INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-121901-98
Date: March 16, 1999

LEGEND:
Spouse =
Children =
Marital Trust =

Trust =
Decedent =

Family Trust =

State =
Company A =
Company B =
State Statute =

ISSUE 1

Does the disposition of the shares in Company A and Company B to the Children as a result of the Spouse's disclaimer constitute a specific bequest or a residuary bequest?

ISSUE 2

Under the terms of the Decedent's will and Trust, does the marital bequest bear any portion of the estate tax?

CONCLUSION ISSUE 1

The disposition of the shares to the Children is a residuary bequest.

CONCLUSION ISSUE 2

Under the terms of the Decedent's will and Trust and State law, the marital bequest does not bear the burden of any portion of the estate tax.

FACTS

The Decedent died testate on December 2, 1995, a resident of State. His will had been executed in 1988. In addition, the Decedent had executed an inter vivos revocable trust (Trust) that became irrevocable on Decedent's death. He was survived by the Spouse and two children (Children).

Article I, Paragraph A, of the will states that, in the Trust instrument, the Decedent directed the trustee to pay all estate taxes.

Article I, Paragraph, B of the will states as follows:

> Despite the provisions of Paragraph A . . . my Personal Representative shall pay the amount of [estate] taxes . . . certified by the trustee as exceeding the principal out of which the trustee is directed to provide for payment. Any such amount payable by my Personal Representative . . . shall be paid out of . . . the share of my residuary estate that does not qualify for the federal estate tax marital deduction, without seeking reimbursement or recovery from any person. [Emphasis supplied.]

Under Article II of the will, Decedent bequeathed all tangible personal property to Spouse, if she survives him. Under Article IV, the residue of the probate estate is to pass to and become part of the principal of Trust.

Article First of the Trust directs the trustee to distribute to Decedent during his lifetime such amounts of income and principal as Decedent may request at any time.

Article Second of the Trust provides for the payment of estate tax as follows:

> Upon my death the Trustee shall pay from the principal of the Trust estate, the expenses of my last illness and funeral, claims allowable against my estate, inheritance taxes and generation-skipping taxes on direct skips assessed by reason of my death . . . Assets or funds otherwise excludable in computing Federal estate taxes shall not be used to make the foregoing payments. [Emphasis supplied.]

Under Article Third A of the Trust, if Decedent is survived by Spouse, a Marital Trust (intended to qualify for a marital deduction under § 2056(b)(7) of the Internal Revenue Code) is established, as follows:

> If my spouse [Spouse] survives me . . . the Trustee . . . shall set aside out of the Trust estate, that pecuniary amount . . . equal to the value . . . of "qualified property" (as defined in this paragraph) reduced by the largest amount, if any, which, if allocated to the Family Trust . . . would result in no increase in federal estate tax payable at my death . . . As used in this paragraph, "qualified property" is all property disposed of by this Trust or my Will, and . . . which is not otherwise effectively disposed of by . . . the payment of debts, expenses of administration and other charges payable from principal by my Personal Representative or Trustee including the death taxes referred to in Article I of my Will. [Emphasis supplied.]

Under the terms of the Marital Trust, the spouse is to receive all trust income for her life, and principal is to be distributed for her health, support in reasonable comfort, and maintenance. On Spouse's death, the remaining principal is to be distributed to those of the Decedent's descendants as Spouse appoints by will.

Article Fourth, in the flush language, provides that "The Trustee as of my death, shall set aside the balance of the Trust as a separate Trust named the Family Trust . . ."

Under Article Fourth, Paragraph A and B, the income from the Family Trust is to be paid to Spouse for life, and principal is to be distributed for Spouse's health, support in reasonable comfort, and maintenance. On Spouse's death, the corpus is to pass to those of Decedent's descendants as Spouse may appoint by will.

Article Fourth, Paragraph C, of the Trust provides that, on the death of the last to die of Decedent and Spouse, "the remaining principal of all Trusts then held under Articles Third and Fourth" is to be distributed per stirpes to the Decedent's then living descendants to the extent the funds are (i) not effectively appointed by the Spouse, and (ii) not entirely exempt from generation-skipping transfer tax.

At Decedent's death, the Trust held assets having a value of more than $4,000,000. The probate estate had a value of $22,500, all of which passed to the Trust. Based on the above-described testamentary dispositions, the Trust corpus, but for $47,000 (reflecting the amount that would pass tax-free as a result of the estate's available unified credit), passed to the Marital Trust. The balance of the Trust corpus was to pass to the Family Trust.

At the time of Decedent's death, certain shares of stock in Company A and Company B, having a value of approximately $2,000,000, were held in the Trust and were distributable to the Marital Trust and/or the Family Trust. However, the Spouse executed a qualified disclaimer, within the meaning of section 2518, pursuant to which she disclaimed her income and principal rights and her power of appointment with respect to all shares held by the trusts in Company A and Company B. By reason of the disclaimer, Spouse was considered (under applicable State law) to have predeceased the Decedent with respect to the shares. Accordingly, the shares passed outright to the Children under the flush language and Paragraph C of Article Fourth of the Trust.

LAW AND ANALYSIS

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

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

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

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

In Estate of Lewis v. Commissioner, T.C. Memo. 1995-168, the decedent's will provided that the residue of her estate was to pass to a revocable trust which became irrevocable at her death. The will further provided that estate taxes were to be paid "out of the residue of my estate without apportionment and with no right of reimbursement from any recipient of any such property . . . " The trustee of the trust was to establish a "Marital Trust" funded with the minimum amount necessary to reduce the estate tax to zero, taking into account all available credits. The balance passed to a "Family Trust." The trustee had the discretion to pay to the executor amounts for estate taxes. However, any such amount was to be paid from the Family Trust.

The issue before the court was whether the estate tax should be paid from the residue of the probate estate, as provided in the will, or the Family Trust, as provided in the revocable trust. The court held that, although the trust provisions referred to the maximum marital deduction and gave the trustee the discretion to pay estate taxes, this did not override the clear direction in the will. The court concluded that the tax payment clause in the will governed, and the estate taxes were to be paid from the residue of the probate estate. See Estate of Fagan v. Commissioner, T.C. Memo. 1999-46; Estate of Miller v. Commissioner, T.C. Memo. 1998-416. But see, McKeon v. United States, 151 F.3d 1201 (9th Cir. 1998).

State statute provides that if a part of the property concerning which the estate tax is levied or assessed is held under the terms of any trust created intervivos, then, unless the governing instrument directs otherwise:

> 1. If any portion of the trust is directed to pass or to be held in further trust by reference to a specific property, or type of property, fund, sum or in any other nonresiduary form, the net amount of the tax attributable to that portion must be charged to and paid from the corpus of the residuary share of the trust without requiring contribution from the nonresiduary interest or the persons receiving or benefiting from that interest.

2. The net amount of the tax directly attributable to the residuary share of the trust must be charged as follows: the net amount of the tax attributable to each residuary temporary interest must be charged to that portion of the residuary principal that supports the temporary interest without apportionment, and the net amount of the tax attributable to the balance of the residuary share must be equitably apportioned among the residuary beneficiaries, by charge to the corpus of their interest in the proportions that the value of the residuary interest of each included in the measure of the tax bears to the total of all residuary interests included.

Under State law, a direction against application of the State apportionment statute may be explicit or implicit, but the direction must be clear and unequivocal; however, an implicit direction is not sufficient to avoid the state statute unless the court finds that the testator considered and made a deliberate and informed decision about the burden of taxation.

ISSUE 1

Under State law, a specific bequest is a gift of specific property that can be distinguished from all other property in the estate of the same kind. In contrast, a residuary bequest is satisfied out of the general assets of the estate, and it is payable after other legacies have been satisfied and debts and expenses have been paid. In re Estate of Gilbert v. The Society of New York Hospital, et. al., 585 So.2d 970 (1991); Estate of Jones v. Jones, 472 So.2d 1299 (1985).

In this case, under the dispositive arrangement, if Decedent is survived by Spouse, a pecuniary amount (determined by formula) passes to the Marital Trust as a preresiduary disposition. In addition, under the flush language of Article Fourth, on Decedent's death (whether or not survived by Spouse), all other property not passing to the Marital Trust under Article Third is disposed of under the flush language of Article Fourth as residuary property, i.e., the "balance of the property."

The Spouse disclaimed her entire interest in the Company A and Company B stock, arising under both the Marital Trust and Family Trust. As a result of the disclaimer, under applicable State law, Spouse was treated as predeceasing Decedent with respect to the disclaimed property. Thus, as a result of the disclaimer, the shares passed to the Family Trust and then outright to the Children under the flush language of Article

Fourth and Paragraph C of Article Fourth. Although the disclaimer referenced specific assets to be disclaimed, the characterization of these assets passing as a result of the disclaimer as either a specific or residuary bequest is dependent on the dispositive terms of the Trust. In this case, as a result of the disclaimer, the shares passed under the flush language of Article Fourth of the Trust as a residuary bequest.

ISSUE 2

In this case, the will specifically refers to the directions in the Trust for payment of estate tax. The will contains directions for the executor to act (in conjunction with the trustee) in paying the tax, under certain circumstances. However, since virtually all of Decedent's assets were held by the Trust, the tax payment clause in Decedent's will (directing payment of taxes from the probate residue only if the tax liability exceeds the Trust assets) did not become operative. Thus, this case is distinguishable from cases such as Estate of Fagan and Estate of Lewis, where the probate estate contained substantial assets and the will contained unequivocal directions regarding the payment of estate taxes.

The terms of the Trust direct the Trustee to pay estate taxes out of the "principal" of the Trust estate. We do not believe this provision constitutes a direction regarding which assets, or groups of assets, are intended to bear the burden of payment of estate taxes. However, Article Second of the Trust does specifically direct that property excludible in computing the federal estate tax is not to be burdened with payment of estate taxes.

As discussed above, we have concluded that as a result of the dispositive scheme in the Trust and Spouse's disclaimer, a pre-residuary bequest of a pecuniary amount passed to the Marital Trust, and a residuary bequest funded almost in total with the disclaimed property passed outright (with the exception of $47,000) to the Children. Under the State apportionment statute discussed above, all estate taxes are to be paid out of the Trust residue. There is nothing in the Trust instrument that would override this result. Accordingly, in this case, all estate taxes are to be paid out of the residuary bequest passing under

Article Fourth; that is, the shares of stock in Corporation A and Corporation B, plus $47,000. The marital bequest under Article Third is not burdened with the payment of any estate tax.[1]

CAVEAT(S)

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

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[1] We note that the application of § 2207B would not change this result. Section 2207B(a), prior to amendment by the Taxpayer Relief Act of 1997 (which eliminated the requirement that the provision can be waived only by specific reference to § 2207B), provided:

> (1) if any part of the gross estate on which tax has been paid consists of the value of property included in the gross estate by reason of § 2036, the decedent's estate shall be entitled to recover from the person receiving the property the amount that bears the same ratio to the total tax under this chapter that has been paid as (A) the value of the property, bears to (B) the taxable estate.
>
> (2) section 2207B(a)(1) shall not apply if the decedent otherwise directs in a provision of his will (or revocable trust) specifically referring to § 2207B.