The Apportionment of the Federal Estate Tax in Pennsylvania

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NOTES

THE APPORTIONMENT OF THE FEDERAL ESTATE TAX
IN PENNSYLVANIA

Since its origin as a stamp tax on testaments in 1797, Federal taxation of decedents' estates has long ago ceased to be a novelty. The same is true of the more modern—1916—Federal Estate Tax. And, with its fourteenth birthday next July 2, the Pennsylvania offspring of Estate Tax legislation, the Estate Tax Apportionment Act of 1937, has achieved, if not maturity, at least a well-developed adolescence. The purpose of this article is to trace the Pennsylvania statute from the conditions which gave birth to it through the court decisions which have given it its present form. In certain aspects the statute has not been satisfactory. These aspects will be noted, and suggestions made for their correction. But primarily this article is historical. Its opinions are posed as questions, and their acceptance or rejection is of small import.

THE INCIDENCE OF THE ESTATE TAX UNDER THE REVENUE CODE

In the absence of apportionment legislation or testamentary direction to the contrary, the decedent's residuary estate is, under the Revenue Code, chargeable for the entire Estate Tax. The obligation is personal to the executor and continues till the tax is paid or the executor is discharged by the Revenue Commissioner.

The gross estate for Estate Taxation purposes, on the other hand, may far exceed the property held by the executor. It may include, for example, proceeds of insurance policies payable to named beneficiaries, property over which the decedent exercised certain taxable powers of appointment, various types of inter vivos trusts, and property held by the decedent as joint tenant with rights of survivorship.

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1 Act of July 6, 1797, c. 11, 1 Stat. 527 (U. S.).
2 A summary analysis of the early federal death taxes will be found in Knowlton v. Moore, 78 U. S. 41, 44 L. Ed. 969 (1899).
4 Act of July 2, 1937, P. L. 2762, 20 P. S. 844 (Pa.):
6 26 U. S. C. A. § 822 (b).
7 The procedure for discharge of an executor by the Commissioner is set forth in 26 U. S. C. A. § 825.
8 The determination of the decedent's gross estate is provided for in 26 U. S. C. A. § 811.
Yet, to its full extent, the testamentary estate and those taking under it—usually "the widow, children, or nearer and more dependent relatives"—alone must bear the burden. Only where there is a contrary testamentary direction, or where the residuary estate is inadequate to satisfy fully the tax levy, does a party other than the executor and property other than the testamentary property become liable for the tax payment!

The hardship of such provisions is, no doubt, to some extent alleviated by Code authority permitting the executor to recover a pro rata share of the Tax from the beneficiary (other than the executor or one taking under charitable or marital exemption) of life insurance policies, or from a person (with the exceptions noted above) receiving property by reason of a taxable power of appointment. Even these cushions have been criticized and justly: because they are spotty, in that they deal only with specific situations; because they are only permissive, imposing no duty upon the executor to protect the interest of the residuary legatees. But the point to be emphasized in the present discussion is that, prior to 1942, the liability of one taking insurance was subject to a $40,000 non-proratable exemption, while a transferee under a power of appointment could not even be touched. At the time the Pennsylvania Apportionment Act was drafted, then, in the absence of contrary direction by the decedent, to the full extent of its assets, the residuary estate of the average taxable decedent bore unaided the Estate Tax burden, a burden which under the most elementary principles of equity should have fallen pro rata upon each and every participant in the gross taxable estate.

In Ely's Estate, a Pennsylvania case decided prior to the Act of 1937, the executor attempted to secure contribution for Estate Taxes from an inter-vivos trust whose assets had been included in computing the levy; his petition was denied. Citing New York and Massachusetts decisions for authority, the court declared:

"Since the Federal Estate Tax is an estate rather than an inheritance tax and is graduated upon the capacity to pay rather than upon the amount of the individual bequests, it partakes of the nature of an administrative expense, and this is so even though a portion of the tax is imposed by reason of general assets in a revocable trust inter-vivos."

When confronted with Kentucky and New Hampshire decisions awarding apportionment on the theory of equitable contribution, the court sniffed "not

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9 The provision for contrary direction appears in 26 U. S. C. A. § 826 (b).
10 26 U. S. C. A. § 827 (b) defines the liability of those other than the executor.
11 26 U. S. C. A. § 826 (c).
14 Revenue Code § 826 (d) amended by Act of Oct. 21, 1942, c. 619, Title IV, 404 (b) and 414 (b), 56 Stat. 943 (U. S.).
15 Revenue Code § 826 (d) added by Act of Oct. 21, 1942, c. 619, Title IV, 403 (c), 56 Stat. 943 (U. S.).
sense, but sensibility” and dismissed not only the foreign authority but also an unreported Pennsylvania case in accord therewith. It is interesting to note, however, that the writer of the discarded opinion, Judge—later Justice—Stearne took pains to reiterate his theory in the now governing Mellon's Estate. That case, though decided under the Act of 1937, stated by way of dictum that even in the absence of statute, apportionment might be granted as a matter of general equity, and that a cause of action therefor had always existed. If this be true, and the same statement has been repeated in subsequent Pennsylvania cases, the pre-statute decisions appear doubly abominable, based then as they would appear to be, not on misguided statutory direction, but on blind judicial misinterpretation!

The doctrine of the Ely case was again applied and the decision cited as authority in Uber's Estate, involving a similar attempt to secure contribution for Estate Taxes from a taxable inter-vivos trust. Also cited by the Uber court in denying the executor's petition was Y. M. C. A. v. Davis, a leading federal case in which the court assessed the entire Estate Tax against the residuary interest, even though the interest was earmarked for charity and therefore had not been included in computing the decedent's gross taxable estate! What is most astonishing of all, however, is that the Uber court went out of its way to comment on the then novel New York statute governing apportionment of Estate Taxes: such legislation, the court announced, was not to be admired—it placed inequitable burdens upon smaller legacies! To speak of the inequity of statutory apportionment and in the same breath to deny judicial apportionment in a situation where it is entirely proper would seem to be taking one’s stand in a not too tenable position. But, be that as it may, in 1937, the very year of the Ely and Uber decisions, the legislature of Pennsylvania staggered into the “inequitable” path blazed by their New York brethren and enacted apportionment legislation containing identical provisions. The impetus in both states was the same: “Experience has demonstrated that in most estates, the residuary legatees (bearing the load of taxation) are the widow, children or nearer and more dependent relatives (of the decedent).”

THE ESTATE TAX APPORTIONMENT ACT OF JULY 2, 1937

Scope, Nature, Procedure, and Jurisdiction

The Act of July 2, 1937, P. L. 2762, 20 P. S. 844, referred to herein as “the Apportionment Act” or “the Act of 1937”, provides that, in the absence of testamentary direction to the contrary, where a fiduciary has paid or may be required

17 Roberts' Estate, Orphans' Court of Phila., no. 526 of 1917 (1935).
18 347 Pa. 520, 32 A.2d 749 (1943).
20 264 U. S 47, 68 L. Ed. 558 (1924).
to pay estate taxes, the burden of the tax is to be apportioned *pro rata* among the distributees to be included for tax purposes in the estate of the decedent. Technically the Act is an amendment to Sec. 48 of the Fiduciaries Act of 1917, becoming Sec. 48.1 thereof, and in the face of the general repeal of the Act of 1917 by the Fiduciaries Act of 1949, Sec. 48.1 has been preserved.

The Act of 1937 applies to taxation levies under the Act of 1927 (providing for the levying of such state estate tax as shall be necessary to obtain the full benefit of the federal grant of 80% of the basic estate tax to any state which should make such an assessment) and also to any Estate Tax levied under federal statute. It does not apply to inheritance taxes.

As a matter of procedure the Act provides that the Orphans' Court, upon determining the proper allocation, shall make a decree directing the executor or other fiduciary to charge the prorated amounts against the persons against whom the tax has been so prorated, in so far as he is in possession of property or interests of such persons; and summarily directing all other persons against whom the tax has been prorated, or who are in possession of property or interests of such persons, to make payment of the prorated amounts to the executor. This provision has been interpreted as creating no new substantive rights, but rather as merely spelling out those already existing and implementing their enforcement by giving the Orphans' Court jurisdiction over persons found liable, including persons who might not otherwise be before the court and who as ordinary debtors would not be subject to its jurisdiction. "One of several persons jointly liable for the payment of the Federal Estate Tax who makes payment," the Pennsylvania Supreme Court has said, "is entitled to contribution from the others upon the broad equitable principle of contribution." Since the right of contribution arises wherever one of several parties who are liable for a common debt discharges it for the benefit of all parties, and since such a right is enforced not only in the Orphans' Court but in any tribunal enforcing equitable principles, any court of equity may, even in the absence of statute, decree contribution.

As for the extension of jurisdiction conferred by the Act of 1937, the authorization to make an order "summarily" directing payment for a while created difficulty. In one early case, after pleading the Apportionment Statute as granting him a cause of action, an executor sought to assess beneficiaries of taxable insurance policies, even though the court had before it no accounting charging the respondents, and even though the executor did not possess the funds he sought to have prorated. While the court admitted its statutory authority to make

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24 Act of April 8, 1949, P. L. 512, 20 P. S. 320; 1401 (Pa.).
25 Act of May 7, 1927, P. L. 859, 72 P. S. 2303 (Pa.).
the proration, it ruled that it was without jurisdiction in such a summary proceeding to compel the parties cited to pay the amount found due; in so far as the Act of 1937 conferred such jurisdiction the court held it unconstitutional as a violation of "due process". Fortunately for the validity of the Statute, this dicta has since been repudiated. In Moreland Estate, the Pennsylvania Supreme Court denied the "due process" argument of the respondent, as Mr. Justice Stearne voiced the opinion of the majority that the authorization of "summary" direction was not to be construed as doing away with the constitutional requirement of adequate notice to interested parties.

Apparently, then, in exercising its right to summarily decree apportionment, the Orphans Court must act within its in rem authority as conferred by the Orphans' Court Act of 1917. And this being so, an interested party is not only entitled to notice but may, in accordance with the provisions of the Act of 1917, have the decree opened for rehearing and possibly set aside. However, the fact that the Commonwealth has an interest in proration for inheritance tax purposes (as where the payment of the tax assessment will so depreciate the respondent's inheritance that the remainder thereof will be inadequate to satisfy the state's levy upon it) does not entitle the Commonwealth to notice nor confer upon it a right to protest the apportionment decision.

Constitutional Problems: Herein of Retroactivity

As is the case with every controversial statute, but particularly with those dealing with taxation, many of the early cases under the Act of 1937 questioned its constitutionality, usually as to general authority, but also because of allegedly retroactive provisions involving supposedly unlawful deprivation of property. Since these questions are warp and woof with each other they will be considered under the same heading.

Prior to the passage of the tradition breaking New York apportionment statute of 1930, and with the exception of the isolated decisions noted previously as supporting proration as a matter of inherent equity, it was generally believed that the final as well as the original incidence of Estate Taxes was entirely the province of the Federal Government. But while the validity of the contrary contention had not been conclusively settled on July 2, 1937, before the issue found its way into the appellate courts of Pennsylvania, the constitutionality of the identical New York statute was upheld.

In Riggs v. Del Drago, involving an appeal on constitutional grounds from a statutory proration assessment, the Supreme Court of the United States overruled a contrary decision by the New York Court of Appeals in declaring

33 Mellon's Estate, 347 Pa. 520, 32 A.2d 749 (1943).
35 517 U. S. 95, 87 L. Ed. 106 (1942).
that state apportionment of the Federal Estate Tax violated no provision of the
United States Constitution. To the contention of the appellee that state appor-
tionment violated the Federal "Supremacy" and "Uniformity" clauses, Mr. Jus-
tice Murphy, arguing from history, ruled, *first*, that apportionment statutes did
not violate "Supremacy" provisions, since Congress was only interested in Estate
Tax collection, the final incidence thereof being a proper subject for a state's
power to regulate devolution; and, *second*, that there existed no conflict between
state apportionment and "Uniformity", since federal collection provisions were
uniform, and though the eventual incidence differed, such variation was due
entirely to the exercise of the discretion of each state in regulating death trans-
fers of property within its jurisdiction or that belonging to its own domiciliaries.

With the *Riggs* decision as a guidepost, the Supreme Court of Pennsylvania
experienced little difficulty in disposing of questions of federal constitutionality
in cases which subsequently came before it.36

With respect to alleged conflict between the provisions of the Apportion-
ment Act and the requirements of the Pennsylvania constitution, in *Harvey
Estate*,37 after using the *Riggs* decision to beat down arguments of federal in-
validity, the court went on to hold that the fact that under the Apportionment
Act charitable bequests were not proratable was not such a one as rendered the
legislation in conflict with Pennsylvania's constitutional requirement of uni-
formity of local taxation, since the exemptions of charities was due not to any
favoritism created by state statute, but rather to that of the United States Reve-
nue Acts. The usual contention that the Act of 1937 violated constitutional re-
quirements of notice in title appeared and was disposed of in *Moreland's Estate*,38
the court declaring that no substantive matter, entirely disconnected with the
named legislation, was contained in the folds thereof.

The most troublesome of constitutional arguments concerning the Act of
1937 have been concerned with the alleged invalidity of the Act because of sup-
posedly unconstitutional retroactive provisions. While the problem was at best
but a temporary one and can therefore no longer be the subject of litigation, it
nevertheless merits discussion as emphasizing the broad scope of the state's power
to regulate devolution.

As a matter of fact the Act of 1937 is not entirely clear as to the estates
which its provisions were meant to affect. Was it to apply only to estates of de-
cedents dying subsequent to its passage—as an abstract sense of justice would
seem to require, or was it to apply to any estate in the process of settlement as of
the day of its enactment, even though the decedent had died prior to July 2, 1937?
Foreign authorities construing identical provisions are conflicting39 (so that

37 Ibid.
38 351 Pa. 623, 42 A.2d 63 (1945).
39 For a commentary on the issue as decided in all jurisdictions, see, Münick, *State Legisla-
at least one state has since made express statutory provisions on the question). In Jeffery's Estate, however, by interpreting the Statute literally, the court held that the Act of 1937 applied to all estates which, on the date the Act became effective, had not yet been finally adjudicated. In making their decision, the Pennsylvania Supreme Court upheld a lower court ruling prorating a trust fund established in 1927 by a decedent dying before the Apportionment Statute was enacted! Such a holding did not represent an unconstitutional deprivation of property, the court reasoned, since (and here they followed an opinion by Mr. Justice Moschzisker in a case involving the constitutionality of an act containing similar provisions) the state it was which created the right of devolution, and the state it was which might limit it, even after the death of a decedent, provided his estate had not yet finally passed to his successors; the decedent, knowing of the existence of such power, must therefore be deemed to consent to its exercise!

*The Rights and Duties of the Personal Representative*

Though the Apportionment Act clearly outlines the procedure by which the personal representative may make his assessment, it makes no express provision for the period for asserting the cause of action, the powers incidental to its invocation, the liability of the executor for neglecting to prorate extra-testamentary interests, and the possible exercise of the right to proration by one other than the personal representative. These questions, each of them of some importance, have appeared in subsequent litigation. The answers, so far as there are answers, are discussed below.

With respect to the limitation of time placed upon the right to demand apportionment, proration proceedings must commence after the final assessment of the Tax has been determined and before the final distribution of the residuary estate. The condition precedent arises from necessity: the executor cannot sue until he knows the exact amount which he is seeking. The condition subsequent is imposed out of a sense of justice: with the rendition of a final decree vesting title in them absolutely, those taking upon the death of a decedent have the right to dispose of their inheritances as owners, without threats of liability for past charges lingering like thunderheads to mar their full enjoyment.

Where, therefore, the estate has been distributed and nothing remains upon which the executor may make proration, assessment will not be permitted merely because the remainder interest in a distributed trust fund is to become part of

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40 Md. Code (1939) Art 81, Sec. 126, par. 2, as amended by Md. Laws (1937), c. 156.
41 333 Pa. 15, 3 A.2d 393 (1939).
46 That the right of action may also be waived by release, see Parker Estate, 348 Pa. 211, 34 A.2d 514 (1943).
the residuary estate upon the death of the life tenant. In such a case distribution has been made and title becomes vested as much in the residuary legatees as in the recipient of the temporary interest.

In order to protect himself in his right to apportionment, the executor may delay distribution of the property in his possession pending settlement of tax litigation. And in this connection it is to be noted that under Pennsylvania practice the executor may retain property held by the decedent and passing upon his death by the exercise, non-exercise, or release of a power of appointment; this though, as a matter of legal technicality, property passing by appointment vests in the beneficiary immediately upon appointment. Such extensive rights are conferred because of the nature of the executor's obligations, since, as has been noted previously until he has satisfied the Estate Tax assessment or has been released by the Revenue Commissioner, the personal representative is personally liable for payment of the Tax levy to the extent of the residuary estate.

Often, of course, tenuous tax proceedings and the consequent delay in distribution impose great hardship upon residuary legatees. In one Pennsylvania case, for example, five years had elapsed since the death of the testator and the deficiency tax was still in the course of adjustment; yet the court denied the petition of a legatee that the executor be commanded to prorate the unpaid taxes and to make assessment and distribution. Such unfortunate situations, which are all too common in the settlement of the large estates subject to Estate Taxation, have aroused a certain amount of just criticism. Taxes being what they are, however, and likewise the disinclination of those liable to pay them, it is difficult to see how the problem might be avoided. Pennsylvania, more enlightened than some of her sister states, has made provision for advanced distribution upon the furnishing of proper security, and this would seem the only practicable aid which might be offered under the circumstances. As evidence of the fact that all legatees are not oblivious of their rights under the bonding clause of the 1937 Act, in Hansen's Estate, where it appeared that three years had elapsed since the death of the testatrix and the estate tax had not yet been determined, upon furnishing the requisite security, testamentary trustees were sustained in their contention that the executors under the Act of 1937 no longer had a right to delay distribution of the trust fund.

47 Ibid.
49 Curran's Estate, 312 Pa. 416, 167 A. 597 (1933). But that even this rule has its exceptions, see Harris Estate, 34 Pa. D. & C. 378 (1939).
50 26 U. S. C. A. § 822 (b).
52 Mitnick, State Legislative Apportionment of the Federal Estate Tax, 10 Md. L. Rev. 289, 331 (1949).
54 344 Pa. 12, 23 A.2d 886 (1942).
As to the nature of the right to apportionment, *i. e.* whether its exercise by the fiduciary is mandatory or permissive, though the clauses in the federal statutes permitting proration of insurance proceeds and property taken by taxable power of appointment are phrased in such a way that they would appear to be permissive, it seems clear under the Pennsylvania Act that the law confers upon the executor no mere right but with it imposes a duty. Thus, in one lower court decision, there is dictum to the effect that the failure of a fiduciary to make an authorized proration exposes him to liability for surcharge. Such a holding would appear the only possible one under the circumstances. The executor as a fiduciary must act for the best interests of his principal, and short of fraud, a clearer dereliction could not be imagined than his failure to lighten the burden of the residuary legatee.

Before concluding consideration of the extent and limitations of the action defined by the Act of '37, it is well to emphasize that though the formal legislation confers the right only upon an "executor, administrator, or other fiduciary", not only such a person, but any distributee making payment in excess of his aliquot portion has, under the theory of equitable contribution discussed previously, a right to recover for his generosity from those who have benefited thereby. In *Mellon's Estate,* for example, where legatees (who were also the executors) had paid out of their personal funds the taxes upon the entire estate of the decedent, they were permitted to recover a sum in excess of the pro rata share of each of them out of property held by themselves as executors for the benefit of a non-contributing legatee. The action was sustained not only on the authority of the Act of 1937 (by which legatees under the same will were construed to be "other fiduciaries" within the meaning of the Statute), but also on general principles of equity. Even under the federal law, as a matter of fact, the legatee-executors might have had recovery; under Sec. 826 (b) of the Revenue Code they qualified as persons other than the executor as such who have paid all or a portion of the tax so that they become entitled to reimbursement therefor from any part of the estate still undistributed, or by equitable contribution from persons whose interests benefited by the payment.

**Interests Subject to Liability**

The Act provides that:

"Except where a testator otherwise directs in his will, the tax so paid shall be equitably prorated among the persons interested in the estate to whom the property is or may be transferred or to whom any benefit accrues in the proportion as near as may be to the total value of the property, interests and benefits received by all such persons interested in the estate, except that, in making such proration, allowance..."
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 provisions made whereby any person is given an 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."

Under such a provision, just what interests are subject to proration? Though the Pennsylvania cases offer no complete answer to this question, such issues as the assessment of charitable bequests, of property passing under separation agreements, and of insurance proceeds have all been the subject of well-reasoned Pennsylvania decisions. Furthermore, while there are as yet no appellate decisions on the problem, from a study of the above holdings it should be possible to give some hint as to the probable course of future decisions upon the new "marital exemption."

*Charitable Bequests.* The first Pennsylvania case dealing with the attempted proration of a charitable bequest arose where a testator bequeathed specific sums to each of two charities and the rest of his estate to a large testamentary trust. When the issue was raised as to whether the charitable legacies should be assessed a portion of the Estate Tax, the court held that the words of the Statute directing, "allowance 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 net value of the estate," indicated an intention upon the part of the legislature to recognize the exemptions of the federal act imposing the tax, including that of bequests to charity, and that therefore the charitable legacies should not be subject to contribution. This entirely reasonable position has been affirmed by the Pennsylvania Supreme Court in one of its subsequent cases, and qualified in still another decision holding that even a gift to charity might be subject to proration where it is so directed in the decedent's will.

*The Marital Exemption.* As a part of the program to more equitably apportion the federal tax load among states having Community Property and those, such as Pennsylvania, which were not so fortunate, the Revenue Act of 1948 exempted from liability for Estate Taxes "an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse" to the extent that such interest is included in determining the value of the estate. The ceiling for such exemption is stipulated in the proviso that "the aggregate amount of the deductions allowed shall not exceed 50 per centum

60 26 U. S. C. A. § 182 (d).
64 26 U. S. C. A. § 826 (c) (1) (A).
65 26 U. S. C. A. § 826 (e) (1) (H).
of the value of the adjusted gross estate," defined as being equal to the gross estate minus funeral expenses, losses, indebtedness, and taxes incurred by the decedent, prior to his death. Also amended by the Act of 1948 were Secs. 826 (c) and 826 (d) of the Revenue Code, so that they now provide that where benefits of an insurance policy or property passing under a taxable power of appointment are included in the "marital exemption," the executor has no right to prorate such interest; also where it appears that the exemption covers the amount passing by insurance alone, or the amount passing by appointment alone, but not the total of both of them, then the exemption is to be allowed the insurance proceeds in preference to the appointed property.

If the Pennsylvania courts apply the reasoning of the charitable exemption cases to future ones involving claim for marital exemption, property covered by such exemption will not be subject to proration under the Act of 1937. This, of course, is mere surmise. But there appears no reason for distinguishing the problems.

Proration of Property Passing under Separation Agreements. Assume a contract between husband and wife by which the former, in exchange for an agreement by his spouse to waive her marital rights as his survivor, bequeaths her $100,000 at his death. Is the wife to be considered a creditor of the husband and tax-exempt as satisfying a bona fide claim against his executor, or is she to be treated as the legatee of an interest in her husband's gross taxable estate and therefore liable to proration? In answering this question, the Supreme Court of Pennsylvania has talked itself into a position sufficiently confusing as to be capable of misleading otherwise reliable commentators.

For the purposes of prorating the Estate Tax the court holds the wife's separation interest taxable, the decision being based on a proviso of the Revenue Code that, "a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration in money or money's worth" to qualify one as a creditor taking a tax-free interest in the decedent's estate. Since, under this provision, the $100,000 bequeathed the wife in the hypothetical would be included in the gross taxable estate of her husband, it must bear its fair share of the Estate Tax levy.

If the issue be liability for payment of the State's Transfer Inheritance Tax, however, one finds the Pennsylvania court reaching a quite opposite conclusion.

66 26 U. S. C. A. § 826 (e) (2).
68 Stadtfeld Estate, 359 Pa. 147, 58 A.2d 478 (1948). The court disposed of the respondent's contention that its decision impaired the obligation of contract by pointing out that every contract is made with knowledge that the rights thereunder may subsequently be taxed by the sovereign power.
In a case decided a year previous to that in which the Estate Tax liability was settled, the court held that a wife taking from a deceased husband as a result of a separation agreement was a bona fide creditor "for an adequate and full consideration in money or money's worth" within the meaning of an identically phrased Pennsylvania statute defining deductible debts under the Pennsylvania Inheritance Tax statute of 1919. Because of the additional proviso of the Revenue Act specifically denying claims under separation agreements, the cases are no doubt distinguishable. Nevertheless, as was pointed out by Mr. Justice Jones in his dissent to the inheritance decision, to hold that a wife under a post-nuptial agreement is a creditor exempt from the Inheritance Tax or the Estate Tax is to make a grievous blunder; under cover of such a ruling any spouse might exempt him or herself from succession taxation merely by executing a post-nuptial agreement forfeiting marital rights in the estate of his or her survivor in exchange for contractual rights equally as broad!

Proration of Insurance Annuities. Under both Pennsylvania and federal statutes in the absence of exemption or contrary direction by the decedent, the interest of a named beneficiary in the proceeds of the decedent's insurance is liable for Estate Tax contribution. The important question is the identity of the defendant who may be sued. Certainly the beneficiary unless his interest be entitled to a marital or charitable exemption is liable. But what about the insurance company? May it be treated as a trustee holding legal title to the beneficiary's interest and therefore personally liable for proration suit? Or is the insurance company but a debtor of the beneficiary and therefore free from liability to any but him? Since a fair proportion of life policies provide that the proceeds shall be payable in stated installments of interest and principal spread over a period of time — "sometimes as long as the lives of two generations" — and since therefore the beneficiary may be unable to meet the demand for lump sum apportionment, the possible hardship imposed in such cases upon the residuary legatees whose interests have been depleted by tax inroads makes the question a far more important one than might at first be imagined.

As a matter of practice rather than theory, one authority has stated the problem as follows:

"Shall the court direct the insurance company which holds the funds to deduct forthwith the total amount of the share of such tax applicable to the life insurance proceeds and pay it over to the executor who paid the tax? In such case, what is to happen to the settlement agreement between the insured and the insurance company which stipulated for a

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71 Act of May 27, 1943, P. L. 757, 72 P. S. 2302 (Pa.).
72 Act of June 20, 1919, P. L. 521, 72 P. S. 2301 et seq. (Pa.).
73 26 U. S. C. A. § 826 (c).
74 Polisher, Proration of Federal Estate Tax among Life Insurance Beneficiaries, 50 DICK. L. Rev. 1, 3 (1945).
75 Ibid, 3.
certain number of payments of fixed amounts over a stated period? Shall the amounts of the respective payments be reduced, since the total proceeds have been reduced by the payment of the estate tax? Or shall the amount of the payments remain constant but the number of such payments be diminished?

"The other alternative is to refuse to deplete the insurance proceeds by an immediate lump sum reimbursement to the executor for the share of federal estate tax due the estate and relegate him to the position of a 'hat in hand' creditor who must await satisfaction of his just claim by attachment or sequestration of the stated installments receivable by the beneficiaries as and when they are paid to them under the provisions of the settlement arranged by the insured decedent in his lifetime."

Neither solution then is entirely satisfactory. But, for better or for worse (that the choice has been unfortunate see, Wentling, "Insurance Proceeds and Estate Tax Proration," 20 U. OF PITT. L. REV. 157), Pennsylvania has followed the lead of a federal decision and barred action against the insurer. In an influential circuit court opinion written by Judge—now Chief Justice—Vinson, it was held in John Hancock Mutual Life Insurance Co. v. Helvering that though the testamentary estate of the decedent was insolvent and unable to pay the Estate Tax upon the gross estate, the decedent's life insurer could not be subjected to the Government's suit for satisfaction of the Tax obligation. Under the governing provisions of the Revenue Code, the court argued, an insurance company is neither "a transferee, trustee, or beneficiary," of an interest in the decedent's taxable estate, and therefore free of any liability for taxes. Only the beneficiary of an insurance policy may be sued for the estate levy.

This highly technical reasoning (the insurer is not a "transferee," since nothing is transferred to him; nor a "trustee," since he has no res in his possession; nor yet a "beneficiary," since in fact he is a debtor) was followed verbatim in Moreland's Estate, the leading Pennsylvania case denying liability of an insurance company under the Apportionment Act of 1937. Too, the court added, any other decision would render the Pennsylvania statute unconstitutional as impairing the obligation of contract. The answers to such objections and appeals for a revision of the Pennsylvania attitude will be found in the learned discussions cited in the opinion. Suffice it to say here that as yet the Moreland case is good Pennsylvania law. However, as evidence that the lower judiciary at least is sympathetic to the opposition, one District judge later went out of his way to construe a testamentary provision as exempting an annuity policy from apportionment, where to have permitted such action would have resulted in hardship to the testator's wife and children, the beneficiaries of the contract.

77 351 Pa. 625, 42 A.2d 63 (1945).
Temporary Estates and Apportionment of Penalties and Interest

One administrative difficulty, the apportionment of Taxes between temporary estates and their remainder, the statute has obviated by express provision: "The tax on both such temporary interest and on the remainder...thereafter shall be...paid out of the corpus...without apportionment between remainders and temporary estate." Were it not for such an unequivocal direction there might well have resulted, as under the annuity cases, the government's becoming a "hat in hand" creditor with the consequent difficulty of collecting from the recipient of periodic income. However, so explicit is the dictate of the statute that the only cases dealing with apportionment and temporary interests are those concerned primarily with proration of interest and other tax penalties, another issue as to which the Act demands construction. These questions, and their answers, are discussed simultaneously below.

Superficially the Apportionment Act purports to deal only with "Estate Taxes." But in many cases there accrues an additional liability for interest (at 4 per centum where the date of payment has been permissively extended;79 or at 6 per centum, by way of penalty, where the estate must pay a deficiency assessment or where payment is otherwise overdue).80 In such cases there arise two problems: first, whether the Act of 1937 provides for apportionment of interest; and second, whether, if the Act be given such construction, interest is payable out of capital or income where there is involved a temporary estate. In determining these issues the cases are in apparent conflict. But, as will be shown, the skein is not such that it cannot be untangled.

Primary authority upon the issues presented is, again, Mellon's Estate,81 where the legatee-executors were permitted to recover tax and interest from the property of a non-contributing legatee. Since the Revenue Code82 provided that "interest...shall be collected as a part of the Tax," the Mellon court reasoned that when the Apportionment Act purported to speak of the "Estate Tax," it was to be construed as referring to tax and interest and the provisions for the one as applying to both. (The inherent importance of the issue, incidentally, is nowhere better emphasized than in the accounts presented in the Mellon decision: interest alone amounted to nearly three million dollars, and its deduction from the inheritance rendered the legatee insolvent for Pennsylvania Inheritance Tax assessment.)

With the flat holding in the Mellon case that the apportionment of the Estate Tax and its interest were to be governed by identical provisions, it would seem that no additional problem would arise where the assessment or non-assessment of a temporary interest was in issue: "The tax (i.e., tax and interest) on both

81 347 Pa. 520, 32 A.2d 749 (1943).
such temporary interest and the remainder. . .shall be charged against the corpus. . .without apportionment between remainders and temporary estates." Yet it is upon this very point that the Pennsylvania law becomes confusing, a confusion rife enough to lead one commentator to declare absolutely that under the law of Pennsylvania interest on Estate Taxes, like interest upon any other encumbrance against the corpus of a divided estate, is payable out of income! While such a statement at the time it was made could not have been labelled erroneous, it does not seem to be the Pennsylvania law today.

Source of the confusion as to the apportionment of interest is Commissioner of Internal Revenue v. Pearson, a federal case decided three years after the Mellon case, yet purporting to apply the Pennsylvania law. Citing a federal case applying Pennsylvania's general rule that interest upon an encumbrance of the corpus is payable out of the income of a temporary estate, the federal court held that testamentary trustees could not be surcharged by a life beneficiary for paying the interest due upon a deficiency Estate Tax out of their income account. Entirely ignored in the discussion was the ruling of the Mellon court that, whatever might be the Pennsylvania law with respect to other charges, by reading the provisions of the Revenue Code into the State Apportionment Act, interest upon Estate Taxes was to be apportioned as the Tax was apportioned, i.e. payable entirely out of the principal without charge upon the temporary estate. That this, and not the Pearson decision, represents domestic law upon the subject is emphasized by a lower court holding subsequent to both decisions which, in a situation identical to that in the federal case, applies the rule of Mellon's Estate.

The Problem of Contrary Direction

Under the provisions of the Revenue Code as well as those of the Act of '37, the statutory incidence of the Estate Tax may be altered by the testator's contrary direction. And, under the Apportionment Act as it is interpreted in Pennsylvania, in the absence of any expression upon the part of the decedent, it will be presumed that, knowing of the state provisions for apportionment, in keeping silence he intended them to govern. The problem remains, however, as unwieldy as in the beginning: what constitutes an expression adequate to prevent statutory apportionment; and assuming such an expression, to what degree did the decedent intend it to apply. The determination of just such an issue, in Pennsylvania as in other jurisdictions, has furnished the bulk of litigation under proration statutes. In attempting to bestow order upon the chaos, the writer professes himself no Jehovah. He prays the reader's indulgence.

84 154 F.2d 236 (C. C. A. 3d, 1946).
87 26 U. S. C. A. § 826 (c).
Generally the following is true. As to the form of the contrary direction, though it is usually testamentary, it may also be embodied in an inter-vivos instrument, in which case, however, it affects only such property as passes under that writing. Furthermore, with respect to the extent of his power, the decedent may, with one exception—dealing with an attempt to pay taxes out of income, negative any or all of the statutory provisions for apportionment. He may provide that the residuary estate shall bear all of the tax, or that every interest—including a legacy to charity—shall bear a portion, or that there shall be apportionment between remainder and temporary estate. The Pennsylvania cases, indeed, have concerned themselves not at all with what the decedent had the power to do. Rather they involve the determination of what he intended to do.

The one general rule governing the judicial construction is that enunciated by Mr. Justice Hughes in Harvey Estate:

"The Apportionment Act expressly supplies a presumption of the testator's intention, and, when read into a will, is the equivalent of an express provision that the pecuniary legacies are subject to federal taxes. Unless there is some provision which is clearly inconsistent with such construction, and, when the will is construed as a whole, will override it, the will shall be construed in accordance with the presumption provided by the Statute."

Applying this rule of construction then, the Harvey court went on to hold that the testator's direction that pecuniary legacies should be "subject to the payment of the Pennsylvania State Inheritance Tax" did not clearly imply that they should not be subject to the Federal Estate Tax. Likewise, in another case, a pecuniary bequest of a specified sum "outright" was held not to constitute an adequate expression of intent that the legacy should be free of taxes. But, as an example of such adequate expression, a direction that "the payment of my just debts, the expense of probating my estate, and all inheritance and estate taxes (are) to be paid out of my estate before payment of the legacies and bequests" has been held sufficient to prevent statutory apportionment.

Not only must there be a clear manifestation of intention that the residuary estate shall bear other than its proportionate share of the Estate Tax, but it must also be clear just what gifts the decedent intended to exempt from taxation. A direction that "all legacies shall be free of tax," therefore, while it clearly exempts the legacies from liability, is not adequate to prevent assessment of a fractional interest in a joint bank account passing on the decedent's death to the surviving co-depositor.

89 Mitnick, State Legislative Apportionment of the Federal Estate Tax, 10 Md. L. Rev. 289, 316 (1949).
93 Edwards' Estate, 56 Pa. D. & C. 682 (1946). Actually the case dealt with inheritance taxes, but it seems the ruling would have been no different had Estate Taxes been the issue.
94 Horn Estate, 351 Pa. 131, 40 A.2d 471 (1945).
This rule requiring identification of the exempted interests becomes particularly important where an attempt is made to find an intention to exempt by testamentary direction property passing otherwise than by will. Thus, a provision in a will that all inheritance and estate taxes in respect to any property passing under the will shall be paid out of the principal of the estate is not broad enough to cover property which does not pass under the will but is nevertheless subject to the Federal Estate Tax.\(^9\)

Of course, where it clearly appears, expressly or by implication, that the testamentary direction was intended to cover not only the residuary but also the extra-testamentary estate, then all interests will be exempted; e.g. where a testator directs, "all Estate Tax, inheritance tax, succession tax, transfer tax, or any other tax in the nature thereof which may be chargeable upon my estate or any portion thereof, or upon any bequest, trust benefaction, or any interest in my estate or any part thereof given, or provided for by my will, shall be paid out of my general estate."\(^9\)

Too, though the expression in the will may be ambiguous, the intent to exempt may be shown by other evidence. Where, for example, a testatrix directs by will the payment out of her residuary estate of all taxes "which may be imposed upon my estate or any part thereof, or any estate or any interest herein given," the expression itself appears inadequate to exempt from contribution any non-testamentary property. But when a contemporaneously executed deed of trust directs payment out of the trust principal of all taxes imposed upon the trust, construing the instruments together, it appears that the decedent intended that the trust should carry its own load, but that all other interests, whether or not passing by testament, should be tax exempt. By construing the "estate" referred to in the testament as meaning the decedent's "gross estate" for tax purposes, a Pennsylvania case\(^9\) has so held. In decisions rendered while the Apportionment Act was yet a novelty, it might be added, deeds of trust containing provisions similar to that in the case just cited were not uncommon.\(^9\) The object of such provisions, of course, was to specifically demand apportionment where the prevailing federal rule did not require it, and, realizing the equities of apportionment, the courts accorded such directions very liberal construction.

A more common example of an extrinsic circumstance acting as a determinative factor in otherwise doubtful situations has appeared in cases where a finding of contrary direction would be beneficial to the decedent's near relations. Where a testator directed in his will that "any Estate Taxes that might be imposed upon my estate or any interest therein given. . .shall be paid out of my resi-

\(^9\) Stadfsfeld Estate, 359 Pa. 147, 58 A.2d 478 (1948).
\(^99\) See: Jeffery's Estate, 333 Pa. 15, 3 A.2d 393 (1939); and McLaughlin's Estate, 39 Pa. D. & C. 373 (1940).
duary estate," though it is doubtful that such direction in the absence of other circumstances would have proved adequate for the purpose, where it appeared that much of the testator's non-testamentary property had passed to his widow, the court presumed that the decedent intended to act for her maximum benefit, construed "estate" to mean "gross estate," and thus exempted from assessment the widow's interest in her husband's life insurance.\(^{100}\) This same element of possible hardship to wife or children has been decisive in other cases.\(^{101}\) In one decision, indeed, where the widow's sole interest in her husband's property was represented by insurance proceeds payable in installments, the court did absolute violence to the decedent's language in order to find a testatorial intention to exempt the insurance from taxation.\(^{102}\)

In construing allegedly contrary directions, of course, the Pennsylvania courts have occasionally emphasized that not only must there be an expression of intent to exempt from taxation, but there must also be an expression to exempt from Estate taxation. A recent lower court case,\(^{108}\) therefore, held a direction that "all inheritance, succession or transfer taxes, or taxes in the nature thereof" be deducted from the residuary estate was not sufficient to relieve life insurance policies and a taxable inter-vivos trust from liability for Estate Taxes, since an inheritance or transfer tax is not an Estate Tax. Though this point has been decisive only in the single case referred to, the fact that the decision is a recent one might well indicate that, since courts and decedents are today more familiar than formerly with apportionment provisions, the judiciary will tend to be less liberal in finding allegedly contrary directions.

Any discussion of contrary direction is, of course, incomplete without emphasizing that in no case can a contrary direction prevent apportionment when the interests directed to meet the obligation are not adequate for the purpose. In White Estate,\(^{104}\) for example, where the testatrix specifically directed that all her bequests should be free and clear of taxes, and that all taxes should be paid out of her residuary estate, when it appeared that the residuary estate was far exceeded by the Estate Tax, the "exempted" bequests nevertheless bore an aliquot portion of the deficit burden.

Finally, a direction might fail for a reason other than muddled expression of inadequacy of means. Though there are no Pennsylvania cases specifically evidencing such an instance under the Apportionment Act, in a case\(^{105}\) in which a testator directed that an inheritance tax be paid out of the income rather than the principal of a testamentary trust, the direction was disregarded, because, the court

\(^{101}\) See, for example: Pribe's Estate, 50 Pa. D. & C. 703 (1945), involving minor grandchildren.
\(^{103}\) Lucey Estate, 63 Pa. D. & C. 645 (1948).
\(^{104}\) 63 Pa. D. & C. 408 (1948).
\(^{105}\) In re Billings Estate, 268 Pa. 71, 110 (1920).
decided, to carry out such a command would have required an unlawful accumula-
tion of income.

Enforcement and Conflict of Laws

Omitted from this discussion have been problems of assessment enforcement
and conflict of laws. The omission is due not to any misconception of their true
importance, but to the fact upon these issues there are no Pennsylvania decisions.
From the cases decided in other jurisdictions, however, the following is sub-
mitted with some confidence. When an Orphans' Court of Pennsylvania in the
proper exercise of its in rem power prorates Estate Taxes among the participants
in the estate of a Pennsylvania domiciliary, the decree of proration will be en-
forced within the Commonwealth like any other domestic decree and may be the
basis for an action against the tax debtor in any foreign state in which service may
be had. While the tax laws of a foreign state may not be enforced in a court of
domestic jurisdiction, the rule concerning tax judgments is otherwise. And
where there is conflict between the apportionment law of the state of death and
that of the state of domicile, the law of the latter would seem to govern.

CONCLUSION

The preceding has, to the best of the author's knowledge, included a dis-
cussion of every case decided under the Pennsylvania Apportionment Act of July
2, 1937. Thirteen years of experience with the legislation have revealed in its
makeup certain inadequacies. Specifically:

1. Apportionment places upon smaller legacies the same burden which
   falls on larger ones.

2. Judicial reluctance to assess insurance companies under installment poli-
   cies brings delay and often hardship to those taking property under the
decedent's residuary estate.

3. Since litigation over apportionment is the rule rather than the exception,
   before obtaining distribution residuary legatees must often wait unre-
  asonable periods pending assessment and proration of extra-testamentary
   interests in which the legatees have small stake.

4. In addition to these problems, there is that of determining the proper al-
   location of apportionment credits in computing the Inheritance Tax. This
   phase of Estate Taxation, however, is beyond the scope of this article,
   and such mention as is now made of it is inserted only to emphasize
   for the inquisitive the writer's realization that the difficulty does exist.

105 Martin's Estate, 136 Misc. 1, 240 N. Y. S. 393 (1930).
107 See, Mitnick, State Legislative Apportionment of the Federal Estate Tax, 10 Md. L. Rev. 289, 307-10 (1949) for a concise review of cases in foreign jurisdictions.
These inadequacies are no skin blemishes. Save for the insurance problem they are bred in the bone of Estate Taxation. Because the levy is imposed upon the giver's property as a whole before it is distributed (and apportionment, therefore, is made upon the same basis), each interest, large or small, must pay a common tariff. But if this bears with a heavier impress upon the smaller inheritance, the testator, with his knowledge of apportionment provisions, must by his failure to provide otherwise be deemed to have intended the result.

Indeed, as has been pointed out by one commentator, every apportionment problem is basically one of draftsmanship. As a possible solution to the insurance dilemma, for example, there has been suggested a draftsmanship expedient—the inclusion within each policy of a clause "giving the beneficiary the choice of having the tax paid at once by the insurer, thereby changing either the amount of the stipulated installments to be paid or shortening the duration of the payments; or of receiving the stated installments for the stipulated period of time and paying the tax himself."

As for the flood of litigation resulting from apportionment—an objection so severe that it has led to the repeal of a proration statute in another jurisdiction, after a study of the Pennsylvania cases, this much may with confidence be said. Omitting from consideration the early decisions dealing with constitutionality and retroactivity, more than half of the disputes have concerned contrary direction. That this should be so is evidence, among the profession, of an astounding incapacity for lucid expression. The difficulty boils down to that. But if this be true, of course, the problem of litigation is not insurmountable. That it is already partially overcome, indeed, is manifested by a sharp decline in recent years of apportionment wrangles.

Finally, as the residue of every difficulty, there is the problem of delay. On that subject little can be added to that said previously. Despite the most careful feats of draftsmanship, tax litigation—part of it due to apportionment—there will always be. And with it, delay. The Act of 1937, as has been pointed out earlier, in permitting advanced distribution on tender of security offers the only remedy practicable under the circumstances. What difficulty remains does seem unavoidable. Taxes, after all, are taxes. And he who says, "Nothing is sure but death and taxes," must be construed, as he has always been construed, as referring not to the payment of taxes but rather to attempts at assessing and avoiding them.

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111 Polisher, Estate Tax Apportionment, 84 TRUSTS AND ESTATES 99, 103 (1947).