ACTEC Law Journal

Volume 47 | Number 1 Article 6

6-1-2021

The Ultimate Gift Horse: Modernizing the UPC on Advancements to Avoid Unintended Redistributions

Jackie Elder

Frederick E. Vars

The Ultimate Gift Horse: Modernizing the UPC on Advancements to Avoid Unintended Redistributions

Jackie Elder & Fredrick E. Vars***

A common tax avoidance strategy is to make annual lifetime gifts in the maximum amount exempt from the gift tax in order to reduce or avoid the estate tax. These gifts are likely intended as an intergenerational transfer of wealth, only differing from passing through the estate in timing. The donors probably don't intend for their tax avoidance strategy to affect the ultimate equitable distribution of their wealth. However, under the Uniform Probate Code (UPC) and case law applying it, these gifts are generally not treated as advancements, so an uneven distribution can result from something as simple as differing ages of descendants resulting in a different number of annual lifetime gifts. This article proposes to update and modernize the UPC by presuming that gifts in the exact amount of the annual gift tax exemption are advancements, thus bringing the distributive effect of these transfers in line with decedents' probable intent. President Biden has proposed taxing thousands more estates, so the time to make this change is now.

I. Introduction

A common tax avoidance strategy is to make annual lifetime gifts in the maximum amount exempt from the gift tax.[1] This reduces the size of the donor's estate and can thereby reduce, or even avoid altogether, the estate tax. So far so good, but the strategy could have unintended distributional effects. An example illustrates.

As she advanced in age, Hilda began worrying that her accumulated wealth would be subject to the estate tax when she died. She wanted instead to maximize the amount going to her two surviving adult children and two grandchildren from her deceased son. When Hilda learned in 2002 that she could give $11,000 each year to any recipient tax-free, she wrote $11,000 checks to both of her children and to her

* J.D., University of Alabama School of Law.

** Ira Drayton Pruitt, Sr. Professor of Law, University of Alabama School of Law.

1 *See* David Joulfaian & Kathleen McGarry, Special Issue, *Estate and Gift Tax Incentives and Inter Vivos Giving*, 57 Nat'l Tax J. 429, 430 (2004).

grandchild who was 18. She continued making maximum tax-free gifts in this manner until her second grandchild turned 18 eight years later, in 2010, when she began including him in her annual giving plan. Hilda died unmarried and intestate two years later, in 2012.

The estate will be divided one-third each to Hilda's two children and one-sixth each to her two grandchildren.[2] That may seem like fair distribution, but recall that the younger grandchild received $106,000 less in tax-avoidance gifts than the other relatives. It is clear that Hilda's intent in making the annual gifts was not to disfavor her younger grandchild, but rather to avoid the estate tax. Under the UPC, however, this intent does not matter unless memorialized in a contemporaneous writing.[3] Few who die intestate will know about this requirement.

This article argues that the Uniform Probate Code should be amended to presume that a gift is an advancement when made in the amount of the annual gift tax exemption. In other words, the donee's inheritance should be reduced by the amount of the gift. Part II discusses the background of advancement law and tax minimization strategies through inter vivos giving. Part III demonstrates that the problem of uneven distribution resulting from tax-avoidance gifts is not merely hypothetical and analyzes state-specific variations in both advancement law and tax policy that increase the likelihood of this problem arising. Part IV lays out the proposed changes to the UPC that could ameliorate the problem. President Biden has proposed taxing thousands more estates, so the time to make this change is now.[4]

II. Background

The problem this article identifies arises at the intersection of two areas of law: the advancements doctrine and the tax-avoidance gift strategy.

A. Development of Advancement Doctrine

As a part of the law of intestacy, advancement statutes are meant to reflect the probable intent of decedents while reducing the likelihood of

[2] *See* Robert H. Sitkoff & Jesse Dukeminier, Wills, Trusts, and Estates 80 fig.2.2 (10th ed. 2017).

[3] Unif. Prob. Code § 2-109 (Unif. L. Comm'n amended 2019).

[4] *See* Christine Fletcher, *What Does a Biden White House Mean for Estate Taxes?*, Forbes (Nov. 30, 2020, 12:05 PM), https://www.forbes.com/sites/christinefletcher/2020/11/30/what-does-a-biden-white-house-mean-for-estate-taxes [https://perma.cc/7TVS-UWQQ]; Paul Sullivan, *The Estate Tax May Change Under Biden, Affecting Far More People*, N.Y. Times, https://www.nytimes.com/2021/01/15/your-money/estate-tax-biden.html (Jan. 19, 2021) [https://perma.cc/XKJ8-X6HV] ("Mr. Biden has said the federal exemption level for the estate and gift taxes should be decreased.").

litigation to resolve individual intent.[5] The assumption that decedents intend to benefit their children equally underlies intestacy statutes generally, and the advancements doctrine is intended to further this equal treatment.[6] Prior to promulgation and widespread adoption of the UPC provision on advancements, there was significant variation in state law, with some states imposing a writing requirement to show intent.[7] Inquiries into whether a transfer is intended to be an advancement are factually intensive and administratively burdensome on courts, and jurisdictions with a writing requirement for advancements had less litigation on the question than did jurisdictions without.[8] On retaining the presumption against finding a transfer to be an advancement and the contemporaneous writing requirement, a comment to the 1990 amendment of the UPC stated the position that "[m]ost inter vivos transfers today are intended to be absolute gifts or are carefully integrated into a total estate plan," so finding against advancement was more likely to reflect decedents' intent.[9] This position fails to account for the relatively simple and highly incentivized gifting strategy discussed here.

B. Tax-Avoidance Gift Strategy

The other piece of the puzzle is the estate and gift tax being structured in a way that incentivizes giving tax-free annual gifts. In 2021, the gift tax exemption is $15,000 annually and $11.7 million in a lifetime.[10] Those who expect to be subject to estate tax can minimize their tax liability by transferring wealth via exempt annual gifts during life. A study found that the wealthy do in fact engage in this type of inter vivos transfers to minimize estate tax.[11]

While gifts have been advantaged over bequests in tax policy throughout most of the twentieth century, the annual gift exclusion was introduced in 1982.[12] This change created a much stronger incentive to engage in lifetime transfers as an estate tax minimization strategy, as compared to the existing structure of a unified gift and estate lifetime exclusion amount only.[13] The UPC provision on when to find that a transfer is an advancement has remained unchanged since it was first

---

5 *See* Mary Louise Fellows, *Concealing Legislative Reform in the Common-Law Tradition: The Advancements Doctrine and the Uniform Probate Code*, 37 VAND. L. REV. 671, 677 (1984).

6 *Id.* at 674-75.

7 *See id.* at 682-84.

8 *Id.* at 684.

9 UNIF. PROB. CODE § 2-109 cmt. (UNIF. LAW COMM'N amended 2019).

10 I.R.C. § 2503; 26 U.S.C.A. § 1.

11 Joulfaian & McGarry, *supra* note 1.

12 *Id.* at 431 n.7, 432.

13 *See id.* at 431.

promulgated in 1969.[14] Therefore, the annual gifting tax avoidance strategy was not incentivized at the time of drafting, thus not taken into account.

Around five thousand estates are large enough to incur estate tax liability in the US each year, transferring billions of dollars in assets.[15] Thousands of American households are possibly engaging in this strategy every year, so the potential problems in conjunction with advancement law are significant. In fact, the problem does occur in real-world cases.

III. Real World Impact

In re Estate of Soule, a case decided by the Supreme Court of Nebraska, arose from a series of gifts made to the decedent's children during his life in order to minimize estate tax upon his death.[16] Before being placed under conservatorship, Soule twice gave gifts of $10,000, which was the maximum annual tax-exempt gift at the time, to his six living children.[17] Soule's conservator then continued the annual gifts, which ultimately totaled $465,000.[18] However, the conservator did not know that the decedent had one child who had predeceased him, from whom he had five grandchildren who were excluded from the annual gifts.[19] When a portion of the will failed and part of the estate passed through intestacy, the grandchildren who were excluded argued that the gifts were advancements.[20]

Nebraska's advancement statute followed the UPC in requiring a contemporaneous writing to rebut the presumption that a gift is not an advancement.[21] The court looked to Soule's two series of gifts prior to being placed under conservatorship, which, the court found, were not accompanied by any contemporaneous writing that the gifts were to be treated as advancements.[22] The fact that all of the gifts were made purely to reduce the estate's tax liability was undisputed and supported by court orders approving the conservator's gifts.[23] The conservator's gifts included notes of "gift," "annual gift," or "gift, no tax," which the court held did not satisfy the requirement of contemporaneous writing

14 Unif. Prob. Code § 2-110 (Unif. L. Comm'n 1969).

15 Joint Comm. on Tax'n, JCX-52-15, History, Present Law, and Analysis of the Federal Wealth Transfer Tax System 1 (2015).

16 540 N.W.2d 118, 120 (Neb. 1995).

17 *Id.* at 121.

18 *Id.*

19 *See id.*

20 *Id.* at 121-22.

21 Neb. Rev. Stat. § 30-2310 (2021).

22 *Soule*, 540 N.W.2d at 124.

23 *Id.* at 121.

showing intent to be advancements.[24] The court noted that the intent to be an advancement can be expressed in the gift itself, but again found the notes to fall short of expressing that intent.[25] There was no evidence showing that the decedent had any intent to create an unequal distribution of his wealth in making the gifts.[26]

This case is likely to arise elsewhere, as at least thirty-eight states follow the UPC on advancements.[27] Several others are similar to the UPC in presuming a transfer is a true gift rather than an advancement, but with different or additional ways to rebut the presumption.[28] Only one state, Kentucky, has an advancement statute with a presumption that runs opposite the UPC.[29] A change in the UPC would likely have a

---

24 *Id.* at 124.

25 *Id.*

26 *See id.* Even when considered under the UPC without the proposed change, the evidence here that the gifts were part of a tax strategy should be enough to consider the gifts to be advancements. There is contemporaneous writing showing that the gifts were part of a tax strategy (especially the "gift, no tax" notation), so the next logical step is to assume that they were not intended to change the distribution of the estate. Though not explicitly described as advancements, the contemporaneous writing here heavily implies an intent to be an advancement and should be enough to rebut the presumption. In the alternative, the decedent's contemporaneous writing here indicates that the gift is to be taken into account in computing the division and distribution of the decedent's intestate estate because of its status as an annual, tax-free means of spending down the estate. This should be enough to satisfy one of the ways of rebutting the presumption against advancements in UPC section 2-109. *See* UNIF. PROB. CODE § 2-109(a) (UNIF. L. COMM'N amended 2019).

27 ALA. CODE § 43-8-49 (2021); ALASKA STAT. § 13.12.109 (2021); ARIZ. REV. STAT. ANN. § 14-2109 (2021); ARK. CODE ANN. § 28-9-216 (2021); CAL. PROB. CODE § 6409 (West 2021); COLO. REV. STAT. § 15-11-109 (2021); DEL. CODE ANN. tit. 12, § 509 (2021); FLA. STAT. § 733.806 (2020); GA. CODE ANN. § 53-1-10 (2021); HAW. REV. STAT. § 560:2-109 (2021); IDAHO CODE § 15-2-110 (2021); 755 ILL. COMP. STAT. 5/2-5 (2020); IND. CODE § 29-1-2-10 (2021); ME. STAT. tit. 18-C, § 2-108 (2019); MD. CODE ANN., EST. & TRUSTS § 3-106 (West 2021); MASS. GEN. LAWS ch. 190B, § 2-109 (2021); MICH. COMP. LAWS § 700.2109 (2021); MINN. STAT. § 524.2-109 (2020); MO. REV. STAT. § 474.090 (2020); MONT. CODE ANN. § 72-2-119 (2019); NEB. REV. STAT. § 30-2310 (2021); NEV. REV. STAT. § 151.120 (2021); N.H. REV. STAT. ANN. § 561:13 (2021); N.J. STAT. ANN. § 3B:5-13 (West 2021); N.M. STAT. ANN. § 45-2-109 (2021); N.Y. EST. POWERS & TRUSTS LAW § 2-1.5 (McKinney 2021); N.D. CENT. CODE § 30.1-04-10 (2021); OHIO REV. CODE ANN. § 2105.051 (West 2021); OR. REV. STAT. § 112.135 (2020); 20 PA. CONS. STAT. § 2109.1 (2021); 33 R.I. GEN. LAWS § 33-1-11 (2021); S.C. CODE ANN. § 62-2-110 (2021); S.D. CODIFIED LAWS § 29A-2-109 (2021); TENN. CODE. ANN. § 31-5-101 (2021); TEX. EST. CODE ANN. § 201.151 (West 2021); UTAH CODE ANN. § 75-2-109 (West 2021); W. VA. CODE § 42-1-3g (2021); WYO. STAT. ANN. § 2-4-108 (2021).

28 IOWA CODE § 633.224 (2021); N.C. GEN. STAT. § 29-23 (2020); OKLA. STAT. tit. 84, § 225 (2021); VT. STAT. ANN. tit. 14, § 1723 (2021); WASH. REV. CODE § 11.04.041 (2021); WIS. STAT. §§ 852.11, 854.09 (2021).

29 KY. REV. STAT. ANN. § 391.140 (West 2021); *see* Carolyn S. Bratt, *Kentucky's Doctrine of Advancements: A Time for Reform*, 75 KY. L.J. 341, 341 (1987).

widespread impact in correcting for this potential problem, because the UPC has been so widely adopted.

Though federal estate tax only affects the very wealthy, variations in state estate and inheritance taxes could further incentivize the use of annual inter vivos transfers to minimize tax liability for a larger portion of the population. The federal floor for estate tax in 2021 is $11.70 million, but several states have estate taxes with lower exemptions or filing thresholds.[30] For example, Oregon taxes estates starting at $1 million.[31] A few states have inheritance taxes with low exemptions (e.g., $500 in Kentucky) or no exemption in terms of the size of the estate, although most exempt immediate family and/or lineal descendants.[32] Therefore, in several states there is a much larger portion of the population for which giving tax-free annual gifts would minimize ultimate tax liability than for the federal estate tax alone. These variations in state estate and inheritance taxes create additional incentive to use annual tax-exempt gifts to spend down one's estate, making it even more likely that unintended distributions will arise.

IV. Proposal

A narrow exception in the UPC provision on advancements could prevent this problem. Gifts given in the amount of the maximum annual gift tax exemption should be presumptively advancements, rebuttable by contemporaneous writing. This could be accomplished by amending part (a) of UPC section 2-109:

> If an individual dies intestate as to all or a portion of the estate, property the decedent gave during the decedent's lifetime to an individual who, at the decedent's death, is an heir is treated as an advancement against the heir's intestate share only if (i) the decedent declared in a contemporaneous writing or the heir acknowledged in writing that the gift is an advancement, (ii) the decedent's contemporaneous writing or the heir's written acknowledgment otherwise indicates that the gift is to be taken into account in computing the division and distribution of the decedent's intestate estate, *or (iii) the gift is in the exact*

[30] The federal floor roughly doubled in 2017, and the change is set to expire in 2026. If no action is taken, the floor will then be $5 million. It could drop sooner and lower than that with the change in administration, however, and affect many more estates. *See* Fletcher, *supra* note 4.

[31] Or. Rev. Stat. § 118.010(4).

[32] Iowa Code § 450.4; Ky. Rev. Stat. Ann. § 140.010, .070, .080; Neb. Rev. Stat. § 77-2018.04 (containing no familial exemptions); N.J. Stat. Ann. § 54:34-2; 72 Pa. Cons. Stat. § 9116 (stating that the only exemption is for parents or for children under 21; all other inheritance is subject to tax).

amount of the maximum annual exclusion to federal gift tax at the time it was given, and the intent to be an advancement is not contradicted by a contemporaneous writing.

This change would create an appropriately narrow exception to account for this particular tax minimization strategy and prevent unintended inequalities in distribution. The purpose of the laws of intestacy is to further probable decedents' intent without increasing litigation, and this change would fall comfortably within those goals. Giving tax-free annual gifts is a strategy advised as a general intergenerational transfer of wealth, only differing from passing through the estate in timing.[33] It is unlikely that those engaging in tax minimization through annual gifts intend to confer a disproportionate benefit on donees when lifetime gifting is unequal, whether by virtue of age, inadvertent omission, or some other factor. Adopting this change would account for this common tax minimization strategy while honoring decedents' likely intent that their wealth be distributed equitably.

33 *See Sharing the Wealth: How Lifetime Gift Tax Exemption Works*, CHARLES SCHWAB (Sept. 27, 2021), https://www.schwab.com/resource-center/insights/content/giving-while-living-do-you-understand-gift-tax [https://perma.cc/7FDB-SZWG].