TAX ISSUES IN SETTLING TRUSTS & ESTATES LITIGATION

JOHN A. HARTOG
CALIFORNIA TRUST & ESTATE COUNSELORS, LLP
4 Orinda Way, Suite 250-B
Orinda, CA 94563
Tel (925) 253-1717
Fax (925) 253-0334
JAHARTOG@CALTECLAW.COM
WWW.JAHARTOG.COM

JOHN A. HARTOG maintains a private law practice in Orinda, California. He is a Fellow of the American College of Trust & Estate Counsel and a Certified Specialist in Taxation Law, and in Estate Planning, Probate and Trust Law, California State Board of Legal Specialization. He is a member of the Taxation Section and a past Chair of the Trusts & Estates Section of the State Bar of California. He has written numerous articles in the area of Trusts and Estates law, and has published in the field of taxation and estate planning. He is a co-author of *California Trust Practice*, released by Matthew Bender. He is the lead consulting editor and a co-author for the Matthew Bender publication *California Wills & Trusts,* a multi-volume treatise and document assembly program.

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John A. Hartog

I. Introduction

The Internal Revenue Code of 1986, as amended ("IRC") section 2053 provides for a deduction from the taxable estate for funeral expenses, administration expenses, claims against the estate and for indebtedness in respect of property included in the value of the gross estate. IRC section 2053(a). Expenses such as attorney's fees incurred in trust and estate litigation may be deductible expenses of the estate if they comply with certain conditions imposed by the IRC and case law. The IRC also permits certain administration expenses to be deducted from the taxable income of an estate or trust, but creates limitations on deducting the same expense for both estate and income taxes. IRC section 642(g). Recently issued treasury regulations clarify how deductions may be taken for disputed claims against the estate. This outline focuses on the estate tax issues arising from trust and estate litigation, including the allowance of deductions for expenses and apportionment of the estate tax liability among beneficiaries**.**

II. Administration Expenses Generally

A. Estate Administration Expenses that may be deducted include executor's commissions, attorney's fees and miscellaneous administration expenses. Treas. Reg. § 20.2053-3(a). These three classes of administration expenses are deductible from a decedent's gross estate as long as they are "actually and necessarily incurred in the administration of the decedent's estate, that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it." *Hefner v. U.S.* 93-1 USTC 60, 138 (W.D. Okla. 1993). Expenses that are not essential to the property settlement of the estate but are incurred for the individual benefit of the heirs, legatees or devisees are not deductible. Treas. Reg. § 20.2053-3(a).

B. In order to be deductible under IRC section 2053, the expense must be found reasonable for purposes of state probate law and federal estate tax law. TAM 8838009, 9132003. The Second, Fourth, Fifth, Sixth and Ninth Circuits recognize a federal standard, distinct from the standard of the state probate court in order to discern whether an administration expense may be deducted for federal estate tax purposes.

C. Approval of payment of the expense by the local probate court holds considerable weight in determining whether the expense may be deducted for federal estate tax purposes. (In the Seventh Circuit, the

approval by the local probate court is viewed as conclusive. *Senner Est. v. Comr.* (7th Cir. 1978) 577 F.2d 1100.

III. Will Construction or Reformation Actions

A. *Will Constructions.* The courts appear to be inclined to apply a broad definition of deductible administration expenses when the subject of an action involves the construction of a Will. If the expense was approved by the probate court and was not solely related to a dispute between beneficiaries as to their respective shares in the estate the courts have been lenient in finding deductibility. See *Cadden v. Welch* (6th Cir. 1962) 298 F.2d 343 (Where the probate court had jurisdiction to enter the order, the order was not contrary to Ohio law and did not violate the Internal Revenue Code, it was controlling on a district court. Deduction of attorney fees relieved the estate and, indirectly, the residuary legatee, from paying a tax on assets the estate paid out and never distributed to the residuary legatee.); *Bullock Est. v. Comr.*, T.C. Memo 1960-204.

B. *Deduction Allowed When Allowed by Probate Court.* Courts have often held expenses of a construction or reformation litigation to be deductible when allowed by the probate court. The proper distribution of amounts by the executor is viewed as a necessary element in the administration of the estate. In order to be deductible expenses the expenses must have been allowable under applicable local law and under the Treasury Regulations. *Reilly Est. v. Comr.*, 76 T.C. 369 (1981); Attorney's fees were deductible administration expenses when paid from estate funds pursuant to an order of the state court. *Dulles v. Johnson*, 273 F.2d 362 (2d Cir. 1959), *cert. denied*, 364 U.S. 834 (1960); *Pridmore Est. v. Comr.*, 20 T.C.M. 47 (1961); *Schmalstig v. Comr.*, 46 F. Supp. 531 (S.D. Ohio 1942);

IV. Attorney's Fees

A. *In General.* Attorney's fees paid, or expected to be paid, in connection with the administration and maintenance of an estate are deductible. The amount of attorney's fees deducted on the return must be reasonable in amount and must be allowable by and enforceable under local law. *Malone v. U.S.* 80-2 USTC, 13,366 (S.D. Tex. 1980). Attorney's fees must also be allowable under Regs. §20.2053-3(a), *i.e.,* the fees must be actually and necessarily incurred in the administration of the estate. *DeWitt Est. v. Comr.*, 54 T.C.M. 759 (1987).

B. *Attorney's Fees Must Be Reasonable.* No bright line test is available to determine the reasonableness of attorney's fees. Each case must be determined upon its own facts and circumstances, with consideration given to the amount involved, time and effort expended by the attorney, the seriousness of the problems involved, the results obtained, and the experience and ability of the attorney. *Schnorbach v. Kavanagh*, 102 F. Supp. *828 (W.D. Mich. 1951).*

(1) Time and Effort. The time and effort required of the attorney for a large or unusually complicated estate may justify a sizeable attorney's fee.When the IRS insisted that the reasonableness of the fee could not be determined without evidence of the amount of time spent, courts have held that the decision of the probate court was controlling.*Prell Est. v. Comr.*, 48 T.C. 67 (1967); *Hunt Est. v. Comr.*, 11 T.C. 984 (1948), *acq.*, 1949-1 C.B. 2; *Mulconroy Est. v. Comr.*, 15 T.C.M. 887 (1956); *First Nat'l Bank of Nevada v. U.S.*, 77-2 USTC ¶ 13,207 (D. Nev. 1977); *Bank of Nevada v. U.S.*, 80-2 USTC ¶ 13,361 (D. Nev. 1980); *DeWitt Est. v. Comr.*, 54 T.C.M. 759 (1987)

(2) Amount Involved. Whether attorney's fees are reasonable may depend on the size of the estate. *Leewitz v. U.S.* (Ct. Cl. 1948) 75 F. Supp. 312. A court may refer to the fee schedule of the local bar association. *First National Bank of Topeka* (D. Kan. 1964) 233 F. Supp. 19. If the probate court has guidelines regarding attorney fees as a percentage of the estate, they may be taken into consideration.

(3) Seriousness of the Matter. The reasonableness of a deduction for attorney's fees may also be determined on the basis of the matter for which the services were necessary. The more serious or complicated the specific matter involved, the more likely it is that the estate will pay attorney's fees in excess of those normally incurred. *DeWitt Est. v. Comr.*, 54 T.C.M. 759 (1987). Estates involving valuation issues, generation skipping taxes, or closely held business interests will typically justify larger fees.

(4) Results Obtained. The results of the attorney services may also justify the attorney's fees as reasonable. When the fee charged was only 10% of the amount recovered by the estate after protracted litigation, the attorney's fees were reasonable. *First National Bank of Topeka v. U.S.* (D. Kan. 1964) 233 F. Supp. 19.

(5) Experience and Skill of the Attorney. The experience and ability of the attorney may also be a factor in the reasonableness of the fee. "Broad experience and recognized ability" may help to justify the fee. *Schnorback v. Kavanagh, supra.*

(6) Length of Administration. As a corollary to the size of the estates, several courts have cited the length of the period of administration as a factor to be considered in determining reasonableness of the fee. Although estate administration must not be unnecessarily prolonged, a substantial period of administration may increase the likelihood that the attorney's fee will be regarded as reasonable. *Irving Bank-Columbia Trust Co. v. Comr.* (1929) 16 B.T.A. 897; *Brewer Est. v. Comr.* (1941) 45 B.T.A. 1160 (when the administration lasted 5 years); *Prell Est. v. Comr* (1967) 48 T.C. 67.

C. *Attorney Services Must Be Beneficial or Essential to the Estate.* Attorney's fees must be expended for the benefit of the estate to be deductible. The attorney's services must be appropriate or necessary to the settlement of an estate generally. More particularly, they must be appropriate or necessary to the collection of assets, payment of debts, or distribution of the estate's property to the person legally entitled to it. *Schmalstig v. Conner*, 46 F. Supp. 531 (S.D. Ohio 1942); *Bluestein v. Comr.*, 15 T.C. 770 (1950), *acq.*, 1951-1 C.B. 1; *Peck v. Comr.*, 40 T.C. 238 (1963); *Swayne Est. v. Comr.*, 43 T.C. 190 (1964), *acq.*, 1965-2 C.B. 6. *Cf.*, *O'Neal Est. v. U.S.*, 258 F.3d 1265 (11th Cir. 2001) (evidence insufficient to establish deduction for attorneys' fees as administrative expense when estate invoked attorney-client privilege and declined to present legal fee invoices to court).

(1) Under the rule stated in Treas. Regs. §20.2053-3(c)(3), deductibility is tested by the provision that the fees must be incurred in litigation essential to the proper settlement of the estate, if they are to be deductible.

Attorney's fees that fail this test are not deductible, even if approved by a probate court.

(2) The Tax Court has allowed the deduction of attorney's fees incurred by a widow in litigation against the estate involving the ownership of assets the decedent previously had transferred to her, which were payable under a compromise agreement approved by the probate court. *Reilly Est. v. Comr.*, *supra,* 76 T.C. 369 (1981). The court offered three separate grounds for the deduction: (1) as attorney's fees of a beneficiary that were essential to the proper settlement of the estate under Treas. Regs. §20.2053-3(c)(3). (2) as a cost of administration that the executor incurred in collecting assets and making distribution under IRC §2053(a)(2).;and (3) as payment of the widow's "claim" against the estate, which was based on the decedent's actions during his life under IRC §2053(a)(3). Relying on this decision, the IRS has ruled that litigation expenses incurred by an estate that are necessary for the collection of estate assets are deductible as administrative expenses. PLR 8723011.

D. *Allowance Under Local Law.* An estate was allowed to deduct attorney's fees only to the extent of a one-third interest in a recovered estate tax refund because, under applicable state law, reasonable attorney's fees in a contingent fee agreement were limited to one-third of the recovery. *Malone v. U.S.*, 80-2 USTC ¶ 13,366 (S.D. Tex. 1980).

E. *Who May Claim the Deduction.*

(1) In *Windsberg Est. v. Comr.,*37 T.C.M. 455 (1978) the court held that the executor of his parent's estate was not allowed to deduct on his individual income tax return as trade or business expenses the administration expenses of the estate, because the deductions were those of the estate.

(2) Attorney's fees and administration, expenses paid or incurred by the fiduciary of an estate in connection with the administration of the estate, including expenses incurred in the determination, collection, or refund of any tax, are not deductible in the fiduciary's personal income tax return. Nevertheless, expenses incurred during the administration of an estate which are paid by the executor or administrator in his capacity as the fiduciary of the decedent's estate are deductible under section 23(a)(2) of the Internal Revenue Code of 1939, in the estate's income tax return for the year in which the payment was made, provided such expenses are not claimed as a deduction in computing the net estate subject to the estate tax. Rev. Rul. 55-190, 1955-1 C.B. 275. *See also Henderson v. Comr.,* 11 T.C.M. 419, 420 (1952).

F. *Extraordinary Fees*. Legal fees for extraordinary services are less likely to be allowed as deductions. Extraordinary fees are often viewed as expended for the

benefit of the individual beneficiaries rather than the estate. Even if they benefit the estate they may be disallowed as a deduction if they are at variance with applicable state law. Treas. Reg. §20.2053-1(b)(2).

(1) If a probate court finds that the fees may be charged against the estate, the deduction should be allowed for federal estate tax purposes. *Cadden v. Welch* (6th Cir. 1962) 298 F. 2d 343. Nevertheless, to the extent that the extraordinary fees are charged against an individual beneficiary rather than the estate, the fees will be disallowed as a deduction, even though the entire fee is incurred by the same litigation. *Bullock Est. v. Comr.* T.C. Memo 1960-204 (A California probate court permitted a portion of the extraordinary fees of litigation to be charged against the estate and the remainder to be charged against one beneficiary. Only the portion chargeable against the estate was allowed as a deduction.)

(2) A probate court decree allowing a charge against the estate under local law is usually sufficient to allow the deduction when the court passes upon the merits of the issue. Treas. Reg. §20.2053-1(b)(2); *Melville Est. v. Comr* T.C. Memo 1993-484; *Miller Est. v. Comr.* (1962) 21 T.C.M. 43.

G. *Legal Fees When Administration Not Necessary*

(1) Legal fees may be deducted when a formal probate administration of the estate is not required. The primary consideration in these estates is whether the fees would have been allowable under stte law if the estate had been formally administered. *Pitner v. U.S.* (5th Cir. 1967) 388 F.2d 651.

V. Will Contests

A. *Generally.* Unless evidence regarding the nature of the proceeding is offered, a tax court will typically disallow as deductions all expenses incurred in the contest. *U.S. v. Lachman*, 73-1 USTC ¶ 12,904 (S.D.N.Y. 1973).

B. *Attorney's Fees Must Benefit the Estate and Not the Beneficiaries.* Attorney's fees incurred by beneficiaries incident to litigation as to their respective interests do not generally constitute a proper deduction, since expenses of this character are normally incurred on behalf of the beneficiaries personally and, accordingly, are not "administration expenses." Treas. Reg. §20.2053-3(c)(3). *See LeFever v. Comr.*, T.C. Memo 1995-321, *aff'd*, 100 F.3d 778 (10th Cir. 1996) (legal fees incurred by estate beneficiaries in litigating their liability for the §2032A(c) recapture tax are not a deductible expense of the estate, since the expenses were incurred for the benefit of the heirs. The litigation expenses were not

necessary to the settlement of the estate). If the expenses were essential to the proper settlement of the estate and were not incurred for the individual benefit of the legatees such expenses may be deductible.

C. *When Fees Allowed by Probate Court.* When the probate court has authority to allow the expenses of both successful and unsuccessful litigants to be paid out of the decedent's estate, as in California, such fees will be deductible. Commercial Nat'l Bank of Charlotte v. U.S., 196 F.2d 182 (4th Cir. 1952). In contrast, the Tax Court has held that attorney's fees incurred in resisting the probate of a Will were not deductible. The litigation, said the court, did not assist in the administration of the estate, but actually complicated effective administration. *Baldwin v. Comr.*, 59 T.C. 654 (1973).

(1) When the challenge to the testamentary document is upheld, the expenses incurred by the purported executor are nevertheless deductible if paid by the administrator of the estate. *Peck Est. v. Comr., supra.* (Without the litigation, it could not be determined whether the decedent had died testate or intestate, whether the estate was to be administered by the named executor or by an appointed administrator, or who was entitled to beneficial interests in the estate.)

D. *Settlement Payments.* When a Will contest is settled by a payment to the person claiming a share of the estate, such payment is usually regarded as an inheritance, so that no deduction is allowable. Even though the executors may regard the suit as a nuisance claim, and may pay the claim in order to proceed with the administration of the estate, the payment is nondeductible if it emanated from the claimant's position as a potential heir. *Pennsylvania Bank and Trust Co. v. U.S.*, 451 F. Supp. 1296 (W.D. Pa. 1978).

E*.* *Identity of the Claimant.* If a relative of the decedent makes a claim against the estate based on a business relationship rather than as an heir, payment of that claim by the executor may be deductible. *Baldwin Est. v. Comr.*, T.C. Memo 1961-89.

VI. Effect of Subsequent Events on Deductions for Claims Against the Estate

A. When an estate has been involved in litigation questions may arise as to valuation of the claim against the estate. Case law has created confusion as to whether the claim is to be valued as of the date of the decedent's death or if subsequent events will alter the amount of the deduction (such as settlement for less than the original amount of the claim.) The IRS issued regulations in 2009 to clarify that subsequent

events are to be taken into account when determining the amount of a deduction.

B. IRC section 2053 permits deductions only for claims against the estate that are enforceable. In order to be deductible the claim must also be based upon arm's length dealings and not instigated solely for the purpose of establishing an "enforceable" claim for tax advantage. *May v. Henslee* (M.D. Tenn. 1952) 53-1 USTC 10,897.

C. A distinction must be made between a claim to share *in* the estate and a claim *against* the estate. For example, when an executor paid an amount to the decedent's nieces to settle their claims against the estate the Tax Court found that the payment was not deductible because the claims were those of beneficiaries rather than creditors. *Lazar Estate v. Commissioner* (1972) 58 T.C. 543.

D. Although an enforceable claim may exist at the time of the decedent's death, subsequent events may relieve the estate of all or a portion of the liability. Before the IRS issued regulations in 2009 on the issue, significant confusion existed among the circuits.

> (1) In one line of decisions, courts followed the doctrine of *Ithaca Trust Co. v. U.S.* (1929) 279 U.S. 151. In that case a wife died only six months after her husband. The court agreed with the government that her life tenancy should be valued based on actuarial tables, thus limiting the charitable deduction to much less than the amount actually paid to the charity. The Fifth, Tenth and Eleventh Circuits have followed the *Ithaca Trust* doctrine in ruling that post-death events are not to be considered in valuing claims against the estate. *Smith Estate v. Commissioner* (5th Cir. 1999) 198 F. 3d 515; *McMorris Estate v. Commissioner* (10th Cir. 2001) 243 F. 3d 1254; *O'Neal Estate v. U.S.* (11th Cir. 2001) 258 F. 3d 1265.
>
> (2) The Ninth Circuit has held that IRC section 2053 precludes consideration of post-death events . *Propstra v. U.S.* (9th Cir. 1982) 680 F. 2d 1248.
>
> (3) Another line of cases is based on *Jacobs v. Commissioner* (8th Cir. 1929) 34 F. 2d 233, in which the Eight Circuit found that Congress intended for actual claims to be deducted, not theoretical ones. The Court of Claims has supported the *Jacobs* doctrine. *Schiffman v. U.S.* (Ct. Cl. 1943) 51 F. Supp. 728.

(4) The Fifth Circuit has affirmed a Tax Court holding that a deduction was not permissible, when the decedent's obligations were not filed as required by local law and therefore became void and unenforceable. Nevertheless, the Tax Court has also ruled to allow a deduction when the creditor failed to file a timely notice of its claim within the statutory period required by the state. The executor rejected the claim and the creditor filed suit alleging misrepresentation by the executor, in accordance with a judicial exception to the statutory filing requirement. The executor settled the claim. The settlement was entered and approved by all interested parties and the state court rendered a consent decree. In allowing the deduction the Tax Court felt compelled to honor the state court decree. *Greenberg Estate v. Commissioner* (1981) 76 T.C. 680.

(5) A third line of cases narrowed the *Ithaca Trust* doctrine to valuation cases. *Kyle Estate v. Commissioner* (1990) 94 T.C. 52.

D. In an attempt to bring clarity to the issue of whether to consider post-death events in allowing a deduction for claims against the estate, the IRS issued final regulations in 2009. Treas. Regs. Sections 20.2053-1(d) – 4(a) (applicable to estates of decedents dying on or after October 20, 2009.) Those regulations provide that post-death events are to be considered in determining the amount deductible. Deductible expenses are generally limited to amounts actually paid by the estate in satisfaction of deductible expenses. Under Treas. Reg. 20.2053-4(a)(1), amounts that may be deducted as claims against the decedent's estate are limited to amounts for bona fide claims that:

(1) represent personal obligations of the decedent existing at the time of the decedent's death;

(2) are enforceable against the decedent's estate at the time of payment; and

(3) are actually paid by the estate in settlement of the claim or satisfy the ascertainable amount requirements of regulations 20.2053(1)(d)(4) (ascertainable with reasonable certainty and will be paid, such as administrator's fees).

(4) Example: (Treas. Reg. 20.2053-1(d)(7))

Prior to death, Decedent (D) is sued by Claimant (C) for $100x in a tort proceeding and responds asserting affirmative defenses available to D under applicable local law. C and D are unrelated. D subsequently dies

and D's Form 706 is due before a final judgment is entered in the case. The executor of D's estate (E) may not claim a deduction with respect to C's claim on D's Form 706 under the special rule contained in paragraph (d)(4) of this section because the deductible amount cannot be ascertained with reasonable certainty. However, E may file a timely protective claim for refund in accordance with paragraph (d)(5) of this section in order to preserve the estate's right to subsequently claim a refund at the time a final judgment is entered in the case and the claim is either paid or meets the requirements of paragraph (d)(4) of this section for deducting certain ascertainable amounts.

E. Exceptions to the general rule created by the new regulations. The regulations create exceptions for claims against the estate.

(1) The estate may deduct the current value of a claim for which there is one or more substantially related claims or integrally related assets that are included in a decedent's estate if the aggregate value of the related claims or assets of the estate constitutes at least 10% of the gross estate; or

(2) An estate may deduct the current value of claims against the estate even though payment has not been made to the extent that (1) the total amount deducted by the estate does not exceed $500,000.

The regulations provide the following examples of the exceptions:

Example 1.

There are three claims against the estate of the decedent (D) that are not paid and are not deductible under §20.2053-1(d)(4) or paragraph (b) of this section: $25,000 of Claimant A, $35,000 of Claimant B, and $1,000,000 of Claimant C. The executor of D's estate (E) may not claim a deduction under this paragraph with respect to any portion of the claim of Claimant C because the value of that claim exceeds $500,000. E may claim a deduction under this paragraph for the total amount of the claims filed by Claimant A and Claimant B ($60,000) because the aggregate value of the full amount of those claims does not exceed $500,000.

Example 2.

There are three claims against the estate of the decedent (D) that are not paid and are not deductible under §20.2053-1(d)(4) or paragraph (b) of this section; specifically, a separate $200,000 claim of each of three claimants, A, B and C. The executor of D's estate (E) may claim a

deduction under this paragraph for any two of these three claims because the aggregate value of the full amount of any two of the claims does not exceed $500,000. E may not deduct any part of the value of the remaining claim under this paragraph because the aggregate value of the full amount of all three claims would exceed $500,000.

Example 3.

As a result of an automobile accident involving the decedent (D) and A, D's gross estate includes a claim against A that is valued at $750,000. In the same matter, A files a counterclaim against D's estate that is valued at $1,000,000. A's claim against D's estate is not paid and is not deductible under §20.2053-1(d)(4). All other section 2053 claims and expenses of D's estate have been paid and are deductible. The executor of D's estate (E) deducts $750,000 of A's claim against the estate under §20.2053-4(b). E may claim a deduction under this paragraph (c) for the total value of A's claim not deducted under §20.2053-4(b), or $250,000. If, instead, the value of A's claim against D's estate is $1,500,000, so that the amount not deductible under §20.2053-4(b) exceeds $500,000, no deduction is available under this paragraph (c).

VII. Apportionment of Estate Taxes

A. The question of what property should be burdened with estate taxes is often litigated in several contexts. Frequently, the Internal Revenue Service challenges an executor's decision as to how to apportion taxes if the executor's decision has the impact of lowering estate taxes. Thus, for instance, the IRS has successfully argued that when a decedent makes a residuary marital bequest and declares that all taxes are to come from the residue of the estate, then the marital deduction must be reduced. *See, e.g., Lewis Est. v. Comr.*, 69 T.C.M. 2396 (1995)

B. A second source of friction comes from the beneficiaries themselves. *See Estate Of Margaret C. Wathen* 56 Cal. App. 4th 48; 64 Cal. Rptr. 2d 805; 1997 (extrinsic evidence was admissible to clarify decedent's intent. when construing ambiguous tax apportionment clauses in will and trust.). *Estate of Fasken* (1977) 19 Cal. 3d 412; *Estate of Armstrong*,(1961) 56 Cal. 2d 796 (ambiguities in a will must be resolved in favor of apportionment); *Estate of Skinker* (1956) 47 Cal. 2d 290.

C. California has adopted a statutory scheme of equitable proration of estate taxes among the recipients of the assets. Probate. Code §§20110-20117.

(1) Proration of estate taxes is to be made in the proportion that the value of the property received by each person interested in the estate bears to the total value of all property received by all persons interested in the estate. Probate Code section 20111.

(2) Allowances are to be made for credits allowed for state or foreign death taxes, credits, exemptions and deductions allowed by federal estate tax law. Probate Code section 20112.

(3) Life estates and other temporary interests are not subject to apportionment. Rather, the tax is chargeable against the corpus of the property. Probate Code section 20113. When a will left a house to a friend for life, the estate tax applicable fell to the house even though this required the house to be sold. *Estate of Malpas* (1992) 7 Cal. App. 4th 1901.

D. There is a strong policy in favor of statutory apportionment. Those contending against it bear the burden of proof. When there is no reference to proration of taxes in the will, extrinsic evidence of intent is inadmissible. Nevertheless, when the will directs that taxes be paid from the residue of the estate and there was no probate estate extrinsic evidence of intent should be admitted. A will may direct that probate assets be used to pay taxes on assets in a living trust, and the reverse is also true. *Hoover v. Hartman* (1982) 136 Cal. App. 3d 1019.

E. The decedent's intention must be plainly expressed in order to overcome a statutory rule concerning the payment of such taxes. *See, e.g., Simpson v. White*,(1997) 57 Cal.App.4th 814, 822 (noting the strong policy in favor of apportionment and finding that intent to override the statutory presumption must be clear and unambiguous); *Carley Estate*, (1978) 90 Cal.App.3d 582; *Estate of Stokley* (1980)108 Cal. App. 3d 461 (the decedent's will unambiguously directed against apportionment.) This statement belies the complexity of this area, because the case law is littered with opinions of judges trying their best to determine a decedent's intention when such intention has not been clearly expressed.

F. A will directed that if the residue of the estate was insufficient to pay taxes they should be "prorated among all of the devisees under this will." This required the charitable devisees to pay a share since the testator had clearly expressed an intent contrary to the statute. The charitable devisees had to pay a share of the taxes even though this resulted in an increased total tax burden of $54,000 for the estate. *Estate of Silveira* (1983) 149 Cal. App. 3d 604.

G. The Tax Court found that charitable deductions for gifts made to charitable beneficiaries had to be reduced by the amount of estate taxes attributable to their gifts because the language of the will opted out of the

proration statutes, which would exempt charitable gifts from proration. *McKay v. Commissioner,* T.C. Memo 1994-362. The Tax Court disallowed the full charitable deductions even though an order of the Superior Court of California had permitted all of the estate taxes due to be charged against the one non-charitable beneficiary. The Tax Court was not bound by the decision of the Superior Court because it was not a "bona fide adversary proceeding."

H. The personal representative has the power to withhold any apportioned taxes that are due from a beneficiary and also gives a direct cause of action to the fiduciary or other person required to pay a tax against the person to whom the tax should be apportioned. *See, e.g.,* Cal. Probate Code §20116 (authorizing the personal representative to recover from persons who received property that did not come into the hands of the personal representative).

I. In Estate of William C. Talbot (1968) 257 Cal. App. 2d 687, the executrix of a will appealed from an order apportioning state and federal estate taxes. The executrix was the wife of the decedent and step-mother to the decedent's three children. The decedent's will left his entire estate of $340,000 to his wife. The will expressed an intention that the executrix not be liable for estate taxes to the extent that the property left to her qualified for the marital deduction**.** After the decedent's death the children contested his will. The parties arrived at a settlement agreement that granted $125,000 to the children "free and clear of all administrative costs, estate taxes, inheritance taxes" and any other charges or expenses against the estate.

The executrix later learned that in addition to the probate estate there were insurance proceeds from policies on the life of the decedent of which the three children were direct and equal beneficiaries. The executrix filed a request that the court direct the children to pay a proportionate share of federal estate tax and California inheritance tax. The lower court adopted the suggestion of the children and determined that the apportioned share of the tax of the children would be in the proportion that the insurance proceeds bore to the adjusted gross estate, without taking into consideration the marital deduction. The appellate court determined that the amount of the allowed marital deduction must be excluded in fixing the widow's share of tax. The children's share of the taxes must be increased because their proportionate share of taxes should be determined by the proportion that the insurance proceeds bore to the *net estate*. The court found that it would be "grossly inequitable to deprive the widow on the one hand of the tax-free feature of the marital deduction and then apply the ratio thus arrived at to a tax that is $65,936.58 less than it would have been but for the marital deduction."

CONCLUSION

Deductions for administrative expenses, attorney fees, and disputed claims against the estate must be carefully considered by practitioners when settling trusts and estates litigation. Attorneys must examine the nature of the deduction and its benefit to the estate. Careful consideration should also be given to whether a disputed claim may be deducted against the estate and whether subsequent events will alter the amount of the deduction. The attorney should analyze whether seeking court approval of the expense or claim may assist them in claiming a deduction against the gross estate. Questions of who will bear the liability of the estate tax will also significantly affect the final outcome of a settlement for the parties. These peripheral issues often take center stage when parties and their counsel fail to address them before executing a settlement agreement. Proper planning for the tax consequences of settling trusts and estates litigation can provide the attorney with a clearer perspective in the negotiation process and will often avoid unnecessarily protracted litigation.

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