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11/20/85

#L-830

Memorandum 85-99

Subject: Study L-830 - Estates and Trust Code (Proration of Estate
Taxes--comments on tentative recommendation)

The Commission distributed for comment this Fall its tentative recommendation for revision of the statutes governing proration of estate taxes. We have received letters commenting on the tentative recommendation attached to this memorandum as Exhibits 1 to 8. We also anticipate a letter from Ken Klug, who has been instrumental in development of the tentative recommendation, discussing a few of the policy questions raised in the comments we have received that we have asked him to address for the benefit of the Commission. We will forward his letter when we receive it.

Generally the letters were favorable to the tentative recommendation. Professor Frantz (Exhibit 1) "heartily approves", as does Henry Angerbauer, C.P.A. (Exhibit 2), without further comment. Other commentators express general approval, while noting concerns with specific matters in the draft. See letters of Robert K. Maize, Jr. (Exhibit 3), Herbert P. Moore, Jr. (Exhibit 4), State Bar Taxation Section (Exhibit 7), and Legislative Subcommittee on Estate Planning, Trust and Probate Legislation for San Diego County Bar Association (Exhibit 8).

With regard to the specific comments or concerns raised in the letters, the staff has noted each comment or concern in the tentative recommendation draft following the section to which the comment or concern relates. At the December meeting we plan to review the notes and make any necessary revisions in the draft so that a final recommendation can be submitted to the Legislature in January.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

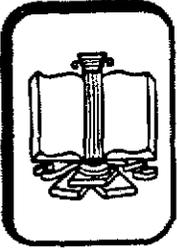


EXHIBIT 1

COMMUNITY LEGAL SERVICES

McGEORGE SCHOOL OF LAW

September 20, 1985

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Attention: Mr. John H. DeMouilly

Re: Recommendation for Proration of Estate Taxes

Dear Mr. DeMouilly:

I heartily approve the proposed legislation for the proration of estate taxes.

Parenthetically, don't you think it's about time that we deleted the reference to "notary" in Section 712?

With best regards, I am

Very truly yours,

A handwritten signature in cursive script that reads "Benjamin D. Frantz".

BENJAMIN D. FRANTZ
Professor of Law

BDF:bk

EXHIBIT 2

HENRY ANGERBAUER, CPA
4401 WILLOW GLEN CT.
CONCORD, CA 94521

9/21/85

Law Revision Commission:

I have read the Tentative Recommendation relating to the Proration of Estate Taxes and approve of your recommendation.

I suggest you propose it to the legislature and have it enacted into law.

Many thanks for permitting me to make this recommendation and

hope you will continue to keep me informed of the developments in Probate Law, among other things.

Best Personal Regards

Sincerely
H

ROBERT K. MAIZE, JR.

Attorney at Law

1604 FOURTH STREET
POST OFFICE BOX 11648
SANTA ROSA, CALIFORNIA 95406

(707) 544-4462

September 23, 1985

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Report L-830
Proration of Estate Taxes

Gentlemen:

I have reviewed your tentative recommendations, and generally have no objections to what is being proposed. However, I do have one concern that is brought into clear focus by your proposal.

On page 2 you state:

Although there is a potential for the modification to occur many years after the estate is closed, the Commission does not recommend a limitation period for modification. Rather, the matter is left to the doctrine of laches and other judicial equitable powers in the circumstances of each case.

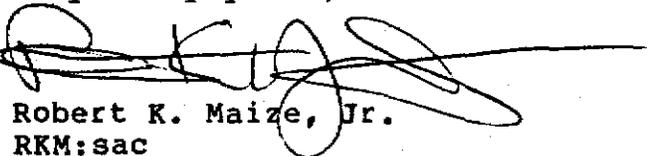
I am concerned about the contingent liability to which a beneficiary may be subject when taking a distribution from an estate. One of the purposes of a probate estate is to settle all claims against the decedent by providing for the short statute of limitations for filing claims against the estate of a decedent. Now you are adding a provision that will subject the beneficiary to potential liabilities, and frustrate this purpose of the probate.

I would suggest that the probate court be allowed to retain jurisdiction over the proration of estate taxes upon the petition of an interested party, in the cases that it is warranted and the executor and interested parties cannot agree on how to plan for the effect of a tax audit or other event that would result in a change in the proration of estate taxes.

If jurisdiction was not reserved, then the case would be closed so that the beneficiaries of the smaller estate would have their rights finally determined.

Thank you for taking my ideas into consideration.

Very truly yours,



Robert K. Maize, Jr.
RKM:sac

EXHIBIT 4
LAW OFFICES OF
HERBERT P. MOORE, JR.
23 ORINDA WAY, SUITE 312
ORINDA, CALIFORNIA 94563

TELEPHONE
(415) 254-2850

September 27, 1985

The California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Proration of Estate Taxes, No. L-830

Gentlemen:

I generally favor the subject tentative recommendation regarding proration of estate taxes.

I question whether the definition of "value" is clear enough vis-a-vis the alternate valuation date.

The definition used is probably satisfactory, but there are a lot of judges who have no feeling for federal estate tax matters.

My other concern is with respect to Section 971.040 and Section 976.040.

I was involved with an estate recently wherein the only material asset in the probate estate was a gracious residence located on substantial related acreage, which residence and acreage were worth in the neighborhood of \$700,000.

A legal life estate was created in favor of the surviving spouse. The death pre-dated the unlimited marital deduction and Q-TIP.

The holder of the remainder interest was interested in selling but the life tenant was not. Borrowing on the property was impractical because there would be no cash flow with which to repay the loan. There were arguments about selling off part of the acreage.

We were in a period when the interest on unpaid federal estate taxes was high. The life tenant wanted to pay the federal estate tax to stop the running of the interest after a substantial amount of interest had accrued.

Because the liability for estate tax fell upon the estate and not the life tenant, it appeared that if the life tenant paid the federal estate tax, there would be no interest deduction, the life tenant being deemed to make a loan to the estate.

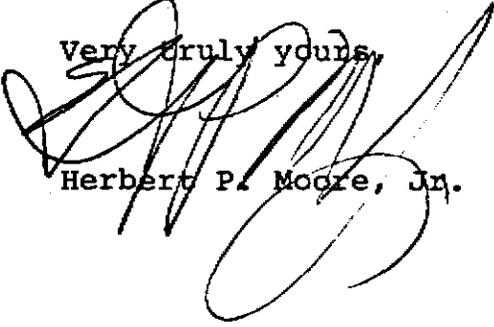
I do not have a ready solution, but suggest that the commission give some thought to providing machinery to avoid this type of problem.

There should at least be a provision whereby a life tenant could go to court and obtain an interest-bearing lien against the underlying property for advances to the estate to pay the tax. This does not take care of the desire for an interest deduction against income taxation.

However, maybe the accrued interest should be deducted as an expense of administration on the federal estate tax return per an amended return, resulting in rough justice.

I wish I had more time to think this through, but I no longer represent the life tenant, and it is now someone else's problem.

Very truly yours,



Herbert P. Moore, Jr.

HPMjr:msr

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WRITER'S DIRECT DIAL NUMBER

October 2, 1985

(415) 777-6035

Mr. John H. DeMouilly
Executive Secretary
Mr. Stan G. Ulrich
Staff Counsel
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

Dear John & Stan:

Thank you for sending me a copy of your Tentative Recommendation relating to Probate Law (Proration of Estate Taxes), dated August 1985. I am enclosing copies of the pages on which I suggest changes for your consideration.

I call your attention in particular to my suggested addition to Section 971.050(b). Although this may seem like a radical suggestion, the result in the illustration on page 9 is unfair to A. If there is an early disposition or cessation of qualified use of the qualified real property by A, he would have to pay the full \$97,500 deficiency under Section 971.050(c) as written, without any right of reimbursement for the additional \$2,500 from B. It would be fairer to A and not unfair to B if B were required to pay not only the full \$92,500 estate tax actually paid, but an additional \$2,500 to A. It is important to remember that by making an election under Section 2032A, A would be substantially restricted in his use of the property without incurring the additional tax. If A did not make the election, B would have had to pay \$95,000 in tax. B should not be better off as a result of A's election. (The unfairness to A would be more apparent if the estate consisted of cash of \$400,000 and realty worth \$400,000 [and a Section 2032A value of \$200,000] and the decedent died in 1987.)

I have two other general comments with regard to

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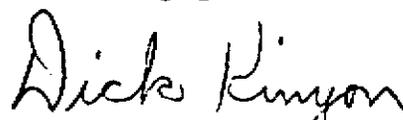
October 2, 1985

Page Two

the tentative recommendation: (1) Because of the similarity in Chapters 15.3 and 15.5, is it not possible to draft a single chapter dealing with the proration of transfer taxes generally? and (2) Can not these provisions be placed somewhere that will avoid the necessity of decimal numbers for the sections?

Finally, I could not help compare the procedure under these proposals relating to the proration of transfer taxes with my suggestion regarding creditors' claims and non-probate property, discussed in my letter to Chuck Collier dated July 18, 1985. If an executor, trustee, or other person can be given rights to recover transfer taxes from transferees of non-probate property, why not give such a person the right to enforce creditors' claims generally against such transferees? Furthermore, given the similarity in these concepts, what is the policy reason for providing that in the absence of a provision in the will or trust instrument to the contrary, transfer taxes should be "equitably" apportioned against all taxable property whereas creditors' claims, expenses of administration, etc., are paid according to Probate Code Sections 750 et seq? In any event, it would seem that the residue of a revocable living trust should be treated the same as the residue of a probate estate for purposes of liability for creditors' claims if the residue of the revocable trust is payable to the same beneficiaries as the residue of the probate estate.

Sincerely yours,



Richard S. Kinyon

RSK:mjf

cc: Professor Edward C. Halbach, Jr.

Charles A. Collier, Esq.

James V. Quillinan, Esq.

Theodore J. Cranston, Esq.

without later disruption. The revised statute permits proration of an estate tax that has been imposed whether or not actually paid at the time of proration.

Proration by personal representative. Existing law requires the court to order the proration of estate taxes.⁴ There is no reason to involve the court in making the proration if all the persons interested in the estate agree on the proration. This is a matter within the purview of the personal representative. The revised statute eliminates mandatory court involvement and provides an optional procedure for obtaining a court determination of proration in the event of a dispute.

Modification of proration order. Where there is a court order for proration, the order may be rendered incorrect by a subsequent adjustment of the estate tax after the return is filed. This may be done as a result of audit, or as a result of filing an amended estate tax return upon locating additional property or discovering additional deductions. In this event, the court should modify the proration order, and the revised statute provides for this. ~~Although~~ ^{Since} there is a potential for the modification to occur many years after the estate is closed, the Commission does not recommend a limitation period for modification. Rather, the matter is left to the doctrine of laches and other judicial equitable powers in the circumstances of each case.

Uncollectable proration. A practical problem arises where the estate tax prorated against a person proves to be uncollectable, whether because the person or property is not subject to the jurisdiction of the court or for other reasons. In this situation,

4. Prob. Code § 971.

§ 970.010. Definitions

970.010. Except where the context otherwise requires, as used in this chapter:

(a) "Estate tax" means a tax imposed by any federal or California estate tax law, now existing or hereafter enacted.

(b) "Person interested in the estate" means any person, including a personal representative, guardian, conservator, or trustee, entitled to receive, or who has received, from a decedent while alive or by reason of the death of a decedent any property or interest therein.

(c) "Property" means ~~all~~ property included in the gross estate for federal estate tax purposes.

(d) "Value" means fair market value as determined for federal estate tax purposes.

(e) "Personal representative" means executor, administrator, trustee,
Comment. Section 970.010 supersedes former Section 977. The definition of "gross estate" in former Section 977(b) erroneously had the effect of prorating taxes to adjusted taxable gifts, or other person charged with the responsibility of paying the estate tax.

§ 970.020. Transitional provision

970.020. (a) This chapter applies to the estate of a decedent who dies on or after January 1, 1987.

(b) Notwithstanding the repeal of any provision by this act, the applicable law in effect before January 1, 1987, remains in effect and applicable to the estate of a decedent who dies before January 1, 1987. No inference as to the applicable law in effect before January 1, 1987, shall be drawn from the enactment of this chapter.

Article 2. Proration

§ 971.010. Proration among persons interested in estate

971.010. (a) Except as provided in subdivision (b), any estate tax, and interest on any deficiency, shall be equitably prorated among the persons interested in the estate in the manner prescribed in this article.

(b) This section does not apply in any of the following cases:

(1) Where a testator directs otherwise by will.

(2) Where by written instrument executed inter vivos direction is given for apportionment within the fund of taxes assessed upon the specific fund dealt with in the inter vivos instrument.

deductions allowed by the federal estate tax law for the purpose of determining the taxable estate and attributable to property located in this state.

Comment. Section 971.030 continues former Section 972 without substantive change. Although the federal estate tax exemption is replaced by a unified tax credit and other credits are allowed, subdivision (a) also refers to exemptions in anticipation of future enactment of exemptions.

§ 971.040. Trusts and temporary interests

971.040. If a trust is created, or other provision made whereby a person is given an interest in income, or an estate for years, or for life, or other temporary interest in any property or fund, the estate tax on both the temporary interest and on the remainder thereafter shall be charged against and paid out of the corpus of the property or fund without apportionment between remainders and temporary estates.

Comment. Section 971.040 continues former Section 973 without substantive change.

CROSS-REFERENCES

Definitions

Estate tax § 970.010(a)

§ 971.050. Proration of additional tax on certain qualified real property

971.050. (a) As used in this section, "qualified real property" means qualified real property as defined in Section 2032A of the Internal Revenue Code.

(b) If an election is made pursuant to Section 2032A of the Internal Revenue Code, the proration shall be based upon the amount of federal estate tax that would be payable but for the election. The amount of the reduction in federal estate tax resulting from an election pursuant to Section 2032A of the Internal Revenue Code shall be attributed to the qualified real property to which the election applies, to the extent of the federal estate tax that would have been prorated against the qualified real property but for the election. If there is no tax as a result of the Section 2032A election but there would have been a tax if no election had been made, the tax that would have been paid by persons not receiving qualified real property -8- subject to the election shall be paid to the persons receiving such property.

(c) If additional federal estate tax is imposed under Section 2032A(c) of the Internal Revenue Code by reason of early disposition or cessation of qualified use, the additional tax shall be a charge against the portion of the qualified real property to which the additional tax is attributable, and shall be equitably prorated among the persons interested in that portion of the qualified real property in proportion to their interests.

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Comment. Section 971.050 is new and deals with specially valued real property. Where an election is made to specially value qualified real property under Internal Revenue Code Section 2032A, the qualified heirs who receive the qualified real property receive the entire benefit of the estate tax reduction resulting from the election, and are likewise liable for the entire amount of any additional tax subsequently imposed on the property. For example, assume an estate in which, absent a special valuation election, each beneficiary receives property of equal value and shares equally in the prorated estate taxes. If one beneficiary makes a special valuation election that reduces the total estate tax, the amount of the reduction must be allocated entirely to that beneficiary, and the others must pay the amount they would have been liable for absent the special valuation election.

To illustrate the operation of Section 971.050, assume the decedent dies in 1986, leaving an estate consisting of \$500,000 cash and real property having a fair market value of \$500,000 (and a value under Internal Revenue Code Section 2032A of \$250,000). The decedent's will leaves the real property to A and the cash to B.

If no election is made under Section 2032A, the taxable estate is \$1,000,000. The estate tax is \$190,000, which is prorated \$95,000 to A and \$95,000 to B.

If an election is made under Section 2032A, the taxable estate is \$750,000. The estate tax is \$92,500; the reduction in estate tax is \$97,500. A is credited with \$95,000 against the fair market value proration. (This represents the amount of the reduction in tax resulting from the election, to the extent of the tax that would be attributable to the qualified real property but for the election.) A pays no tax and B pays the full tax of \$92,500.

Subdivision (b) ensures that A receives the benefit of the tax relief under Section 2032A, up to the amount of tax that would have been prorated to the fair market value of the qualified real property. B may also benefit from the election, but no further compensating adjustment is required.

Subdivision (c) provides that any additional tax under Int. Rev. Code § 2032A(c) will be imposed only upon those who received the qualified real property and benefited from the election. If A causes the full additional tax to be assessed under Internal Revenue Code Section 2032A(c), the entire additional tax of \$97,500 will be prorated to A. This is true even though B also may have benefited from the election under Section 2032A.

§ 971.060. Proration of extended estate tax

971.060. Where the payment of any portion of the federal estate tax is extended under the provisions of the federal estate tax law, the amount of extended tax and interest thereon shall be a charge against the specific property that gives rise to the extension.

Comment. Section 971.060 ensures that the persons who receive property that gives rise to the extension of estate tax are the persons who benefit from the extension privilege and from any favorable interest rate on the extended tax. Section 971.060 makes it clear that where a decedent's estate consists of a closely held business with respect to which the estate taxes may be extended, the deferred tax and interest thereon follow the business.

§ 971.070. Where property not in possession of personal representative

971.070. (a) If ^{all} property does not come into the possession of the personal representative, the personal representative is entitled, and has the duty, to recover from the persons interested in the estate the proportionate amount of the estate taxes with which ^{those} ~~the~~ persons ~~interested in the estate~~ are chargeable under the provisions of this ~~article~~ chapter.

(b) If the personal representative ~~or other person required to~~ ~~pay the tax~~ cannot collect from any person interested in the estate the amount of tax apportioned to the person, the amount not recoverable shall be paid from the residuary estate. To the extent that the residuary estate is not adequate, the balance shall be equitably prorated among the other persons interested in the estate who are subject to proration.

Comment. Subdivision (a) of Section 971.070 continues former Section 975 without substantive change. The court may by order direct payment of the amount of taxes owed by a person to the personal representative. Section 872.040 (court order to effectuate proration). Subdivision (b) is drawn from Section 7 of the Uniform Estate Tax Apportionment Act (1964).

CROSS-REFERENCES

Definitions

Person interested in the estate § 970.010(b)

Property § 970.010(c)

{ the personal representative and ^{every} other

§ 972.030. Notice of hearing

972.030. At least 10 days before the hearing the petitioner shall:

(a) Cause notice of the hearing and a copy of the petition to be mailed to ~~each~~ person interested in the estate against whom prorated amounts may be charged pursuant to subdivision (a) of Section 972.040.

(b) Cause summons and a copy of the petition to be served on ~~each~~ person interested in the estate who may be directed to ~~make~~ payment of prorated amounts pursuant to subdivision (b) of Section 972.040.

Comment. See Comment to Section 972.010.

CROSS-REFERENCES

Definition

Person interested in the estate § 970.010(b)

§ 972.040. Court order to effectuate proration

972.040. The court, upon making a determination as provided in this article, shall make an order:

(a) Directing the personal representative ~~or other fiduciary~~ to charge the prorated amounts against the persons against whom the estate tax ^{has} ~~has~~ been prorated insofar as the personal representative or other fiduciary is in possession of any property or interests of the persons against whom the charge may be made.

(b) Summarily directing all other persons against whom ^{the} estate tax ~~has~~ ^{has} been prorated to make payment of the prorated amounts to the personal representative, ~~or other fiduciary~~.

Comment. Section 972.040 continues former Section 976 without substantive change. See also Comment to Section 972.010.

CROSS-REFERENCES

Definition

Estate tax § 970.010(a)

§ 972.050. Modification of court order

972.050. Upon petition by the personal representative or any person pursuant to this article whenever it appears that the amount of interested in the estate, the court shall modify an order made

cf. § 977.01

estate tax as actually determined is different from the amount of ~~estate~~ tax on which the court based the order.

Comment. Section 972.050 provides for the possibility that subsequent to the making of an order, the taxes may be adjusted as a result of audit or the filing of an amended return. Section 972.050 does not apply to any additional tax under Internal Revenue Code Section 2032A(c) resulting from a disposition or cessation of qualified use of specially valued property. Cf. Section 971.050 (proration of additional tax on certain qualified real property). See also Comment to Section 972.010. Section 972.050 does not provide a limitation period for modification of a proration order; the matter is left to laches and other equitable doctrines within the discretion of the court.

CROSS-REFERENCES

Definitions

Estate tax § 970.010(a)

Person interested in the estate § 970.010(b)

§ 972.060. Reciprocity of enforcement

972.060. (a) Subject to subdivision (c), a personal representative ~~or other fiduciary~~, acting in another state or a person required to pay the estate tax who is resident in another state may commence an action in this state and may recover any of the following from a person interested in the estate who is either resident in this state or who owns property in this state:

- (1) A proportionate amount of the federal estate tax.
- (2) An estate tax payable to another state.
- (3) A death duty due by the decedent's estate to another state.

(b) For the purposes of the action the determination of apportionment by the court having jurisdiction of the administration of the decedent's estate in the other state is prima facie correct.

(c) This section applies only if the state in which the determination of apportionment was made provides a substantially similar remedy.

Is this a good requirement?

Comment. Section 972.060 is drawn from Section 8 of the Uniform Estate Tax Apportionment Act (1964).

CROSS-REFERENCES

Definitions

Person interested in the estate § 970.010(b)

Probate Code §§ 975.010-977.050 (added). Proration of taxes on generation-skipping transfers

SEC. 3. Chapter 15.5 (commencing with Section 975.010) is added to Division 3 of the Probate Code, to read:

CHAPTER 15.5. PRORATION OF TAXES ON
GENERATION-SKIPPING TRANSFERS

Note. This article is tentative, pending the outcome of federal legislation affecting taxes on generation-skipping transfers.

Article 1. General Provisions

§ 975.010. Definitions

975.010. Except where the context otherwise requires, as used in this chapter:

(a) "Generation-skipping transfer tax" means a tax imposed by any federal or California generation-skipping transfer tax law, now existing or hereafter enacted.

(b) "Property" means ~~all~~ property on which a generation-skipping transfer tax is imposed.

(c) "Transferee" means any person who receives, who is deemed to receive, or who is the beneficiary of, any property, ~~that is subject to a generation-skipping transfer tax.~~

(d) "Trustee" means any person who is a trustee within the meaning of the federal generation-skipping ^{transfer} tax law.

(e) "Value" means fair market value as determined for generation-skipping transfer tax purposes.

Comment. Section 975.010 to 977.050 parallel comparable provisions of Article 4.5 (commencing with Section 970.010) (proration of estate taxes).

§ 975.020. Transitional provision

975.020. (a) This chapter applies to the estate of a decedent who dies on or after January 1, 1987.

(b) No inference as to the applicable law in effect before January 1, 1987, shall be drawn from the enactment of this chapter.

Article 2. Proration

§ 976.010. Proration among transferees

976.010. (a) Except as provided in subdivision (b), any generation-skipping transfer tax, and interest on any deficiency, shall be equitably prorated among the transferees in the manner prescribed in this article.

(b) This section does not apply in any of the following cases:

(1) Where ~~the written instrument that makes the transfer~~ directs otherwise, by a written instrument.

(2) Where federal law directs otherwise.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Generation-skipping transfer tax § 975.010(a)

Transferee § 975.010(c)

§ 976.020. Manner of proration

976.020. The proration required by this article shall be made in the proportion, as near as may be, that the value of the property received by each transferee bears to the total value of all property received by all transferees.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Property § 975.010(b)

Transferee § 975.010(c)

Value § 975.010(e)

§ 976.030. Allowance for credits and deductions

976.030. In making a proration required by this article, allowances shall be made for credits, exemptions, and deductions allowed for the purpose of determining the tax payable.

Comment. See Comment to Section 975.010.

§ 976.040. Trusts and temporary interests

976.040. If a trust is created, or other provision made whereby a transferee is given an interest in income, or an estate for years,

or for life, or other temporary interest in any property ~~or fund~~, the tax on both the temporary interest and on the ~~remainder, thereafter~~ ^{other interests in the} property shall be charged against and paid out of the corpus of the property ~~or fund~~ without apportionment between ~~remainders and~~ ^{the} temporary estates and ~~remainders~~ ^{other} interests.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Property § 975.010(b)
Transferee § 975.010(c)

§ 976.050. Where property not in possession of trustee or transferee

976.050. (a) If ^{all} property does not come into the possession of the trustee or other person required to pay the tax, the trustee or other person is entitled ^{and has the duty} to recover from the ~~person in possession, or from each~~ transferees the proportionate amount of the tax with which the transferees ^{are} chargeable under the provisions of this chapter.

(b) If the trustee or other person required to pay the tax cannot collect from any transferee the amount of tax apportioned to the transferee, the amount not recoverable shall be paid from the residuary estate. To the extent that the residuary estate is not adequate, the balance shall be equitably prorated among the other transferees who are subject to proration.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Property § 975.010(b)
Transferee § 975.010(c)
Trustee § 975.010(d)

Article 3. Judicial Proceedings

§ 977.010. Who may commence proceedings

977.010. (a) The trustee ^{or other person required to pay the tax} or any transferee may commence proceedings to have a court determine the proration pursuant to this chapter.

^{Subject to subdivision (b),}
(b) Proceedings under this article shall be commenced in the superior court of the county in which the decedent was a resident at

the time of death or in the superior court of any county in which the property is situated.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Transferee § 975.010(c)

Trustee § 975.010(d)

§ 977.020. Petition

977.020. Proceedings under this article shall be commenced by filing a verified petition that sets forth all of the following information:

(a) The jurisdictional facts.

(b) Other facts necessary for the court to determine the proration of the generation-skipping transfer tax.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definition

Generation-skipping transfer tax § 975.010(a)

§ 977.030. Notice of hearing

977.030. At least 10 days before the hearing the petitioner shall:

(a) Cause notice of the hearing and a copy of the petition to be mailed to ~~the trustee and every other person transferee~~ ~~each transferee~~ against whom prorated amounts may be charged pursuant to subdivision (a) of Section 977.040.

(b) Cause summons and a copy of the petition to be served on ~~each transferee~~ who may be directed to make payment of prorated amounts pursuant to subdivision (b) of Section 977.040.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definition

Transferee § 975.010(c)

§ 977.040. Court order to effectuate proration

977.040. The court, upon making a determination as provided in this article, shall make an order:

(a) Directing the trustee to charge the prorated amounts against the transferees against whom the generation-skipping transfer tax has been prorated insofar as the trustee is in possession of any property or interests of the transferees against whom the charge may be made.

(b) Summarily directing all other transferees against whom the generation-skipping transfer tax has been prorated to make payment of the prorated amounts to the trustee [~~petitioning transferee.~~]

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Generation-skipping transfer tax § 975.010(a)
Transferee § 975.010(c)
Trustee § 975.010(d)

§ 977.050. Modification of court order

977.050. Upon petition by the trustee or any transferee, the court shall modify an order made pursuant to this article whenever it appears that the amount of generation-skipping transfer tax as actually determined is different from the amount of tax on which the court based the order.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Generation-skipping transfer tax § 975.010(a)
Transferee § 975.010(c)
Trustee § 975.010(d)

Probate Code § 980 (amended). Apportionment of debts (heading)

SEC. 4. The heading of Article 5 (commencing with Section 980) of Chapter 15 of Division 3 of the Probate Code is amended to read:

~~Article 5~~ Chapter 15.7. Apportionment of Debts

Comment. This amendment is technical.

EXHIBIT 6

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October 30, 1985

FILE NO.

Mr. John H. DeMouilly
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

Re: Tentative Recommendation Relating to Probate Law
(Proration of Estate Taxes)

Dear Mr. DeMouilly:

This letter contains the comments of the Probate and Estate Planning Section of the Kern County Bar Association relating to the Commission's Tentative Recommendation Relating to Probate Law (Proration of Estate Taxes).

Please add the following persons to your mailing list:

Ann H. Davis
Darling, Maclin & Day
1430 Truxtun Avenue
Suite 600
Bakersfield, CA 93301

Melvin Magnus
828 Chester Avenue
Bakersfield, CA 93301

The members of our Section who met to discuss this matter were unanimous in their comments. In outline form, our comments will follow the section numbers of the proposed statute. If a particular section number is not mentioned in this letter, we felt the section was satisfactory.

1. We question why the Commission intends to adopt a numbering system for the sections which uses the same section number repeatedly, distinguishing each section only by a decimal point followed by additional numbers. We can see the need for this when a new section is added to the Probate Code and there is no room for the new section in the series of section numbers. If you feel you must enact all of these sections between sections 970 and 980, we prefer that you number them "971.1" rather than "971.010," for example.

2. We found section 971.010(b)(2) to be very confusing. If the intent of the sentence is to say "where a settlor of an

inter vivos trust directs otherwise," we feel it should be stated this way. If the Commission's sentence has been awkwardly phrased so it will include the exercise of a power of appointment, we suggest that a separate subsection cover this event or do away with all of these subsections and use the Commission's language in section 976.010(b)(1), i.e., "Where the written instrument that makes the transfer directs otherwise."

3. We object to the use of the phrase "as near as may be" in sections 971.020 and 976.020. We would prefer that the phrase read: "in the same proportion that the value. . ." The federal estate tax values will be specifically determined. The interest of each person interested in the estate will also be specifically known. We can see no reason why the taxes cannot be precisely prorated. The inclusion of the phrase "as near as may be" causes ambiguity since something will have to be read into the phrase in order for it to have any meaning.

4. We had a discussion about whether section 971.020 required the donee of property includible in the gross estate under Internal Revenue Code section 2035 to pay his proportion of the taxes. We determined that such a donee would fit within the definition of a "person interested in the estate" since he would be a "person. . . who has received from a decedent while alive. . . property." We feel that this should be the law and that if this is the Commission's interpretation of the sections, this should be mentioned in the comment to either section 970.010 or 971.020.

5. Another question we had is whether a donee of property not includible in the estate under section 2035 but whose gift was a taxable gift (thereby resulting in increased estate tax under Internal Revenue Code section 2101(b)(1)(B)) would be treated as a person interested in the estate and be charged a portion of the estate tax liability. Our interpretation of the sections is that he would not be charged with any federal estate tax. The definition of "property" in section 970.010(c) includes only property "included in the gross estate." Taxable gifts are not included in the gross estate. Again, it would be helpful if the Commission would comment on this situation. We question whether our interpretation should be the law. Why should the donee get his property tax free while the persons taking property at death have to pay higher taxes because of this? The taxes are higher because the benefit of the unified

credit is being given completely to the donee instead of each person interested in the estate sharing it proportionately. We suggest that the definition of "property" be changed so that such a donee would have to pay his prorata share of the taxes caused by the taxable gifts being subject to the tentative tax in IRC section 2101(b)(1).

6. We question whether sections 971.030 and 976.030 are needed. If the intent of the sections is to simply state that it is the net estate tax or net generation-skipping transfer tax that is prorated after taking into account all credits, exemptions and deductions, this could be incorporated into the definition of "estate tax" or "generation-skipping transfer tax" in sections 970.010(a) and 975.010(a). If it means that the credits, exemptions and deductions are allocated in a manner different than the estate or generation-skipping transfer tax, we do not read the wording to say this and we would object to this provision. If there is some reason for these sections which we are missing, we point to the phrase "allowances shall be made" as the source of our confusion. What does the phrase mean and how are allowances made? If the intent of the section is merely to point out that it is the net tax payable which is to be prorated, we suggest that this be made clear in the definition of "estate tax" and "generation-skipping transfer tax" and that sections 971.030 and 976.030 not be included.

7. We liked section 971.050 in all respects.

8. While section 971.060 is fine for what it says, we question whether it will have any utility. The section will not be binding on the Internal Revenue Service. It will not prevent the Service from collecting the tax from non-business interest beneficiaries. For example, assume that "A" receives \$500,000.00 in cash, "B" receives the business interest and section 6166 is elected to defer the payment of the estate tax on the business interest. If "B" defaults in the payment of the remaining federal estate tax, we believe the Service is not prevented from following the assets and collecting the tax from "A." In fact, the Service would rather go after cash than a business interest. If so, "A" would then be forced to bring an action against "B" for reimbursement of the taxes to be paid. This is not a good situation for "A." We do not see a resolution to this problem. We are merely pointing out that section 971.060 does not appear to solve it.

Mr. John H. DeMouilly
California Law Revision Commission
October 30, 1985
Page 4

9. We do not feel that the amount of tax which is uncollectible should be charged solely to the residuary estate in sections 971.070(b) and 976.050(b). Instead, we feel that it should be equitably prorated among all the other persons interested in the estate. Will substitutes are in wide use today. We view this section as a potential trap for testators where the residuary beneficiary (who was the person the testator wanted to primarily benefit) is hurt. We feel that most testators would intend and it is more fair for everyone to bear their prorata share of the uncollectible amount. We would leave it up to the testator to draft a different tax proration clause if he wanted to vary this rule.

10. We feel that ten days is too short a period of time in sections 972.030 and 977.030. We suggest a twenty day period.

11. Sections 972.040 and 977.040 are fine except we would like subsection (b) modified so it is clear that the order of the Court is a judgment which the personal representative can then seek to enforce. With the provisions of section 972.030(b), we feel the Court will have personal jurisdiction over the person against whom the taxes have been prorated. It will make things much easier for the personal representative if he receives a judgment in this proceeding.

12. There must be an error in section 972.050 because the sentence is not a complete sentence. Section 977.050 is similar and we have no objection to it.

If you desire elaboration on any of the points covered in this letter or if you have a response to any of our comments, please do not hesitate to contact me.

Very truly yours,

PROBATE AND ESTATE PLANNING SECTION
KERN COUNTY BAR ASSOCIATION

By: Hal M. Koontz
HAL M. KOONTZ, President

HMK/bkp

EXHIBIT 7

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*A PROFESSIONAL CORPORATION

November 4, 1985

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

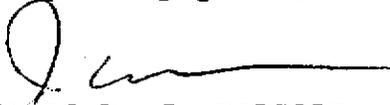
Re: Tentative Recommendation Relating
To Probate Law (Proration Of Estate Taxes)

Gentlemen:

At your request the Taxation Section of the State Bar of California has reviewed your Tentative Recommendation concerning amendments to the Probate Code provisions governing the proration of estate taxes. It is our conclusion that the amendments to the Probate Code that you recommend would be beneficial and should adequately address the various shortcomings of the current law that you have identified. We would, however, suggest that an additional problem, which you have not identified, be dealt with in these amendments. After an order has been made directing proration (per Section 972.040 or 977.040) the personal representative may be required to take further action to enforce the order against persons who have received property outside of the probate estate (e.g., life insurance beneficiaries or surviving joint tenants). We believe that the Probate Code should provide that the reasonable costs of such action and attorneys' fees should be payable by the beneficiary, and would recommend that such a provision be added to both Section 972.040 and 977.040.

We appreciate the opportunity to comment on this Tentative Recommendation. If we can be of further help, please call.

Very truly yours,



JAMES D. C. BARRALL,
A PROFESSIONAL CORPORATION
CHAIRMAN, TAXATION SECTION
STATE BAR OF CALIFORNIA

JDCB:am

cc: George H. Cole, Jr., Esq.
Ms. Robyn Murphy

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November 5, 1985

Mr. John H. DeMouilly, Esq.
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Memorandum 85-69 -- Proration of Estate Taxes

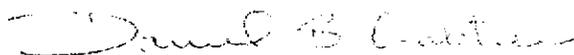
Dear Mr. DeMouilly:

On November 4, 1985 the Legislative Subcommittee on Estate Planning, Trust and Probate Legislation for the San Diego County Bar Association considered the Memorandum 85-69 dealing with Proration of Estate Taxes. Although the proposed legislation would clear up a number of ambiguous areas dealing with proration, there continue to exist unclear areas.

The practical problems dealing with estate taxes prorated against a person which proved to be uncollectable continue to be a murky area to which there appears to be no equitable solution. For instance, what would be the solution to a situation where the Personal Representative has determined that a portion of the estate taxes prorated against a certain individual are uncollectable but the beneficiaries believe the Executor has not made a good faith effort and said taxes are collectable.

In addition, if the proposed legislation is enacted as drafted and that amount of prorated estate taxes which proved to be uncollectable are satisfied from the residuary estate those beneficiaries who are detrimentally affected in the residue should be subrogated to the place of the Executor. This would entitle them to pursue that individual or individuals who would normally be liable for a portion of the estate taxes but have not contributed. Although this area of the law may come up less frequently because of the increase in the unified credit amount for estate taxes, it would certainly be awkward if an entire residue was utilized for estate taxes because a recipient of some type of property outside the State of California was not subject to the jurisdiction of California courts. To allow those beneficiaries detrimentally affected to pursue a recalcitrant beneficiary would seem most equitable in this awkward case.

Very truly yours,



Daniel B. Crabtree, Chairman

DBC/tlm

7/11/85

TENTATIVE RECOMMENDATION

relating to

PRORATION OF ESTATE TAXES

The California statute governing proration of estate taxes among the beneficiaries of a decedent's estate were enacted in 1943.¹ Despite major changes in the federal and state estate and gift tax laws since that time, there have been no significant amendments to the California statute, other than in 1984 to recognize enactment of the California estate tax.² As a result, the proration statute is now obsolete in many respects and is in substantial need of modernization.

The California Law Revision Commission recommends revision of the statute in the manner described below. In addition, the revised statute incorporates numerous minor and technical improvements that are noted in the Comments following the text of the revised provisions.

Time of proration. Existing California law requires that the estate tax be actually paid before a proration may be made.³ But federal law allows for deferral of payment of estate taxes for up to 15 years in certain cases. Once the amount of tax is determined, the proration should be made, even though the tax hasn't yet been paid. This will enable settlement and closing of estates expeditiously

¹Prob. Code §§ 970-977, enacted 1943 Cal. Stats. ch. 894, § 1.

²1984 Cal. Stats. ch. 1711.

³Prob. Code § 970.

without later disruption. The revised statute permits proration of an estate tax that has been imposed whether or not actually paid at the time of proration.

Proration by personal representative. Existing law requires the court to order the proration of estate taxes.⁴ There is no reason to involve the court in making the proration if all the persons interested in the estate agree on the proration. This is a matter within the purview of the personal representative. The revised statute eliminates mandatory court involvement and provides an optional procedure for obtaining a court determination of proration in the event of a dispute.

Modification of proration order. Where there is a court order for proration, the order may be rendered incorrect by a subsequent adjustment of the estate tax after the return is filed. This may be done as a result of audit, or as a result of filing an amended estate tax return upon locating additional property or discovering additional deductions. In this event, the court should modify the proration order, and the revised statute provides for this. Although there is a potential for the modification to occur many years after the estate is closed, the Commission does not recommend a limitation period for modification. Rather, the matter is left to the doctrine of laches and other judicial equitable powers in the circumstances of each case.

Uncollectable proration. A practical problem arises where the estate tax prorated against a person proves to be uncollectable, whether because the person or property is not subject to the jurisdiction of the court or for other reasons. In this situation,

⁴Prob. Code § 971.

the proposed law provides that the uncollectable amount is to be satisfied first out of the decedent's residuary estate, and if that is insufficient, then it is to be apportioned among the remaining beneficiaries. This rule is drawn from Section 7 of the Uniform Estate Tax Apportionment Act (1964).

Treatment of specially valued qualified real property. Under federal law an election may be made to specially value certain qualified real property.⁵ The special value may be as much as $\$3/4$ million less than the fair market value of the qualified real property, with the result of a substantial estate tax savings. If the election is made, the persons who receive the real property must continue to use the real property as a farm or other trade or business for ten years. If they dispose of the property or cease the qualified use, then the estate tax savings resulting from the special value are lost, and an additional tax is imposed, for which the persons receiving the property are personally liable. In this situation, the reduction of estate taxes resulting from the special valuation should be allocated entirely to the persons receiving the qualified real property, and any additional tax imposed as a result of cessation of a qualified use should be imposed entirely on them.

Treatment of extended estate tax. Federal law allows payment of a portion of the estate tax attributable to specified property (such as a closely held business or a remainder interest) to be extended.⁶ The present California proration statute does not require that the extended tax follow the property. The revised

⁵Int. Rev. Code § 2032A.

⁶See e.g., Int. Rev. Code §§ 6163-6166.

statute makes it clear that where tax attributable to a closely held business is extended, the privilege to pay the tax in installments goes to the person who receives the closely held business.

Conflict of state and federal law. In some cases, the manner of proration required by the California statute may conflict with the proration prescribed by federal law. For example, federal law provides that the tax on a Qualified Terminable Interest Property trust will be at the highest incremental bracket, with the effect that the other property of a decedent's estate is taxed at lower brackets.⁷ This conflicts with the present California statute. In such a situation, federal law should control, and the revised statute so provides.

Reciprocity. The Uniform Estate Tax Apportionment Act (1964) deals with the problem of collecting an estate tax apportioned to a non-resident by granting reciprocal enforcement rights by non-residents in the state. The proposed law adopts this uniform provision.

Proration of taxes on generation-skipping transfers. Existing federal law imposes personal liability on the distributee for the generation-skipping tax, not exceeding the value of the property received by the distributee.⁸ The present California proration statute does not deal with equitable proration of the generation-skipping tax among trust beneficiaries. The Commission recommends, and the revised statute includes, generation-skipping tax proration provisions, comparable to the estate tax proration

⁷Int. Rev. Code § 2207A.

⁸Int. Rev. Code § 2603.

provisions. The Commission recognizes the possibility that the generation-skipping tax may be repealed or restructured by Congress in the immediate future. However, a proration statute is important in the interim.

The Commission's recommendations would be effectuated by enactment of the following measure:

An act to amend the heading of Article 5 (commencing with Section 980) of Chapter 15 of, to add Chapter 15.3 (commencing with Section 970.010) and Chapter 15.5 (commencing with Section 975.010) to, and to repeal Article 4a (commencing with Section 970) of Chapter 15 of, Division 3 of the Probate Code, relating to proration of taxes.

The people of the State of California do enact as follows:

Probate Code §§ 970-977 (repealed). Payment of federal estate tax

SECTION 1. Article 4a (commencing with Section 970) of Chapter 15 of Division 3 of the Probate Code is repealed.

Comment. Sections 970-977 are superseded by Sections 970.010-972.060 (proration of estate taxes). Comparable provisions of the old and new law are listed below.

<u>OLD LAW</u>	<u>NEW LAW</u>
970	971.010
971	971.020
972	971.030
973	971.040
975	971.070
976	972.040
977	970.010

NOTE. Dick Kinyon (Exhibit 5) and Kern County (Exhibit 6) both expressed concern about use of decimal numbers in the new sections.

The new sections are placed here in a temporary location with temporary numbers, with the intent to relocate them with whole numbers in an appropriate location in the Estates and Trusts Code. One alternative would be to give these provisions whole numbers at the outset that they would retain when transferred to the new code. They could constitute a new Division 9, running from Section 14500 to 14645, located between Division 8 (disposition of estates without administration) and Division 10 (trusts). It seems somewhat anomalous to give the proration provisions the status of a division, but this would avoid the need for a later renumbering.

Probate Code §§ 970.010-972.060 (added). Proration of estate taxes

SEC. 2. Chapter 15.3 (commencing with Section 970.010) is added to Division 3 of the Probate Code, to read:

CHAPTER 15.3. PRORATION OF ESTATE TAXES

Article 1. General Provisions

§ 970.010. Definitions

970.010. Except where the context otherwise requires, as used in this chapter:

(a) "Estate tax" means a tax imposed by any federal or California estate tax law, now existing or hereafter enacted.

(b) "Person interested in the estate" means any person, including a personal representative, guardian, conservator, or trustee, entitled to receive, or who has received, from a decedent while alive or by reason of the death of a decedent any property or interest therein.

(c) "Property" means all property included in the gross estate for federal estate tax purposes.

(d) "Value" means fair market value as determined for federal estate tax purposes.

Comment. Section 970.010 supersedes former Section 977. The definition of "gross estate" in former Section 977(b) erroneously had the effect of prorating taxes to adjusted taxable gifts.

NOTE. We have received comments concerning the following definitions:

Subdivision (c) "property". Dick Kinyon (Exhibit 5) would delete the word "all" from the definition. This is cleaner, and the staff would make this change. We would also add to the Comment a note that, "The definition of "property" in subdivision (c) makes clear that the term includes property transferred by the decedent during life if included in the gross estate for federal estate tax purposes. See, e.g., I.R.C. § 2035; cf. subdivision (b) ("person interested in estate" includes person who received property from a decedent while alive)."

Subdivision (d) "value". Herbert Moore (Exhibit 4) questions whether the definition is clear enough vis-a-vis the alternate valuation date. The staff believes the definition is clear in this respect, but would add to the Comment the following language: "Subdivision (d) defines the term "value" to mean value as determined for federal estate tax purposes. Thus where an alternate valuation is elected pursuant to Section 2032 of the Internal Revenue Code, "value" means the value determined as of the alternate valuation date for federal estate tax purposes."

Subdivision (e) "personal representative". Dick Kinyon suggests that the term "personal representative" be defined for purposes of the proration provisions. The staff agrees that this would simplify drafting and would insert the following definition in appropriate alphabetical order: "'Personal representative" includes trustee or other person charged with the responsibility of paying the estate tax." We would also add a cross-reference to the general personal representative definition in Section 59 (executor, administrator, administrator with the will annexed). The definition of "person interested in the estate" will be modified accordingly.

§ 970.020. Transitional provision

970.020. (a) This chapter applies to the estate of a decedent who dies on or after January 1, 1987.

(b) Notwithstanding the repeal of any provision by this act, the applicable law in effect before January 1, 1987, remains in effect and applicable to the estate of a decedent who dies before January 1, 1987. No inference as to the applicable law in effect before January 1, 1987, shall be drawn from the enactment of this chapter.

NOTE. The staff plans to change the word "estate" to "property" in this section consistent with the definition of "property" in Section 970.010(c).

Article 2. Proration

§ 971.010. Proration among persons interested in estate

971.010. (a) Except as provided in subdivision (b), any estate tax, and interest on any deficiency, shall be equitably prorated among the persons interested in the estate in the manner prescribed in this article.

(b) This section does not apply in any of the following cases:

(1) Where a testator directs otherwise by will.

(2) Where by written instrument executed inter vivos direction is given for apportionment within the fund of taxes assessed upon the specific fund dealt with in the inter vivos instrument.

(3) Where federal law directs otherwise.

Comment. Section 971.010 continues former Section 970 without substantive change, but recognizes that federal law may provide for a different means of proration. Section 971.010 allows proration of an extended estate tax prior to actual payment of the tax. Section 971.060 (proration of extended estate tax). Cf. Int. Rev. Code § 2207A.

CROSS-REFERENCES

Definitions

Estate tax § 970.010(a)

Person interested in the estate § 970.010(b)

NOTE. Kern County (Exhibit 6) finds subdivision (b)(2) to be confusing. The staff agrees that this provision could be stated more clearly, although we note that this is existing law verbatim. We also believe that subdivision (b)(1) is not an adequate statement of the law. We would combine the two subdivisions in one, thus: "This section does not apply to the extent the decedent in a written inter vivos or testamentary instrument disposing of property directs that the property be applied to the satisfaction of an estate tax or that an estate tax be prorated to the property in the manner provided in the instrument."

§ 971.020. Manner of proration

971.020. The proration required by this article shall be made in the proportion, as near as may be, 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.

Comment. Section 971.020 continues former Section 971 without substantive change, but does not require a court order to make the proration. Cf. Sections 972.010-972.060 for optional court procedure to determine proration. The proration is based on fair market value as determined for federal estate tax purposes, even though the estate tax may be based on a special value.

CROSS-REFERENCES

Definitions

Person interested in the estate § 970.010(b)

Property § 970.010(c)

Value § 970.010(d)

NOTE. Kern County (Exhibit 6) suggests deletion of the phrase "as near as may be" from this section. The staff notes that this is

existing law, but agrees that the phrase doesn't appear to serve a useful purpose and should be deleted.

Kern County also believes it would be useful to state in the Comment that estate taxes are prorated to property received from the decedent during life as a gift if included in the decedent's gross estate. The staff has no problem with pointing this out--"The proration is made against all property included in the decedent's gross estate for federal estate tax purposes, including gifts includible in the estate pursuant to Section 2035 of the Internal Revenue Code. See Sections 970.010 (definitions) and 971.010 (proration among persons interested in estate) and Comments thereto."

A related point raised by Kern County is whether taxable gifts made during the decedent's life but not included in the decedent's estate should be required to bear a share of the increased tentative estate tax to the extent the increase results from inclusion of the tax on the gift in the decedent's gross estate. Kern County argues that since the gift causes an increase in the estate tax, the gift recipients should be required to pay the increase--it should not be borne by others who receive no benefit from the gift. We have asked Ken Klug to comment on this point.

§ 971.030. Allowance for credits, deductions, and other adjustments

971.030. (a) In making a proration of the federal estate tax, allowances shall be made for credits allowed for state or foreign death taxes in determining the federal tax payable and for exemptions and deductions allowed for the purpose of determining the taxable estate.

(b) In making a proration of the California estate tax, allowances shall be made for (1) credits (other than the credit for state death taxes paid) allowed by the federal estate tax law and attributable to property located in this state, and (2) exemptions and deductions allowed by the federal estate tax law for the purpose of determining the taxable estate and attributable to property located in this state.

Comment. Section 971.030 continues former Section 972 without substantive change. Although the federal estate tax exemption is replaced by a unified tax credit and other credits are allowed, subdivision (a) also refers to exemptions in anticipation of future enactment of exemptions.

NOTE. Kern County (Exhibit 6) would simplify or eliminate Section 971.030 by referring to the net estate tax, rather than to the estate tax with allowances made for credits, exemptions, and

deductions. The problem with such a simplification is that it would give the benefit of credits, exemptions, and deductions attributable to specific property to all persons receiving property of the decedent whether or not the property they receive is the basis for the credits, exemptions, or deductions. Despite an understandable inclination to want to simplify, the staff believes the more elaborate provision of this section is necessary.

§ 971.040. Trusts and temporary interests

971.040. If a trust is created, or other provision made whereby a person is given an interest in income, or an estate for years, or for life, or other temporary interest in any property or fund, the estate tax on both the temporary interest and on the remainder thereafter shall be charged against and paid out of the corpus of the property or fund without apportionment between remainders and temporary estates.

Comment. Section 971.040 continues former Section 973 without substantive change.

CROSS-REFERENCES

Definitions

Estate tax § 970.010(a)

NOTE. Herbert Moore (Exhibit 4) raises the problem of property of substantial value given to one person for life, with the remainder to another person. Estate taxes are substantial and interest is accruing; the life tenant doesn't want to sell the property to pay the estate taxes, the remainderman does. Mr. Moore suggests that in this situation the life tenant should be able to pay the estate tax and interest and obtain an interest-bearing lien on the property. This assumes, of course, that the life tenant has sufficient funds to pay the taxes. An alternative would be for the life tenant to get a loan secured by the property in order to pay the taxes. In either case, the security interest would have to extend to the remainder in order for the lien concept to be feasible. The concept sounds interesting to the staff; perhaps our consultants and State Bar advisors can address this matter.

§ 971.050. Proration of additional tax on certain qualified real property

971.050. (a) As used in this section, "qualified real property" means qualified real property as defined in Section 2032A of the Internal Revenue Code.

(b) If an election is made pursuant to Section 2032A of the Internal Revenue Code, the proration shall be based upon the amount of federal estate tax that would be payable but for the election. The amount of the reduction in federal estate tax resulting from an election pursuant to Section 2032A of the Internal Revenue Code shall be attributed to the qualified real property to which the election applies, to the extent of the federal estate tax that would have been prorated against the qualified real property but for the election.

(c) If additional federal estate tax is imposed under Section 2032A(c) of the Internal Revenue Code by reason of early disposition or cessation of qualified use, the additional tax shall be a charge against the portion of the qualified real property to which the additional tax is attributable, and shall be equitably prorated among the persons interested in that portion of the qualified real property in proportion to their interests.

Comment. Section 971.050 is new and deals with specially valued real property. Where an election is made to specially value qualified real property under Internal Revenue Code Section 2032A, the qualified heirs who receive the qualified real property receive the entire benefit of the estate tax reduction resulting from the election, and are likewise liable for the entire amount of any additional tax subsequently imposed on the property. For example, assume an estate in which, absent a special valuation election, each beneficiary receives property of equal value and shares equally in the prorated estate taxes. If one beneficiary makes a special valuation election that reduces the total estate tax, the amount of the reduction must be allocated entirely to that beneficiary, and the others must pay the amount they would have been liable for absent the special valuation election.

To illustrate the operation of Section 971.050, assume the decedent dies in 1986, leaving an estate consisting of \$500,000 cash and real property having a fair market value of \$500,000 (and a value under Internal Revenue Code Section 2032A of \$250,000). The decedent's will leaves the real property to A and the cash to B.

If no election is made under Section 2032A, the taxable estate is \$1,000,000. The estate tax is \$190,000, which is prorated \$95,000 to A and \$95,000 to B.

If an election is made under Section 2032A, the taxable estate is \$750,000. The estate tax is \$92,500; the reduction in

estate tax is \$97,500. A is credited with \$95,000 against the fair market value proration. (This represents the amount of the reduction in tax resulting from the election, to the extent of the tax that would be attributable to the qualified real property but for the election.) A pays no tax and B pays the full tax of \$92,500.

Subdivision (b) ensures that A receives the benefit of the tax relief under Section 2032A, up to the amount of tax that would have been prorated to the fair market value of the qualified real property. B may also benefit from the election, but no further compensating adjustment is required.

Subdivision (c) provides that any additional tax under Int. Rev. Code § 2032A(c) will be imposed only upon those who received the qualified real property and benefited from the election. If A causes the full additional tax to be assessed under Internal Revenue Code Section 2032A(c), the entire additional tax of \$97,500 will be prorated to A. This is true even though B also may have benefited from the election under Section 2032A.

NOTE. Dick Kinyon (Exhibit 5) points out that in the illustration contained in the Comment to this section, A's election to specially value real property under Internal Revenue Code Section 2032A has the effect of reducing B's tax by \$2,500. He suggests that in order to be fair, B should pay the \$2,500 savings to A, so that if A ever discontinues the special value use and has to make up the difference in the estate tax, A will have the needed \$2,500 to help make up the difference. We have asked Ken Klug to comment on this point.

Also in connection with this section, noting that it refers to a specific provision of the Internal Revenue Code, we plan to cross-refer to Section 7 (reference made to any law applies to amendments made to the law).

§ 971.060. Proration of extended estate tax

971.060. Where the payment of any portion of the federal estate tax is extended under the provisions of the federal estate tax law, the amount of extended tax and interest thereon shall be a charge against the specific property that gives rise to the extension.

Comment. Section 971.060 ensures that the persons who receive property that gives rise to the extension of estate tax are the persons who benefit from the extension privilege and from any favorable interest rate on the extended tax. Section 971.060 makes it clear that where a decedent's estate consists of a closely held business with respect to which the estate taxes may be extended, the deferred tax and interest thereon follow the business.

NOTE. Kern County (Exhibit 5) points out a problem where an extended estate tax is prorated against the property as to which the extension is made and the recipient of the property fails to pay the tax. In this situation the Internal Revenue Service will probably collect against other liquid assets in the estate rather than the affected property, thereby frustrating the intent of the proration

statute. In this situation, the person having to bear the tax should have a right of action against the person who failed to pay. This will be made clear in connection with Section 971.070 (property not in possession of personal representative). We would add the following comment to Section 971.060: "If the persons who receive the property fail to pay the tax when due and the tax is collected from persons other than the persons to whom the tax is prorated, the persons from whom the tax is collected have a right of reimbursement against the persons to whom the tax is prorated. See Section 971.070 (where property not in possession of personal representative)."

§ 971.070. Where property not in possession of personal representative

971.070. (a) If property does not come into the possession of the personal representative, the personal representative is entitled, and has the duty, to recover from the persons interested in the estate the proportionate amount of the estate taxes with which the persons interested in the estate are chargeable under the provisions of this article.

(b) If the personal representative or other person required to pay the tax cannot collect from any person interested in the estate the amount of tax apportioned to the person, the amount not recoverable shall be paid from the residuary estate. To the extent that the residuary estate is not adequate, the balance shall be equitably prorated among the other persons interested in the estate who are subject to proration.

Comment. Subdivision (a) of Section 971.070 continues former Section 975 without substantive change. The court may by order direct payment of the amount of taxes owed by a person to the personal representative. Section 872.040 (court order to effectuate proration). Subdivision (b) is drawn from Section 7 of the Uniform Estate Tax Apportionment Act (1964).

CROSS-REFERENCES

Definitions

Person interested in the estate § 970.010(b)
Property § 970.010(c)

NOTE. A number of comments were directed to the problem of taxes that are prorated but prove to be uncollectible or difficult to collect. The State Bar Taxation Section (Exhibit 7) believes that if the personal representative has to take further action to enforce the order against recipients of nonprobate assets, the law should provide that the reasonable costs of the action and attorney's fees should be awarded. Making the order a directly enforceable judgment should take

care of part of this problem. See discussion under the Note to Section 972.040. As for the rest, we see no reason why enforcement of this judgment should be treated any differently from enforcement of any other judgment. Code of Civil Procedure Section 685.040 provides that, "The judgment creditor is entitled to the reasonable and necessary costs of enforcing a judgment. Attorney's fees incurred in enforcing a judgment are not included in costs collectible under this title unless otherwise provided by law." We would add a reference to this section to the Comment.

San Diego (Exhibit 8) is concerned about the personal representative who fails to make a good faith effort to collect the share of taxes from a person against whom they are apportioned. We would add to the Comment a note that, "Failure of the personal representative to make a good faith effort to collect taxes prorated against a person is a breach of the fiduciary obligation of the personal representative, for which the personal representative is liable personally and on the bond, if any."

Despite the best efforts of the personal representative, a person may end up paying more than the share of taxes prorated to him or her because the share prorated to others is practically uncollectible at the time. In this situation, the person having to pay more than the prorated amount should be entitled to reimbursement from persons not paying their prorated share, and should be subrogated to the personal representative in the right to enforce the proration judgment against such persons. This is a point made by San Diego (Exhibit 8), and the staff believes it is important to implement it by statute. We would add a subdivision (c) to this section to state:

(c) If a person is charged with or required to pay an estate tax greater than the amount prorated to the person because another person does not pay the amount of estate tax prorated to that person, the person charged with or required to pay the greater amount has a right of reimbursement against the other person. The right of reimbursement may be enforced through the personal representative or may be enforced directly by the person charged with or required to pay the greater amount, and for the purpose of direct enforcement the person is subrogated to the position of the personal representative.

Kern County (Exhibit 6) questions whether taxes that are uncollectible from a person against whom they are prorated should be assessed against the residue of the estate. They feel that uncollected amounts should be prorated among all other persons interested in the estate--"We feel that most testators would intend and it is more fair for everyone to bear their prorata share of the uncollectible amount." We have asked Ken Klug to comment on this point.

Article 3. Judicial Proceedings

§ 972.010. Who may commence proceedings

972.010. (a) The personal representative or any person interested in the estate may commence proceedings to have a court determine the proration pursuant to this chapter.

(b) If proceedings for the administration of the decedent's estate are pending, proceedings under this article shall be combined with the administration proceedings. If proceedings are commenced at any time before final distribution, there shall be no additional filing fee.

(c) Subject to subdivision (b), proceedings under this article shall be commenced in the superior court of the county of which the decedent was a resident at the time of death or in the superior court of any county in which the property is situated.

Comment. Sections 972.010 to 972.060 supersede a portion of former Section 971, requiring court proration, and a portion of former Section 975, providing for a court order for payment.

CROSS-REFERENCES

Definitions

Person interested in the estate § 970.010(b)
Property § 970.010(c)

NOTE. Subdivision (c) as drafted appears to offer an opportunity for forum shopping. The staff will substitute the rule that the proceedings shall be commenced in the superior court of the county in which the "estate of the decedent may be administered." This is consistent with the standard used in the Commission's drafts in other areas.

§ 972.020. Petition

972.020. Proceedings under this article shall be commenced by filing a verified petition that sets forth all of the following information:

(a) The jurisdictional facts.

(b) Other facts necessary for the court to determine the proration of estate taxes.

Comment. See Comment to Section 972.010.

CROSS-REFERENCES

Definition

Estate tax § 970.010(a)

§ 972.030. Notice of hearing

972.030. At least 10 days before the hearing the petitioner shall:

(a) Cause notice of the hearing and a copy of the petition to be mailed to each person interested in the estate against whom prorated amounts may be charged pursuant to subdivision (a) of Section 972.040.

(b) Cause summons and a copy of the petition to be served on each person interested in the estate who may be directed to make payment of prorated amounts pursuant to subdivision (b) of Section 972.040.

Comment. See Comment to Section 972.010.

CROSS-REFERENCES

Definition

Person interested in the estate § 970.010(b)

NOTE. Kern County (Exhibit 6) feels that 10 days is too short a time for notice on a hearing for proration and that 20 days would be more appropriate. The 10 day period is consistent with all the other notice periods under the Probate Code; this proceeding would seem to demand no greater notice than any other. We do observe, however, that the proceeding may also involve persons not previously parties to an administration proceeding--for example persons who have taken property by nonprobate transfer. This may be the concern Kern County has in mind, although it is not expressly stated.

§ 972.040. Court order to effectuate proration

972.040. The court, upon making a determination as provided in this article, shall make an order:

(a) Directing the personal representative or other fiduciary to charge the prorated amounts against the persons against whom the estate taxes have been prorated insofar as the personal representative or other fiduciary is in possession of any property or interests of the persons against whom the charge may be made.

(b) Summarily directing all other persons against whom estate taxes have been prorated to make payment of the prorated amounts to the personal representative or other fiduciary.

Comment. Section 972.040 continues former Section 976 without substantive change. See also Comment to Section 972.010.

CROSS-REFERENCES

Definition

Estate tax § 970.010(a)

NOTE. With respect to the problem of uncollectible taxes, Kern County (Exhibit 6) points out that it will make things much easier for the personal representative if the court order is an enforceable judgment that can be used directly against the person against whom the taxes are prorated. The staff believes this is a useful clarification, and would add that "The court order is a judgment that may be enforced against the persons against whom estate taxes have been prorated."

§ 972.050. Modification of court order

972.050. Upon petition by the personal representative or any person interested in the estate, the court shall modify an order made pursuant to this article whenever it appears that the amount of estate tax as actually determined is different from the amount of estate tax on which the court based the order.

Comment. Section 972.050 provides for the possibility that subsequent to the making of an order, the taxes may be adjusted as a result of audit or the filing of an amended return. Section 972.050 does not apply to any additional tax under Internal Revenue Code Section 2032A(c) resulting from a disposition or cessation of qualified use of specially valued property. Cf. Section 971.050 (proration of additional tax on certain qualified real property). See also Comment to Section 972.010. Section 972.050 does not provide a limitation period for modification of a proration order; the matter is left to laches and other equitable doctrines within the discretion of the court.

CROSS-REFERENCES

Definitions

Estate tax § 970.010(a)

Person interested in the estate § 970.010(b)

NOTE. Robert Maize (Exhibit 3) is concerned about the problem of a modification occurring as a result of an audit or other redetermination of taxes many years after the estate is closed. He is worried about the contingent liability of a beneficiary--"One of the purposes of a probate estate is to settle all claims against the decedent by providing for the short statute of limitations for filing claims against the estate of a decedent. Now you are adding a provision that will subject the beneficiary to potential liabilities, and frustrate this purpose of the probate." He suggests as a solution that the court be able to reserve jurisdiction to alter the proration if there does not appear to be any other satisfactory way to plan for a subsequent change in proration. Otherwise, the case would be closed so that beneficiaries would have their rights finally determined.

The staff is not sure what his suggested solution would accomplish. Suppose the case is closed and beneficiaries have their rights finally determined; this would not bind the Internal Revenue Service, which could come back and seize what they need to make up any deficiency. If they seize property of one beneficiary, should that be where the loss falls, even though others received property that contributed to the deficiency? We think the court needs to be able to revise the proration in the interest of justice, despite a natural desire to give finality to the proceedings.

§ 972.060. Reciprocity of enforcement

972.060. (a) Subject to subdivision (c), a personal representative or other fiduciary acting in another state or a person required to pay the estate tax who is resident in another state may commence an action in this state and may recover any of the following from a person interested in the estate who is either resident in this state or who owns property in this state:

- (1) A proportionate amount of the federal estate tax.
- (2) An estate tax payable to another state.
- (3) A death duty due by the decedent's estate to another state.

(b) For the purposes of the action the determination of apportionment by the court having jurisdiction of the administration of the decedent's estate in the other state is prima facie correct.

(c) This section applies only if the state in which the determination of apportionment was made provides a substantially similar remedy.

Comment. Section 972.060 is drawn from Section 8 of the Uniform Estate Tax Apportionment Act (1964).

CROSS-REFERENCES

Definitions

Person interested in the estate § 970.010(b)

NOTE. This provision permits an out of state person to enforce an estate tax prorated against a person or property located in this state, provided the other state provides a comparable remedy for residents of this state. Dick Kinyon (Exhibit 5) wonders whether the requirement of reciprocity is a good idea. The staff believes the reciprocity requirement is an important inducement to other jurisdictions to extend enforcement rights to California residents, and would preserve the requirement in the statute. This provision is drawn from a uniform act, which seeks to attain uniformity in part through the reciprocity device.

Probate Code §§ 975.010-977.050 (added). Proration of taxes on generation-skipping transfers

SEC. 3. Chapter 15.5 (commencing with Section 975.010) is added to Division 3 of the Probate Code, to read:

CHAPTER 15.5. PRORATION OF TAXES ON
GENERATION-SKIPPING TRANSFERS

Note. This article is tentative, pending the outcome of federal legislation affecting taxes on generation-skipping transfers.

NOTE. Dick Kinyon (Exhibit 5) wonders whether it is possible to draft a single chapter dealing with proration of transfer taxes generally, rather than two separate but parallel chapters. Setting up the generation-skipping chapter as a separate entity will make it easier to repeal in the event of the anticipated repeal of the generation-skipping transfer tax. In any case, the topic is sufficiently complex that the staff does not feel it hurts to keep the statutes as simple as possible by having each chapter deal with a single subject.

Where we have made changes above in the statute governing proration of estate taxes, we will make comparable changes below in the statute governing proration of generation-skipping transfer taxes.

Article 1. General Provisions

§ 975.010. Definitions

975.010. Except where the context otherwise requires, as used in this chapter:

(a) "Generation-skipping transfer tax" means a tax imposed by any federal or California generation-skipping transfer tax law, now existing or hereafter enacted.

(b) "Property" means all property on which a generation-skipping transfer tax is imposed.

(c) "Transferee" means any person who receives, who is deemed to receive, or who is the beneficiary of, any property that is subject to a generation-skipping transfer tax.

(d) "Trustee" means any person who is a trustee within the meaning of the federal generation-skipping tax law.

(e) "Value" means fair market value as determined for generation-skipping transfer tax purposes.

Comment. Section 975.010 to 977.050 parallel comparable provisions of Article 4.5 (commencing with Section 970.010) (proration of estate taxes).

§ 975.020. Transitional provision

975.020. (a) This chapter applies to the estate of a decedent who dies on or after January 1, 1987.

(b) No inference as to the applicable law in effect before January 1, 1987, shall be drawn from the enactment of this chapter.

Article 2. Proration

§ 976.010. Proration among transferees

976.010. (a) Except as provided in subdivision (b), any generation-skipping transfer tax, and interest on any deficiency, shall be equitably prorated among the transferees in the manner prescribed in this article.

(b) This section does not apply in any of the following cases:

(1) Where the written instrument that makes the transfer directs otherwise.

(2) Where federal law directs otherwise.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Generation-skipping transfer tax § 975.010(a)

Transferee § 975.010(c)

§ 976.020. Manner of proration

976.020. The proration required by this article shall be made in the proportion, as near as may be, that the value of the property received by each transferee bears to the total value of all property received by all transferees.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Property § 975.010(b)

Transferee § 975.010(c)

Value § 975.010(e)

§ 976.030. Allowance for credits and deductions

976.030. In making a proration required by this article, allowances shall be made for credits, exemptions, and deductions allowed for the purpose of determining the tax payable.

Comment. See Comment to Section 975.010.

§ 976.040. Trusts and temporary interests

976.040. If a trust is created, or other provision made whereby a transferee is given an interest in income, or an estate for years,

or for life, or other temporary interest in any property or fund, the tax on both the temporary interest and on the remainder thereafter shall be charged against and paid out of the corpus of the property or fund without apportionment between remainders and temporary estates.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Property § 975.010(b)

Transferee § 975.010(c)

§ 976.050. Where property not in possession of trustee or transferee

976.050. (a) If property does not come into the possession of the trustee or other person required to pay the tax, the trustee or other person is entitled to recover from the person in possession, or from each transferee, the proportionate amount of the tax with which the transferee is chargeable under the provisions of this chapter.

(b) If the trustee or other person required to pay the tax cannot collect from any transferee the amount of tax apportioned to the transferee, the amount not recoverable shall be paid from the residuary estate. To the extent that the residuary estate is not adequate, the balance shall be equitably prorated among the other transferees who are subject to proration.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Property § 975.010(b)

Transferee § 975.010(c)

Trustee § 975.010(d)

Article 3. Judicial Proceedings

§ 977.010. Who may commence proceedings

977.010. (a) The trustee or any transferee may commence a proceeding to have a court determine the proration pursuant to this chapter.

(b) Proceedings under this article shall be commenced in the superior court of the county in which the decedent was a resident at the time of death or in the superior court of any county in which the property is situated.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Transferee § 975.010(c)
Trustee § 975.010(d)

NOTE. Dick Kinyon (Exhibit 5) notes that the draft lacks a provision like Section 972.010(b) (proration of estate taxes), which provides for combination of the proration proceedings with pending estate administration proceedings. The staff will cure this omission.

§ 977.020. Petition

977.020. Proceedings under this article shall be commenced by filing a verified petition that sets forth all of the following information:

(a) The jurisdictional facts.

(b) Other facts necessary for the court to determine the proration of the generation-skipping transfer tax.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definition

Generation-skipping transfer tax § 975.010(a)

§ 977.030. Notice of hearing

977.030. At least 10 days before the hearing the petitioner shall:

(a) Cause notice of the hearing and a copy of the petition to be mailed to each transferee against whom prorated amounts may be charged pursuant to subdivision (a) of Section 977.040.

(b) Cause summons and a copy of the petition to be served on each transferee who may be directed to make payment of prorated amounts pursuant to subdivision (b) of Section 977.040.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definition

Transferee § 975.010(c)

NOTE. While the 10 day notice period is appropriate for proration of estate taxes because it is consistent with other notice periods in probate, it is not appropriate for proration of

generation-skipping transfer taxes because it is not consistent with other notice periods applicable to trusts. We would change the 10 day period to 30 days, consistent with other trust notice periods.

§ 977.040. Court order to effectuate proration

977.040. The court, upon making a determination as provided in this article, shall make an order:

(a) Directing the trustee to charge the prorated amounts against the transferees against whom the generation-skipping transfer tax has been prorated insofar as the trustee is in possession of any property or interests of the transferee against whom the charge may be made.

(b) Summarily directing all other transferees against whom the generation-skipping transfer tax has been prorated to make payment of the prorated amounts to the trustee or petitioning transferee.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Generation-skipping transfer tax § 975.010(a)

Transferee § 975.010(c)

Trustee § 975.010(d)

§ 977.050. Modification of court order

977.050. Upon petition by the trustee or any transferee, the court shall modify an order made pursuant to this article whenever it appears that the amount of generation-skipping transfer tax as actually determined is different from the amount of tax on which the court based the order.

Comment. See Comment to Section 975.010.

CROSS-REFERENCES

Definitions

Generation-skipping transfer tax § 975.010(a)

Transferee § 975.010(c)

Trustee § 975.010(d)

Probate Code § 980 (amended). Apportionment of debts (heading)

SEC. 4. The heading of Article 5 (commencing with Section 980) of Chapter 15 of Division 3 of the Probate Code is amended to read:

~~Article 5~~ Chapter 15.7. Apportionment of Debts

Comment. This amendment is technical.