Improvements Made to Florida's Estate Tax Apportionment Statute

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During its recent session, the Florida Legislature passed legislation that amends both the Florida Probate and Florida Trust Codes.[1] Included within this legislation was an amendment (the "Amendment") to Section 733.817 of the Florida Statutes (the "Apportionment Statute"), which is the section of the Florida Probate Code that governs the apportionment of estate taxes.[2] The impetus for the Amendment was a study and analysis of the prior Apportionment Statute by the Estate and Trust Tax Planning Committee of the Real Property, Probate and Trust Law Section of the Florida Bar.

The Amendment updates the Apportionment Statute for changes in the federal estate tax law, clears up ambiguities, addresses tax issues not previously covered, codifies some case law and includes changes reflecting what it is believed most decedents would intend.

Background

The purpose of the Apportionment Statute is to provide default rules for determining the share of the estate tax that is apportioned to the various property interests passing as a result of a decedent's death and to provide for the collection of the estate tax. Prior to the Amendment, the Apportionment Statute had not been substantially revised since 1997. Generally, the Apportionment Statute provides for a modified equitable apportionment regime. Property interests generally bear their share of the taxes, except there are special provisions for property interests passing under a will or trust and for homestead. The default apportionment provisions apply only if the decedent does not direct otherwise. The Apportionment Statute provides rules for determining whether a decedent has overridden the default rules.

Overview of Changes made by the Amendment

The Amendment rearranged the Apportionment Statute, added titles for clarity and made other clarifying changes with a goal of eliminating ambiguities and making it easier for practitioners to work their way through it. Following the definitions[3] are rules for determining the tax attributable to various property interests,[4] rules for determining who is charged (apportioned) with the tax attributable to a property interest,[5] rules for what is required in order to direct against statutory apportionment and rules for resolving conflicts between governing instruments.[6] The remaining provisions of the Apportionment Statute[7] are substantially unchanged and deal with the collection of the estate tax by the personal representative. The purpose of this article is to describe the changes to the Apportionment Statute made by the Amendment.

Definitions

Two new definitions have been added to subsection (1) of the Apportionment Statute: "generation skipping transfer tax" and "Section 2044 property".[8] These definitions have been added for clarity but do not change the law. In addition and more importantly, the definition of "included in the measure of the tax" has been reorganized for clarity and subparagraph (1)(e)3 addresses two items included in the measure of the tax that were not addressed in the prior Apportionment Statute.

A decedent's gross estate for federal estate tax purposes includes gift taxes paid within three years of death.[9] Under the Amendment, gift taxes paid within three years of death are excluded from the definition of "included in the measure of the tax." The effect of this change is that recipients of such gifts are not allocated the estate tax attributable to the gift taxes although the gift taxes are a part of the amount upon which the estate tax is calculated. The result is an increase in the estate tax charged to all other interests.

Section 529 of the Internal Revenue Code permits a donor of a gift to a qualified tuition program (commonly known as a "529 Plan") to treat a gift exceeding the gift tax annual exclusion as being made over five years.[10] If the donor dies prior to the end of the five-year period, the donor's taxable estate includes a portion of the gift. The Amendment excludes those gifts from the definition of "included in the measure of the tax". As with the gift taxes paid, the effect of this change is that the recipients of those gifts are not allocated the estate tax on those gifts, which results in an increase to the estate tax charged to all other interests.

Allocation of Tax

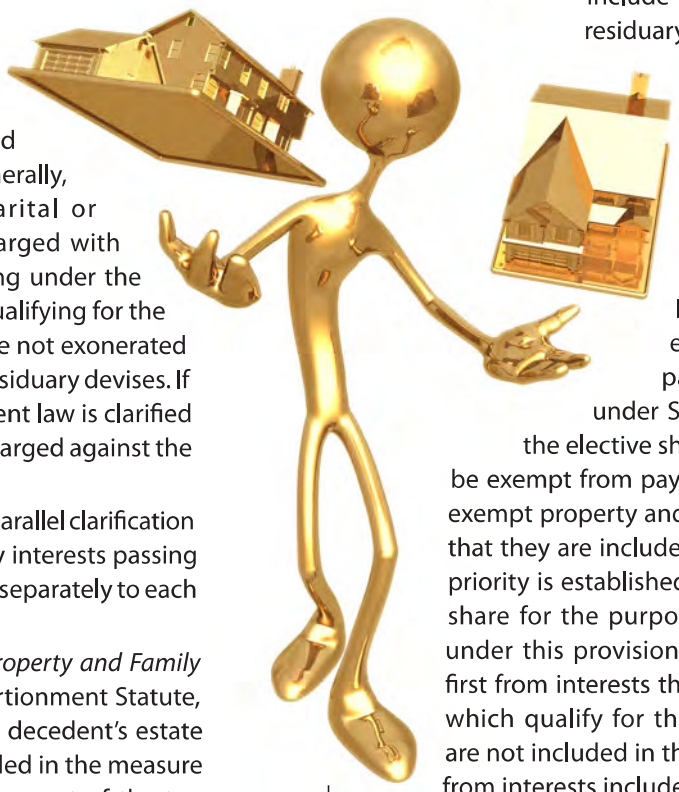
Subsection (2) provides rules for determining how much estate tax is attributable to each property interest included in the measure of the tax. The general rule is to allocate tax among the property interests included in the measure of the tax in proportion to their relative values.

The Amendment deletes references to the state death tax credit and clarifies that the state death tax deduction is allocated to the interests producing the deduction for the purpose of determining the tax attributable to the interest. The federal estate tax credit was eliminated in 2005 and replaced with a deduction for state death taxes.[11]

Apportionment of Tax

Subsection (3) provides rules for determining who is charged with payment of the tax attributable to various property interests included in the measure of the tax.

Section 2044 Interests. Section 2044 interests may pass under a trust or the decedent's will, or pass outside of the will or a trust. The Amendment clarifies current law to insure that (1) the net tax attributable to the Section 2044 interests, which may be at a higher effective rate than the tax attributable to other property interests, is charged to the Section 2044 interests, and (2) the Section 2044 interests are not charged with the tax on other property interests.[12]



Wills. For property passing under the decedent's will, the residue is charged first with the tax on non-residuary devises and then with tax on the residue. Generally, devises qualifying for the marital or charitable deduction are not charged with any of the tax on property passing under the will; however, residuary devises qualifying for the marital or charitable deduction are not exonerated from the payment of tax on non-residuary devises. If the residue is insufficient the current law is clarified so that, the balance of the tax is charged against the non-residuary interests.[13]

Trusts. The Amendment make a parallel clarification to the rules applicable to property interests passing under trusts and generally applies separately to each trust.

Protected Homestead, Exempt Property and Family Allowance. Under the prior Apportionment Statute, the recipients of the assets of the decedent's estate and revocable trust that are included in the measure of the tax bear the burden of payment of the tax on protected homestead. The first group (Class I) bearing the tax on protected homestead are recipients of property not disposed of under the will or revocable trust. As a result, the recipients of exempt property, family allowance, elective share, pretermitted shares and property passing by intestacy were responsible for the payment of the tax on homestead. The second group (Class II) bearing the tax was the residuary beneficiaries. The third group (Class III) was the non-residuary beneficiaries (i.e., recipients who are to receive a specific property or specific type of property, fund or sum).

The Amendment provides that the tax on exempt property and the family allowance is also to be apportioned against other estate and revocable trust property in the same manner as the tax on protected homestead. Further, exempt property and family allowance are no longer charged with payment of estate tax on the homestead (in furtherance of the purposes of exempt property and family allowance). The Amendment continues the limitation that only property within a particular Class that is included in the measure of the tax is charged with payment of the tax. Thus, property interests qualifying for the marital or charitable deduction will not be responsible for paying the tax on homestead, family allowance and exempt property.

For purposes of apportioning the tax on homestead, exempt property and family allowance, the Amendment modified (a) Class I to include only property that passes by intestacy and (b) Class II to include pretermitted shares along with residuary interests. No change was made to Class III.

Under the Amendment, property necessary to satisfy the elective share will not bear any part of the tax on protected homestead, exempt property or the family allowance. If the surviving spouse elects the elective share, and the interests passing to the surviving spouse under Section 732.2075(1), F.S., exceed the elective share, the excess interests will not be exempt from payment of tax on the homestead, exempt property and family allowance to the extent that they are included in Class I, II or III. An order of priority is established for the funding of the elective share for the purpose of determining the "excess" under this provision. Funding is deemed to occur first from interests that pass to the surviving spouse which qualify for the marital deduction (and thus are not included in the measure of the tax), and then from interests included in the measure of the tax and described in Classes I, II, and III.

Finally, the Amendment clarifies that the apportionment of the tax on protected homestead, exempt property and the family allowance occurs after the application of the apportionment provisions for property passing under the will and revocable trust, but prior to the apportionment of tax to assets passing outside the will and revocable trust and prior to the apportionment of the generation-skipping transfer tax. If the assets in Classes I, II and III are exhausted, the remaining tax attributable to homestead, exempt property and family allowance will be apportioned proportionately to those interests.

Assets Passing to the Estate or a Trust. If an estate or trust is the beneficiary of an annuity or insurance policy or under a power of appointment and thus such property is disposed of pursuant to the will or trust, the Amendment clarifies current law that

the tax on such interests will be apportioned in the manner provided for interests passing from the estate or the trust.[14]

Common Instrument Construction. Under the prior Apportionment Statute, a decedent's will and revocable trust were construed together to apportion the tax as if all recipients of the estate and trust (other than the estate and trust themselves) were taking under one common instrument. This simplified the tax apportionment to recipients of residuary and non-residuary interests under the provisions regarding wills, trust and homestead. The prior Apportionment Statute did not apply if one revocable trust poured into another, but applied to a will and revocable trust even if one did not pour into the other.

The Amendment modifies existing law to require that a decedent's will and revocable trust (or two revocable trusts, if applicable) must pour into one another for the common instrument construction to apply.[15] The purpose of this provision is to determine which interests are, in effect, pre-residuary interests and which are residuary interests where a will or trust (or another trust) pours into the other so that the tax attributable to those interests may be apportioned accordingly. Under the Amendment, the common instrument construction will not apply if the will or trusts stand alone from one another.

Assessment of Liability by Court. The prior Apportionment Statute did not expressly provide direction for the apportionment of estate taxes if the Apportionment Statute did not cover a particular situation, e.g., where the recipient of a property interest included in the measure of the tax cannot be determined. The Amendment provides that in such circumstances, the court may assess liability for payment of the tax in the manner it finds equitable.[16]

Direction Against Apportionment.

Subsection (4) provides rules for determining whether a decedent has effectively directed against statutory apportionment and rules for resolving conflicts between governing instruments.

As under the prior Apportionment Statute, a governing instrument may not direct that taxes be paid from property other than property passing under that governing instrument except as permitted in the Apportionment Statute,[17] and the decedent's will may direct the payment of taxes from the decedent's revocable trust if there is no contrary direction contained in the trust.[18]

The Amendment provides that a direction in the governing instrument against statutory apportionment for property interests passing under the governing instrument must be express.[19]

The Amendment removes the provision that required a decedent who wished to direct that property passing under the governing instrument pay tax on property not passing under the governing instrument to expressly refer to "this section."[20] The concern was that the prior Apportionment Statute not only contained default apportionment provisions, but also contained provisions for obtaining an order of apportionment and the collection of the tax, and a waiver of the default apportionment provisions by reference to Section 733.817, F.S., could be construed as also waiving the provisions for obtaining an order of apportionment and collecting the tax.

Sections 2207A and 2207B of the Internal Revenue Code of 1986, as amended (the "Code") provide a decedent's estate with the right to recover the estate taxes described in those sections from the recipients of the property that generated the tax. [21] Those sections provide that the decedent may direct otherwise but require the decedent to specifically indicate an intent to waive these rights of recovery. Section 2603 provides that the generation-skipping transfer tax is imposed on the property constituting the transfer unless otherwise directed by the governing instrument but requires a specific direction to do so. The purpose of the Code provisions requiring specificity in directing against a right of recovery is to guard against the decedent's inadvertent waiver of those rights for the benefit of the estate. The Amendment clarifies that in order to waive recovery, the decedent must meet both the express direction requirements of the Apportionment Statute and the specificity requirements by those Code provisions.

In addition, some property interests are included in the gross estate for estate tax purposes under more than one section of the Code although the interests are taxed only once. Sections 2041 (general powers of appointment) and 2044 (QTIP) may both apply in certain situations. Sections 2038 and 2036 overlap in part so that most revocable trusts are includible in the decedent's gross estate under both Sections. The provisions of Section 2207A apply to property included in the decedent's gross estate under Section 2044 and the provisions of Section 2207B apply to property included in the decedent's gross estate under Section 2036. The overlapping application could affect the apportionment of taxes. The prior Apportionment Statute was silent on these issues. The prior Apportionment Statute applied to revocable trusts long before the enactment of Section 2207B, which the authors believe was never intended to apply to revocable trusts and there is no policy reason why it should.

The Amendment describes what is sufficient to comply with the specificity requirement of Section 2207A and is intended to clarify current law.[22] A reference to "qualified terminable interest" property, "QTIP" or property in which the decedent had a "qualifying income interest for life" is deemed to suffice. The list is not intended to be exclusive.

Further, the Amendment provides that if property is included in the gross estate for estate tax purposes under both Sections 2041 and 2044, the property is deemed to be included under Section 2044 for purposes of the allocation and apportionment of tax under the Apportionment Statute.

To direct otherwise, the decedent must comply with the provisions of Subparagraph (4)(d)1. For both Section 2041 and Section 2044 to apply, the property must have first been a Section 2044 interest. The Amendment reflects the view that most decedents would expect taxation under Section 2044 to continue and to be required to comply with Section 2207A to waive the right of recovery.

The Amendment also describes what is sufficient to comply with the specificity requirement of Section 2207B. It is not intended to be exclusive. Again this is a clarification of existing law.[23]

If property is included in the gross estate under both Sections 2038 and 2036, the Amendment provides that such property will be deemed included under Section 2038 and not Section 2036 for purposes of allocation and apportionment of the tax and there is no right of recovery under Section 2207B. This is a clarification of existing law.

The Amendment clarifies that a general statement in the decedent's will or revocable trust waiving all rights of recovery under the Code is not an express waiver of the rights of recovery provided in Sections 2207A or 2207B.[24]

As a clarification of existing law, the Amendment describes what is sufficient to comply with the specificity requirement of Section 2603.[25] A reference to "the generation-skipping transfer tax or s. 2603 of the Internal Revenue Code" is deemed to suffice. Again, however, this list is not intended to be exclusive.

Under the prior Apportionment Statute, the net tax attributable to property over which the decedent held a general power of appointment (a "general power") is calculated in the same manner as other property included in the measure of the tax (with the exception of the tax on Section 2044 interests). The risk of granting a general power is that the power will be exercised so as to direct the trust property away from the donor's intended beneficiaries. As there are four possible classes of takers under a general power (i.e., the power holder, the power holder's estate, the power holder's creditors or the creditors of the power holder's estate), this risk can be minimized (although not eliminated) by limiting the takers to only one of these classes. For example, a beneficiary will often be granted a testamentary general power to appoint property to the creditors of the beneficiary's estate, which is perhaps the most limited of the four classes. Although the power is still a general power, it would appear more likely than not that the trust property will ultimately pass to the donor's intended beneficiaries.

The Amendment permits the power holder to direct that the property subject to the general power of appointment bear the additional tax incurred by reason of the inclusion of the property subject to the general power of appointment in the power holder's gross estate.[26] This additional tax is calculated in the same manner as the tax attributable to Section 2044 interests.

The Code enables the personal representative of the estate to recover the estate tax attributable to life insurance or property subject to a general power of appointment from the beneficiaries of those interests, but provides that the decedent may direct otherwise by will. Many decedents insert their tax apportionment provisions in their revocable trusts. To avoid any issues with the federal provisions, the Amendment provides that an effective direction of apportionment in the revocable trust is deemed to be a direction in the will as well as the revocable trust.[27]

The decedent's will may direct that estate taxes be paid from the decedent's revocable trust unless the trust contains a contrary provision.[28] The Amendment clarifies that the revocable trust that is to pay the tax must be specifically identified in the decedent's will.

The prior Apportionment Statute covered conflicts between the decedent's will and another governing instrument, but did not cover conflicts between two or more governing instruments which were not wills. Further, the prior Apportionment Statute gave priority to the will even if the conflicting non-will governing instrument was executed at a later date. In view of the prevalence of tax clauses in revocable trusts, the Amendment modifies the Apportionment Statute to apply to conflicts between all governing instruments (whether a conflicting instrument is a will or other instrument) and provides that the last executed governing instrument containing an effective tax apportionment clause controls to the extent of the conflict.[28] If a will or trust is amended, the date of the amendment is the controlling date only if the amendment contains an express tax apportionment provision. Only tax apportionment provisions that would be effective, but for the conflict, create a conflict.

Finally, the general provisions of the Apportionment Statute apply to any tax remaining unpaid after the application of effective directions against statutory apportionment. The Amendment codifies case law that an effective direction for payment of tax on a type of interest in a manner different from that provided in the Apportionment Statute is not effective as an express direction for payment of tax on other types of interests.[30] There are three separate effective date provisions for the amendments to the Apportionment Statute. The reader should review Ch. 2015-27 for the effective date provisions.

Conclusion

As a result of changes made by the Amendment, practitioners should find the Apportionment Statute more user friendly, updated to reflect changes in federal estate tax law and court decisions, and covers issues not previously addressed.

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Keith, David and Pam were the members of the Estate Tax Apportionment Subcommittee of the Estate and Trust Tax Planning Committee of the Real Property, Probate and Trust Law Section of the Florida Bar that drafted the proposal which formed the basis of the Amendment.

Endnotes

1 Ch. 2015-27.
2 The Amendment was signed into law by the Governor on May 14, 2015.
3 Fla. Stat. § 733.817(1).
4 Fla. Stat. § 733.817(2).
5 Fla. Stat. § 733.817(3).
6 Fla. Stat. § 733.817(4).
7 Fla. Stat. §§ 733.817(5) through (11).
8 Section 2044 property is property included in the measure of the tax by reason of Section 2044 of the Internal Revenue Code and is commonly described as "QTIP property". Throughout this article, such property may also be referred to as "Section 2044 interests.
9 I.R.C. § 2035(b).
10 I.R.C. §529(c)(2)(B).
11 I.R.C. § 2058.
12 Fla. Stat. § 733.817(3)(b).
13 Fla. Stat. § 733.817(3) (c).
14 Fla. Stat. § 733.817(3)(f).
15 Fla. Stat. § 733.817(3)(g).
16 Fla. Stat. § 733.817(3)(i).
17 Fla. Stat. § 733.817(4)(a).
18 Fla. Stat. § 733.817(4)(g).
19 Fla. Stat. § 733.817(4)(b).
20 Fla. Stat. § 733.817(4)(c).
21 Unless otherwise specifically stated, all section references shall be references to the Code.
22 Fla. Stat. § 733.817(4)(d)1.
23 Fla. Stat. § 733.817(4)(d)2.
24 Fla. Stat. § 733.817(4)(d)3.
25 Fla. Stat. § 733.817(4)(d)4.
26 Fla. Stat. § 733.817(4)(e).
27 Fla. Stat. § 733.817(4)(f).
28 Fla. Stat. § 733.817(4)(g).
29 Fla. Stat. § 733.817(4)(h).
30 Fla. Stat. § 733.817(4)(j).