a clear directive and the estate's strained reading of the provision should not be viewed as creating an ambiguity where none exists.

Issue 2

TAM-116975-98

Section 2207B(a), prior to amendment by the Taxpayer Relief Act of 1997¹, provided that:

(1) if any part of the gross estate on which tax has been paid consists of the value of property included in the gross estate by reason of § 2036, the decedent's estate shall be entitled to recover from the person receiving the property the amount that bears the same ratio to the total tax under this chapter that has been paid as (A) the value of the property, bears to (B) the taxable estate.

(2) section 2207B(a)(1) shall not apply if the decedent otherwise directs in a provision of his will (or revocable trust) specifically referring to § 2207B.

In this case, Decedent retained the right, under Paragraph 1.2 of the Family Trust, to revoke the trust and, under Paragraph 2.1, retained the right to receive all of the trust income. Therefore, the value of Family Trust was includible in his gross estate under § 2036 for federal estate tax purposes. Decedent did not waive the right of reimbursement under § 2207B by specific reference to § 2207B in his testamentary instrument. We believe that § 2207B obligates the trustee to pay the estate tax generated by the trust.

Therefore, under § 2207B, the burden for payment of the estate taxes generated by inclusion of the Family Trust corpus in the gross estate is to be borne by the Family Trust. However, we note that the Family Trust is burdened only with the tax generated by inclusion in the taxable estate of the assets held in the Family Trust on the date of death. Under the terms of the Family Trust, the portion of the trust estate passing for the spouse's benefit under Paragraphs 4.1(3) and (4) is not to be burdened with the payment of these taxes.

Under the terms of Decedent's will, as discussed above, all other estate taxes not attributable to the assets held in the Family Trust on the date of death are payable from the probate estate before distribution to the Family Trust. Such taxes would include, for example, federal estate tax generated by the inclusion of the probate estate assets (that do not pass for the benefit of Spouse) in the gross estate, and nonprobate assets passing to Daughter such as insurance and retirement benefits.

CAVEAT(S)

¹ Section 2207B was added to the Code by P.L. 100-647, § 3031(f), and is effective for transfers after November 10, 1988. Section 2207B(a)(2) was amended by § 1302(b) of the Taxpayer Relief Act of 1997, to eliminate the requirement that the provision can be waived only by specific reference to § 2207B. The amendment is effective with respect to estates of decedents dying after August 5, 1997.

TAM-116975-98

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.