New York Law Journal

Trusts and Estates Law

Estate Tax Apportionment and Ratable Contribution to Elective Share

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November 12, 2015

When a spouse exercises his or her right to elect against a decedent's will pursuant to EPTL 5-1.1-A, there is, in effect, an alteration to the decedent's testamentary intent as expressed in that will. The statute is designed to deal with that alteration while keeping as much of the decedent's original intent intact as possible. This is true with respect to the payment of estate taxes as well as the proportions in which a decedent's named beneficiaries share in the estate.

The general rule in New York regarding the payment of estate taxes is that they are equitably apportioned among the recipients of assets included in the taxable estate unless otherwise provided in a will or non-testamentary instrument. EPTL 2-1.8(c). Thus, the general rule is a default provision, which can be, and is routinely, circumvented by a testator in a tax apportionment clause in her will. For example, testators often provide that all estate taxes be paid from the testamentary residuary estate without apportionment. But what effect do such clauses have when a spouse elects against the will?[1] Does the spouse's election result in a forfeiture in any benefit that a tax apportionment clause might provide to the spouse?

Another question posed by the spousal election relates to determining the contribution to the elective share. EPTL 5-1.1-A(c)(2) provides that the elective share must be paid ratably by the decedent's other beneficiaries. The question is whether this ratable contribution is computed based on the value of the estate before estate taxes are deducted or the value of the estate net of estate taxes. The answer to this can seriously affect the rights of the beneficiaries depending on the tax apportionment clause.

These questions are not easily answerable on the face of EPTL 5-1.1-A. Just a few weeks ago, the Appellate Division, Second Department, affirmed the Suffolk County Surrogate's Court upon one of the only reported decisions that has tackled these questions. See *Matter of Priedits*, 40 Misc.3d 482 (Sur. Ct. Suffolk Co., 2013), aff'd, ___ NYS3d ____, 2015 NY Slip Op. 07508 (2d Dept. 2015).

In *Priedits*, the decedent died testate leaving an estate with a total value of approximately $9.3 million in combined probate and non-probate assets. Decedent specifically devised real property valued at about $2 million to friends in his will and his residuary estate to a charity.

Decedent's spouse was not provided for under his will, but she was the recipient of substantial testamentary substitutes. Decedent's will also provided for the payment of all estate taxes from the residuary estate, including taxes imposed on non-probate assets. Specifically, decedent's will broadly provided:

> I direct that…all estate, inheritance, transfer, succession, legacy, gift, and similar taxes (including, without limitation, all taxes of a personal nature assessed, levied, or imposed upon any recipient or property), including interest and penalties thereon imposed by any government in respect to any property required to be included in my gross estate for estate tax or like purposes by any such government, whether the property passes under this Will or otherwise, without contribution by any recipient of any such property, be paid out of my residuary estate.

The decedent's surviving spouse was a non-citizen, which was one of the driving forces of the dispute since she elected not to form a qualified domestic relations trust, thus making her interest in the estate taxable.

Not surprisingly, the spouse took the position that she was not responsible for her pro rata contribution to estate taxes based on the will's exoneration clause. The charity and Attorney General espoused the opposite view.

Spousal Forfeiture

The issue was thus presented to the Surrogate's Court as to whether or not the surviving spouse's choice to elect against decedent's will also meant that she forfeited the benefits of the will's estate tax exoneration provision. This spousal forfeiture principle holds that when a spouse elects against a will, he or she rejects all of the provisions of the will and "surrenders" his or her rights under the will. *Matter of Rosenzweig*, 19 NY2d 92 (1966). The rationale of this forfeiture principle has been explained as follows:

> [W]hen the scheme of the will has been thwarted and materially changed by the voluntary act of testator's spouse, we deem it fairer to declare that the spouse has forfeited all privileges and benefits rather than speculate as to testator's intention under the materially changed circumstances. We think the risk should be on the surviving spouse who has an option to exercise or not to exercise the right of election, not on the testator who is no longer available to declare his intention to cover the new situation.

Matter of Friedman, 67 Misc.2d 304, 307 (Sur. Ct. Westchester Co., 1971) (where the court held that the surviving spouse surrendered her right to exercise a limited power of appointment granted to her in her spouse's will by exercising her right of election, even though the power of appointment was not a pecuniary benefit to her.)

If the foregoing principle is recognized, it would appear inconsistent that the spouse can accept the benefits of a will's tax clause, but reject the rest of the will to claim an elective share. Although the Surrogate's Court in *Priedits* disagreed with that premise, at least two other New York courts did not. See *Matter of Clark*, 107 Misc.2d 17 (Sur. Ct. N.Y. Co., 1980) and *In re Gingold's Will*, 116 N.Y.S.2d 868 (Sur. Ct. Queens Co., 1952).

However, *Matter of Clark* applied Virginia's elective share statute and *In re Gingold's Will* was

decided in 1952 under the predecessor statute to the EPTL, to wit, the Decedent's Estate Law. On the other hand, the Surrogate's Court in *Priedits* relied heavily on it's construction of certain provisions of the current controlling statute—EPTL 5-1.1-A.

The court noted that the "first rule in statutory construction requires that the court look to the statutory text as the best evidence of the legislature's intent (internal citations omitted)," supra at 485. Specifically, the court looked to EPTL 5-1.1-A(c)(1) which states:

> Where an election has been made under this section, the will or other instrument making a testamentary provision, as the case may be, is valid as to the residue after the share to which the surviving spouse is entitled has been deducted, and the terms of such will or instrument remain otherwise effective so far as possible, subject, however, to the provisions of clause (a)(4)(A).

Clause (a)(4)(A) provides:

> Unless the decedent has provided otherwise, if a spouse elects under this section, such election shall have the same effect with respect to any interest which passes or would have passed to the spouse, other than absolutely, as though the spouse died on the same date but immediately before the death of the decedent.

Based on these provisions, the Surrogate's Court concluded, "…the right of election does not provide that every benefit or advantage afforded a spouse be forfeited as a result of the exercise of one's right to an elective share." Id. at 485. The court further stated, "[t]his is also consistent with the general rule that statutory provisions concerning spousal rights are to be liberally construed." Id.

With respect to the forfeiture of an interest relating to estate taxes specifically, the court referred to EPTL 5-1.1-A(a)(2), which provides, in relevant part, that "nothing contained herein relieves the surviving spouse from contributing to all such taxes the amounts apportioned against him or her under EPTL 2-1.8." From that provision, the court reasoned that the converse must also be true—that is, "…nothing contained in the statute would obligate a spouse to pay taxes not otherwise apportioned against her especially, where as here, her spouse has specifically and intentionally opted out of the default tax apportionment statute." Id at 485, 486.

Accordingly, the court held that the spouse was entitled to the benefits of the estate tax exoneration provision under decedent's will notwithstanding her election.

In affirming the Surrogate's Court, the Second Department did not engage in any analysis of EPTL 5-5.1-A. Indeed, the decision does not cite the elective share statute at all. Instead, the court relied on case law concerning tax clauses in general. The court noted the default statutory provision under EPTL 2-1.8(c), which requires apportionment unless otherwise provided in the decedent's will and that "…such contrary direction must be clear and unambiguous." *Priedits*, 2015 NY Slip Op. 07508 at *2.

> Although there is a strong policy favoring apportionment (see *Matter of Shubert*, 10 NY2d 461, 471) that policy gives way where the clear and unambiguous wishes of the testator direct otherwise (see *Matter of Cord*, 58 NYS2d 539, 545; *Matter of Dewer*, 62 AD2d 352, 354; see also *Matter of Collia*, 118 AD2d 778, 779). Analysis begins with general rules of construction which provide that a court is to determine and effectuate the intent of the testator and that in doing so, it must construe his or

her words according to their ordinary and natural meaning.

Id.

Based upon the foregoing, the Second Department held that the tax clause in the decedent's will "…clearly and unambiguously reflect[s] decedent's intent that his preresiduary and non-testamentary beneficiaries, including Bonora, his surviving spouse, are to take their property without liability for the payment of estate taxes, regardless of whether taxes are imposed on property passing under the will or outside the will." Id.

Clearly, the tax clause in this case was broad and that fact weighed in favor of the interpretation that the Surrogate and the Second Department gave to it. However, one might still ask whether providing exoneration from tax apportionment with respect to property passing "under this Will or otherwise" is explicit enough to include property that is not passing under the will, or by way of a traditional non-testamentary beneficiary designation, but rather, because of a statutory election that a spouse has made—especially where such an election actually alters the decedent's intended plan.

One argument in favor of an affirmative answer to this question is that it can be fairly assumed that a testator is aware that his or her spouse has the right to elect against his will and has taken that into consideration when choosing to include a broad exoneration tax clause. The total forfeiture principle assumes the opposite. Although the Second Department did not explicitly say it, its holding is, in effect, a rejection of the total forfeiture principle.

Whatever different views reasonable minds might have on this issue, there is a prime lesson to be drawn from these decisions. To wit, in order to avoid litigation as to whether the total forfeiture principle applies, a testator should explicitly state that he or she intends or does not intend (as the case may be) the spouse to benefit from the will's estate tax provision whether or not the spouse elects under EPTL 5-1.1-A.

Ratable Contribution

The second issue presented to the court in *Priedits* was whether the calculation of the beneficiaries' contribution to the elective share should have been determined before or after the estate taxes were deducted. The substantial estate taxes (approximately $2 million), which were assessed solely against the charitable residuary beneficiary made a significant difference in this context. If the charity's contribution is to be determined before the estate taxes are deducted, then it will contribute a significantly higher percentage/amount toward the elective share.

Since there seemed to be no case law on this issue prior to the Surrogate's determination here, the court looked solely to EPTL 5-1.1-A in deciding that it was proper to calculate the beneficiary's pro rata contribution to the elective share before estate taxes were deducted from the net elective share estate. The court was persuaded by section 5-1.1-A(a)(2) which specifically provides that debts and administration expenses shall be deducted in determining the "net estate", but estate taxes are to be disregarded.

The Attorney General and the charity argued, however, that 5-1.1-A(a)(2) only applies to the determination of how the elective share is to be computed. Ratable contribution is dealt with in a different clause of 5-1.1-A altogether. In particular, clause (c)(2) provides, in relevant part, "…

ratable contribution to the share to which the surviving spouse is entitled shall be made by the beneficiaries and distributees (including the *recipients* of any such testamentary provision), other than the surviving spouse, under decedent's will, by intestacy and other instruments making testamentary provision, which contribution may be made in cash or in the specific property *received* from the decedent by the person required to make such contribution…" (emphasis added).

If the Attorney General and charity are correct about which section controls, then the word "recipients" and "received" would seem to support the notion that a beneficiary's contribution can only be made from funds actually received. Consequently, computing ratable contribution after estate taxes are first deducted would seem consistent. However, the Second Department apparently agreed with the Surrogate on this issue although no insight is given as to its reasoning. The Second Department merely stated that the Attorney General and the charity's contentions "are without merit." Id.

That being the case, these decisions leave an unresolved quandary. Under different facts, the estate taxes could have reduced the residuary estate to below the amount of the ratable contribution creating a shortfall. In other words, the beneficiaries responsible to contribute to the elective share will not be receiving enough to pay their ratable contribution amounts. Indeed, the residuary estate could be wiped out. What happens then? Does the beneficiary become personally liable to make good on the ratable contribution? It is hard to imagine that it was ever the legislative intent for a beneficiary to use his or her own funds to meet the shortfall. We are thus left with the, as yet, unanswered question as to who is liable for sufficient contribution to pay the full elective share in case of such a shortfall? Perhaps a legislative change to the statute is necessary to clarify this issue.

Endnotes:

1. This is not an issue in many cases because a spouse is entitled to benefit from the estate tax marital deduction. However, the marital deduction is not available to non-citizen spouses without a qualified domestic relations trust.

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