JURISDICTION:	OKLAHOMA TAX COMMISSION
CITE:	2007-05-01-37 (NON-PRECEDENTIAL)
ID:	P-06-096-K
DATE:	MAY 1, 2007
DISPOSITION:	SUSTAINED
TAX TYPE:	ESTATE
APPEAL:	NONE

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Estate of DECEDENT, (hereinafter "Estate") is represented by ATTORNEY, Attorney at Law. The Audit Division of the Tax Commission (hereinafter "Division") previously represented by OTC ATTORNEY 1, Assistant General Counsel, is represented by the OTC ATTORNEY 2, Assistant General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

On August 28, 2003, the personal representative of the Estate caused to be filed with the Division an Oklahoma Estate Tax Return. Accompanying the return was a check in the amount of $44,602.51 in remittance of the tax reported due on the return. On November 15, 2004, the Estate filed a claim for refund of a portion of the taxes previously paid. The return was thereafter audited and by *Order* issued August 23, 2005, the Division proposed a refund to the Estate of $1,494.07. The Estate timely protested the *Order* by letter dated September 15, 2005.

On June 21, 2006, the Division referred its file to the Office of the Administrative Law Judges ("ALJ's Office") for further proceedings consistent with the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure before the Oklahoma Tax Commission[2]. The case was docketed as Case No. P-06-096-K and assigned to ALJ, Administrative Law Judge.[3]

A pre-hearing conference was scheduled for August 15, 2006, by *Prehearing Conference Notice* issued on July 13, 2006.[4] The conference was held as scheduled. Pursuant to the conference, a *Prehearing Conference Order* was issued setting forth the procedure by which the protest would be submitted for decision.[5]

A *Joint Stipulation of Facts and Statement of Issues* was filed October 19, 2006. The Estate's *Brief* was filed November 27, 2006. The *Estate Tax Division's Reply Brief* was filed December 13, 2006. *Protestant's Reply Brief* was filed December 28, 2006. The record was closed and the protest was submitted for decision on December 29, 2006.[6]

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[1] 68 O.S. 2001, § 201 et seq.

[2] Rules 710:1-5-20 through 710:1-5-47 of the *Oklahoma Administrative Code (OAC)*.

[3] *OAC*, 710:1-5-22(b).

[4] *OAC*, 710:1-5-28.

[5] *OAC*, 710:1-5-28(b) and 710:1-5-38.

[6] *OAC*, 710:1-5-39(a).

FINDINGS OF FACT

Upon review of the file and records, including the *Joint Stipulation of Facts and Statement of Issues*, Exhibits A and B attached thereto and the briefs, the undersigned finds:

The parties stipulate to the following:

1. The Schedule H-1 deduction for debts and expenses allowed to the estate totaled $45,514.91 (Funeral expenses, $9,564.91; Monument, $500; Executors' commissions, $22,850.00; Attorney fees, $11,500.00; and miscellaneous expenses, $1,100.00).

2. 65.91% of the total estate passed to the surviving spouse.

3. If the martial deduction is "charged" with 65.91% of the Schedule H debts ($29,998.88) then the refund would equal $1,494.07 (OTC position).

4. A). Property of a total value of $688,656.07 passed directly to the spouse by reason of joint tenancy between the spouse and decedent.

   B). Total life insurance proceeds of $31,505.96 were paid directly to the spouse.

   C). Household goods of a value of $500.00 passed to the spouse.

5. If the above described joint tenancy property, life insurance proceeds and household goods are omitted in determining the percentage of the estate passing to the spouse, then 38.76% of the remaining estate passed to the spouse.

6. If the marital deduction is "charged" with 38.76% of the Schedule H debts then the refund would equal $3,224.09 (ESTATE'S position).

7. The Decedent died intestate on November 26, 2002.

8. On August 28, 2003, the personal representative for the Estate caused the Oklahoma Estate Tax Return to be filed with the Division.

9. By Oklahoma Tax Commission Order dated August 4, 2004, the Estate of DECEDENT was released by the Oklahoma Tax Commission.

10. By letter dated November 14, 2004, the Estate sent notice of an "error" in the Estate Tax return and requested assistance in seeking a refund.

11. By Assessment dated August 23, 2005, the Division adjusted the Estate Tax figures resulting in a refund to the Estate of $1,494.07.

12. By letter dated September 15, 2005, the Estate timely protested the amount of refund.

13. The estate tax protest of the Estate is properly before the Commission.

ISSUE AND CONTENTIONS

The issue presented for decision, as stipulated by the parties, is "[W]hat percentage of Schedule H-1 debts are 'chargeable' to the marital deduction under § 807(B) of Title 68 of the Oklahoma Statutes and what [i]s the correct refund?"

The Estate contends that property passing to a surviving spouse outside of probate should be excluded from the assets charged with the debts and expenses of the estate. In support of this contention, the Estate argues that such property passes, by operation of law, free and clear of the debts of the decedent and is not available to the personal representative to pay the probate expenses. The Estate further argues that under § 807(B) the marital exclusion is to be reduced only by the debts chargeable against assets vesting in the surviving spouse.

The Division contends that the debts of an estate are required to be apportioned to the surviving spouse, for purposes of the marital exemption, based on the value of the gross estate vesting in the surviving spouse, rather than only the value of the estate passing to the surviving spouse under probate. In support of this contention, the Division argues that the language of § 807(B) provides that the value of the gross estate vested in the surviving spouse is chargeable with the debts of the estate. The Division further argues that § 807(B) does not delineate or make a distinction between those assets which vest in the surviving spouse under probate or outside of probate.

CONCLUSIONS OF LAW

WHEREFORE, premises considered, the undersigned concludes as a matter of law that:

1. The Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding. 68 O.S. 2001, § 815(B).

2. A tax, at the rates prescribed in § 803 of the Oklahoma Estate Tax Code ("Code")[7], is levied upon the transfer of the net estate of every decedent, whether in trust or otherwise, to persons, associations, corporations, or bodies politic, of property, real, personal, or mixed, whether tangible or intangible, or any interest therein or income therefrom, by will or the intestate laws of Oklahoma, by any order setting apart property and/or granting family allowances pursuant to the probate code, by deed, grant, bargain, sale, or gift made in contemplation of death of the grantor, vendor or donor, or intended to take effect in possession or enjoyment at or after such death. 68 O.S. 2001, § 802. The tax is imposed on the value of the net estate and transfers at the rates, under the conditions, and subject to the exemptions and limitations prescribed by the Code. *Id*.

3. The value of the gross estate of an Oklahoma decedent, which is used as the basis for determining the value of the net estate, includes among other property: (1) all personal property in which the decedent had an interest, whether vested or contingent;[8] (2) any property owned by the

[7] 68 O.S. 2001, § 801 et seq.

[8] 68 O.S. 2001, § 807(A)(1).

decedent and any other person as joint tenants;[9] and (3) the proceeds of any life insurance policy upon the life of the decedent[10]. 68 O.S. 2001, § 807(A).

4. The value of any interest in decedent's estate, beneficial or otherwise, vesting in the surviving spouse is excluded in the determination of the value of decedent's gross estate. 68 O.S. Supp. 2003, § 807(B).[11] The marital exclusion is limited by any "debts, mortgages, liens, administration charges or other encumbrances chargeable against the value of the gross estate so vested" in the surviving spouse. *Id*.

5. As a general rule, statutes exempting property from taxation are to be strictly construed against the allowance of an exemption. ***Autumn House v. Oklahoma Tax Commission***, 1991 OK 73, 814 P.2d 1036; ***Matter of Wal-Mart Stores, Inc.***, 1991 OK CIV APP 73, 817 P.2d 1281; ***Bert Smith Road Machinery Co. v. Oklahoma Tax Commission***, 1977 OK 75, 563 P.2d 641. Claims of exemption from taxation must be plainly and unmistakably supported by express grant. ***In re Noble's Estate v. State ex rel. Oklahoma Tax Commission***, 1938 OK 324, 80 P.2d 243. An exemption cannot exist by implication and any doubt is fatal to the claim of exemption. ***Phillips Petroleum Co. v. Oklahoma Tax Commission***, 1975 OK 146, 542 P.2d 1303; ***Oklahoma City v. Shields***, 1908 OK 195, 22 Okla. 265, 100 P. 559. The burden of proving the existence of an

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[9] 68 O.S. 2001, § 807(A)(4).

[10] 68 O.S. 2001, § 807(A)(6).

[11] The Oklahoma marital exclusion was enacted by the Legislature in 1975. Laws 1975, c. 1, § 2, emerg. eff. Feb. 4, 1975. As originally enacted the exclusion provided:

> (B) In determining the value of the gross estate under this section, there shall be excluded:
>
> (1) The value of any interest in decedent's estate passing to the surviving spouse. Provided that the value of such interest shall be included for the purpose of computing additional tax liability under Section 804 of this title.
>
> (2) Such exclusion under Section 807(B)(4) shall be limited to that value of the gross estate passing to surviving spouse, less debts, mortgages, liens, administration charges or other encumbrances chargeable against the value of the gross estate so passing.
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> (3) Property or any interest therein passing to a surviving spouse must pass to such spouse as beneficial owner to qualify for this deduction and such deduction shall not apply to any nondeductible terminable interest as defined in Section 2056(b) of the Internal Revenue Code of 1954, as amended, and the regulation thereunder.
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> (4) This exclusion shall apply to Oklahoma residents only.

Section 807(B) was amended by Laws 1976, c. 266, § 1, emerg. eff. June 17, 1976, to provide:

> (B) In determining the value of the gross estate under this section, there shall be excluded:
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> (1) The value of any interest in decedent's estate, beneficial or otherwise, vesting in the surviving spouse, provided that the value of such interest shall be included for the purpose of computing additional tax liability under Section 804 of this title.
>
> (2) Such exclusion under paragraph 1 of this subsection shall be limited to that value of the gross estate, beneficial or otherwise, vesting in the surviving spouse, less debts, mortgages, liens, administration charges or other encumbrances chargeable against the value of the gross estate so vested.

Section 807(B) remained unchanged until the 2003 amendment. Law 2003, c. 472, § 11, eff. Nov. 1, 2003.

exemption is on the one claiming the exemption to show it falls squarely within the specific language of the exemption. ***Austin, Nichols & Co. v. Oklahoma County Bd. of Tax-Roll Corrections***, 1978 OK 65, 578 P.2d 1200.

6. In 1982, the Supreme Court of Oklahoma abandoned the doctrine of the burden on the residuary concluding "the time ha[d] come to join the modern trend of thought" with respect to the payment of estate taxes and adopted the "principles of equitable apportionment." ***In re Estate of Bovaird***, 1982 OK 48, 645 P.2d 500, 505. *See*, ***In re Davidson***, 1982 OK 27, 641 P.2d 1110. "Generally stated, this doctrine is that, absent explicit instructions in a Will, all persons receiving a taxable interest in property by reason of a person's death must bear a pro rata part of the estate tax burden. Property passing on death that is estate tax exempt, such as marital interest and charitable bequests, do not bear any part of the tax. However, all other beneficiaries under a Will, specific as well as residuary, bear a proportionate part of the estate tax, along with all recipients of taxable non-probate property." 2 Okla. Prob. Law & Prac. § 39.7 (3d ed.). (Citations omitted).

Prior to 1982, the Supreme Court had the occasion to address the issue whether non-probate property should bear a proportionate part of the estate tax attributable to such property. ***Tapp v. Mitchell***, 1960 OK 135, 352 P.2d 900. In that case, all primary funds and assets preceding in order of resort for payment of the debts of the estate, including state and federal estate taxes, had been exhausted, and only specific devises and legacies remained. The court held that absent a state statute or a testamentary direction charging proportionate part of estate tax attributable to a non-probate asset against the recipient, the entire estate tax burden fell upon the estate, thus the specific devises and legacies would abate and contribute ratably, inter se, to satisfy the remaining liabilities of the estate. The Court reasoned that estate taxes, both state and federal, constitute an expense of administration and such taxes could not be apportioned against recipients of non-probate property passing outside the estate.

In 2000, the Supreme Court again addressed the issue whether non-probate property should be burdened with any part of the estate tax liability of the estate, the debts of the decedent or expenses of administration. ***In re Estate of MacFarline***, 2000OK 87, 14 P.3d 551. In that case, the residue of the estate had been exhausted and the only remaining probate asset was the decedent's principal residence which she had bequeath to a charitable institution. With respect to the estate tax liability of the estate, the Court wrote at footnote 3:

> For estate tax purposes the taxable estate may include non-probate assets, including funds in joint tenancy bank accounts. *Estate of LeDonne v. Stearman*, 1986 OK 77, 730 P.2d 519, 522. Under the equitable apportionment doctrine – which became entrenched in Oklahoma with *In re Davidson*, 1982 OK 27, 641 P.2d 1110 – in the absence of a contrary expression of testamentary intent, equitable principles impose the responsibility for the payment of estate tax on property generating the tax and exonerate property which does not incur federal or state estate tax liability. *Estate of LeDonne v. Stearman*, 730 P.2d at 522.
>
> Thus, without a contrary testamentary expression of intent, a surviving joint tenant of a bank account may be responsible for his/her proportionate share of estate tax, even though the joint tenancy funds are not considered

> assets of a decedent's probate estate. On the other hand, a probate estate asset that passes to a religious institution – like decedent's residence – bears no share of the estate tax liability because its value is entitled to deduction from the value of the gross estate for estate tax purposes [68 O.S. 1991, § 808(h)] and generates no tax liability. *See Lomon v. Citizens Nat. Bank & Trust of Muskogee*, 1984 OK 68, 689 P.2d 306, 311; *In Re Davidson*, 641 P.2d at 1114.

With respect to the funding source for payment of debts and costs of administration, the Court held that the non-probate property "simply cannot be considered a part of decedent's estate or liable for her debts/estate expenses."[12] *Id*. at ¶ 18. The Court reasoned that because the surviving joint tenant became sole owner of the non-probate property (bank accounts held in joint tenancy) immediately upon the death of the decedent, the bank account funds were not responsible for payment of decedent's debts or estate administration costs. *Id*. The Court further held that pursuant to 84 O.S. 1991, § 3, the order of resort for payment of decedent's debts and estate expenses "would be the residuary estate, and if exhausted, then decedent's residence, because that is the only other asset shown by the record to be part of her estate." *Id*. at ¶ 20.

7. The language of § 807(B) is plain and unambiguous language. ***Neer v. State ex rel. Oklahoma Tax Commission***, 1999 OK 41, 982 P.2d 1071. Under § 807(B), the marital exclusion is only reduced by the "debts, mortgages, liens * * * or other encumbrances" peculiar to the property vesting in the surviving spouse". In other words, "only the net value of deductible property interests vesting in the surviving spouse qualifies for the marital exclusion." 34 Am. Jur. 2d Federal Taxation ¶ 41402.[13] *See*, I.R.C. 2056(b)(4) and Treas. Reg. § 20.2056(b)-4 (d).

Section 807(B) likewise prevents an estate from claiming a double deduction for the property vesting in the surviving spouse. *See*, 68 O.S. 2001, § 808(a)[14] and I.R.C. 2056(b)(9). Further, the phrase "administration charges" as used in the context of § 807(B) should receive the same construction as "administration expenses" in I.R.C. § 2056. For federal estate tax purposes,

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[12] Footnote 8 original to the opinion provides, "[l]iability for estate taxes, as explained in note 3, *supra*, is different and joint tenancy property may bear an appropriate share of estate tax liability."

[13] The second subparagraph of ¶ 41402 further provides:

> Items which can reduce the gross value of a property interest passing to the surviving spouse include: mortgages and other encumbrances, certain administration expenses, obligations imposed by the decedent, relinquishment of community property interest, and death taxes. (Footnotes omitted).

[14] *See*, *OAC*, 710:35-5-48 which prior to June, 2001 provided:

> A deduction is allowed from a decedent's gross estate of the full unpaid amount of a mortgage upon, or of any other indebtedness in respect of any property of the gross estate, including interest which had accrued thereon to the date of death, provided the value of the property, undiminished by the amount of the mortgage or indebtedness, is included in the value of the gross estate. Only interest accrued to the date of the decedent's death is allowable even under the alternate valuation method.

Amended at 18 Ok Reg 2809, eff 6-25-01 by deleting the language "provided the value of the property, undiminished by the amount of the mortgage or indebtedness, is included in the value of the gross estate."

"[t]he value of the marital share is reduced by the amount of estate transmission expenses paid from the marital share." 34 Am. Jur. 2d Federal Taxation ¶ 41402. Paragraph 41402 further provides:

> Estate transmission expenses are expenses that wouldn't have been incurred but for the decedent's death and the consequent necessity of collecting the decedent's assets, paying the decedent's debts and death taxes, and distributing the decedent's property to those who are entitled to receive it. The value of the marital share is not reduced by the amount of estate management expenses attributable to and paid from the marital share, unless those expenses are deducted as administration expenses on the decedent's federal estate tax return. Estate management expenses are expenses that are incurred in connection with the investment of estate assets or with their preservation or maintenance during a reasonable period of administration. Treas. Reg. § 20.2056(b)-4 (d). (Footnote original).

8. Here, the decedent's surviving spouse received probate and non-probate property. The non-probate property did not contribute to the Estate's administration expenses and is not responsible for payment of decedent's debts. ***MacFarline***, *supra* at ¶18. Accordingly, neither the decedent's debts nor the Estate's administration costs can be charged against the non-probate property under § 807(B) or the principles of equitable apportionment.

9. Protestant's protest to the Division's *Order* should be sustained. The percentage of Schedule H-1 debts chargeable to the marital exclusion under § 807(B) is 38.76% and the correct amount of the refund is $3,224.09.

DISPOSITION

THEREFORE, based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the protest of the Estate of DECEDENT be sustained.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.