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August 7, 2017

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**Re: ACTEC Proposal Concerning Federal Estate Tax Recovery Provisions**

Dear Senators Hatch and Wyden and Congressmen Brady and Neal:

On behalf of The American College of Trust and Estate Counsel (“ACTEC”), please find attached a report that recommends that the federal estate tax recovery provisions in the Internal Revenue Code be amended in order to eliminate inconsistencies and to expand the right of tax recovery to all estate tax inclusionary code sections.

ACTEC is a professional organization of approximately 2,600 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift, and GST tax planning, fiduciary income tax planning, and compliance. ACTEC offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

Should you have any question concerning this letter and the attachments, please contact Beth Kaufman, Chair, Washington Affairs Committee, at (202) 862-5062 or [bkaufman@capdale.com](mailto:bkaufman@capdale.com) and Trent S. Kiziah, Chair, ACTEC Transfer Tax Committee, at (213) 861- 5028 or [Trent.Kiziah@ustrust.com](mailto:Trent.Kiziah@ustrust.com).

Respectfully yours,



Susan T. House, President

# **Report of the ACTEC Transfer Tax Study Committee** **Concerning Federal Tax Recovery Code Sections**

## **I. Introduction**

The American College of Trust and Estate Counsel (“ACTEC”) is a professional organization of approximately 2,600 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the field of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift and generation-skipping transfer tax planning, fiduciary income tax planning, and compliance. ACTEC offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives. We offer recommendations to improve existing tax laws to more clearly, simply, and fairly implement the policies those laws are intended to serve. This report recommends revisions to Internal Revenue Code (IRC) §§2205, 2206, 2207, 2207A and 2207B in order to eliminate inconsistencies and to expand the right of tax recovery to all estate tax inclusionary code sections.

The Internal Revenue Code contains five code sections that grant certain individuals the right to recover estate taxes from others.<sup>1</sup> These five code sections were enacted over a period of 72 years. Because of the manner in which they were enacted, they contain numerous inconsistencies and fail to address comprehensively the federal right of tax recovery. We recommend these code sections be amended to address the inconsistencies as set forth herein.

The Internal Revenue Code imposes upon the executor the duty to pay federal estate taxes.<sup>2</sup> This duty has rested upon the executor from the time of the first federal estate tax in 1916.<sup>3</sup> This duty is premised upon the assumption that the executor will pay the tax before the distribution of the estate.<sup>4</sup> In the event that a person, other than the executor, pays an estate tax, that person is entitled to reimbursement from the person who is apportioned the tax.<sup>5</sup>

Sections 2206, 2207, 2207A and 2207B grant the executor or the decedent’s estate a right to recover from certain individuals a portion of the estate taxes arising from certain non-probate properties being included in the federal gross estate. Section 2206 entitles the executor to recover a pro rata portion of the estate taxes from each beneficiary of a life insurance policy on

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<sup>1</sup> 26 U.S. Code §§2205, 2206, 2207, 2207A and 2207B. Hereinafter all section references are to the Internal Revenue Code of 1986, as amended, unless otherwise noted.

<sup>2</sup> §2002.

<sup>3</sup> Revenue Act of 1916, Pub. No. 271, Ch. 643, 39 Stat. 756, Sept. 8, 1916, §207.

<sup>4</sup> *Id.*, §208.

<sup>5</sup> §2205.

the decedent's life that is included in the gross estate. Section 2207 entitles the executor to recover a pro rata portion of the estate taxes from each person receiving property arising from the exercise, non-exercise, or release of a general power of appointment. Section 2207A entitles the decedent's estate to recover the additional estate tax caused by the inclusion of qualified terminable interest property (QTIP) in the federal gross estate. Section 2207B entitles the decedent's estate to recover a pro rata portion of the estate taxes from each person receiving property includible in the gross estate due to a retained life estate.

These code sections contain numerous inconsistencies, as described below.

## **II. Inconsistencies**

### **A. Selective Recovery Inclusion**

Sections 2206, 2207, 2207A and 2207B grant the executor or the decedent's estate the right to recover from certain individuals receiving non-probate property includible in the gross estate by reason of sections 2042(2) (life insurance), 2041 (general powers of appointment), 2044 (QTIP), and 2036(a) (retained life interest). The executor is not given the right to recover estate tax arising from other non-probate properties includible in the gross estate under other Code provisions, such as sections 2035 (transfers within 3 years), 2037 (reversionary interests), 2038 (revocable transfers), or 2039 (annuities). There is no logical justification for granting the executor the right to recover estate tax for inclusion resulting from sections 2036(a), 2041, 2042(2) and 2044, but not to recover estate tax for inclusion resulting from other code sections that similarly cause inclusion of non-probate properties in the federal gross estate. It appears that the only explanation for the selective recovery provisions is the ad hoc manner in which these four code sections were enacted.

### **B. Executor v. Decedent's Estate**

Sections 2206 and 2207 grant the executor the right to recover estate tax. Sections 2207A and 2207B grant the decedent's estate the right to recover estate tax. The term "executor" is defined as "the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent."<sup>6</sup> The term "decedent's estate" is not defined in the Code. A consistent, defined, term should be used in all four code sections to avoid confusion.

### **C. Expansion of Recovery Right beyond Executor and Decedent's Estate**

Without a definition of "decedent's estate," it is not clear whether the recovery right in sections 2207A and 2207B includes recovery by any individuals other than the executor. Practically speaking, the right of recovery should be more broad than "executors" and

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<sup>6</sup> Section 2203.

“decedent’s estates.” Many times an executor is formally appointed by a state probate court when most of the decedent’s assets are in a revocable trust. In those situations, the trustee may be the fiduciary issuing the check for the estate taxes to the Internal Revenue Service. However, in such cases, because there is an appointed executor, the trustee of the revocable trust is not considered the executor under §2203 and thus cannot pursue recovery. Likewise, the appointed executor has not paid the tax, so he or she also cannot pursue a recovery. There is no reason to limit the right of recovery to the executor and the decedent’s estate; rather it should be extended to any individual who has paid estate tax apportioned to another.

#### D. Direction by Instrument

The various Code sections are also inconsistent in how the decedent can waive a right to recovery. Sections 2206 and 2207 permit a decedent to direct “otherwise by his will.” Sections 2207A and 2207B permit a decedent to direct otherwise “in his will (or a revocable trust).” These code sections should be consistent. The decedent should be able to use a revocable trust provision to “direct otherwise” with respect to recovery of tax on life insurance and property subject to general powers of appointment.

#### E. Standard to Direct Otherwise

Sections 2206 and 2207 provide that the right of recovery exists “unless the decedent directs otherwise.” Sections 2207A and 2207B provide that the right of recovery shall not apply to the extent that the decedent in his will (or revocable trust) “specifically indicates” an intent to waive any right of recovery. The standard set forth in sections 2207A and 2207B is more stringent than that set forth in sections 2206 and 2207. This inconsistency could lead to a court finding that the decedent met the standard in sections 2206 and 2207 but not the standard in sections 2207A and 2207B.<sup>7</sup> There is no discernable justification for imposition of two different standards.

#### F. Penalties and Interest

Sections 2207A(d) and 2207B(c) permit the executor to recover penalties and interest along with estate tax. Sections 2206 and 2207 do not contain a similar provision. These provisions should be consistent.

#### G. Marital Deduction

The last sentences of both sections 2206 and 2207 address the recovery of estate tax from the surviving spouse. These sentences were drafted prior to the enactment of the unlimited

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<sup>7</sup> Section 3 of The Uniform Estate Tax Apportionment Act (2003) provides the statute applies except to the extent that the will, revocable trust or other dispositive instrument “expressly and unambiguously” directs the apportionment of an estate tax.

marital deduction and have outlived their usefulness. They should be eliminated from both code sections.

#### H. Tax Calculation Issues

Section 2207A requires QTIP property included in the surviving spouse's gross estate pursuant to section 2044 to bear the additional estate tax caused by its inclusion, as if they were the last dollars added to the estate. Sections 2206, 2207 and 2207B apply an average rate. Section 2206 provides that a life insurance beneficiary bears "such portion of the total tax paid as the proceeds of such policies bear to the taxable estate." Section 2207 provides that a person receiving property includible in the gross estate by reason of the decedent's power of appointment over that property (i.e., property includible pursuant to section 2041) bears "such portion of the total tax paid as the value of such property bears to the taxable estate." Section 2207B contains a standard similar to that in section 2207. In sections 2206, 2207 and 2207B, a fraction is multiplied by the "total tax." However, if the decedent's federal gross estate includes QTIP property as well as life insurance, property over which the decedent held a power of appointment, or property in which the decedent had a retained life estate, the equation in sections 2206, 2207 and 2207B generates too much recovery. The "total tax" in sections 2206, 2207 and 2207B should first be reduced by the additional estate tax arising from the QTIP's inclusion so that only the remaining tax is borne by recipients of these other assets and distributees of the probate estate.

Section 2206 provides that the numerator of the fraction is the proceeds of the life insurance policies. Sections 2207 and 2207B reference the "value of the property." The denominator in all three code sections is the "taxable estate." Because the taxable estate is determined by reducing the value of the assets in the gross estate by deductions, presumably the "value of the property" for purposes of sections 2207 and 2207B should be the gross value of the items less deductions taken on the estate tax return paid by or allocated to such property. However, these code sections do not explicitly so provide; rather, they imply that the numerator is the gross value. Any deductions paid or allocated to life insurance should also reduce the "proceeds" for purposes of the computation.

### **III: Proposal**

The existing recovery provisions in the Code should be consolidated and made consistent. Specifically, current section 2205 should be retained. Current sections 2206 and 2207 should be deleted and their provisions consolidated into section 2207B. Sections 2207A and 2207B should be amended to read as follows:

#### **§ 2207A. Right of recovery in the case of certain marital deduction property**

##### **(a) Recovery with respect to estate tax**

**(1) In general**

If any part of the gross estate consists of property the value of which is includible in the gross estate by reason of section 2044 (relating to certain property for which a marital deduction was previously allowed), the executor, or any other person paying the tax, shall be entitled to recover from the person receiving the property the amount by which—

(A) the total tax under this chapter which has been paid, exceeds

(B) the total tax under this chapter which would have been payable if the net value of such property had not been included in the gross estate.

**(2) Decedent may otherwise direct**

Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property.

**(b) Recovery with respect to gift tax**

If for any calendar year tax is paid under chapter 12 with respect to any person by reason of property treated as transferred by such person under section 2519, such person shall be entitled to recover from the person receiving the property the amount by which—

(1) the total tax for such year under chapter 12, exceeds

(2) the total tax which would have been payable under such chapter for such year if the value of such property had not been taken into account for purposes of chapter 12.

**(c) More than one recipient of property**

For purposes of this section, if there is more than one person receiving the property, the right of recovery shall be against each such person.

**(d) Penalties and interest**

In the case of penalties and interest attributable to additional taxes described in subsections (a) and (b), rules similar to subsections (a), (b), and (c) shall apply.

**(e) Value**

Value means the pecuniary worth of the Section 2044 property as finally determined for purposes of the estate tax after deducting any debt, expense, or other deduction chargeable to the Section 2044 property for which a deduction was allowed in determining the amount of the estate tax. A lien or other encumbrance is not regarded as chargeable to the Section 2044 property to the extent that it will be paid from other property. The value of the Section 2044 property is not reduced by reason of the charge against it of any part of the estate tax.

**§ 2207B. Right of recovery from non-probate assets**

**(a) Estate tax**

**(1) In general**

If any part of the gross estate on which tax has been paid consists of the value of property included in the gross estate by reason section 2035 (relating to gifts

made within 3 years of decedent's death), section 2036 (relating to transfers with retained life estate), section 2037 (relating to transfers taking effect at death), section 2038 (relating to revocable transfers), section 2039 (relating to annuities), section 2040 (relating to joint interests), section 2041 (relating to powers of appointment), section 2042 (relating to life insurance), and section 2043 (relating to transfers for insufficient consideration) or Chapter 14 (special valuation rules), the executor, or any other person paying the tax, shall be entitled to recover from the person receiving the property the amount which bears the same ratio to the total tax under this chapter which has been paid as—

(A) the value of such property, bears to

(B) the taxable estate.

**(2) Decedent may otherwise direct**

Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property.

**(b) More than one recipient**

For purposes of this section, if there is more than 1 person receiving the property, the right of recovery shall be against each such person.

**(c) Penalties and interest**

In the case of penalties and interest attributable to the additional taxes described in subsection (a), rules similar to the rules of subsections (a) and (b) shall apply.

**(d) No right of recovery against charitable remainder trusts**

No person shall be entitled to recover any amount by reason of this section from a trust to which section 664 applies (determined without regard to this section).

**(e) Value**

Value means the pecuniary worth of the property as finally determined for purposes of the estate tax after deducting any debt, expense, or other deduction chargeable to the property for which a deduction was allowed in determining the amount of the estate tax. A lien or other encumbrance is not regarded as chargeable to the property to the extent that it will be paid from other property. The value of the property is not reduced by reason of the charge against it of any part of the estate tax.

**(f) Calculation if Section 2044 Property Includible in Estate**

If the gross estate consists of property includible by reason of section 2044 and to the extent the right of recovery of section 2207A(a)(1) has not been waived, then for purposes of subsection (a)(1) of this section:

(1) the "total tax" paid shall be reduced by the tax computed in accordance with the manner set forth in Section 2207A(a)(1); and

(2) the "taxable estate" shall be reduced by the value of such Section 2044 property.



#### **IV: Notes on Proposed Changes**

1. As provided under current law, the proposed changes retain the requirement that section 2044 property bear tax at the highest applicable marginal rate. *See* Proposed §2207A(a)(1).
2. The right of recovery has been expanded to include all non-probate inclusionary provisions. *See* Proposed §2207B(a)(1).
3. The right of recovery is not limited to the executor or the decedent's estate; rather, any person paying the tax that is apportioned to another may seek reimbursement. *See* Proposed §§2207A(a)(1) and 2207B(a)(1).
4. The term "decedent's estate," currently found in sections 2207A and 2207B, has been deleted.
5. If an estate includes both QTIP and other non-probate property, the QTIP bears the marginal tax. In computing the tax owed by the other non-probate property, the value of the QTIP and the tax owed by the QTIP are removed from the calculation. *See* Proposed §2207B(f).
6. Unlike current law, which sets forth different standards for a decedent to direct against the application of the recovery provisions of the statute,. The standard for directing against tax apportionment has been standardize in proposed sections 2207A(a)(2) and 2207B(a)(2).
7. The decedent may direct against the application of these statutes by will or revocable trust. *See* Proposed §§2207A(a)(2) and 2207B(a)(2).
8. The right to recover penalties and interest applies to all rights of recovery. *See* Proposed §§2207A(d) and 2207B(c).
9. The term "value" has been defined. *See* Proposed §§2207A(e) and 2207B(e).
10. The reference to the "marital deduction" currently contained in §§2206 and 2207 has been deleted.