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# Apportionment of the Federal Estate Tax -- Should North Carolina Adopt an Apportionment Statute

Robert Lee Watt III

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## COMMENTS

### Apportionment of the Federal Estate Tax—Should North Carolina Adopt An Apportionment Statute?

There is an old saying that only two things are certain—death and taxes. After the first has occurred, the problem of the second arises by virtue of the federal estate tax requirements of the Internal Revenue Code.<sup>1</sup> Since the federal government exacts payment for a person's privilege of transferring his assets at his death, the problem arises as to who will bear this burden and how it will be proportioned. It is important to recognize that in every jurisdiction a testator may determine the allocation of the federal estate tax burden by an appropriate provision in his will.<sup>2</sup> Nevertheless, many individuals die intestate, and wills prepared with or without<sup>3</sup> a lawyer's assistance may not include adequate provisions for the allocation of the tax.<sup>4</sup> Thus a statutory solution, which is within the control of each state legislature,<sup>5</sup> is needed to ensure the preservation of the decedent's plan for the distribution of his assets.

This comment is designed to encourage North Carolina to change its current policy towards the allocation of the federal estate tax<sup>6</sup> and to give North Carolina lawyers and legislators a better understanding of the various choices available and the problems with each. The latter portion of this comment is devoted to a proposed statute, which, if adopted, would bring North Carolina in line with the method of determining the tax burden adopted by a majority of the states.

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1. INT. REV. CODE OF 1954, §§ 2001-209.

2. Powell, *Ultimate Liability for Federal Estate Taxes*, 1958 WASH. U.L.Q. 327, 328.

3. N.C. GEN. STAT. § 31-3.2(2) (1966) allows holographic wills to be probated.

4. Sheffield, *Notes on Equitable Apportionment of Federal Estate Taxes—A Consideration of the New York Statute*, 19 CONN. B.J. 6, 15 (1945).

5. As explained by the Supreme Court: "[C]ongress intended that the federal estate tax should be paid out of the estate as a whole, and that the applicable state law as to the devolution of property at death should govern the distribution of the remainder and the ultimate impact of the federal tax . . . ." *Riggs v. Del Drago*, 317 U.S. 95, 97-98 (1942).

6. Length limitations prevent a detailed examination of the numerous policy factors involved in this area, and the reader is invited to examine the numerous authorities cited herein for further investigation. Many of the pre-1955 articles concerning this subject are listed in Scoles, *Apportionment of Federal Estate Taxes and Conflict of Laws*, 55 COLUM. L. REV. 261, 264 n.10 (1955).

## I. THE EVOLUTION OF THE APPORTIONMENT DOCTRINE

The present federal estate tax had its beginning in 1916 although death taxes imposed by the federal government had been adopted and abandoned several times before then.<sup>7</sup> The death tax imposed in 1916 was an "estate" tax levied upon a *decedent's* right to *transfer* his property at his death.<sup>8</sup> Thus the new federal tax varied in its fundamental purpose from the "inheritance" taxes imposed by some states<sup>9</sup> on a *beneficiary's* right to *receive* property transferred by the decedent. This distinction was expressly recognized by the United States Supreme Court in *YMCA v. Davis*.<sup>10</sup>

When first faced with the question of who should ultimately pay the new federal tax, state courts logically classified the tax as an administration expense and required it to be paid out of the residue of the estate.<sup>11</sup> Moreover, since the new federal act required payment of the tax by the executor,<sup>12</sup> it was thought that congressional intent mandated payment from the residuary estate.<sup>13</sup> Thus most courts adopted what is frequently called the "burden on the residue" rule.<sup>14</sup> This allocation created no great financial problem so long as the tax rate remained low. But as Congress began increasing the impact of the tax, the problem of who bore the burden increased proportion-

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7. An interesting discussion of the history of the federal death taxes appears in Eisenstein, *The Rise and Decline of the Estate Tax*, 11 TAX L. REV. 223, 223-36 (1956).

8. *Riggs v. Del Drago*, 317 U.S. 95, 98 (1942).

9. *E.g.*, N.C. GEN. STAT. § 105-2 (1972).

10. 264 U.S. 47 (1924). The Court stated: "What was being imposed here was an excise upon the transfer of an estate upon death of the owner. It was not a tax upon succession and receipts of benefits under the law or the will. What this law taxes is not the interest to which the legatees and devisees succeeded on death, but the interest which ceased by reason of the death." *Id.* at 50.

11. *See* Lauritzen, *Apportionment of Federal Estate Taxes*, 1 TAX COUNSELOR'S Q., June 1957, at 55, 62.

12. INT. REV. CODE OF 1954, § 2002.

13. Lauritzen, *supra* note 11, at 62-63; *see, e.g.*, *Plunkett v. Old Colony Trust Co.*, 233 Mass. 471, 475-76, 124 N.E. 265, 267 (1919); *In re Hamlin*, 226 N.Y. 407, 410-16, 124 N.E. 4, 6-7, *cert. denied*, 250 U.S. 672 (1919).

14. *See, e.g.*, *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); *In re Hamlin*, 226 N.Y. 407, 124 N.E. 4, *cert. denied*, 250 U.S. 672 (1919).

However, courts in Florida, Georgia and Kentucky refused to follow the residue rule and apportioned the federal tax burden. *See Henderson v. Usher*, 125 Fla. 709, 170 So. 846 (1936); *Regents of Univ. System v. Trust Co. of Georgia*, 194 Ga. 255, 21 S.E.2d 691 (1942); *Hampton's Adm'rs v. Hampton*, 188 Ky. 199, 221 S.W. 496 (1920); *Sutter, Apportionment of the Federal Estate Tax in the Absence of Statute or an Expression of Intention*, 51 MICH. L. REV. 53, 58 (1952).

ately.<sup>15</sup>

Two major undesirable consequences of the "burden on the residue" rule soon arose, both of which are currently problems in North Carolina. First, when the residuary estate was forced to bear this increased tax burden, a testator's otherwise well-conceived plan for the distribution of his property might be completely destroyed.<sup>16</sup> As one writer has observed, "the residuary estate usually is intended for the enjoyment of beneficiaries who are the nearest next of kin of the decedent."<sup>17</sup> If a testator made several large specific bequests to friends or relatives while leaving the residue to his wife and children, it was possible that the latter would be left with little or nothing after the tax was paid.<sup>18</sup> The same result followed when a sizable non-probate asset<sup>19</sup> was included in the taxable estate since the corresponding increase in the tax burden was borne by the residuary estate.<sup>20</sup> The second unfortunate consequence of the residue rule was that a large tax burden was often placed on property which would otherwise qualify for a marital or charitable deduction. Under these circumstances the tax burden was actually increased.<sup>21</sup> This result would rarely seem to be the testator's intention.

Recognizing the undesirable consequences which might result from the application of the "burden on the residue" rule,<sup>22</sup> New York

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15. Cf. Gump, *Apportionment of the Federal Estate Tax*, 6 MD. L. REV. 195 (1942).

16. See J. FARR, AN ESTATE PLANNER'S HANDBOOK § 45H, at 271 (3d ed. 1966).

17. Polisher, *Proration of Federal Estate Tax Among Life Insurance Beneficiaries*, 50 DICK. L. REV. 1, 2 (1945).

18. See J. TRACHTMAN, ESTATE PLANNING 63 (rev. ed. 1968).

19. The various types of non-probate assets that may be included in the taxable estate are set out in the Internal Revenue Code of 1954: dower or curtesy interests (§ 2034); transactions in contemplation of death (§ 2035); transfers with retained life estate (§ 2036); transfers taking effect at death (§ 2037); revocable transfers (§ 2038); annuities (§ 2039); joint interests (§ 2040); powers of appointment (§ 2041); proceeds of life insurance (§ 2042); and transfers for insufficient consideration (§ 2043).

20. A striking example of this possibility is found in *In re Mellon's Estate*, 347 Pa. 520, 32 A.2d 749 (1943). There the testator left a probate estate of over \$11,000,000, but when certain non-testamentary assets were included in his taxable estate, the tax bill came to over \$37,000,000. Obviously, under the burden on the residue rule, the probate assets would be completely exhausted to pay the tax.

Other examples of the inequitable consequences of the application of the residue rule are presented in Lauritzen, *supra* note 11, at 55-57; Lindsay, *Florida's Estate Tax Laws—Apportionment Versus a Charge Against Residue*, 12 U. FLA. L. REV. 50 (1959).

21. See text accompanying notes 101-02 *infra*.

22. The Decedent's Estate Commission of New York stated:

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

became the first state to enact a statute<sup>23</sup> that apportioned the federal estate tax burden among all beneficiaries pro rata.<sup>24</sup> The United States Supreme Court upheld the statute's constitutionality in *Riggs v. Del Drago*.<sup>25</sup> The Court observed that "[the] legislative history [of the Revenue Act of 1916] indicates clearly that 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."<sup>26</sup>

As clearly stated in *Riggs*, the allocation of the ultimate burden of the federal estate tax is almost<sup>27</sup> entirely within the control of the individual states. In arriving at a policy on allocation, states have developed three basic approaches: first, to place the entire burden of the tax on the residuary estate; secondly, to allow apportionment of the tax burden for non-probate assets, while retaining the residue principle for assets comprising the probate estate;<sup>28</sup> and finally, to al-

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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 and more dependent relatives. . . . The burden of the tax has been imposed upon the residuary legatees not only as to the property passing under the will, but also upon transfers whether by gift or *inter vivos* trust, or other forms of transfer taking effect at death.

NEW YORK COMMISSION TO INVESTIGATE DEFECTS IN THE LAWS OF ESTATES, COMBINED REPORTS OF THE COMMISSION TO INVESTIGATE DEFECTS IN THE LAWS OF ESTATES 338 (reprint ed. 1935).

23. Ch. 709, [1930] N.Y. Laws 1283-84 (now N.Y. EST., POWERS & TRUSTS LAW § 2-1.8 (McKinney 1967)); see Scoles & Stephens, *The Proposed Uniform Estate Tax Apportionment Act*, 43 MINN. L. REV. 907, 915 (1959).

24. Pro rata apportionment means that each beneficiary pays the amount of tax determined by the proportion that the value of his interest bears to the total value of the taxable estate. For example, a recipient of a \$10,000 bequest from the taxable estate of \$100,000 would pay 10% of the federal estate tax.

25. 317 U.S. 95 (1942).

26. *Id.* at 98. This position was later reaffirmed in *Harrison v. Northern Trust Co.*, 317 U.S. 476 (1943).

27. The Internal Revenue Code currently contains only two provisions dealing with the question—one concerning life insurance proceeds and the other with powers of appointment. INT. REV. CODE OF 1954, § 2206 stated:

Unless the decedent directs otherwise in his will, if any part of the gross estate on which tax has been paid consists of proceeds of policies of insurance on the life of the decedent receivable by a beneficiary other than the executor, the executor shall be entitled to recover from such beneficiary such portion of the total tax paid as the proceeds of such policies bear to the sum of the taxable estate and the amount of the exemption allowed in computing the taxable estate . . . .

INT. REV. CODE OF 1954, § 2207 contains provisions similar to those of § 2206 concerning powers of appointment. See J. BOWE, ESTATE PLANNING AND TAXATION § 3.40 (3d C.L.U. ed. 1972).

28. This would mean that non-probate assets such as life insurance proceeds and jointly held property would bear a pro rata share of the tax, while the residuary estate would bear the tax burden for all property passing under the will.

low apportionment as to *all* assets included in the taxable estate.<sup>29</sup> Although each of these possible choices has some following among the states,<sup>30</sup> a majority of the states that have addressed the subject adhere to the total apportionment principle, and the trend is in that direction.<sup>31</sup> Recognizing the desirability of uniform treatment throughout the United States, a proposed Uniform Act advocating total apportionment has been formulated.<sup>32</sup> States such as North Carolina, which do not recognize the apportionment doctrine, should closely examine the possibility of adopting such an approach. In order to

29. All assets, even those passing under the will, would bear their pro rata share of the tax.

30. States applying the "burden on the residue" principle include: Alabama, ALA. CODE tit. 51, § 449(1) (1958); Colorado, *Ramsey v. Nordloh*, 143 Colo. 526, 354 P.2d 513 (1960); District of Columbia, *In re Estate of Collins*, 269 F. Supp. 633 (D.D.C. 1967); Georgia, GA. CODE ANN. § 92-3401 (1961); Illinois, *In re Estate of Phillips*, 1 Ill. App. 3d 813, 275 N.E.2d 685 (1971); Iowa, IOWA CODE ANN. § 633.449 (1964); Kansas, *Spurrier v. First Nat'l Bank*, 207 Kan. 406, 485 P.2d 209 (1971); Maine, *Old Colony Trust Co. v. McGowan*, 156 Me. 138, 163 A.2d 538 (1960); Mississippi, MISS. CODE ANN. § 27-9-33 (1972); North Carolina, *Park v. Carroll*, 18 N.C. App. 53, 196 S.E.2d 40 (1973); Oklahoma, *In re Rettemeyer's Estate*, 345 P.2d 872 (Okla. 1959); Texas, *Sinnott v. Gidney*, 159 Tex. 366, 322 S.W.2d 507 (1959) (at least as to probate assets); Washington, *In re Estate of Eberle*, 4 Wash. App. 638, 484 P.2d 478 (1971); Wisconsin, *In re Uihlein's Will*, 264 Wis. 362, 59 N.W.2d 641 (1953).

The following states apportion non-probate assets: Florida, FLA. STAT. ANN. § 734.041 (1964); Massachusetts, MASS. ANN. LAWS ch. 65A, § 5 (1971); Missouri, *Carpenter v. Carpenter*, 364 Mo. 782, 267 S.W.2d 632 (1954); Montana, *In re Estate of Marans*, 143 Mont. 388, 390 P.2d 443 (1964); New Mexico, *In re Gallagher's Will*, 57 N.M. 112, 255 P.2d 317 (1953); Ohio, *McDougall v. Central Nat'l Bank*, 157 Ohio St. 45, 104 N.E.2d 441 (1952); South Carolina, S.C. CODE ANN. § 65-563 (Supp. 1971).

A majority of jurisdictions compel apportionment as to *all* assets: Alaska, ALASKA STAT. § 13.16.610 (1972); Arkansas, ARK. STAT. ANN. § 63-150 (1971); California, CAL. PROB. CODE § 970 (West 1956); Connecticut, CONN. GEN. STAT. ANN. § 12-401 (1972); Delaware, DEL. CODE ANN. tit. 12, § 2901 (1953); Hawaii, HAWAII REV. STAT. § 236A-2 (Supp. 1973); Idaho, IDAHO CODE § 15-3-916 (Supp. 1973); Indiana, IND. ANN. STAT. § 29-2-12-1 (Burns 1972); Kentucky, *Gratz v. Hamilton*, 309 S.W.2d 181 (Ky. 1958); Michigan, MICH. STAT. ANN. § 27.3178 (167.102) (Supp. 1973); Minnesota, MINN. STAT. ANN. § 525.521 (1969); Nebraska, NEB. REV. STAT. § 77-2108 (1971); Nevada, NEV. REV. STAT. § 150.310 (1971); New Hampshire, N.H. REV. STAT. ANN. § 88-A:2 (1970); New Jersey, N.J. STAT. ANN. § 3A:25-30 (1953); New York, N.Y. EST., POWERS & TRUSTS LAW § 2-1.8 (McKinney 1967); North Dakota, N.D. CENT. CODE § 30-21.1-02 (Supp. 1973); Oregon, ORE. REV. STAT. § 116.303 (1971); Pennsylvania, PA. STAT. ANN. tit. 20, § 3701 (Spec. Pamphlet 1972); Rhode Island, R.I. GEN. LAWS ANN. § 44-23.1-2 (Supp. 1972); South Dakota, S.D. COMPILED LAWS ANN. § 29-7-71 (1967); Tennessee, TENN. CODE ANN. § 30-1117 (1955); Virginia, VA. CODE ANN. § 64.1-161 (1973); West Virginia, W. VA. CODE ANN. § 44-2-16a (1966); Wyoming, WYO. STAT. ANN. § 2-338 (Supp. 1973).

31. See Willoughby, *Federal Estate Taxation—Testator's General Direction Against Apportionment—Effect Upon Nonprobate Property*, 46 ORE. L. REV. 199, 201-02 (1967).

32. UNIFORM ESTATE TAX APPORTIONMENT ACT (1964 revision), reprinted in 9A UNIFORM LAWS ANNOTATED 491-502 (1965).

appreciate its benefits, it is necessary to understand the current status of North Carolina law.

## II. THE NORTH CAROLINA APPROACH

Since there is no North Carolina statute concerned with the allocation of the federal estate tax, the state's position has been developed exclusively through case law. The North Carolina decisions may be divided into three separate groups: first, cases dealing with the subject in a general manner; secondly, cases concerned with the impact of the marital deduction provisions of the Internal Revenue Code on the problem; and finally, a case which enunciates the conflicts rule which North Carolina apparently will follow in cases dealing with the burden of the tax. Throughout all these cases, North Carolina, in the absence of a will provision to the contrary, has never varied from the application of the "burden on the residue" principle.<sup>33</sup>

### A. Tax Allocation in General

The North Carolina Supreme Court first confronted the problem of the allocation of the federal estate tax in *Buffaloe v. Barnes*.<sup>34</sup> There the court stated that:

The ruling of the trial judge that the Federal Estate tax should be paid out of the general funds of the estate is affirmed. *Riggs v. Del Drago* . . . . The general rule, in the absence of contrary testamentary provision, is that the ultimate burden of an estate tax falls on the residuary estate.<sup>35</sup>

The question of the tax burden appears to have been only a minor issue in that case, and the court made no attempt to discuss the policies and consequences of placing the entire burden on the residuary estate.<sup>36</sup> Yet the court has steadfastly relied on this one paragraph holding despite a subsequent nation-wide trend towards a more equitable solution of the problem.<sup>37</sup> Only four years after *Buffaloe* the court was

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33. 1 N. WIGGINS, WILLS AND ADMINISTRATION OF ESTATES IN NORTH CAROLINA § 156 (1964); cf. Note, *Federal Estate Tax—Marital Deduction—Apportionment*, 31 N.C.L. REV. 491, 498 (1953).

34. 226 N.C. 313, 38 S.E.2d 222 (1946).

35. *Id.* at 332, 38 S.E.2d at 228-29. It is ironic that *Buffaloe* cites the *Riggs* decision in adopting the "burden on the residue" rule, since *Riggs* is considered the most prominent decision in the evolution of the apportionment doctrine. See text accompanying notes 25-26 *supra*.

36. The *Buffaloe* decision falls squarely within an observation made by Sutter, *supra* note 14, at 70: "[T]he recent decisions denying apportionment have done so largely on a citation of the 'majority rule,' whereas those requiring apportionment have set forth reasons at some length."

37. See authorities cited noted 30 *supra*.

once again confronted with the tax problem in *Craig v. Craig*.<sup>38</sup> In a *per curiam* opinion the court upheld the trial court's ruling that the entire burden of the federal estate tax was chargeable to the residuary estate without reimbursement from any beneficiary for his proportionate share.<sup>39</sup> Again, there was no discussion of the problems involved.

In 1963 in *Cornwell v. Huffman*<sup>40</sup> the court was confronted with the allocation of the federal estate tax due from an estate containing a large trust, the assets of which passed to the beneficiaries outside the will. The decedent had specified in her will that the residuary estate was liable for all estate taxes due from probate property but that any taxes due on account of property passing outside the will were to be paid from the trust. The court was asked to determine which assets should bear the estate tax burden and how that burden should be proportioned. Instead of relying on the specific will provision, the court emphasized the equities of the situation:

[W]e have no statute which is controlling in the present factual situation. We must, therefore, look to the equity of the situation and apply rules previously announced in somewhat related cases. The right of equitable contribution has been recognized and applied with respect to gift taxes.<sup>41</sup>

The court upheld the will provision and compelled the trust beneficiaries to contribute to the payment of the tax.

Thus it appeared after *Cornwell* that the court might be willing to apply the theory of equitable contribution to the payment of the federal estate tax, at least when both probate and non-probate assets were involved. This theory appeared to gain support in 1966 when the court, faced with a choice of law problem in *First National Bank v. Wells*,<sup>42</sup> stated:

[W]e deem it unnecessary to consider whether or not the tax involved is apportionable under the decisions of this jurisdiction. Even so, this Court has heretofore recognized and applied the doctrine of equitable contribution with respect to gift taxes. . . . This doctrine was cited with approval in *Cornwell v. Huffman* . . . .<sup>43</sup>

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38. 232 N.C. 729, 62 S.E.2d 336 (1950).

39. *Id.* at 730, 62 S.E.2d at 336.

40. 258 N.C. 363, 128 S.E.2d 798 (1963).

41. *Id.* at 369, 128 S.E.2d at 802.

42. 267 N.C. 276, 148 S.E.2d 119 (1966).

43. *Id.* at 288, 148 S.E.2d at 127.



However, the possibility that North Carolina was leaning toward equitable apportionment for probate assets was eliminated recently in *Park v. Carroll*.<sup>44</sup> In that case the North Carolina Court of Appeals refused to recognize any equitable contribution between the specific and residuary beneficiaries in spite of a persuasive argument by appellants based on the language in *Cornwell* and *Wells*.<sup>45</sup> The question of apportionment with respect to non-probate assets is still open, but the *Park* court failed to mention any distinction between the two types of property.<sup>46</sup>

### B. Tax Allocation In Connection With Marital Property

In 1948 Congress adopted a marital deduction provision which granted to married couples in common-law jurisdictions the same estate tax benefits previously enjoyed only by husbands and wives living in community property states. The provision in effect allows up to fifty percent of a deceased spouse's estate to pass tax free if left to the surviving spouse in a manner prescribed by the statute.<sup>47</sup> However, only the amount which actually passes to the surviving spouse can qualify for the deduction.<sup>48</sup>

The North Carolina Supreme Court first dealt with the impact of the tax burden problem on the marital deduction in *Wachovia Bank & Trust Co. v. Green*.<sup>49</sup> In that case the testator's widow elected to dissent from the will and thereby take her share as if the deceased had died intestate.<sup>50</sup> Since there was neither a living child nor a legal

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44. 18 N.C. App. 53, 196 S.E.2d 40 (1973). The court simply stated that "[n]o North Carolina decisions have applied the doctrine [equitable contribution] to the apportionment of federal estate taxes." *Id.* at 59, 196 S.E.2d at 44.

45. Brief for Appellant at 9-10, *Park v. Carroll*, 18 N.C. App. 53, 196 S.E.2d 40 (1973).

46. It is unfortunate that persons concerned with estate planning and administration must speculate on what type of situation the court will find proper for equitable contribution. As the court in *Cornwell v. Huffman*, 258 N.C. 363, 128 S.E.2d 798 (1963), stated: "Where the ultimate burden of paying estate taxes rests has been the subject of much litigation. Results of course vary with the many differing factual situations. Where, as here, the taxable estate includes properties outside the probate estate, there is lack of uniformity of decision." *Id.* at 368, 128 S.E.2d at 801. A legislative enactment providing for the apportionment of estate taxes would constitute a uniform rule which could be relied upon in any situation where the tax burden is a significant factor.

47. See INT. REV. CODE OF 1954, § 2056.

48. See *id.* § 2056(a). This problem is discussed in text accompanying notes 100-02 *infra*.

49. 236 N.C. 654, 73 S.E.2d 879 (1953).

50. N.C. GEN. STAT. § 30-3 (Supp. 1973).

representative of a deceased child, the widow was entitled to one-half of the estate.<sup>51</sup> In view of the new marital deduction, there would have been less federal tax if the widow had received her share free of any estate tax burden.<sup>52</sup> To the detriment of many surviving spouses in North Carolina, the court held that since an intestate's property is distributed after payment of debts<sup>53</sup> and since "[t]he word 'debts' . . . would seem to include the federal estate tax,"<sup>54</sup> the dissenting widow's share must be computed after the payment of the tax.<sup>55</sup> The court also relied on the holdings in *Buffaloe* and *Craig* without any attempt to distinguish them on the basis that no marital deduction benefit was possible in those cases. The *Green* court also held that since the widow had dissented from the will, she could not avail herself of any provision in the will directing how the estate tax was to be paid. However, the court noted:

The public policy of the state is a matter for the legislative branch of the government and not for the courts. Whether any change should be made in the manner of distribution to the widow of her interest in the estate of her husband, in view of the provision for marital deduction contained in the federal statute, is a matter for the General Assembly.<sup>56</sup>

The General Assembly was thus invited to enact legislation which would provide married couples in North Carolina with the maximum tax benefit allowed under the marital deduction provision of the Internal Revenue Code. The General Assembly did act; the result, a proviso to section 30-3(a) of the North Carolina General Statutes, was, however, woefully inadequate—it affected only situations identical to that of *Green*.<sup>57</sup> As one writer has noted, the General Assembly actually added

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51. Ch. 113, § 53(3), [1868] N.C. Pub. Laws 270-71 (repealed 1959).

52. Only the amount actually passing to the surviving spouse qualifies for the deduction. Since this amount is reduced to the extent of any tax paid, the amount of deduction is reduced, thereby increasing the taxable estate. For further discussion see text accompanying notes 101-04 *infra*.

53. N.C. GEN. STAT. § 28-105

54. 236 N.C. at 660, 73 S.E.2d at 883.

55. This view has not gained unanimous support. In *Hammond v. Wheeler*, 347 S.W.2d 884 (Mo. 1961), the court, after examining other cases on the question, stated: "[I]t seems . . . to be inequitable and grossly unjust to require a surviving spouse to pay a portion of the federal estate tax on the deceased spouse's estate solely by reason of the fact that the surviving spouse receives a statutory share of the estate which is not taxed and the receipt of which share does not cause or contribute to cause any part of the tax . . . .

*Id.* at 893.

56. 236 N.C. at 659, 73 S.E.2d at 883.

57. N.C. GEN. STAT. § 30-3(a) (Supp. 1973) states:

Upon dissent . . . the surviving spouse . . . shall take the same share of the deceased spouse's real and personal property as if the deceased had

to the problem by enacting such narrowly drawn legislation.<sup>58</sup> Despite appeals that the scope of the legislation be expanded,<sup>59</sup> no further action has been taken.

Two years after *Green* in *Tolson v. Young*<sup>60</sup> the new proviso was held not to apply to a dissenting spouse where there were children of the testator by a former marriage. Justice Sharp, writing for the court, gave the statute a literal interpretation and consequently the small class of persons benefited was further limited.<sup>61</sup>

Even in situations not involving a surviving spouse's dissent from a will, the decision in *Green* and the legislation which it produced may affect the amount of the allowable marital deduction. In *Adams v. Adams*<sup>62</sup> the North Carolina Supreme Court affirmed the trial court's holding that a widow's one-half testamentary share of the estate must pay one-half of the estate taxes. The court reasoned that since the new legislation enacted after *Green* was confined solely to the facts of that case, the *Green* rule applied to all other situations. Although the devise and bequest to the widow was specific, and under *Buffaloe* the tax burden falls on the residuary estate, the court found that the will created no residuary estate, and consequently the widow's share was liable for a part of the tax burden.

died intestate; provided, that if the deceased spouse is not survived by a child, children, or any lineal decedents of a deceased child or children, or by a parent, the surviving spouse shall receive only one half of the deceased spouse's net estate . . . which one half shall be estimated and determined before any federal estate tax is deducted or paid and shall be free and clear of such tax.

(emphasis added.)

58. Kahn, *The Federal Estate Tax Burden Borne By A Dissenting Widow*, 64 MICH. L. REV. 1499, 1520-21 (1966), states:

[T]he presumption should be made in favor of maximizing the widow's share, unless the legislature has indicated a contrary intent (such as was done by . . . North Carolina), rather than to presume that the widow's share (and the estate) should not benefit from the marital deduction unless the legislature has affirmatively indicated that it desires that result.

59. 1 N. WIGGINS, *supra* note 33, § 160, at 532 states:

In light of the tax savings which are available to the surviving spouse under the marital deduction provision of the federal estate tax law, consideration should be given to the adoption of legislation which will provided [sic] that in every instance the share of the surviving spouse will pass free of the federal estate tax. In a majority of cases this would prove to be a greater over-all benefit to the family of the decedent since it would result in less taxes.

See Note, 31 N.C.L. REV. *supra* note 33, at 498; 42 N.C.L. REV. 717, 717-18 (1964).

60. 260 N.C. 506, 133 S.E.2d 135 (1963).

61. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963), represents the only reported case where all the prerequisites of section 30-3(a) of the General Statutes were met and the widow was allowed to take her statutory share free of the federal tax burden.

62. 261 N.C. 342, 314 S.E.2d 633 (1964).

Thus under current North Carolina law the only surviving spouse who may take his share free of the federal estate tax burden is the one who dissents from the will of a testator who had no surviving children or other lineal decedents by any marriage and no parent surviving him. In all other situations the spouse receiving property through intestate succession or through dissent must bear a pro rata share of the estate tax burden. If the spouse receives property through the residuary clause of the will, he must bear the entire estate tax payment—absent a will provision to the contrary. There is no obvious reason why the General Assembly should continue such a policy.

### C. Tax Allocation and North Carolina Conflicts Of Laws

The final aspect of the North Carolina approach to the allocation of the estate tax burden concerns the question of the proper law to be applied when a conflicts problem arises. In *First National Bank v. Wells*<sup>63</sup> the North Carolina Supreme Court considered the estate of a Nevada resident who left property in trust to a North Carolina resident through a power of appointment. The court decided to apply the Nevada estate tax apportionment act, which required the North Carolina devisee to pay pro rata share of the estate tax levied on the Nevada resident's estate.<sup>64</sup> If this choice of law principle is followed in other jurisdictions,<sup>65</sup> North Carolina residents would be required to pay a portion of the estate taxes if they receive property from a decedent residing in an apportionment state, but foreign residents taking under a general or specific bequest or devise in a North Carolina resident's will would pay no tax. If North Carolina adopts an apportionment policy, this inequity would be eliminated.

## III. PROBLEMS IN FORMULATING AN APPORTIONMENT STATUTE AND POSSIBLE SOLUTIONS

Although several states have adopted some type of apportionment theory judicially,<sup>66</sup> the majority have effected this change through

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63. 267 N.C. 276, 148 S.E.2d 119 (1966). This case is discussed in Wurfel, *Choice of Law Rules in North Carolina*, 48 N.C.L. REV. 243, 291 (1970).

64. The court stated, "When questions of apportionment of estate taxes arise in courts of a state of the *situs* of a trust whose assets are includable in decedent's gross estate for tax purposes, the law of the *situs* refers to the law of decedent's domicile to resolve the questions." 267 N.C. at 287, 148 S.E.2d at 126, quoting *Doetsch v. Doetsch*, 312 F.2d 323, 328 (7th Cir. 1963).

65. The conflicts problems are discussed in text accompanying notes 82-88 *infra*.

66. See cases cited note 30 *supra*.

legislation.<sup>67</sup> In spite of the fact that there are well-established equitable principles on which to base an apportionment doctrine,<sup>68</sup> the North Carolina judiciary has clearly indicated that it believes the legislature must make the changes in this area.<sup>69</sup> Therefore the following discussion is presented on the assumption that a statutory provision will be necessary.

#### A. *Should Probate Assets Be Included?*

A question which must be resolved at the outset is whether a statutory apportionment of the tax burden should be applied to all assets or only those passing outside the will (non-probate assets). Although several writers have persuasively argued for the latter policy,<sup>70</sup> only a few states have statutorily adopted such an approach.<sup>71</sup> The argument for apportioning taxes only as to non-probate assets, while requiring the residuary estate to pay the entire tax on the probate assets, is based on the assumption that while the testator may not realize that some assets will be included in his estate for tax purposes, he nevertheless is aware of the property included in his will and the tax consequences that will result from it.

It can be argued, however, that a testator having a will without a tax clause simply did not consider the tax consequences of his estate plan. In such a case it seems that the testator would desire that all the beneficiaries pay their pro rata share of the tax.<sup>72</sup> Consequently a statute advocating total apportionment would appear preferable since it would be less likely to do violence to the testator's testamentary plan.

#### B. *Contrary Will Provisions*

Perhaps the major problem with an apportionment statute is the question of how a testator may overcome its effects if he so desires. In states with statutory apportionment over one-half of the dis-

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67. See statutes cited note 30 *supra*.

68. See Fleming, *Apportionment of Federal Estate Taxes*, 43 ILL. L. REV. 153, 156 (1948); Lauritzen, *supra* note 11, at 57-59.

69. See *Wachovia Bank & Trust Co. v. Green*, 236 N.C. 654, 659, 73 S.E.2d 879, 883 (1953), *quoted in text* accompanying note 56 *supra*.

70. See, e.g., Lindsay, *supra* note 20, at 70; Powell, *supra* note 2, at 336-38; Comment, *The Apportionment Doctrine—A Proposed Ohio Estate Tax Apportionment Statute*, 41 U. CIN. L. REV. 897, 905-07 (1972).

71. See statutes cited note 30, *supra*.

72. Gump, *supra* note 15, at 203-04.

putes have been concerned with a contrary will provision.<sup>73</sup> Although the question of when a will provision preempts the statutory directive is a serious one, the states still adhering to the "burden on the residue" principle face a similar problem. In those states the courts must decide when a will provision is effective to apportion the tax.<sup>74</sup> It is obvious that "there is no real substitute for good legal draftsmanship clearly expressing a well-informed testator's intention."<sup>75</sup> This maxim is relevant regardless of which position a state maintains as to estate tax allocation.

States with apportionment statutes have established different requirements for a testamentary direction sufficient to overcome apportionment.<sup>76</sup> New York requires a will provision "with certainty of expression,"<sup>77</sup> and the New York statute states that the provision will apply only to probate assets unless it states otherwise.<sup>78</sup> This position has been criticized because it does not observe a testator's normal intention when he seeks to avoid apportionment—that no apportionment be applied to *any* asset.<sup>79</sup> This argument is even more persuasive when a testator's family is the recipient of the non-probate assets.

Numerous writers have discussed this problem, and some have formulated sample will provisions that would be effective to overcome the operation of the statute when that is desirable.<sup>80</sup> Neverthe-

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73. Note, *The Apportionment of the Federal Estate Tax in Pennsylvania*, 54 DICK. L. REV. 432, 451 (1950); see Lauritzen, *supra* note 11, at 90; Sheffield, *supra* note 4, at 12.

74. Suggestions for will clauses sufficient to overcome the residue rule are discussed in Kennon, *Provision for Payment of Death Taxes*, 27 N.C.L. REV. 94, 111-12 (1948).

75. Fleming, *supra* note 68, at 164.

76. Comment, 41 U. CIN. L. REV. *supra* note 70, at 909.

77. *In re Mills' Estate*, 64 N.Y.S.2d 105 (N.Y. County Sur. Ct. 1946).

78. N.Y. EST., POWERS & TRUSTS LAW § 2-1.8(d) (McKinney 1967).

79. Willoughby, *supra* note 31, prefers the proposed Uniform Act, which does not contain such a statutory presumption:

Allowing the general [will] direction to exonerate nonprobate as well as probate assets is in accord with the deceased's probable expectation. Moreover, the proposed act is commensurate with the deceased's probable preference to exonerate members of his family and other primary objects of his bounty whether they receive probate or nonprobate property. Finally, it is this writer's conclusion that a general direction to pay "all" estate taxes out of the residuary estate or some other designated fund, where not qualified by other words, is explicit enough to exonerate nonprobate assets from the burden of such tax.

*Id.* at 210.

80. This problem is discussed in 2 A. CASNER, ESTATE PLANNING 2014-16 (Supp. 1973); Mitnick, *State Legislative Apportionment of the Federal Estate Tax*, 10 MD. L. REV. 289, 310-17 (1949); Note, *Statutory Apportionment of Federal Estate Taxes*,

less, a statute providing for this contingency should eliminate much of the litigation which has arisen in other states.<sup>81</sup> The problem of tax allocation is most acute where there is *no* will provision at all, and the method dealing most equitably with the beneficiaries in that situation should be the one adopted as the "normally operative rule."

### C. Conflict of Laws

As long as there is a split of authority on the allocation of the federal estate tax, there will be difficulties when estate administration traverses state boundaries. If a decedent dies domiciled in an apportionment state, leaving assets located in a residue jurisdiction to a beneficiary also located in a residue jurisdiction, the personal representative may be compelled to bring suit in the foreign state to collect a portion of the tax. The problem is whether the forum should apply its own law or the law of the decedent's domicile.

New York established the rule that the law of the domicile should be applied even though the result may be non-apportionment.<sup>82</sup> This position has been adopted in several other jurisdictions.<sup>83</sup> Nevertheless, where the assets include an *inter vivos* trust, both Massachusetts<sup>84</sup> and Minnesota<sup>85</sup> have applied the law of the situs in deciding the tax allocation question. The conflicts problems involved should be solved by using the policies applicable in any conflicts situation—predictability and uniformity of result without regard to the choice of forum and, in this particular area, a uniform treatment for all parts of the

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62 HARV. L. REV. 1022, 1025-26 (1949); Note, *Proposal for Apportionment of the Federal Estate Tax*, 30 IND. L.J. 217, 229 (1955); Note, *The Minnesota Federal Estate Tax Apportionment Statutes: Directing Against Its Application*, 52 MINN. L. REV. 1288, 1298 (1968); see Annot., 37 A.L.R.2d 7 (1954).

Sample will provisions are found in Susman & Fourticq, *Apportionment of Death Taxes: A Comprehensive Survey with Proposed Statute*, 45 TEXAS L. REV. 1348, 1357-60 (1967).

81. See text accompanying note 127 *infra*.

82. See *In re Peabody's Estate*, 115 N.Y.S.2d 337 (Sur. Ct. 1952); *In re Gato's Estate*, 276 App. Div. 651, 97 N.Y.S.2d 171, *aff'd*, 301 N.Y. 653, 93 N.E.2d 924 (1950).

83. See, e.g., *Doetsch v. Doetsch*, 312 F.2d 323 (7th Cir. 1963) (Illinois); *Trust Co. v. Nichols*, 62 N.J. Super. 495, 163 A.2d 205 (1960); *In re Gallagher's Will*, 57 N.M. 112, 255 P.2d 317 (1953).

Other articles discussing the conflicts problems are Scoles, *Conflict of Laws in Estate Planning*, 9 U. FLA. L. REV. 398, 438-39 (1956); Note, *Conflict of Laws in Estate Tax Apportionment—The Inter Vivos Trust*, 9 U. FLA. L. REV. 194 (1956).

84. See *Issacson v. Boston Safe Deposit & Trust Co.*, 325 Mass. 469, 91 N.E.2d 334 (1950).

85. See *First Nat'l Bank v. First Trust Co.*, 242 Minn. 226, 64 N.W.2d 524 (1954).

estate wherever situated.<sup>86</sup> This last policy demands application of the law of a decedent's domicile, and it was the deciding factor in convincing North Carolina to follow the New York rule, at least for *inter vivos* trusts.<sup>87</sup>

One writer, in an excellent and thorough discussion of the problem, has advocated that each state, regardless of its tax allocation position, enact legislation providing that all assets of a nonresident decedent be controlled by the tax allocation law of the decedent's domicile.<sup>88</sup> A simple federal conflicts statute would also solve the problem. But, barring these possibilities, it appears that the conflicts problem will remain.

#### D. Allocation of Interest, Penalties, and Credits

A common mistake in drafting the early apportionment statutes was "the failure to deal with the apportionment of interest and penalties for deficiencies and late tax payments."<sup>89</sup> The decisions under the early New York statute adopted the theory that any penalty or interest payments would be chargeable to the person whose conduct caused them.<sup>90</sup> If the statute is well drafted, however, there should be no need for litigation over this question. The preferred approach appears to be the apportionment of interest and penalties in the same manner as the tax burden. This would provide an element of certainty and would be equitable in the vast majority of cases. In a situation where this method would lead to an unfair result, discretion should be given to the judicial official having jurisdiction over the estate to allocate this burden in the manner deemed most equitable to all concerned.<sup>91</sup>

There are two ways to provide for this contingency, both equally effective. One would be to state that "[a]ny interest resulting from the late payment of the tax shall be apportioned in the same manner

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86. Scoles, *supra* note 6, at 266-67.

87. *First Nat'l Bank v. Wells*, 267 N.C. 276, 287-88, 148 S.E.2d 119, 126-27 (1966).

88. Scoles, *supra* note 6, at 309, proposes the adoption of the following statute:

Estate or death taxes imposed by the United States by reason of the inclusion of real or personal property located or administered in this state in the estate for tax purposes of a non-resident of this state shall be apportioned among the persons interested in the estate to whom such property may be transferred or to whom any benefit accrues only in accordance with the law of the decedent's domicile applicable to property located therein.

89. Fleming, *supra* note 68, at 162.

90. Reidy, *Apportionment of Estate Taxes*, 88 TRUSTS & ESTATES 623, 628 (1949); see, e.g., *In re Jamison's Estate*, 64 N.Y.S.2d 786 (Sur. Ct. 1946); *In re Ryle's Estate*, 170 Misc. 450, 10 N.Y.S.2d 597 (Sur. Ct. 1939).

91. See text accompanying note 129 *infra*.



as the tax and shall be charged wholly to principal."<sup>92</sup> The other would be to include interest and penalties in the basic statutory definition of "tax."<sup>93</sup> Either method would preclude the necessity of litigation to settle the question.

The proper allocation of the various credits allowed by the Internal Revenue Code<sup>94</sup> is another problem which should be provided for in the statute. The Uniform Act allows the credit for any state death tax paid to inure to the benefit of the beneficiaries chargeable with the payment of the tax<sup>95</sup> and allocates other credits to the benefit of the whole estate.<sup>96</sup> It has been suggested that if a donee is charged with the payment of the gift tax, some provision should be made allowing him to benefit directly.<sup>97</sup>

Regardless of how interest, penalties, and credits are treated, it is essential that they be expressly provided for in the statute to avoid needless litigation.<sup>98</sup>

#### *E. Property Qualifying For A Deduction Under The Federal Estate Tax Laws*

In formulating any apportionment statute, provision must be made for property which is not subject to a tax because of a deduction or exemption given to it.<sup>99</sup> The basic purpose of an apportionment statute should be to require all beneficiaries to contribute to the tax burden in proportion to the amount of tax *resulting* from the property they receive. In the case of property qualifying for the marital or charitable deduction, the tax burden is not increased, and therefore this property should not be liable for the payment of any tax.<sup>100</sup>

In addition to being the most equitable result, the exoneration of these interests will usually decrease the total amount of tax due, for only the value of the assets actually passing to the recipient can qual-

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92. N.Y. EST., POWERS & TRUSTS LAW § 2-1.8(c)(4) (McKinney 1967).

93. This seems to be the simplest solution to the problem and is the one adopted by the Uniform Act and this writer. See text accompanying note 122 *infra*.

94. INT. REV. CODE OF 1954, §§ 2011-16.

95. UNIFORM ESTATE TAX APPORTIONMENT ACT § 5(d), *supra* note 32, at 498.

96. *Id.* § 5(c).

97. Scoles & Stephens, *supra* note 23, at 932. This recommendation has been adopted in this writer's proposed statute. See text accompanying note 134 *infra*.

98. See Powell, *supra* note 2, at 340.

99. See INT. REV. CODE OF 1954, §§ 2055-56.

100. See *Doetsch v. Doetsch*, 312 F.2d 323, 329-30 (7th Cir. 1963) (marital deduction); *Pitts v. Hamrick*, 228 F.2d 486, 490 (4th Cir. 1955) (marital deduction). An excellent discussion of this policy as it relates to a dissenting spouse is presented in Kahn, *supra* note 58.

ify for the deduction.<sup>101</sup> If taxes are imposed on these interests, the amount of the allowable deduction is correspondingly reduced, and the amount of tax due is increased.<sup>102</sup> The resulting computations involved in a formula containing "two mutually dependent variables" is extremely complicated.<sup>103</sup> Proper provisions in an apportionment statute virtually eliminate these difficulties.<sup>104</sup>

#### F. *Temporary and Remainder Interests*

A difficult problem may arise when the estate tax must be paid from a fund which is divided into both temporary and remainder interests. It would be almost impossible to formulate a workable rule that can be applied to apportion the amount of tax payable by the two interests respectively.<sup>105</sup> Therefore a clear majority of current apportionment statutes provide that the entire tax on such interests is chargeable against the remainder interest.<sup>106</sup> It is evident that this rule may be unfair in certain circumstances. When the remainder interest is composed of assets which would qualify for a deduction, such as those left to a qualified charity or to a surviving spouse, the interest would pay a share of the tax even though it created none. This revives the computation problems discussed previously<sup>107</sup> and is contrary to the general policy of an apportionment statute not to tax assets which did not contribute to the imposition of the tax. Although these are certainly serious considerations, "[t]here is . . . no practical way to work the matter out."<sup>108</sup> As a practical matter this treatment is the most equitable solution in many cases, for if the temporary interest was burdened with a tax payment, the income beneficiaries may receive nothing for a number of years.<sup>109</sup> Most writers agree that the

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101. See INT. REV. CODE OF 1954, §§ 2055(c), 2056(b)(4)(A).

102. *Wachovia Bank & Trust Co. v. Green*, 236 N.C. 654, 658, 73 S.E.2d 879, 882 (1953); 2 N. WIGGINS, *supra* note 33, at 1084; Kahn *supra* note 58, at 1500-01.

103. Lowndes, *An Introduction To The Federal Estate and Gift Taxes*, 44 N.C.L. REV. 1, 35 (1965); Scoles & Stephens, *supra* note 23, at 926-27.

104. See text accompanying note 130 *infra*. The non-tax producing assets problem is discussed further in Lauritzen, *supra* note 11, at 85-88; Lindsay, *supra* note 20, at 63-64; Powell, *supra* note 2, at 341-42; Susman & Fourticq, *supra* note 80, at 1378-79; Note, 30 IND. L.J., *supra* note 80, at 232-34.

105. Cf. Scoles & Stephens, *supra* note 23, at 933.

106. See appendix in Susman & Fourticq, *supra* note 80, at 1401.

107. See text accompanying notes 101-04 *supra*.

108. UNIFORM ESTATE TAX APPORTIONMENT ACT, Commissioner's Note to § 6, *supra* note 32, at 499.

109. See Lauritzen, *supra* note 11, at 85. Other discussions are found in Powell, *supra* note 2, at 343-44; Note, 62 HARV. L. REV., *supra* note 80, at 1027.

solution to these problems is best left to a specific testamentary direction if a result other than that provided for by the statute is desired.<sup>110</sup>

### G. Computation

The effectiveness of an estate tax apportionment statute may be diminished if a uniform method of computation is not established.<sup>111</sup> Although several possible methods are available,<sup>112</sup> a statute could easily provide that a state official establish one formula to be applied for all estates.<sup>113</sup> Although apportionment may increase the complexity of estate accounting, one writer has observed that "[w]hile an annoyance, it hardly seems . . . this objection should be controlling if the statute is otherwise desirable."<sup>114</sup>

### H. Small Bequests

Under a basic tax apportionment theory a small specific bequest, which the testator may intend to pass to a beneficiary in full, would be diminished by its share of the tax. To eliminate this problem the apportionment statute could provide that any specific bequest comprising less than ten percent of the taxable estate would not be required to pay its share of the tax.<sup>115</sup> In a large estate, however, this provision could operate as a loophole allowing a sizable bequest to pass tax free, while increasing the amount of tax to be paid by other beneficiaries. In addition, such a provision would merely add to the complexities of estate accounting while solving a problem which is really important in only a small number of estates. Once testators become aware of the apportionment statute, a simple will provision can insure the tax free passage of small bequests where that is desired.

Another problem with the tax apportionment theory is the fact that the amount of tax levied on a recipient depends not only on the amount he receives, but also on the total amount of the taxable estate. The larger the estate, the higher the tax rate that each recipient must pay on his proportionate share of the tax. Thus smaller legacies will suffer

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110. See, e.g., Scoles & Stephens, *supra* note 23, at 928.

111. Note, 62 HARV. L. REV., *supra* note 80, at 1026. The failure of an early statute adopted in Maryland to allow for such a uniform method is credited as one reason for its repeal. See Mitnick, *supra* note 80, at 328-29.

112. See Mitnick, *supra* note 80, at 328-29.

113. See text accompanying note 125 *infra*.

114. Sheffield, *supra* note 4, at 17.

115. Susman & Fourtice, *supra* note 80, at 1396-97. But cf. Lindsay, *supra* note 20, at 69-70.

more than larger ones.<sup>116</sup> In one case, for example, where the estate totaled three million dollars, a bequest of ten thousand dollars was diminished by one-third because of the estate tax allocated to it.<sup>117</sup> This result is practically unavoidable, but if the basic purposes of an apportionment statute are to prevent the complete depletion of the residuary estate and to treat *all* beneficiaries as fairly as possible, the outcome is satisfactory.<sup>118</sup>

#### IV. PROPOSED NORTH CAROLINA STATUTE WITH COMMENTARY

This comment has examined the problems inherent in the present North Carolina "burden on the residue" principle and those which could arise under an apportionment doctrine. It is now important to detail a statutory scheme which would eliminate most of these difficulties. The commentary following each provision is designed to point out problem areas and also to provide an explanation of how present North Carolina law would be affected. The statute is an integration of provisions found in the Uniform Act,<sup>119</sup> a statute proposed by other writers,<sup>120</sup> and some original contributions.

##### Apportionment of Federal Estate Tax

(a) **Definitions.**—For the purposes of this Act:

(1) "Estate" means the gross estate of a decedent as determined for the purpose of the federal estate tax.

(2) "Fiduciary" means executor, administrator of any description, and trustee.

(3) "Person" means any individual, partnership, association, joint stock company, corporation, governmental agency, including any multiples or combinations of the foregoing as, for example, individuals as joint tenants.

(5) "State" means any state, territory, or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico.

(6) "Tax" means the Federal Estate Tax, and interest and penalties imposed in addition to the tax.

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116. See Mitnick, *supra* note 80, at 330; Comment, 41 U. CIN. L. REV. *supra* 70, at 911.

117. *In re Mollenhauer's Will*, 257 App. Div. 286, 13 N.Y.S.2d 619 (1939).

118. See Mitnick, *supra* note 80, at 330 n.196.

119. UNIFORM ESTATE TAX APPORTIONMENT ACT, *supra* note 32, at 491-502.

120. See Susman & Fourticq, *supra* note 80, at 1382-99.

*Commentary*

This is a basic definitional provision specifically delineating certain terms used throughout the Act. It should be noted that in (6), "tax" is meant to include only the federal estate tax. Although several states have included their own death taxes in an apportionment act,<sup>121</sup> the entire structure of the North Carolina inheritance tax would have to be re-shaped to fit into an apportionment system. Although uniform treatment for both state and federal death taxes seems desirable, the General Assembly should not adopt this approach without carefully considering the long history of its own statutory system. For that reason this statute is designed solely to remedy the effects of the "burden on the residue" rule applicable to the *federal* estate tax.

"Tax" is defined to include interest and penalties. This was done to avoid the problems existing under early statutes which were silent on this point.<sup>122</sup>

**(b) Apportionment**

(1) Except as otherwise provided in this Act, the tax shall be apportioned among all the persons interested in the estate. The apportionment shall be 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. The values as finally determined for federal estate tax purposes shall be used for the purposes of this computation. The method of computation shall be determined by (*appropriate state tax official*) and it shall be applied uniformly to all estates.

(2) The provisions of this act shall not apply where and to the extent that a testator provides otherwise in his will, or where in any other instrument direction to the contrary is provided for taxes assessed upon the specific fund dealt with in such instrument. Such contrary provision in a will shall be effective to preempt the application of this Act as to both probate and non-probate assets unless provided otherwise.

*Commentary*

This is the basic apportionment provision, and it is made applicable to both probate and non-probate assets.<sup>123</sup> The formula is the

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121. *Id.* at 1400.

122. See text accompanying notes 89-93 *supra*.

123. This would statutorily overrule the tax allocation position established in *Bufaloe v. Barnes*, 226 N.C. 313, 38 S.E.2d 222 (1946), and would establish a uniform rule for all assets.

same as that used by the Internal Revenue Code for apportioning taxes imposed on insurance proceeds and powers of appointment, so there should be no conflict with the provisions.<sup>124</sup> The provision expressly placing the responsibility for formulating a uniform method of computation on a state tax official is designed to prevent uncertainty as to the proper accounting method to be used.<sup>125</sup>

Subsection (2) is intended to preserve the decedent's actual intentions on where the tax burden should fall. In addition to a contrary will provision, the statute also permits a decedent to alter its application by the inclusion of a clause in any *inter vivos* instrument. This clause affects, by its terms, only the assets covered by the instrument. This alternative solves several problems inherent in the Uniform Act which allows contrary direction by will only.<sup>126</sup> It also provides a better possibility that the decedent's actual intentions will be preserved.

The last sentence of subsection (2) is designed to avoid the possibility that North Carolina will adopt the New York approach as to what type of will direction is required to prevent apportionment against non-probate assets.<sup>127</sup> A tax clause placing the burden of "my estate and inheritance taxes" upon the residue is surely meant to include those taxes due from *all* assets. This statutory provision is designed to achieve that result. Of course, the testator is free to limit this direction to either probate or non-probate assets.

It would be impossible to draft a statute defining what types of will provisions would be effective to overcome the effects of the statute—that problem must be left to the courts.

### (c) Procedure for Determining Apportionment

(1) The Clerk of Superior Court having jurisdiction over the administration of the testate or intestate portion of the estate of a decedent shall determine the apportionment of the tax upon the application of any person interested in the estate. If there are no probate proceedings, the Clerk of the Superior Court of the county wherein the decedent was domiciled at death shall determine the apportionment of the tax upon the application of the person required to pay the tax.

(2) If the Clerk finds that it is inequitable to apportion in-

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124. See note 27 *supra*.

125. See text accompanying notes 111-14 *supra*.

126. See Scoles & Stephens, *supra* note 23, at 919-22.

127. See text accompanying notes 77-79 *supra*.

terest and penalties in the manner provided in this Act because of special circumstances, he may direct apportionment thereon in the manner he finds equitable.

(3) The expenses reasonably incurred by any fiduciary and by any other person interested in the estate in connection with the determination of the amount and apportionment of the tax shall be apportioned as provided for taxes under this Act. If the Clerk finds that it is inequitable to apportion the expenses as provided, he may direct other more equitable apportionment.

(4) Any amount of tax which cannot be collected from any person shall be apportioned among all the other persons interested in the estate whose interests are subject to apportionment.

### *Commentary*

Subsection (1) is intended to incorporate the apportionment determination into the normal procedure for administering estates in North Carolina.<sup>128</sup> This will enable the new system to be implemented without the unnecessary creation of a special administrative agency or judicial officer.

Subsection (2) authorizes the clerk of Superior Court to alter the normal apportionment of interest and penalties in a situation where apportionment would be inequitable. If interest or penalties are imposed due to the fault of one or more persons interested in the estate or a fiduciary, the Clerk is free to place the burden on them.<sup>129</sup>

Subsection (3) extends the basic apportionment concept to any expenses incurred in determining the amount of tax and what each person should pay. As with interest and penalties, the Clerk has the discretion to apportion expenses in any manner he feels is equitable.

Subsection (4) makes it clear that in any case where a person's share of the tax cannot be collected, it will be apportioned among the other recipients.

### **(d) Exemptions, Deductions, and Credits**

(1) Any interest for which a deduction or exemption is allowable under the federal revenue laws in determining the value of the decedent's net taxable estate, such as property passing to or in trust for a surviving spouse and gifts or bequests for charitable, public, or similar purposes, shall not be included in the

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128. N.C. GEN. STAT. § 28-1 (1966) makes the Clerk of Superior Court responsible for estate administration.

129. See text accompanying notes 89-91 *supra*.

computation provided for in section (b) of this Act to the extent of the allowable deduction or exemption. To that extent no apportionment shall be made against such interest (except that when such an interest is subject to a prior present interest which is not allowable as a deduction or exemption, the estate tax apportionable against the present interest shall be paid from principal.

(2) Any credit for property previously taxed and any credit for gift taxes or death taxes of a foreign country paid by the decedent or his estate inures to the proportionate benefit of all persons liable to apportionment. Provided, however, that if the tax which gives rise to such a credit has in fact been paid by a person interested in the estate, the benefit of such credit shall inure to that person paying the tax.

(3) Any credit for inheritance, succession, or estate taxes or taxes in the nature thereof in respect to property or interests includable in the estate inures to the benefit of the persons or interests chargeable with the payment thereof to the extent that, or in the proportion that, the credit reduces the tax.

(4) To the extent that property passing to or in trust for a surviving spouse or any charitable, public, or similar gift or bequest does not constitute an allowable deduction for purposes of the tax solely by reason of an inheritance tax or other death tax imposed upon and deductible from the property, the property shall not be included in the computation provided for in this Act, and to that extent no apportionment shall be made against the property. This section does not apply in any instance where the result will be to deprive the estate of a deduction otherwise allowable under section 2053(d) of the Internal Revenue Code of 1954 of the United States, relating to deduction for state death taxes on transfers for public, charitable, or religious uses.

### Commentary

Subsection (1) is intended to preserve the idea that property not contributing to the tax should not be made to pay it. Thus, to the extent property qualifies for the marital or charitable deduction, it is omitted from the apportionment formula. This will avoid most computation problems inherent in these situations.<sup>130</sup> This section will overcome the holding in *Wachovia Bank & Trust Co. v. Green*<sup>131</sup> and will expand the proviso in section 30-3(a) of the General Statutes<sup>132</sup> to include all marital deduction situations. Therefore the proviso in

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130. See text accompanying notes 101-03 *supra*.

131. 236 N.C. 654, 73 S.E.2d 879 (1953).

132. N.C. GEN. STAT. § 30-3(a) (Supp. 1973).



section 30-3(a) should be omitted since it would be surplus. The exception for a future interest may be harsh in some situations, but any other method would involve immense computation problems.<sup>133</sup> The testator can always provide for this problem in his will or *inter vivos* instrument.

Subsection (2) provides for credits allowed to the estate for gift and foreign death taxes that have been paid. They will benefit all the recipients unless one or more has actually paid the tax, and in that situation the benefit of the credit should inure to him.<sup>134</sup>

Subsection (3) makes any credit allowed as a result of payment of state death taxes<sup>135</sup> inure to the benefit of those persons responsible for their payment.

Subsection (4), found in the Uniform Act, has been called "the most controversial part of the Act."<sup>136</sup> It is designed to allow the full advantage of a marital or charitable deduction in cases where the beneficiaries of a deductible devise or bequest would ordinarily be made to pay a part of the state death tax, thus reducing the amount actually allowed as a deduction, and thereby making that amount liable for payment of federal taxes.<sup>137</sup> The exception contained in the last sentence is to insure the estate does not lose a deduction available under section 2053(d).<sup>138</sup>

#### (e) Temporary and Remainder Interests

No interest in income and no estate for years or for life or other temporary interest in any property or fund is subject to ap-

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133. Scoles & Stephens, *supra* note 23, at 927-28; see text accompanying notes 107-10 *supra*.

134. See text accompanying note 97 *supra*.

135. See INT. REV. CODE OF 1954, § 2011.

136. Scoles & Stephens, *supra* note 23, at 928.

137. UNIFORM ESTATE TAX APPORTIONMENT ACT, Commissioner's Note to § 5, *supra* note 32, at 499 states:

[This] subsection . . . relates to a complicated portion of the Federal estate tax law concerning the marital deduction and charitable deductions. For the marital deduction, the problem with which the Section deals may be illustrated by the following: If a husband's will bequeaths half of his estate of \$200,000 to his wife, under ordinary circumstances \$100,000 would be deductible from the gross estate as a marital deduction. If, however, a state should assess an inheritance tax of \$10,000 against the bequest of the widow, \$90,000 only would be deductible and \$10,000 would be included in the gross estate and taxed. [The] Subsection . . . provides that in such an instance no apportionment is made against the \$10,000 of the widow's bequest, which was deducted in computing the Federal estate tax. The matter is ignored. The same is true as to transfers to exempt charitable institutions.

See Scoles & Stephens, *supra* note 23, at 929.

138. INT. REV. CODE OF 1954, § 2053(d). The workings of this section are discussed in Scoles & Stephens, *supra* note 23, at 929.

portionment as between the temporary interest and the remainder. The tax on the temporary interest and the tax, if any, on the remainder is chargeable against the corpus of the property or funds subject to the temporary interest and remainder.

### *Commentary*

The reasons for this provision have been discussed previously.<sup>139</sup>

#### **(f) Fiduciary's Rights and Duties**

(1) The fiduciary or other person required to pay the tax may withhold from any property of the decedent in his possession, distributable to any person interested in the estate, the amount of the tax attributable to his interest. If the property in possession of the fiduciary or other person required to pay the tax and distributable to any person interested in the estate is insufficient to satisfy the proportionate amount of the tax determined to be due from the person, the fiduciary or other person required to pay the tax may recover the deficiency from the person interested in the estate. If the property is not in the possession of the fiduciary or other person required to pay the tax he may recover from any person interested in the estate the amount of the tax apportioned to the person in accordance with this Act.

(2) If property held by the fiduciary or other person is distributed prior to final apportionment of the tax, the fiduciary or other person may require the distributee to provide a bond or other security for the apportionment liability in the form and amount prescribed by the fiduciary, with the approval of the Clerk of Superior Court having jurisdiction of the administration of the estate.

### *Commentary*

This section describes the actual method by which the tax may be collected and the property distributed. To avoid any undue delay in distribution, the property may be released by the fiduciary or other person upon the posting of security adequate to pay the tax.

#### **(g) Effective Date**

The provisions of this Act shall not apply to taxes due on account of the death of decedents dying prior to \_\_\_\_\_ (six months after enactment).

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139. See text accompanying notes 105-09 *supra*.

*Commentary*

This provision is designed to eliminate any possible problems with retroactive application.<sup>140</sup> Of course, realistically speaking, the Act will be "retroactive" as to instruments drawn before its enactment which control the estate of a decedent whose death comes after the effective date of the Act. It cannot be assumed that every testator will have his will revised to get the maximum effectiveness from the statutory apportionment. However, most carefully prepared wills contain a tax clause which will operate to effect the testator's intentions regardless of the status of state law. The statute is basically intended to bring about a more equitable result in cases where no careful tax planning was done. The six months delay will enable those persons who purposely relied on North Carolina's "burden on the residue" rule and left their wills silent as to tax payment to specifically include a tax clause in their wills requiring the residuary estate to bear the entire tax burden if they wish to avoid apportionment.<sup>141</sup>

## CONCLUSION

North Carolina's present approach to the allocation of the federal estate tax, the "burden on the residue" rule, is fraught with undesirable consequences. If the decedent fails to provide properly for the tax consequences, his entire testamentary plan may be upset. In most instances it is the decedent's closest relatives who will suffer. In addition, compelling the surviving spouse or a charitable recipient to contribute part of the tax diminishes the amount otherwise qualifying for a deduction, and the amount of tax levied on the entire estate is therefore increased.

Although the apportionment doctrine is not without its own problems, in the majority of situations it will provide an equitable result. It is hoped that the General Assembly will seriously consider the adoption of a statute similar to the one proposed in order to provide North Carolina estate recipients with the benefits currently enjoyed by persons in a majority of other states.

ROBERT LEE WATT III

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140. These problems are discussed in Mitnick, *supra* note 80, at 302-07; Schiaroli, *Apportionment of Federal and State Estate Taxes in Connecticut*, 20 CONN. B.J. 198, 203-06 (1946); Note, *Virginia Statute on Apportionment of Federal Estate Taxes*, 34 U. VA. L. REV. 370, 372-75 (1948).

141. Cf. Note, 34 U. PA. L. REV. *supra* note 140, at 373.