W H E R E T H E R E ' S A W I L L

Charles Kuralt: On the road ... to tax litigation

By Dan W. Holbrook

Folksy CBS reporter Charles Kuralt died wealthy in 1997, leaving the residue of his estate to his wife Petie. He also left a secret girlfriend, Shannon, and enough litigation to keep lawyers busy for years. The most recent case, known as Kuralt IV,[1] resolved an estate tax dispute, suggesting some lessons for all of us.

Shortly before his death, Kuralt sent Shannon a letter telling her he intended for her to have his 90 acres of prime property on the Big Hole River in Montana when he died. In Kuralt II,[2] the Montana Supreme Court concluded the letter was a valid holographic codicil, and Petie lost the Montana property to Shannon. In Kuralt IV, the same court faced the issue of who paid the substantial death taxes on that devise - Shannon or Petie? In a classic case of adding insult to injury, poor Petie was ordered to pay the taxes on Shannon's property.

Unfair? Probably. Perhaps only Charles knew whether he meant to tweak Petie's nose one last time. More likely he never thought about the tax allocation, and that may be the real moral of this story. It's been said that a good tax apportionment clause in a will is the sign of a knowledgeable draftsperson. But even the best laid plans can be undone by acts of the testator, as Kuralt IV demonstrates.

The original Kuralt will provided clearly that all taxes would be paid from the residue. Since wife survived, the residue would qualify for the marital deduction, and there would normally be no taxes to pay. But then Shannon appeared with a codicil leaving valuable property to a non-spouse, creating a taxable estate. New York law governing Kuralt's will provides, in relevant part: "Unless otherwise provided in the will or non-testamentary instrument ... the tax shall be apportioned ..." [3] pro-rata among all beneficiaries. Counsel for Petie's interests[4] argued that the codicil altered the original tax-free testamentary plan, rendering the will's tax allocation clause ambiguous; ergo the statutory default should prevail to apportion taxes among all takers. Not so, said the Montana Supreme Court: "Under New York law ... [a] codicil that is silent on method of payment of estate taxes ... does not add or subtract from clear and unambiguous language in the original will specifically directing how estate taxes should be paid."[5]

Some points to ponder after Kuralt IV:

1. Holographs and secret paramours are a volatile mix. [Perhaps anything and a secret paramour is a volatile mix.] But Charles, on his New York deathbed, could not have asked the family lawyer to write the codicil without creating an ethical dilemma for the lawyer, possibly tipping Petie off to Shannon's existence. Hence, no thought was given to the tax aspects. Charles succeeded in concealing his relationship with Shannon for almost 30 years. On the road indeed!

2. Attorneys may easily underestimate the importance of the tax allocation clause, especially where there are (or may be) significant specific bequests or non-probate assets, such as life insurance, annuities or retirement plans. For example, in the recent case of Estate of James H. Williams,[6] the decedent, whose wife had an affair, died shortly after divorcing her without having changed the beneficiary on several large annuities from his ex-wife to his children. The Court of Appeals upheld the ex-wife's claim as beneficiary. Echoing the unfairness of Kuralt IV, and to the children's dismay, the court also ruled that the tax allocation clause in the will ("I ... direct that all estate ... taxes ... shall be paid entirely out of my residuary estate ... ") required the children to bear all the death taxes on the windfall to their "wicked stepmother." Consider making statutory apportionment under Tenn. Code Ann. §30-2-614 your default in drafting, rather than charging taxes to the residue.[7]

3. There are no cases on point in Tennessee, but our courts are likely to adopt the holding of Kuralt IV: "The Tennessee statute, Tenn. Code Ann. §30-2-614 ... is modeled after the New York statute and is essentially the same as the Uniform Estate Tax Apportionment Act."[8]

4. Unlike the New York statute, which permits a testator to specify the tax allocation (and to opt out of the statutory apportionment) by a clause in either a "will or non-testamentary instrument," Tenn. Code Ann. §30-2-614 requires such a provision to be in a will. Only in a will. Attorneys who create fully funded living trusts as a substitute for probate may find the tax allocation clause in their trust is of no effect. Perhaps the Tennessee legislature should correct this, but until then, beware.[9]

5. If you want a Tennessee will to direct the tax allocation, how specific must it be to negate the statutory default of

Tenn. Code Ann. §30-2-614? Not very. In Caldwell, op cit., the will read: "I hereby direct my Executrix ... to pay all of my just and lawful debts and inheritance and estate taxes as soon after my death as practicable." This seems ambiguous at best, and could just as easily reflect only the executrix's pre-existing duty to pay all taxes from estate assets before seeking reimbursement from beneficiaries pursuant to the statutory approach.10 But the Court of Appeals refused to adopt a requirement that a will provision must clearly and unambiguously opt out of the statute to be effective. Instead, it held that the "grouping" of taxes with other debts of the estate was sufficient to evidence intent to pay all from the residue.

Planning Idea: The "Elective Snare." Could Charles Kuralt (under Tennessee law, anyway) have used Tenn. Code Ann. §30-2-614 as an "offensive weapon" to give most of his estate to Shannon instead of wife Petie, leaving Petie even less than the 40 percent elective share she would otherwise be entitled to? In Third National Bank v. Cotten,11 the will directed that taxes be paid from the residue, and further provided that if the testator's wife took an elective share, any provision in the will favorable to her would become void. When the widow took her elective share, the court held that any taxes attributable to her share should be charged to her share, not to the residue, thus honoring the testator's intent to punish the widow with taxes if she elected.12 Note that the statutory default of apportionment under Tenn. Code Ann. §30-2-614 is "equitable" apportionment, meaning it takes into account any marital or charitable deduction and charges no tax to any recipient who would otherwise receive a share tax-free on account of such deduction. But the statutory default does not apply when "a testator otherwise directs in the testator's will."

To utilize the "Elective Snare," Charles's will would leave his wife a nominal amount, and further provide that if she takes an elective share, then her share would bear a pro-rata share of all taxes of the estate, thus removing the "equitable" effect of the statute. The Cotten case strongly suggests that Petie would end up with something quite a bit less than her elective share,13 although the author could find no other law on this issue in Tennessee.14 What if Charles's will said that if Petie took an elective share, she would bear all the taxes on the entire estate, effectively wiping out her share? Nah ... to repeat one of the common adages of estate planning: "Pigs get fat, but hogs get slaughtered."

Notes

1. Estate of Kuralt, 2003 MT 92 (Mont. Sup. Ct. 2003). The Montana Supreme Court itself adopted the Roman numeral designations to keep track of all the appeals.
2. Estate of Kuralt, 2000 MT 359, 303 Mont. 335, 15 P. 3d 931 (Mont. Sup. Ct. 2000).
3. N.Y. EPTL §§2-1.8(c).
4. Petie died in 1999, her death perhaps hastened by the embarrassing revelations and ensuing litigation.
5. Kuralt IV, op cit, at ¶ 36.
6. In re: Estate of James H. Williams, No. M2000-02434-COA-R3-CV, 28 TAM 23-20 (Tenn. Ct. App. April 28, 2003).
7. Under Tenn. Code Ann. §30-2-614, unless the will provides otherwise, both federal and Tennessee death taxes are charged pro-rata among all "persons interested in theestate," taking into account marital and charitable deductions.
8. In re: Estate of Caldwell v. Woods, 1989 Tenn. App. LEXIS 119, 1989 WL 11738 (Tenn. Ct. App. 1989).
9. Other statutes under which only a will can change the tax allocation include Internal Revenue Code Sections 2205, 2206, and 2207. By contrast, Sections 2207A and 2207B
refer to either a will or a revocable trust.
10. Tenn. Code Ann. §67-8-417(a)(1).
11. Third National Bank v. Cotten, 536 S.W. 2d 330, 1976 Tenn. LEXIS 625 (Tenn. Sup. Ct. 1976).
12. This was in the days before the unlimited marital deduction.
13. For those who want to see the math, suppose the effective combined death tax rate is 50 percent. Under the statutory defaults, if wife Petie takes an elective share, she gets 40 percent tax free, and Shannon pays 50 percent tax rate on her 60 percent share (30 percent taxes), netting her 30 percent of the estate. Score: wife 40, girlfriend 30. Utilizing the "Elective Snare," wife Petie's elective share must bear 40 percent of the 30 percent taxes, or 12 percent of the estate, so it would appear she would net 40 percent minus 12 percent, or 28 percent of the estate. But the reduced amount passing to Petie reduces the marital deduction, which increases the tax, which reduces the marital deduction more, in an interrelated calculation. After doing the algebra, it turns out Petie pays 15 percent total tax, netting her only 25 percent of the estate rather than 40 percent. Shannon gets 60 percent minus 22.5 percent tax, netting her 37.5 percent of the estate. Score: wife 25, girlfriend 37? There is more tax overall, but girlfriend gains, and wife loses all the more.
14. It may also be significant that the 1997 revision of the elective share law, Tenn. Code Ann. §31-4-101, deleted this sentence: "In determining the elective share, it is not reduced by any estate or inheritances taxes."

Dan W. Holbrook practices estate law with Holbrook & Peterson PLLC, in Knoxville. He is certified as an Estate Planning Specialist by the Tennessee Commission on Continuing Legal Education and Specialization, is a Fellow of the American College of Trust and Estate Counsel, and serves on the TBA Probate Study Group reviewing and recommending legislation involving trusts and estates in Tennessee. He can be reached at dholbrook@hpestatelaw.com.

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