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TAX APPORTIONMENT AND INTER-VIVOS TRUSTS — THE CONFLICTS PROBLEM

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DURING the past few years, a large number of persons who foresaw that they would, upon their deaths, be in the Federal Estate Tax bracket have systematically attempted to divest themselves of enough of their money, while they were still alive, to reduce to a minimum that ultimate (and disproportionately heavy) tax burden which their survivors would have to bear.

The simplest method of diminishing the size of their estates was to give the money away during their lives. Since the gift tax is considerably less than the estate tax,[1] this would mean that sons, daughters, nephews, and nieces would get substantially more than they would otherwise receive were their rich relative to wait until his death to make the gift.

However, prudence dictated that the youth not be given the money outright, else he might squander his patrimony like the Prodigal Son, and return for an additional share before his elder's death. Hence, the normal method of making such a gift was by setting up an inter-vivos trust under the terms of which the youngster's grasp was considerably restricted, at least while the donor lived.

As a result of over-prudence, poor legal counselling, and zealous tax-collecting, many of these inter-vivos trusts[2] have been held to be a part of the donor's estate, and taxed for Federal Estate Tax purposes just as though there had been no gift.

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[1] Compare: I.R.C., § 2502 with I.R.C., § 2001.

[2] Of course, what is here said of Trusts applies equally well to any inter-vivos disposition later held a part of the taxable estate. The number of recent cases in which such inter-vivos trusts have been included in the taxable estates of decedents indicates that the problem is still a very real one, despite the time which has elapsed since the treasury made it clear that only the slightest revocability feature in a trust would result in its taxability as though the funds were still a part of the settlor's estate at his death. See, Michigan Trust Company v. Kavanagh, 137 F. Supp. 52, (D.C., E.D. Mich., 1955) where the donor-trustee possessed too much discretion with regard to distribution of trust property, and, hence, his estate was forced to bear an additional tax burden of $98,036.43, because of the determination that the trusts he set up were still a part of his taxable estate on death, and the even more recent case of State Street Trust Company v. United States, 263 F.2d 635 (1st Cir., 1959), in which the powers of the trustees (of which the settlor was one) were considered sufficient to show a retention of control by the settlor justifying inclusion of the inter-vivos trusts he set up in his estate for tax purposes.

To take a typical case: a father decides to take advantage of the lower gift-tax rates by setting up an inter-vivos trust for his son. If he waited until his own death to make the gift to his son, the tax "bite" would be greater, and hence the son would get less than would be the case from such an inter-vivos disposition. However, either because he anticipates the biblical "prodigal son" situation, or because he is afraid that the mother and he will not have enough money for themselves, should the son decide to be "mean" about it, and not take care of them from his gift, or perhaps due to poor legal advice he allows a possibility that, should the son predecease him, the money will come back to him, he retains an "interest" in the trust which he has set up.

If however, at the time of his death he enjoys:

(1) the possesion or enjoyment of, or the right to the income from, the property, or,

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom, or,

(3) if he has retained a "reversionary interest," (i.e., a possibility that the property may return to his disposition) exceeding 5% of the value of the property which is the subject of the gift, and the child's enjoyment of the gift is contingent upon his surviving his donor-father (I.R.C. s, 2037), or,

(4) if the father has any right to "alter, amend, revoke or terminate" the gift (I.R.C. s, 2038), then the entire value of the gift is a part of father's estate for tax purposes.

It is easy, even for competent lawyers, to fall into one of these traps set by the Code under which a life-time gift will unexpectedly be regarded as still the possession of the donor at his death. After the litigation as to its taxability the question then becomes who must pay the tax which has unexpectedly befallen the estate due to the inclusion of these imperfect inter-vivos transfers.

Fairness would seem to dictate that it be the recipient of the gift. However, often, the donor, because he does not anticipate that the trust will be considered a part of his estate at his death, fails to say anything on the subject in the instrument which sets up the trust and makes no clear provision on the subject in his will. What would be the testator's intent were he to be faced with the problem as it has materialized, would still seem to dictate that despite the effective silence of both instruments the tax burden should fall upon the trust recipient.

However, the normal rule is that the testator's (donor's) "official" estate, that is the one covered by his will, bears the burden of *all* Federal taxes levied.[3]

It is customary to leave one's residuary estate to the wife after the customary fixed (in amount) pecuniary legacies, and it is also customary (legally) that only what is left after everything else is paid off (including taxes) goes to the residuary beneficiary.

This has often meant that wives, intended to receive the bulk of the estate, after being forced to pay the taxes on the inter-vivos trust (held "includable" in the estate due to some revocability feature), were left with practically nothing. To remedy this situation, a number of states passed laws requiring that inter-vivos trusts later held includable in the testators' taxable estate bear their proportionate share of the Federal Estate (or local) taxes levied on those estates in which the inter-vivos trusts were included for Federal (or state) estate tax law purposes.[4]

The New York statute is typical. Decedent Estate Law, §. 124 provides:

1. Whenever it appears upon any accounting, or in any appropriate action or proceeding, that an executor, administrator, temporary administrator, testamentary trustee or other person acting in a fiduciary capacity, hereinafter called "fiduciary," has paid or may be required to pay an estate or other death tax under any law of the state of New York or of the United States upon or with respect to any property required to be included in the gross tax estate of a decedent under the provisions of any such law, hereinafter called "the tax," the amount of the tax, except in a case where a testator otherwise directs in his will, and except in a case where by any instrument other than a will, hereinafter called a "non-testamentary instrument," direction is given for apportionment within the fund of taxes

[3] See: Prentice-Hall, Inheritance and Transfer Taxes, paragraph 120,023 (loose-leaf service).

Of course, the incidence of the tax, at least upon this "estate," may be determined by the testator's words in his will on the subject. Difficulties arise when the will must be interpreted by an extra-domiciliary state with regard to the imposition of tax burden on inter-vivos transfers which have a situs in the extra-domiciliary forum state but which are part of the overall "estate" for Federal tax purposes. Added difficulties are encountered when instead (or in addition) there is a provision in the trust instrument regarding tax liability which must be interpreted by the non-situs domiciliary estate. For a possible solution, see note 38, infra.

Under the Federal Estate Tax law (I.R.C. § 2002), of course, the initial responsibility for payment of the tax is placed on the Executor, and, hence, the Will estate.

[4] A list of the states enacting such statutes, which supply an "intent" that each of the decedent's assets which are a part of his taxable estate be required to pay its share of the tax levied on that estate will be found in Prentice-Hall, Inheritance and Transfer Taxes, paragraph 120, 024 (loose-leaf service).

assessed upon the specific fund dealt with in such non-testamentary instrument, shall be equitably apportioned among the persons interested in the gross tax estate whether residents or non-residents of the state to whom such property is or may be transferred or to whom any benefit therein accrues, hereinafter called the "persons benefited," in accordance with the rules of apportionment herein stated, and the persons benefited shall contribute to the tax amounts apportioned against them.

Such statutes are eminently fair in that the father never intended that the mother should be reduced to penury because she had to pay the tax on the son's inter-vivos trust.

No problem, of course, arises where the donor dies in the same jurisdiction where the trust has been set up. Often, however, donors have been more trusting of the banks in states other than those in which they choose to die.

For example, New England testators, although they live in states other than Massachusetts, have often chosen Massachusetts' banks as the trustees of their inter-vivos trusts.[5] This may be understandable. However, Connecticut, Virginia, District of Columbia, California, Florida[6] and even New Jersey[7] residents have chosen New York banks as their trustees. Such a choice is harder to understand. True, Florida is a retirement state, and New York is considered "home" by people from all over the country, while New Jersey is a "commuter" state. It would seem however that the only recently

[5] This was the case in Isaacson v. Boston Safe Deposit & Trust Co., 325 Mass. 469, 91 N.E.2d 334 (1950).

[6] In In Re Cato's Estate, 276 App. Div. 651, 97 N.Y.S.2d 171 (1950), affirmed 301 N.Y. 653, 93 N.E.2d 924 (1950) and In re Bernie's Estate, — Misc. —, 74 N.Y.S.2d 887 (Sur. Ct. N.Y. County 1947) the decedent was a Florida domiciliary who set up a New York trust. Application of Chase Nat. Bank, — Misc. —, 55 N.Y.S.2d 470 (Sup. Ct. 1945) likewise involved a New York trust, but a California domiciliary, while Central Hanover Bank & Trust Co. v. Peabody, 190 Misc. 66, 68 N.Y.S.2d 256 (Sup. Ct. 1947) dealt with a Connecticut testator, settlor of a New York trust, while in Steinhardt v. Steinhardt, 192 Misc. 815, 78 N.Y.S.2d 481 (Sup. Ct., Spec. Term., N.Y. County 1947) although the trust was in New York, the decedent was from Virginia.

In re Berger's Estate, 183 Misc. 366, 50 N.Y.S.2d 550 (Sur. Ct., N.Y. County 1944) had to do with a New York trust and a District of Columbia domiciliary.

A related case under the New York statute was In re Adams' Estate, — Misc. —, 37 N.Y.S.2d 587 (Sur. Ct., N.Y. County 1940) wherein a devisee of New Hampshire land was held liable to contribute his tax share on the New York domiciliary's estate.

[7] In re Dominick's Estate, — Misc. —, 74 N.Y.S.2d 283 (Sur. Ct., N.Y. County 1945) involved a New York trust and a New Jersey decedent.

The New Jersey cases of Goldman v. Goldman, 2 N.J. Super. 412 (Ch. Div. 1949), and, apparently, Bankers Trust Co. v. Hess, 2 N.J. Super. 308 (Ch. Div. 1949), involved trusts set up in New York by New Jersey domiciliaries.

alleviated legal difficulties of a New York trust[8] should counterbalance such emotional ties, understandable as they should be for the legally unenlightened.

But, understandable or not for laymen, the folly of such a course should be obvious to lawyers, even if they do not choose to make it clear to their clients. All of the "apportionment" statutes are vague,[9]

[8] Apart from the problems normally created by bi-state administration, there are problems inherent, even for New Yorkers, in choosing a state which until recently had such a stringent perpetuities rule (See: L. 1958, c. 153 amending Real Prop. Law, § 42), and still has limitations on permissible accumulations (Pers. Prop. Law, § 16 as amended by L. 1959, c. 453).

[9] For example, the New Jersey statute, N.J.S. 3A: 25-31 provides:
"Whenever a fiduciary has paid or may be required to pay an estate tax under any law of the State of New Jersey or of the United States upon or with respect to any property required to be included in the gross tax estate of a decedent under the provisions of any such law . . ." the tax shall be apportioned.
Fiduciary is defined as follows (N.J.S. 3A: 25-30):
"c. 'Fiduciary' means any person acting in a fiduciary capacity who is required to pay the tax."

Thus, the statute includes New Jersey executors as well as New Jersey trustees. The statute, therefore, requires that a local trust contribute to an out-of-state estate, and conversely that the New Jersey executor be given a decree that out-of-state trusts be required to pay their share of taxes levied on New Jersey estates. The statute is silent on the problem raised if the out-of-state court decides that its trusts should not pay any tax, or conversely, if the out-of-state court is the domiciliary court and its law refuses to accept contribution from a New Jersey trust. In fine, the statute does not express a "choice of law" rule: it fails to differentiate between the testator's domicile and the trust situs.

The New York statute as will be noted is equally vague. (See supra, p. 376.)

Another typical statute, that of Florida, (§ 734.041 F.S.A.), although it was explicit in extending its ambit to cover both the executor and the inter-vivos trustee, likewise failed to face the "choice of law" problem bound to arise where domiciliary and situs state are different. It provided:

"(1) Whenever it appears upon any accounting or in any appropriate action or proceeding, that an executor, administrator, trustee or other person acting in a fiduciary capacity, has paid, or there is owing, a death tax levied or assessed under the provisions of the tax laws of the state or under the provisions of any United States revenue act, upon or with respect to any property required to be included in the gross estate of a decedent under the provisions of any such law, the amount of the tax so paid, or owing, except in a case where a testator otherwise directs in his will, and except in a case where by written instrument executed inter vivos, direction is given for apportionment within the fund of taxes assessed upon the specific fund dealt with in such inter vivos instrument, 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. Such proration shall be made by the county judge in the proportion, as near as may be, that the value of the property, interest or benefit of each such person bears to the total value of the property, interest and benefits received by all such persons interested in the estate, except that in making such proration allowances shall be made for any exemptions granted by the act imposing the tax and for any deductions allowed by such act for the purpose of arriving at the value of the net estate; and except that in cases where a trust is created, or other provision made whereby any person is given an interest in income, or an estate for years, or for life, or other temporary interest in any property or fund, the tax on both such temporary interest and on the remainder thereafter shall be charged against and be paid out of the corpus of such property or fund without apportionment between remainders and temporary estates. For the purposes of this act the term 'persons interested in the estate' shall mean, with respect

furthermore, they can clearly have no extra-state force: if New York says the trust is to be taxed it can only enforce its rule against New York trusts.[10] The same is true, of course, of any situations in which the testator-donor's domicile differs from that of the situs of the trust.

In such instances the court of the state where the testator died is faced with a "choice of law" problem, i.e., will the law of the testator's domicile govern the out-of-state trust's liability for taxes, or will the law of the situs of the trust govern? The same problem arises when the out-of-state executor sues in the trust-situs-state for the trust's pro rata share of the tax. Will the trust-situs state enforce its own law or the law of the testator's domicile?[11]

The problem is further complicated when the domiciliary state has a statute which by its terms requires contribution while the situs state has no such statute.[12]

Neither the United States Constitution nor the Federal Estate Tax Law require a choice either way.[13] It is therefore left up to

to both state and federal taxes, all persons who may be entitled to receive or who have received any property or interest which is required to be included in the gross estate of a decedent, or any benefit whatsoever with respect to any such property or interest."

Apparently, dissatisfaction with the uncertainties created by this section was the reason for the drastic revision which took place in 1957, amounting in effect to its repeal. Since amendment by L. 1957, c. 57-87 the section provides:

"(1) All estate, inheritance, succession and death taxes imposed upon the estate of a decedent and required to be paid by the personal representative, shall be paid from the residuary estate of the testator, without requiring contribution from any person receiving property taxable as a part of the estate of the testator. In the event there is no residuary estate or if such residuary estate is insufficient for the payment of such taxes, the property of the testator passing under the provisions of his will shall be used for the payment of such taxes in the order specified in § 734.05. Nothing in this statute shall prohibit a testator from directing in his will that said taxes be apportioned or paid in a manner other than as provided in this section."

[10] See: Restatement of Conflicts, § 610 Comment c:

C. No action can be maintained by a foreign state to enforce its license or revenue laws, or claims for taxes.

[11] The cases dealing with estate tax apportionment where a "conflicts" problem is involved are collected in an Annotation in 16 A.L.R.2d 1282. See also, Nossaman, Trust Administration and Taxation, §§ 762, 763.

[12] This was the situation, e.g., in Fidelity Union Trust Co. v. Anthony, 13 N.J. Super. 596 (Ch. Div. 1951), aff'd, 18 N.J. Super. 49 (App. Div. 1952) decided before New Jersey's apportionment statute was passed.

[13] The Federal Tax law does provide, however, that unless the Will otherwise directs, the executor may recover "such portion of the total tax paid as the proceeds of . . . (insurance policies held to be part of the taxable estate for Federal tax purposes) bear to the sum of the taxable estate and the amount of the exemption allowed in computing the taxable estate, determined under section 2051." (I.R.C. § 2206).

The only effect of I.R.C. § 2205 is to prevent extra-Will-estate assets from being compelled to pay more than their pro rata share. It provides:

"Reimbursement Out of Estate. If the tax or any part thereof is paid by, or

the individual states to decide whether they will decree an apportionment, i.e., compel the trust to pay its pro rata share of the tax, or allow the full tax burden to fall wholly on the estate which passes under the will. And likewise each state's fiduciary (either executor or trustee) is left with his own problem of enforcing his state's decree in the other jurisdiction.

As was to be expected in such a situation, the few cases which have decided the matter have taken divergent views. The New York courts have generally held that the law of the testator's domicile would be applied, even where this meant subjecting New York trusts

collected out of, that part of the estate passing to or in the possession of any person other than the executor in his capacity as such, such person shall be entitled to reimbursement out of any part of the estate still undistributed or by a just and equitable contribution by the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts, or other charges against the estate, it being the purpose and intent of this chapter that so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution."

Only one other provision of the Estate Tax Law has any relevance to the problem. It is § 2207 which provides:

"Unless the decedent directs otherwise in his will, if any part of the gross estate on which the tax has been paid consists of the value of property included in the gross estate under section 2041, the executor shall be entitled to recover from the person receiving such property by reason of the exercise, non-exercise, or release of a power of appointment such portion of the total tax paid as the value of such property bears to the sum of the taxable estate and the amount of the exemption allowed in computing the taxable estate, determined under section 2052, or section 2106(a), as the case may be. If there is more than one such person, the executor shall be entitled to recover from such persons in the same ratio. In the case of such property received by the surviving spouse of the decedent for which a deduction is allowed under section 2056 (relating to marital deduction), this section shall not apply to such property except as to the value thereof reduced by an amount equal to the excess of the aggregate amount of the marital deductions allowed under section 2056 over the amount of proceeds of insurance upon the life of the decedent receivable by the surviving spouse for which proceeds a marital deduction is allowed under such section."

As will be noted none of these provisions cover the typical situation where a completed inter-vivos disposition of property is later (unexpectedly) held includable as a part of the taxable estate of the decedent. (See Warfield v. Merchants National Bank of Boston, — Mass. —, 147 N.E.2d 809 (1958), at 147 N.E.2d 811-812.)

The field of tax apportionment (or ultimate incidence) is therefore generally left to the states. Riggs v. Del Drago, 317 U.S. 95, 63 S. Ct. 109, 87 L. ed. 106 (1942) reversing 287 N.Y. 61, 38 N.E.2d 131 (reargument denied, 287 N.Y. 764, 40 N.E.2d 46 (1942) reversing 175 Misc. 489, 23 N.Y.S.2d 943 (Sur. N.Y. County 1940)).

Although an argument could be made (on the basis, e.g., of such cases as Order of United Commercial Travelers v. Wolfe, 331 U.S. 586, 67 S. Ct. 1355, 91 L.Ed. 1687 (1947)) that the Full Faith and Credit Clause of the Constitution requires the situs state to apply the statute of the domiciliary state, no Supreme Court decision positively supports this view. As to the Constitutional question, therefore, a state is probably justified in ignoring both the apportionment statutes and decisions of the state of decedent's domicile if it chooses to do so, in the present posture of the law. See also note 10, supra.

to taxes,[14] while Masachusetts has held that the law of the trust situs controlled, and, therefore, that a Masachusetts' trust would not be subjected to taxes although the law of the testator's domicile demanded that inter-vivos trusts pay their share of the final tax levied.[15] Minnesota and Michigan have followed the Masachusetts' view.[16]

Probably the ultimate in confusion was reached by a 1949 New Jersey decision (decided before passage of New Jersey's own apportionment statute) forbidding the New Jersey executor to accept the tax contribution to which a New York court had decreed he was entitled from a New York trust included by the Federal tax authorities in the New Jersey decedent's estate.[17]

The chaotic condition of the law in this field is due primarily to the novelty of the situation and the inability of the courts to decide under which of two conflicting conceptual frameworks the problem best fits. The normal rule is that the situs of an inter-vivos trust determines what law will govern it. This is, in effect, merely an extension of the older rule that the law of the place of contracting is the one which will be applied, wholly apart from the place of residence of the parties. This is the present Restatement rule with respect to trust validity and administration, and was the rule selected by the Massachusetts' court to free its local trust of the tax liability.[18]

However, with respect to testamentary matters, for example, the validity and interpretation of wills, the place of the location of per-

[14] See note 6, supra.

[15] See supra note 5, Isaacson v. Boston Safe Deposit & Trust Co.; see supra note 13, Warfield v. Merchants National Bank of Boston.

[16] First National Bank of Miami v. First Trust Co. of St. Paul, — Minn. —, 64 N.W.2d 524 (1954); Knowles v. National Bank of Detroit, 345 Mich. 671, 76 N.W.2d 813 (1956).

[17] Goldman v. Goldman, 2 N.J. Super. 412 (Ch. Div. 1949).

[18] The Massachusetts court relied on Restatement of Conflicts, §§ 47-49. They provide:

"§ 47. Jurisdiction Over Persons in General

(1) A state has jurisdiction over a person:
  (a) if he is within the territory of the state,
  (b) if he is domiciled in the state although not present there,
  (c) if he has consented or subjected himself to the exercise of jurisdiction over him either before or after the exercise of jurisdiction.

"§ 48. Jurisdiction Over Immovables

An immovable thing is subject to the jurisdiction of the state within which it is.

"§ 49. Jurisdiction Over Chattels

Except as stated in § 50 which deals with merger of the title of a chattel in a document, a chattel is subject to the jurisdiction of the state within which it is."

It might perhaps more appropriately have relied on those sections of the Restatement dealing expressly with trusts. For example, Restatement of Conflicts, §§ 294, 297, 299, 241, 243.

sonalty is unimportant. The normal rule is that personalty will be dispensed in accordance with the law of the testator's domicile, regardless of the asset's physical location. This rule too finds support in the Restatement. (Restatement, Conflicts, § 306).[19]

And, since a testator is presumed to draw his will in contemplation of his domiciliary law, such tax apportionment statutes may be read as supplying an omitted distributive intent in the will.

Either view, is therefore, equally *logical,* since the tax ruling merges the inter-vivos transaction with the testamentary. The question remains, however, as to which is practically best.

It seems clear that under the New Jersey statute, should the New Jersey trustee ask that his trust part with some of its money to pay the estate tax on an out-of-state decendent's estate (a rather unlikely prospect), the New Jersey court will now adjudge that the New Jersey trust should remit sufficient cash to cover its proportionate share of the over-all estate tax to the out-of-state executor at least where the law of the testator's domicile has a similar statute (and the testator's will does not conflict with such a determination).[20]

Where the law of the testator's domicile contains no such statute, the determination is even less predictable. Such cases as *Goldman v. Goldman,* 2 N. J. Super. 412 (Ch. Div. 1949), and *Bankers Trust Co. v. Hess,* 2 N. J. Super. 308 (Ch. Div. 1949), involving New Jersey domiciliaries imply that the law of testator's domicile will be applied.[21] Such a choice of governing law, however, is not part of the *ratio decidendi,* but only implicit in the choice actually made, in each of these cases.

[19] Restatement of Conflicts, § 306, provides:
"The validity and effect of a will of movables is determined by the law of the state in which the deceased died domiciled."
There is no present Restatement provision to cover the exact problem here involved.
The problem is hardly aided by the fact that the forthcoming revised Restatement of the Law of Conflicts will probably delete sections 47-49 (See: Restatement of the Law, Second, Conflict of Laws, Tentative Draft No. 3, April 19, 1956, p. 36) and forthcoming § 306 likewise does not make any more express provision on the subject than is contained in the present Restatement rule.

[20] N.J.S. 3A: 25-31, quoted above, note 9. Although the New Jersey trustee might not seek an apportionment against his trust, the definition of "fiduciary" is probably broad enough to allow suit directly by the out-of-state executor to compel the trust to contribute.

[21] See also the early case of Jenkins v. Guarantee Trust & Safe Deposit, 53 N.J. Eq. 194 (Err. & App. 1895) and the case of Fidelity Union Trust Co. v. Anthony, 13 N.J. Super. 596 (Ch. Div. 1951), aff. 18 N.J. Super. 49 (App. Div. 1952) holding that New Jersey trustees who had paid their share to the Ohio executor were not entitled to reimbursement from the estate.

Since there has been no New Jersey case which has actually consciously (if the words of the decision are our guide) faced the choice problem, it is unfortunately impossible to predict definitely the result in the event of litigation on the interpretation to be placed on the statute.

New Jersey is probably typical of the uncertainty existing throughout the country where testators have chosen to set up tax-defective trusts in one state, and have died domiciled in another.

Even the New York courts have not been completely consistent in their interpretation. For example, it is implicit in the *Goldman* case that a New York court (apparently in an unreported opinion) decided that the New York statute would apply and therefore forced the New York trust to pay (or offer) its share of the estate tax even though the domiciliary law (New Jersey prior to the enactment of its apportionment statute) would require the will estate to pay the tax on the inter-vivos trust.

But, of those jurisdictions which have faced the problem, Massachusetts has, in a recent case, taken a position which cannot but help to increase the confusion already present: *Warfield v. Merchants National Bank of Boston,* involved a suit by the executor of a New York decedent to compel a Massachusetts' trust to contribute its share of the Federal tax imposed when an inter-vivos Massachusetts' trust was held includable in the decedent's estate. The New York court had already held, in *In Re Slade's Estate,* 158 N.Y.S.2d 719 (Sur. Ct., N.Y. County, 1956), that the trust was liable to pay its proportionate share of the estate tax levied, and had directed the executor to recover that share from the Massachusetts' trustee which had refused to submit voluntarily to New York jurisdiction.

The Supreme Judicial Court of Massachusetts held that the New York executor was not entitled to recover the amount he had paid from the will estate for taxes assessed on the Massachusetts' trust, despite the New York adjudication, and more surprising, despite the fact that Massachusetts itself has a statute requiring inter-vivos trusts later included in decedents' estates to put up their proper part of the overall estate tax. The Massachusetts' court relied on previous decisions holding that the Massachusetts' statute only applied to residents' estates, and the Isaacson case's[22] determination that the law of decedent's domicile could have no extraterritorial effect.

[22] See note 5, supra.

The court ruled, probably quite properly, that it was not bound under the Full Faith and Credit Clause of the United States Constitution to recognize the New York decree.[23] It, however, ignored the fact that its decision offended the announced policy not only of the state of decedent's domicile, but also of its own state, which likewise has determined by its enactment of an apportionment law,[24] that unexpected additions to a decedent's estate should be treated as, in all likelihood the decedent-donor would decide they should be, had he the opportunity to make a present choice: namely, that they be made to bear their share of the burdens concomitant with the trust beneficiaries' benefit.

Despite the fact that the New York cases with a single exception (which denied apportionment under the circumstances) are lower court decisions, and may lack the clarity of reasoning that the Massachusetts' cases possess, it would seem therefore that the two-fold and somewhat inconsistent New York view is better than the simpler Massachusetts' rationale, since more apt to do substantial justice, and hence accord with the testator's real intent had he the opportunity to exercise it in the unforeseen circumstances which have arisen.

The New York rule is superior because, although professing to support the choice of the law of the testator's domicile as controlling, seems really to be that apportionment will be enforced wherever the

[23] See notes 10 and 13, supra.

[24] Ann. Laws of Mass., C. 65A, § 5 provides:

"Equitable Apportionment of Tax Among Persons Interested in Estate.—Whenever it appears upon any accounting, or in any appropriate action or proceeding, that an executor, administrator, trustee or other person acting in a fiduciary capacity, has paid or may be required to pay an estate tax levied or assessed under the provisions of this chapter, or under the provisions of any estate tax law of the United States heretofore or hereafter enacted, upon the transfer of the estate of any person who at the time of his death was an inhabitant of this commonwealth, the net amount of said tax shall be apportioned among and borne by recipients and beneficiaries of the property and interests included in the gross estate in the following manner:—

* * *

2. If any portion of the property with respect to which such tax is levied or assessed is held under the terms of any trust created inter-vivos or is subject to such a power of appointment, such proportion of the net amount of the tax so levied or assessed shall, except as otherwise provided or directed by the trust enstrument with respect to the fund established thereby, or by the decedent's will, be charged to and paid from the corpus of the trust property or the property subject to such power of appointment, as the case may be, as the net amount of the property of such trust or property subject to such power of appointment and included in the measure of such tax bears to the amount of the net estate as hereafter defined in this section. The amount so charged shall not be apportioned between temporary and remainder estates."

Although by its terms only applicable to estates of Massachusetts' decedents, the statute indicates that no public policy would be offended by according enforcement of another state's similar statute against Massachusetts' trusts.

circumstances would indicate that this is the just solution to the problem. For example, it decreed that a New York trust bear its share of the tax burden even where, as it turned out, the testator's domicile did not require such an apportionment (in the New York counterpart to the *Goldman* case), and, on the contrary, where the assets had long since passed into the hands of innocent third parties, refused to do so in the *Buckman* case,[25] although the testator's domiciliary law (its own) clearly required an adjudication of trust liability.

Undoubtedly, the best solution to the entire problem would be a provision in the Federal Estate Tax law over-ruling *Riggs v. del Drago*,[26] and providing for the ultimate incidence of the estate tax where non-will assets are included in the decedent's estate for tax purposes. Congress had the chance to adopt such a provision in 1954 when the new Internal Revenue Code was enacted. It, unfortunately, chose to reenact practically unchanged the tax liability provisions of the 1939 Code, and has made no changes since.

The next best solution would be a uniform law enacted by all the states. In 1958, after considering the matter for six years, the Commissioners on Uniform State Laws promulgated just such a proposed uniform act.[27]

The operative provision of the proposed statute[28] provides:

[25] Although as indicated above, New York has held that the domiciliary law governs, it has refused to decree the liability of out-of-state inter-vivos assets, where their beneficiaries were not also legatees under the will estate, and were not personally before the court in the estate accounting proceeding. In re Buckman's Will, 270 App. Div. 707, 62 N.Y.S.2d 337 (1st Dept. 1946), aff. per cur. 296 N.Y. 915, 73 N.E.2d 37 (1947), cert. denied 332 U.S. 763, 68 S. Ct. 67, 92 L. Ed. 348, reversing 183 Misc. 1, 50 N.Y.S.2d 201 (Sur. N.Y. County, 1944). Viewed negatively, as a determination merely of the amount of tax owed by the will estate (i.e., that it is not liable for the entire tax burden), there would seem to be a sufficient "res" within the state to confer jurisdiction to decree that an apportionment should be made. The Appellate Division, however, ruled (and was sanctioned by the Court of Appeals) that such an apportionment determination would be unconstitutional. This fear may be allayed by the recent decision of the U.S. Supreme Court in McGee v. International Life Ins. Co., 355 U.S. 220, 78 S. Ct. 199, 2 L. Ed. 2d 223 (1957). See, also, the A.L.I. Restatement, Tentative Draft No. 3, Conflict of Laws, (1956), § 74, which supports jurisdiction so long as "the person's relationship to the state is such as to make the exercise of judicial jurisdiction reasonable."

[26] See note 13, supra.

[27] As to its adoption see: Handbook of the National Conference of Commissioners on Uniform State Laws (1958), p. 131. For text of the proposed uniform law, see: idem p. 221 et seq.

[28] Uniform Estate Tax Apportionment Act. The provisions of the act are set forth at some length because of the relative unavailability of the act itself. Due to its newness, and the consequent failure of any state to adopt the act prior to most recent supplement, it is not included in the Uniform Laws Annotated.

Unless the will otherwise provides, the tax shall be apportioned among all 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 used in determining the tax shall be used for that purpose.

"Tax" is defined as the Federal estate tax, together with interest and penalties imposed, and in optional provisions for states choosing to enact them, is broadened to include "the estate tax payable to this state," and (for states which have an inheritance tax payable by the decedent's estate) "the death duty payable by a decedent's estate to this state." (section 1(e)).

"Estate" is defined as follows (the bracketed portions being optional):

"Estate" means the gross estate of a decedent as determined for the purpose of Federal estate tax (and the estate tax payable to this state) (and the death duty payable by a decedent's estate to this state). (section 1(a)).

Thus, of course, all inter-vivos trusts later held to be a part of the decedent's estate for any tax purpose may be covered, if the state chooses to do so, and thus become subject to paying their proportional share of the tax burden.

Likewise, "all persons interested in the estate," presumably includes all beneficiaries of such inter-vivos dispositions. The term is defined as follows:

"Person interested in the estate" means any person entitled to receive, or who has received, from a decedent or by reason of the death of a decedent any property or interest therein included in the decedent's estate. It includes a personal representative, guardian, and trustee. (section 1(c)).

The definition, of course, could be made clearer by adding after the words "from a decedent," the words "including inter-vivos gifts held includable in the estate." However, the terminology used is probably not sufficiently ambiguous to cause real worry about its meaning.

Section 3 provides the procedure for making the apportionment. It states:

(a) The (Probate Court) having jurisdiction over the administration of the estate of a decedent shall determine the apportionment of the tax. If there are no probate proceedings, the (Probate Court)

of the (county) wherein the decedent was domiciled at death upon the application of the person required to pay the tax shall determine the apportionment of the tax.

(b) If the (Probate Court) finds that it is inequitable to apportion interest and penalties in the manner provided in Section 2, because of special circumstances, it may direct apportionment thereof in the manner it finds equitable.

(c) If the (Probate Court) finds that the assessment of penalties and interest assessed in relation to the tax is due to delay caused by the negligence of the fiduciary, the court may charge the fiduciary with the amount of the assessed penalties and interest.

(d) In any suit or judicial proceeding to recover from any person interested in the estate the amount of the tax apportioned to the person in accordance with this Act, the determination of the (Probate Court) in respect thereto shall be prima facie correct.

Section 3(b), it will be observed, provides for such a situation as that in *In re Buckman's Will,*[29] where the inter-vivos gifts had long since been distributed and the attempt was made to hold the personal representatives of deceased beneficiaries, but, strangely enough, limits its beneficial effect to interest and penalties, and omits the basic tax liability itself.

Section 3(d) is unfortunate in its concession that the domiciliary court's decision will only be deemed to be "prima facie" correct. Such a provision is no answer to the problem posed by the *Warfield* and *Slade* cases.[30] Massachusetts might well concede that the New York court's decision in the *Slade* case was "prima facie correct," *under New York law,* and yet refuse, as it did, to enforce that decision against a Massachusetts' trust's assets. The statute refuses, apparently due to fears of unconstitutionality,[31] to take a more positive

[29] See note 25, supra.

[30] See, supra note 13, Warfield v. Merchants National Bank of Boston.

[31] The Comment to the section states:

"In the original draft of the Act this section was Section 4 entitled 'Procedure for Determining Tax' which provided that the Probate Court of the county in which the decedent was domiciled would have jurisdiction to hear and determine the apportionment. At the Boston meeting in 1953 the Conference directed that the section be eliminated in its entirety because it was thought that in instances where the beneficiary was not before or subject to the jurisdiction of the Orphans Court, for example, in suits for apportionment relating to transfers inter-vivos, the Probate Court could not constitutionally bind the beneficiary. It was thought that the then preceding Section 3, entitled 'Determination of Proration' providing for suits for recovery of the apportioned tax was sufficient. After consideration the Section of Taxation, A.B.A., and the members of the Committee who have expressed an opinion believe that the Probate Court should determine the apportionment as a part of the administration procedure. This is in accord with most, if not all of the state statutes. Moreover, it provides for the alteration of apportionment of interest and penalties in special

stand. It allows the courts of the decedent's domicile to decide whether or not the tax should be apportioned (something the cases indicate it would do anyhow), yet it does not provide that that state's determination will be binding on the state in which the inter-vivos assets are located. Clearly it could do this, at least where both domiciliary and trust state had enacted the same statute.

Like the state statutes already enacted, the uniform act establishes no clear choice of law to be followed by both domiciliary and situs states.

The provision (section 8) for enforcement of the domiciliary state's apportionment determination in the courts of the situs state[32] is even more disappointing. It provides (brackets again indicate optional terms):

(a) Subject to the conditions in subsection (b) of this section, a fiduciary acting in another state or a person required to pay the tax (domiciled) (resident) in another state may institute an action in the courts of this state and may recover a proportionate amount of the federal estate tax, of an estate tax payable to another state or of a death duty due by a decedent's estate to another state, from a person interested in the estate who is either (domiciled) (resident) in this state or who owns property in this state subject to attachment or execution. For the purpose of the action the determination of apportionment by the court having jurisdiction of the administration of the decedent's estate in the other state shall be prima facie correct.

(b) The provisions of subsection (a) of this section shall apply only:

(1) If such other state affords a remedy substantially similar to that afforded in subsection (a) hereof;

(2) With respect to Federal estate tax, if apportionment thereof is authorized by Congress.

Thus, in addition to the previous vagueness inherent in giving the

instances and the charging of interest and penalties against a fiduciary where his neglect has caused them. In order to meet the constitutional objection as above stated, the section provides that the determination of the Probate Court shall be prima facie only in any suit to recover the apportioned tax. For exactness the word 'Tax' in the title has been changed to 'Apportionment.' Provisions of subsections (b) and (c) have been taken from the Pennsylvania and Nevada Acts which seem to have worked well."

32 The statute is, of course like so many of the present laws, drawn in terms to cover suit by the trustee of the inter-vivos trust to recover from the will estate what taxes he might have been required to pay from the trust in excess of its pro rata tax share. Because primary payment responsibility is placed upon the will estate (see I.R.C. (1954) § 2002) such suits are less likely than suit by the executor against the inter-vivos trust for its share of the tax.

domiciliary state's determination only "prima facie" validity, the section only offers the executor the opportunity to sue for contribution where the domiciliary state has a law similar to that of the situs state. This seems a clear retrogression, since it may foreclose suit in a situs state which has the uniform statute by an out-of-state executor whose state has no such statute, even though the situs state, acting out of equitable considerations, might desire to force a contribution from its local trust.

Clearly, the "equity" of its own statute would suggest such a policy,[33] which should not be contingent upon the domiciliary state's having a reciprocal statute.

The section is ambiguous in a further respect. It allows the suit for reimbursement with respect to the Federal estate tax only "if apportionment thereof is authorized by Congress." Congress has only *expressly* authorized apportionment of the Federal Estate tax in three limited cases.[34] With regard to most situations involving inter-vivos dispositions it has, regrettably, not spoken. Is its silence to be taken as an authorization? Or does the statute mean to exclude all but the obvious cases for which no state apportionment statute is needed?

Fortunately, this area of uncertain coverage is perhaps not as large as might at first appear. Although laymen speak of the large estate tax "bite" as the Federal tax, it is usually, in reality, a *state* estate tax designed to take advantage of the credit given on the Federal return to such taxes.[35] Nonetheless, even limited areas of uncertainty are hardly desirable, and render a statute *pro tanto* defective.

Because of the above defects the proposed uniform law is only a slight improvement over the statutes already enacted. Even a reciprocal statute which simply said that the law of the testator's domicile

[33] As to the use of a statute, analogously to a case decision under the common law, as "persuasive authority" to cover situations not expressly included, see de Sloovere, Equity and Reason of a Statute, 21 Cornell L.Q. 591 (1936) Thorne, The Equity of a Statute and Heydon's Case, 31 Ill. L. Rev. 202 (1936); Landis, Statutes and The Sources of Law, Harvard Legal Essays (1934), Stone, The Common Law In the United States, 50 Harv. L. Rev. 4 (1936).

[34] See note 13.

[35] I.R.C. § 2011(a) provides:

"The tax imposed by section 2001 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or Territory or the District of Columbia, in respect of any property included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent)."

The Uniform Act's reference to "Federal estate tax" is, however, still ambiguous, since the expression might be interpreted as barring apportionment of such state estate taxes since so intimately tied to the Federal imposition.

and its court's determination would control (or for that matter one which made the law of the situs dispositive) would be an improvement, since it would avoid confusion. Simple if arbitrary laws are usually better than ones which cause confusion, at least in areas where a person may deliberately plan his conduct in accordance with their certain application. Such a statute would at least do away with tax uncertainty in situations where the testator's domicile and the situs state had the same unambiguous statute.

Unfortunately, no one involved seems concerned enough with the "unseemly spectacle" of ambiguous laws, and their concomitant, unenforceable judgments, to provide a single rule for all such interstate cases. The uniform act, despite its failure to significantly improve the enforcement position of such hapless executors as that in the *Warfield* case,[36] does have the small virtue of impliedly making a choice of law in favor of the testator—settlor's domicile as controlling. However, to date even this slight improvement in the statutory answer to the problem has been enacted in only two states, New Hampshire and Wyoming.

The problem will, therefore, probably remain for a long time one of judicial interpretation of the inadequately drafted statutes already legislated. Since, although twenty states have enacted tax apportionment statutes, only four jurisdictions (New York, Massachusetts, Minnesota and Michigan) so far have definitely passed on the conflicts problem, much more litigation in this field is to be expected. What the conflicts decision in the forty-seven jurisdictions[37] yet to rule on the question should be is thus a matter of more than passing importance.

In the absence of the more adequate statutes which it is hoped will be forthcoming, it is suggested that the donor-testator's testamentary (or final) intent should be the touchstone of decision even in determining which law should govern, and that this intent may always (in the absence of a clear expression in the will or trust instrument to the contrary)[38] be presumed to be that the will estate not

[36] See supra note 13, Warfield v. Merchants National Bank of Boston.

[37] The fifty states and the District of Columbia less the four states which have passed on the question. Fortunately, some of the uncommitted states have indicated in dicta that they would follow the New York rather than the Massachusetts rule. See: Annotation, 16 A.L.R.2d 1282, and Supplements thereto.

[38] There is, of course, an additional problem where there is a conflict between

bear the burden of a tax on inter-vivos dispositions later unexpectedly held tied to the will estate for tax purposes.

On this assumption the New York rule is preferable: The trust situs if it has an apportionment statute should always in the absence of a clear showing of inequity offer to pay the trust's share of the estate tax; the domiciliary state should always, in the absence of a clear showing of inequity, request the trust to contribute, and hope that the situs state will accept its decree.

This is surely the best way of effectuating the testator-settlor's intent—the problem is after all merely the determination of one total intent—and this is true despite a general provision in the will that all taxes be paid from the residuum, and is, therefore, sanctioned on the oldest of policy grounds.[39]

In short, the choice of law should not be determined by either of the mechanical Restatement rules but should be made simply in answer to the question: Which state's law will require the inter-vivos trust to bear its pro rata share of the tax burden? The law of that state, be it the law of the situs or of the domicile should be chosen by the deciding state, whether that forum state be the situs or domicile, and

provisions of the trust instrument and the will as to tax liability. The problem is heightened by the sequence of execution of the two documents. See, e.g., the recent case of In re Berman, 49 N.J. Super. 97, 139 A.2d 139 (Hudson County Ct., Probate Div., 1958) in which provisions in a later will were held to prevent apportionment against an inter-vivos trust although the trust indenture included clauses requiring the trust to bear the burden of any estate taxes imposed, and an earlier will had concurred. A really adequate statute would provide which (the inter-vivos instrument or the will) would control in a case of conflict. In the absence of such a statute, the last expression in point of execution, should probably control in the case of a real conflict. In the absence of real contradiction the problem is like that of any other interpretation of intent: the testator-settlor is, after all, one individual, and all documents should be fitted together to determine his ultimate intent, the usual criterian for interpretation of all legal documents (wills and trust instruments included). A temporal problem also occurs in determining which court's adjudication should be given priority. Here again an adequate statute would specify. A simple solution in the absence of such a statute would be to uphold the determination which is first in point of time. Such a holding would normally be that of the domiciliary court, and can be justified under a broad definition of res judicata, (i.e., one including collateral estoppel with the res (estate) regarded as the real party).

[39] Namely, effectuate what the person would have wanted had he thought about the problem and been faced with the situation actually presented—our testator's imputed "intent."

For other suggested solutions to the problem, see Scoles, Apportionment of Federal Estate Taxes and Conflict of Laws 22 Col. L. Rev. 261 (1955), and Ward, Conflict of Laws In Estate Tax Apportionment—The Inter Vivos Trust, 9 U. Fla. L.R. 194 (1956). Both agree that the testator's domiciliary law should govern.

the other state involved should uphold that decision, in the absence of over-riding inequity.[40]

[40] Such a choice of governing law would seem possible even under the Uniform Act through a not too literal interpretation of section 8's reciprocity requirement.

The problem faced where neither state has any sort of apportionment statute is one less and less likely to arise. In such a case too the settlor-testator's total intent, aided where the instruments are inconclusive by a presumption that he would intend the burdens to accompany the benefits—the impetus for the enactment of apportionment statutes, should be the test, and for stability of the legal system the first state's court's decision should be followed.