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APPORTIONMENT OF FEDERAL AND STATE ESTATE TAXES UNDER FLORIDA LAW

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The imposition of death taxes by the Federal Government has been, since the first taxing act was adopted in 1916, an ever-increasing problem to every taxpayer accumulating even a modest estate. The present federal law is contained in chapter 11 of the Internal Revenue Code of 1954.¹ Florida adopted its inheritance and estate tax laws in 1931² in order to take advantage of the credit allowed against the federal tax for death taxes paid to the state.

As the rates of tax have increased, and deductions and exemptions have been reduced, the burden of such taxes has become a major problem. Comparable increases in gift and income taxes brought on additional problems and have led to tighter laws to cope with the defensive techniques adopted in an effort to escape the burdens.

I. ESTATE AND SUCCESSION TAXES AND THE PAYMENT THEREOF.

An estate tax is an excise tax levied on the right to dispose of one's property at death, while a succession or inheritance tax is levied on the right or privilege to receive property. For most purposes, the distinction is theoretical only. The measure of the estate tax is the total value of the gross estate less certain deductions and exemptions, but the inheritance tax is levied on the amount each beneficiary receives from the estate.

Florida has an estate tax.

The Taxable Estate: Often the taxable gross estate will include property over which the executor or administrator has no control, such as gifts made in contemplation of death, inter-vivos transfers, life insurance and properties over which the decedent had a power of appointment.

Who Pays the Tax: The primary responsibility for filing an estate tax return and paying the tax falls on the executor.³ As noted above, for purposes of the federal estate tax, the gross estate includes all property of which the decedent dies possessed as well as all property or interests in property that, in law, are considered as passing from the decedent. It is obvious, therefore, that the executor will be liable for the total estate tax, although he does not have possession or control over all of the property

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1. INT. REV. CODE OF 1954, §§ 2001-2207.

2. Present law is FLA. STAT. § 198 (1955).

3. INT. REV. CODE OF 1954, § 2002; FLA. STAT. § 198.13 (1955).

being taxed.⁴ Under section 6324(a)(1) of the Internal Revenue Code of 1954, the estate tax is a lien on all property included in the decedent's gross estate for a period of ten years from date of death. If the executor does not pay the tax when due, section 6324(a)(b) makes the transferee, or other person in possession of the property, liable therefor.

II. FLORIDA'S ESTATE TAX APPORTIONMENT LAW.

In 1949 the legislature passed what is now section 734.041, Florida Statutes. This act provides that whenever ". . . an executor, administrator, trustee or other person acting in a fiduciary capacity, has paid, or there is owing . . ." an estate tax in respect to any property includible in decedent's gross estate, the amount of the tax ". . . shall be equitably prorated among the persons interested in the estate to whom such property is or may be transferred or to whom any benefit accrues *except in a case where a testator otherwise directs in his will, and except in a case where by written instrument executed intervivos, direction is given for apportionment within the fund of taxes assessed upon the specific fund dealt with*" (Emphasis supplied)

The act attempts to charge each recipient of the property being taxed a pro rata part of the total state and federal estate tax giving due allowance to such exemptions and deductions as the taxing statute allows. In *In re Fuchs' Estate*,⁵ the Supreme Court of Florida held that a widow's dower was not liable for a portion of the tax, notwithstanding section 731.34 F.S.A., prior to its amendment in 1951, made such dower or widow's allowance liable for a portion of the tax. However, it is pointed out that prior to 1948 there was no such thing as a marital deduction for purposes of the federal estate tax, and, accordingly, the widow's share of the estate as well as all others were fully taxable.⁶ In fact, even charitable bequests were liable for their pro rata share of the tax burden⁷ prior to the enactment of section 734.041, even though an amount for such a bequest was allowable as a deduction for tax purposes. It should be mentioned that the principle of equitable apportionment was the law prior to adoption of section 734.041, and in passing this act, the legislature so indicated.⁸

The Allowance for Exemptions and Deductions: The Florida law, which was patterned after New York's,⁹ expressly provides that in apportioning the tax burden the county judge shall take into account "any exemptions

4. U. S. Treas. Reg. 105, § 81.76 (1942).

5. 60 So.2d 536 (Fla. 1952).

6. *Henderson v. Usher*, 125 Fla. 709, 170 So. 846 (1936).

7. *YMCA v. Davis*, 264 U.S. 47 (1924); *In re Bernay's Estate*, 150 Fla. 414, 7 So.2d 444 (1942).

8. LAWS OF FLA. c. 25435, § 5 (1949); see also *Hagerty v. Hagerty*, 52 So.2d 432 (Fla. 1951).

9. N.Y. Decedent's Estate Law, § 124 (1940).

granted by the act imposing the tax and for any deductions allowed by such act."

The Florida Supreme Court, in *In re Fuchs' Estate, supra*, has already held that a widow's dower was exempt from the tax liability, but the decision did not say or imply that all the widow's share of the taxable estate will escape the incidence of the tax, or the liability therefor. On the contrary, section 731.34, Florida statutes provides that "in any case where the dower interest of the widow shall have the effect of increasing the estate tax, her dower shall be ratably liable with the remainder of the estate for the estate taxes due by the estate of her deceased husband." This provision clearly makes dower *liable* for the tax where any part of the tax liability is attributable to such dower interest. Property owned by the widow and her husband as tenants by the entirety will pass directly to her as will all property jointly owned with right of survivorship, and when taking these amounts into account the widow's total share of the estate including dower, if any, could well exceed the maximum amount allowed by the federal law as a marital deduction,¹⁰ thus giving rise to the question of the excess amount received by the widow over the marital deduction being subject to the tax liability as well as being subject to apportionment under section 734.041. Also, it is possible for the widow to receive property from her husband's estate that does not qualify for the marital deduction such as a future interest, and, therefore, such interest would be equally subject to apportionment.

No Apportionment as to Life Estates or Estates for Years: Florida's apportionment law, like many others, avoids the very awkward problem of apportioning the tax burden in respect to "an interest in income, or an estate for years, or for life, or other temporary interest in any property or fund . . ." by charging the remainder of such fund with the total tax burden incident to such fund.

Deductions and Exemptions not Credits: Prior to 1954, the federal law¹¹ allowed as a *deduction* an amount equal to the value of any property "forming a part of the gross estate," transferred to the decedent by *gift* within five years prior to his death if the property could be identified, but now the code¹² allows a *credit* against the federal tax imposed where similar property is included in the second estate, and, moreover, eliminates the problem of tracing or identifying it. So the 1954 Code changed what formerly was a deduction and presumably exempt from the tax burden under Florida's apportionment act, into a credit¹³ against the federal tax, the effect of which is to subject such property to the tax burden

10. INT. REV. CODE OF 1954, § 2056.

11. INT. REV. CODE OF 1939 § 812(e), 53 Stat. 124.

12. INT. REV. CODE OF 1954 § 2013.

13. The credit against the Federal tax is reduced by 20% for each two years' lapse from the date of death of first decedent.

under our apportionment law. Clearly, the Florida act provides for apportionment of "the amount of the tax *paid* or owing" which, it is submitted, is the net amount found to be due and owing after taking into account all deductions, exemptions and *credits*, while the same apportionment act makes exception only in the case of "any exemptions granted" and "for any deductions allowed." A credit against the tax is not an exemption from the tax nor a deduction in arriving at the tax base, but is a reduction of the liability otherwise found due.

There is a second situation where a "tax credit" can cause troublesome problems and that involves a case where a decedent transfers property in contemplation of death and pays the gift tax only to have the property taxed in his gross estate at death. The question arises as to whether the credit for the gift taxes paid is to be deducted from the burden allocated to the transferee in contemplation of death or is to be deducted from the amount of the taxes otherwise due which, in effect, is to spread the benefit of the credit among all beneficiaries. This problem was solved in New York by two cases¹⁴ holding that the credit was first deducted from the total tax and that the reduced tax was apportioned among all the beneficiaries. Since the two decisions in question were handed down New York has amended its estate tax law providing that the credit for the gift tax shall inure to the benefit of all persons benefited and likewise as respects the benefit arising out of the deduction allowed for property previously taxed.¹⁵

Executor's Remedy: The statute provides that the executor shall have the right and duty to recover from any person in possession of property taxed in the estate, the proportionate amount of the tax chargeable to such beneficiary,¹⁶ and in the case where the executor is already in possession of the property, he is not required to pay over or distribute that property or fund until the tax is first paid or adequate security provided.¹⁷ It appears, therefore, that an executor should make application to the proper county court citing all pertinent information involving the estate taxes, an accounting, and such schedules as may be necessary to show how the tax should be apportioned. A copy of these proceedings should be given to each beneficiary whether the beneficiary takes under the will or by prior gift or operation of law, thus affording each beneficiary a chance to make timely objections to the apportionment as he might deem appropriate.¹⁸

14. Application of Schmidlapp, 267 App. Div. 949, 47 N.Y.S.2d 652 (1st Dep't. Sup. St. 1944) *aff'd.* 293 N.Y. 707, 56 N.E.2d 588 (1944); *In re Dommerich's Estate*, 74 N.Y.S.2d 283 (Surr. Ct. 1945); *In re Blumenthal's Estate*, 182 Misc. 137, 46 N.Y.S.2d 688 (Surr. Ct. 1944).

15. New York Decedent's Estate Tax Law, § 124 (e) (iii) (1950).

16. FLA. STAT. § 734.041(2) (1955).

17. FLA. STAT. § 734.041(3) (1955).

18. *E.g.*, *In re Meyer's Estate*, 119 N.Y.S.2d 737 (Surr. Ct. 1953). *In re Vanderbilt's Estate*, 180 Misc. 431, 39 N.Y.S.2d 941 (Surr. Ct. 1943). *In re Kaufman's Estate*, 170 Misc. 436, 10 N.Y.S.2d 616 (Surr. Ct. 1939).

In order for there to be a valid order apportioning the burden of the state and federal estate taxes, the court making such order must have jurisdiction over the property and persons affected. An "appropriate proceeding" has been held as one where valid notice has been served upon all parties interested in the estate.¹⁹ Where a beneficiary is a non-resident and where the property to be charged is located in a foreign jurisdiction the question of enforcement becomes paramount. In *First Nat. Bank v. First Trust Co.*,²⁰ the Supreme Court of Minnesota held that, where the decedent, who was a resident of Florida at the time of his death, created while a resident of Minnesota an inter vivos trust which was regarded as part of his taxable estate for purposes of the federal and state estate taxes, Florida's apportionment act could reach only that property over which it had jurisdiction and the trust was governed by Minnesota law that charged all of such tax burden against the residue of the estate.²¹ In *Riggs v. del Drago*,²² the question was raised whether New York's apportionment act was unconstitutional as being in conflict with the Federal Estate Tax Law and the Supreme Court held that it was not, saying ". . . Congress did not contemplate that the Government would be interested in the distribution of the estate after the tax was paid, and that Congress intended that state law should determine the ultimate thrust of the tax." It appears, therefore, except in two cases,²³ an executor must look to the beneficiaries of the property taxed in the decedent's estate for their proportionate part of the tax by bringing an appropriate action in the state court for the contribution due. Where the property to be charged with a part of the burden is located in a foreign jurisdiction serious problems of enforcement will arise, the scope of which would require a study in itself, and, of course, cannot fairly be covered in this article.

III. DIRECTIONS IN INSTRUMENTS FOR APPORTIONMENT OF TAXES.

A testator who desires to direct the manner in which the burden of estate taxes shall come to rest, must do so, if the application of the statute is to be avoided, in unequivocal terms and in such manner as will clearly show his intent.²⁴ To be effective, directions must be given in the will,

19. *In re Graham's Estate*, 49 N.Y.S.2d 508 (Surr. Ct. 1944).

20. 242 Minn. 226, 64 N.W.2d 524 (1954).

21. To the same effect, *Isaacson v. Boston Safe Deposit and Trust Co.*, 325 Mass. 469, 91 N.E.2d 334 (1949). The Massachusetts law, like that of Minnesota, charged the tax burden to the residue of the estate unless specific directions were given in the will directing otherwise. *Contra*, *In re Gato's Estate*, 276 App. Div. 651, 97 N.Y.S.2d 171 (1st Dept. Sup. Ct. 1942) *aff'd*, 301 N.Y. 653, 93 N.E.2d 924 (1942).

22. 317 U.S. 95 (1942).

23. The Federal law requires apportionment of the estate tax in respect to recipients of proceeds of life insurance and as to beneficiaries of property passing under a power of appointment unless the will directs otherwise. INT. REV. CODE OF 1954 §§ 2206 and 2207.

24. *In re Blumenthal's Estate*, 180 Misc. 895, 42 N.Y.S.2d 898 (Surr. Ct. 1943).

as it will not suffice that directions be given in instruments executed *inter vivos*;²⁵ at best, such directions can govern only the manner in which the tax chargeable thereto shall be spread among the beneficiaries thereof. The more realistic view leaves the tax liability where the law places it, in cases where there is doubt as to a testator's intent.²⁶

In *Hagerty v. Hagerty*,²⁷ the will provided, "I direct my executor . . . to pay . . . out of my residuary estate all estate, transfer and inheritance taxes so that all payments to my distributees shall be net and free of any such tax." The Supreme Court of Florida held that the language so used was "no impediment to an equitable distribution of the tax burden" as one clause in the sentence neutralized the other.

The general rules relating to construction of wills are equally applicable to tax clauses, as the object in such cases is to determine the intention of the testator.²⁸ In *In re Syke's Will*,²⁹ the court was called upon to construe the intent of the testator to determine whether the language used directed the manner in which the tax burden should fall. The court found:

Returning, then, to the first paragraphs of Articles Second and Third of the will, what is given is only the net estate after deduction of debts, funeral and administration expenses, and estate taxes. By thus grouping or bracketing estate taxes with debts, funeral and administration expenses, which debts and expenses are ordinarily payable out of the general estate, the testator has in effect 'directed otherwise' *i.e.*, has directed that estate taxes, as well as debts, funeral and testamentary expenses, be deducted and paid out of the general estate without apportionment

This case also held that since the will was silent as respects the tax applicable to properties passing outside the will, the apportionment act applied to such properties,³⁰ thus, in effect, saying there can be a partial direction under the act so as to exempt certain legacies or bequests from the burden while requiring others to share it.

In *re McMillan's Estate*,³¹ where the widow claimed against the will and elected to take statutory dower,³² the question was raised as to what effect a clause in the will had on such dower, where the will provided:

I direct that all inheritance and estate taxes becoming due by reason of my death shall be paid by my Executor out of the property passing under this Will as an expense and cost of administering my estate, and before distribution thereof, if possible.

25. Application of Chase National Bank, 55 N.Y.S.2d 470 (Sup. Ct. 1945).

26. See cases collected at 37 A.L.R.2d 28 (1953).

27. 52 So.2d 432 (Fla. 1951).

28. *In re Vanderbilt's Will*, 99 N.Y.S.2d 952 (Surr. Ct. 1950).

29. 53 N.Y.S.2d 442 (Surr. Ct. 1945).

30. *But see In re Vanderbilt's Will*, 99 N.Y.S.2d 952 (Surr. Ct. 1950).

31. 158 Fla. 898, 30 So.2d 534 (1947).

32. FLA. STAT. § 731.34 (1955).

My Executor shall have no duty or obligation to obtain reimbursement for any such tax paid by it even though on proceeds of insurance or other property not passing under this will.

In addition, the will further provided that should any beneficiary claim against the will, including dower, such person should not take any interest under the will. The Supreme Court of Florida held that by electing to take dower, the widow forfeited her rights to take under the will and that the testator intended "that such dower should pay its proportionate part of the estate taxes." It is true, as noted above, that the present apportionment statute gives allowance for "exemptions" and "deductions," and, as decided in the *Fuchs*' case, dower is not liable for a portion of the tax, but where the will is not clear as to what fund shall bear the burden, then taking outside the will that otherwise frees a gift from the burden, will require such gift to bear its proportionate share of the burden. Moreover, it is pointed out that where the widow's dower contributes to the tax liability, it is to that extent liable therefor,³³ and to the extent such dower and other interests exceed the allowable "deduction"³⁴ under federal law, such widow's dower would be chargeable, along with the other property, with its portion of the tax burden as provided under the apportionment statute.

Another problem can arise in the construction of tax clauses in wills where bequests are made by codicils which, when considered with the will as a whole, generate doubt as respect the testator's intent relating to the burden chargeable to such gifts. For example, if a testator wishes certain legacies to be free of the tax while making others subject to apportionment, and subsequently makes a codicil that is silent as respects the tax, the question immediately turns to what was his intent. The usual rule is that where words in a tax clause are broad enough to cover all gifts, such will apply equally to gifts by codicils.³⁵

CONCLUSION

It is obvious that questions of the ultimate "thrust" of the estate tax burden are of vital importance to every person planning the disposition of his estate. Where arrangements are made inter vivos, particularly in irrevocable trusts, the planner should make due allowance for the eventuality of the trust fund being charged with a portion of the estate tax liability. If the application of the statute is to be avoided, words showing that intent must clearly appear in the trust indenture, as otherwise, it might well be that the plan fails in its purpose.

When preparing a will, the planner should carefully weigh the effects

33. FLA. STAT. § 731.34 (1955).

34. See note 10 *supra*.

35. *In re Durkee's Estate*, 183 Misc. 382, 47 N.Y.S.2d 721 (Surr. Ct. 1944).

the apportionment statute will have on each beneficiary, whether that beneficiary takes under the will or otherwise, keeping in mind that only a valid direction given in the will can alter the effects created by the statute. In most cases, equitable apportionment of the tax burden is preferred over the practice of charging the tax to the residue, but in some cases harsh and undesired results will occur if the burden is left to fall where the statute places it.

In the interest of better administration of estates in Florida, the legislature should keep abreast of the changes made in the Federal Estate Tax Law, particularly where new practices are adopted. It appears certain that difficulty will arise, that will lead to litigation, if the question of deductions, exemptions and credits are not clarified.