

Should a tax apportionment clause be in your estate plan?

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Even though the federal gift and estate tax exemption is currently very high (\$11.7 million for 2021), there are families that still have to contend with significant federal estate tax liability. Plus, the exemption is scheduled to drop significantly in 2026, and reducing it sooner has been proposed. Even if you aren't subject to federal tax, there may be taxes levied on your estate by your state. If your estate could be subject to estate tax, it's important to consider how the tax will be apportioned. In some cases, including a carefully worded apportionment clause in your estate plan can be beneficial.

Apportionment options

Without an apportionment clause, apportionment will primarily be governed by applicable state law (although federal law covers certain situations). Most states have some form of an "equitable apportionment" scheme. Essentially, this approach requires each beneficiary to pay the estate tax generated by the assets he or she receives. Some states provide for equitable apportionment among all beneficiaries while others limit it to assets that pass through a will or to the residuary estate.

Often, state apportionment laws produce satisfactory results, but in some cases they may be inconsistent with your wishes. An apportionment clause allows you to specify how the estate tax burden will be allocated among your beneficiaries so that you can ensure your goals are achieved.

There's no one right way to apportion estate taxes, but it's important to understand how taxes would be apportioned under applicable law. If that wouldn't be consistent with your wishes, consider an apportionment clause and any other changes you may need to make to your estate plan to ensure that your wealth is distributed in the manner you intend.

Suppose, for example, that your will leaves real estate valued at \$10 million to your son, with your residuary estate, consisting of \$10 million in stock and other liquid assets, passing to your daughter. Your intent is to treat your children equally. But your will doesn't include an apportionment clause, and applicable law provides for estate taxes to be paid out of the residuary estate. Accordingly, the entire estate tax burden — including taxes attributable to the real estate — would be borne by your daughter.

One way to avoid this result is to apportion the taxes to both your son and daughter. But that approach could cause problems for your son, who may lack the funds to pay the tax without selling the property. To avoid this situation while treating your children equally, you might apportion the taxes to your residuary estate but provide life insurance to cover your daughter's tax liability.

Talk to us

If estate tax liability remains a concern, please consult with us about the need to address tax apportionment in your estate plan. Without including an apportionment clause, heirs may be burdened with paying the tax attributable to assets they don't receive.

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The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com